

Financial and Performance Reporting

Entire Public Sector for the
year ending 30 June 2014





To help the public
service spend wisely

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KEY MESSAGES

The Government has taken some significant steps to addressing the challenges it has faced in reporting consolidated financial results for the entire public sector but it still needs to make further significant progress to be able to present credible and reliable financial information

Entire Public Sector Financial Statements

Adverse Opinion

The year ending 30 June 2014 will be the first year that we have been able to obtain sufficient and appropriate evidence since 2004 in order to reach an opinion on the financial statements. However we have concluded that the financial statements do not fairly present the Entire Public Sector financial results

Schedule of Appropriations

Disclaimer of Opinion

I was not able to obtain sufficient appropriate evidence to provide a basis for an opinion. Accordingly, I was not able to express an opinion on the schedule of appropriations for the year ended 30 June 2014

Financial Results

As a result of the opinions on the EPS and the schedule of appropriations the financial results cannot be considered reliable. Therefore I am not able to provide any commentary on the financial results or on the Government's compliance with the principles of responsible financial management as outlined in the PMFL

Legal Spending Limits

Due to the disclaimer of opinion on the Schedule of Appropriations I am not able to report whether the Government complied with the legal spending limits imposed by the Legislative Assembly through the Appropriations Law (2013). As a result the cornerstone of parliamentary control and oversight is undermined

Governance and Internal Control

Risk management arrangements need to be developed and effectively implemented, to enable the effective management of the risks to the achievement of the Government objectives

Systems and controls need to be enhanced to enable the effective consolidation of the financial results of the Entire Public Sector

The IT control environment faces some significant risks which need to be addressed as part of a wider strategic plan to address the weaknesses in IT governance and security

Systems and controls need to be enhanced to ensure the completeness of revenues collected, and the consistent assessment and transparency of revenue waivers granted

Enhanced and consistent systems and controls need to be established for the management of executive expenses, in particular Transfer Payments

Recommendation

The Government needs to clearly lay out its plans and goals to achieve accountability as required by the PMFL, in both the short and medium term. Government should likewise provide regular reports to the Legislative Assembly on the progress that has been made on achieving those targets in order to hold those who are charged with responsibility for the plans accountable

INTRODUCTION

BACKGROUND

1. The Cayman Islands Government is required by the *Public Management and Finance Law (PMFL)* to prepare annual financial reports for the Legislative Assembly. These requirements include the preparation of two key reports:
 - a. Entire Public Sector Financial Statements (EPS), and
 - b. Schedule of Appropriations.
2. This report provides a summary of our findings arising from our audits of the EPS and the Schedule of Appropriations for the year ending 30 June 2014. This report fulfils our responsibilities to communicate certain matters to those charged with governance of the Cayman Islands Government and provide Members of the Legislative Assembly and the public with information about the work we have completed for an important part of my Office's mandate.
3. My Office's responsibility is to plan and perform our audits to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement by conducting them in accordance with International Standards on Auditing (ISAs). In discharging our responsibilities we also use the International Standards of Supreme Audit Institutions (ISSAIs) which elaborate on the application of ISAs for the government sector.
4. An audit of financial statements is not designed to identify all matters or deficiencies that may be relevant to stakeholders. During the course of an audit, we are required to identify and report on issues we find. We discuss all the issues we find with management; however, it is not possible to report on everything we find. Therefore, we have included in this report only those significant matters that have come to our attention.
5. We are therefore using this opportunity to report the following types of issues found during the audit:
 - Governance – the application of the principles of good governance in the public sector;
 - Control frameworks – policies, procedures and practices used by management to ensure the probity of its activities;
 - Operational performance – relates to management's responsibility to undertake activities in an effective and efficient manner;

- Compliance with authorities – relates to management’s responsibility to undertake activities, use resources, and fulfill accountability requirements, in accordance with authority granted by the legislature and all other relevant directions;
 - Acquiring resources – relates to management’s responsibility to obtain and apply resources in an economical manner, without any public money being wasted; and
 - Accountability – relates to management’s responsibility to meet the expectations of the legislature and the public as they relate to appropriate standards of behavior.
6. Information on the integrity and objectivity of the Office of the Auditor General and audit staff, and the nature and scope of the audit, were outlined in an Engagement Letter following the requirements of ISA. In that letter, we indicated that we are not aware of any impairment to our independence as auditors. However it should be noted that the independently audited financial statements of the Office of the Auditor General are consolidated in the EPS financial statements.

AUDIT FINDINGS

7. Our audit of the EPS financial statements and the Schedule of Appropriations has arrived at four significant conclusions:
- the Government has taken some significant steps in improving reporting consolidated financial information, and for the first time we have been able to reach an opinion on EPS consolidated financial statements;
 - despite this, the EPS consolidated financial statements cannot be considered to be reliable or reflect the true financial position or performance of the EPS. Therefore I have issued an adverse opinion;
 - there was insufficient appropriate evidence on which to base an opinion on the Schedule of Appropriations. Therefore I have issued a disclaimer of opinion; and
 - compliance with the legal spending limits established by the Legislative Assembly through the *Appropriation Law (2013)* could not be ascertained.
8. In the following sections, we report on the underlying reasons behind these key findings. In addition, we report on a number of significant internal control and governance issues, which we believe should be brought to the attention of Members of the Legislative Assembly, along with some “*Other Matters*” which are included to meet the reporting requirements of the auditing standards.

RECOMMENDATIONS

9. The main recommendation of the report is that the Government needs to clearly lay out its plans and goals to achieve accountability as required by the PMFL, in both the short and medium term. Government should likewise provide regular reports to the Legislative Assembly on the progress that has been made on achieving those targets in order to hold those who are charged with responsibility for the plans accountable.
10. In addition I have also made in Appendix C a number of detailed recommendations to those charged with governance. These recommendations address my main concerns as it relates to improvement in the financial and performance reporting, governance and internal controls.

ACKNOWLEDGMENTS

11. I would like to express our thanks to the staff of the Cayman Islands Government and, in particular, those in the Treasury Department for their cooperation during the audit of the 2013-14 financial statements.

ENTIRE PUBLIC SECTOR – AUDIT REPORT

12. For the first time since the introduction of the PMFL, I have been able to obtain sufficient and appropriate evidence to reach an opinion on the EPS consolidated financial statements of the Cayman Islands Government. For the previous five years, I disclaimed my opinion as I was not able to obtain sufficient evidence to reach an opinion. Due to an amendment to the PMFL, the EPS consolidated financial statements were not required to be audited from 2004-05 to 2007-08.
13. Due to significant and pervasive matters that I identified during the course of my audit, I have issued an adverse opinion on the EPS consolidated financial statements for 2013-14. This means that, in my opinion, the EPS consolidated financial statements do not present fairly the consolidated financial position, financial performance and cash flows for operations of the Cayman Islands Government in its entirety. In other words, the financial statements cannot be considered credible and reliable.
14. Despite my adverse opinion, the Government has taken a step forward in addressing the challenges it faces in reporting the consolidated results for the entire public sector, and moving toward providing accountability for the use of public resources. However the Government still needs to address some significant matters, and undertake significant further work to put in place the systems and practices across the public sector to be able to present reliable consolidated financial information in the future.
15. I have included my full draft audit report on the EPS consolidated financial statements in Appendix A. In the following paragraphs I discuss the matters that provided the basis for issuing an adverse opinion and other matters that I included in the audit report that I considered should be brought to the attention of the users of the financial statements.
16. In carrying out their responsibilities under the PMFL, officials in the Cayman Islands Government are responsible for:
 - the preparation and fair presentation of the financial statements in accordance with International Public Sector Accounting Standards (IPSAS);
 - operating an effective internal control framework that enables the preparation of financial statements that are free from material misstatement, whether due to fraud or error;
 - the application of suitable accounting policies and appropriate disclosure of financial and other information in these financial statements; and
 - providing auditors with all information deemed necessary for the conduct of the audit.

BASIS FOR MY AUDIT OPINION

DEFICIENCIES IN THE CONSOLIDATION PROCESS

17. We identified deficiencies in the design and implementation of the process for consolidating all ministries, portfolios, offices, statutory authorities and government companies into one economic entity. As a result I believe it is likely that total assets, total liabilities, total net worth, total revenues and total expenses are pervasively affected by multiple misstatements.
18. The Government had not consistently implemented the controls required to ensure proper consolidation and elimination. In particular, the system to identify and therefore enable the elimination of intercompany balances and transactions was not consistently used. In addition, periodic reconciliations were not in place to detect and rectify any misstatements or coding errors.
19. The Treasury Department implemented compensating controls during the consolidation process. However these were not and could not be adequately designed by the time they were implemented to achieve proper consolidated figures at year-end.

EXCLUSION OF THE PUBLIC SERVICE PENSIONS BOARD FROM CONSOLIDATION

20. The EPS consolidated financial statements do not include components relating to the Public Sector Pensions Board (PSPB), a statutory authority, as the Government has concluded that the assets are being held in trust. Therefore the assets, liabilities, revenues and expenses of the PSPB have been excluded.
21. However I believe that the Government has achieved and maintained control over the PSPB as defined by the relevant accounting standard, IPSAS 6 – Consolidated and Separate Financial Statements, and therefore should have consolidated the transactions and balance of the PSPB.
22. As a result, I believe that the following are understated, as of and for the year ended 30 June 2014:
 - Consolidated total assets: \$487.6 million
 - Consolidated total liabilities: \$2.8 million
 - Consolidated revenues: \$67.0 million
 - Consolidated expenses: \$8.0 million

PROPERTY, PLANT AND EQUIPMENT (PP&E)

23. IPSAS provides entities with the option to value their assets on either the basis of the cost model or the revaluation model. The Government's accounting policy for PP&E requires PP&E to be measured using the revaluation model, and therefore in line with the requirements of IPSAS all PP&E consolidated within EPS financial statement is required to be appropriately revalued. However a number of material statutory authorities and government companies (SAGCs) have not revalued their assets and currently carry PP&E at cost within their individual entity books and financial statements. As a result I have concluded that the consolidated figure for PP&E in the EPS financial statements is materially misstated due to the lack of revalued carrying amounts for certain classes of PP&E owned by SAGCs. The total carrying amount of these SAGC assets not revalued in the financial statements is \$186 million.
24. Complete information regarding the cost and valuation of the road network is not available. Whilst information is available for roads constructed since the creation of the National Roads Authority, this is not the case for roads constructed prior to this, for which there is no detailed inventory or reliable valuation. Government could therefore not provide the requisite assertions on the fairness of the carrying amount for roads and sidewalks and as a result I was unable to reach a conclusion on the balances reported in the financial statements.
25. Other matters that impacted on my conclusions on the PP&E balances contained within the EPS consolidated financial statements, were:
- the Cayman Turtle Farm did not conduct the annual impairment testing required by the financial reporting framework on PP&E with a carrying amount of \$31 million;
 - the Government's inventory assigned a \$Nil value to the land component of the George Town Landfill, which is an inappropriate netting of values with any make-good liabilities arising from the property;
 - certain subsidiaries' financial statements have been qualified due to lack of detailed listings (asset registers) of PP&E, reported with carrying values totaling \$2.5 million; and
 - issues surrounding the classification and accounting for Heritage Assets.
26. As a result, I have not been able to determine the fairness of those items identified, and their impact on the overall balance of property, plant and equipment.
27. The EPS consolidated financial statements also report depreciation and amortization expenses amounting to \$43.7 million. However due to the issues affecting property, plant and equipment outlined above I was not able to conclude on whether these expenses were fairly presented in the financial statements.

LONG-TERM EMPLOYEE BENEFITS

28. IPSAS 25 – Employee Benefits requires that entities recognise the liabilities arising from pension and retirement healthcare obligations. It also requires significant disclosures to be made regarding these obligations.
29. Whilst the Government has included disclosures about these liabilities in the notes to the financial statements, the liabilities arising have not been fully recognized in the financial statements as the Government has indicated that they are currently reviewing the valuations prepared by the actuary as at 1 January 2014. No liabilities have been recognised for retirement healthcare obligations, and for pension obligations liabilities have only been recognised on the basis of the actuarial valuation as at 1 January 2011.
30. On the basis of the actuarial valuation I have determined that the consolidated liabilities of the Government are understated by \$1.39 billion in total, of which \$1.18 billion relates to post-retirement healthcare obligations and \$213 million relates to the pension liabilities.
31. In addition to not recognizing the liabilities, the complete relevant expenses for post-retirement healthcare and pensions obligations have not been recognized within the financial statements for 2013-14. As a result Personnel Costs have been understated. It is not practical to quantify the understatement of these expenses due to the co-mingling of pension expenses attributed to the defined benefit and defined contribution participants' accounts for pensions and the co-mingling of current year healthcare premiums and premium payments for current beneficiaries. However the total expenses reported for the year ended 30 June 2014 by the Government's actuary are:
- \$116 million in respect of post-retirement healthcare; and
 - \$24 million in respect of post-retirement pensions.
32. Consequently the EPS consolidated financial statements are materially misstated as a result of not meeting the requirements of IPSAS 25.

REVENUES AND RECEIVABLES

33. The financial statements reported coercive revenues (revenue earned by core government using the coercive power of the state and for which no direct exchange of service occurs) for the year ended 30 June 2014 of \$612 million.

34. The Government however had no basis on which to confirm the completeness of these revenues due to deficiencies in relevant internal controls. Management was therefore not able to assert as to the completeness of the revenues reported and as a result I was not able to conclude as to whether the amounts reported were fairly presented. For example we identified that the Tourism Accommodation Taxes collected from hotel owners that are included in the coercive revenues reported rely solely on returns from the hotels. The Government does not examine or validate what they are being provided is complete and accurate in terms of the actual operation of the taxable property.
35. The financial statements also report sales of good and services amounting to \$234 million, with \$81 million relating to patient revenues generated by the Health Services Authority. However as we have reported for a number of years on the Health Services Authority financial statements the controls set-up to ensure completeness of patient revenues are not effective, and do not provide sufficient evidence that the reported revenues are complete. In the absence of properly designed and effective controls, I was unable to satisfy myself that patient services fees were complete. Therefore I was not able to conclude whether the sales of goods and services reported were fairly presented.
36. As a result of the uncertainties in coercive and other revenues highlighted above I have also not been able to conclude on the fairness of trade and other receivables of \$62 million and \$36 million at 30 June 2013 and 2014.

POTENTIAL ADJUSTMENTS FROM ONGOING SUBSIDIARY AUDITS

37. The audits of a number of subsidiary entities financial statements for the years ending 30 June 2013 and 30 June 2014 were still ongoing at the time of the completion of the EPS Consolidated Financial Statements. These subsidiary entity financial statements were likely to be subject to adjustments due to material misstatements in the reported figures before they were completed. The EPS consolidated financial statements have been prepared using the draft information from these subsidiary entities and therefore it is likely that they would be subject to adjustment as a result. For example the carrying amounts reported for property, plant and equipment would likely be adjusted by at least \$20 million for an impairment in the valuation of the Clifton Hunter High School, which will be reported in the financial statements of the Ministry of Education once it is quantified. It has not been possible to quantify or estimate the impact of any potential adjustments.

OTHER MATTERS IMPACTING THE AUDIT OPINION

38. The final matters included in my audit report which contributed to the adverse opinion I provided are:

- there was no provision in the financial statements for two matters that are likely to be material to the financial statements. These are the remediation or clean-up of the George Town landfill and Frank Sound;
- other current liabilities amounting to \$8 million were reported. I was not able to conclude on the fairness of this amount as I was not provided with the listing of the details for this account; and
- due to the matters discussed above which have affected the financial results reported in consolidated statements of financial position and of financial performance, I was not able to conclude on the fairness of the amounts reported in the statement of cash flows.

MATTERS REPORTED NOT IMPACTING MY AUDIT OPINION

39. In my audit report I highlighted one matter which did not affect my opinion but which I felt should be drawn to the attention of the users of the financial statements.

40. Due to the adverse opinion I have reported on the EPS consolidated financial statements, and the fact that reported results cannot be relied upon, we did not consider any further the overall presentation of the financial statements, including their fitness to be issued to the wider public. Sufficiency in accordance with and compliance with IPSAS and accounting policies required by laws and regulations has not been thoroughly explored to achieve an agreeable presentation of the EPS consolidated financial statements.

SCHEDULE OF APPROPRIATIONS – AUDIT REPORT

41. The Government is required by the PMFL to include in its annual report an audited annual schedule of appropriations used for the year compared with the appropriations granted under the *Appropriation Law* (together with any supplementary Appropriation Law) for the financial year. My responsibility in accordance with the PMFL is to report whether the schedule of appropriation presents fairly a comparison of the appropriations used and appropriations granted.
42. *The Appropriation Law* is the legal authority provided by the Legislative Authority annually for the Government to incur expenditures to deliver outputs, services and programmes. It is the culmination of the annual budget process. Without this the Government has no legal basis on which to incur expenditure, including providing funding to statutory authorities, government companies or non-governmental organisations. *The Appropriation Law* is a fundamental element of the Legislative Authority's responsibilities for oversight, control and monitoring of the use of public money.
43. Under the PMFL, Ministries, Portfolios and Offices are required to bill Cabinet for the outputs delivered on the basis of the costs incurred for delivering those outputs. The output billings represent the appropriations used for the year compared with the appropriations granted under the *Appropriation Law* for the financial year.
44. At present most Ministries, Portfolios and Offices are not billing cabinet on the cost of delivering their outputs. For example the outputs billed by some ministries and therefore the appropriations used are based solely on the appropriations granted. At present most Ministries, Portfolios and Offices do not have the systems in place to adequately cost the outputs to be billed. As a result the appropriations used by Ministries, Portfolios and Offices are not being determined in accordance with the requirements of the PMFL and the *Appropriations Law*, and as a result it is not possible to determine whether entities complied with the legal spending authority provided by the legislative authority.
45. As a result of these issues the management of the Cayman Island Government indicated that
- “We are not in a position to make any assertions on the fair reporting embodied in the schedule of appropriation due to significant inconsistencies in which individual subsidiaries are measuring the amount of actual usage of appropriations, i.e. certain outputs are being measured but only as a fixed fraction of the annual appropriation without due regard to actual measurable outputs based on the purchase agreements.”*
46. As a result I was not able to obtain sufficient, appropriate evidence to provide a basis for an opinion. Accordingly, I was not able to express an opinion on the schedule of appropriations. The Audit Report on the schedule of appropriations including my disclaimer of opinion is at Appendix B.

FINANCIAL RESULTS

47. In this section it is our intention to provide analysis and some additional commentary on the results reported in the EPS consolidated financial statements and the Schedule of Appropriations. It is also our intention to report on compliance with principles for responsible financial management as set out in section 14 of the PMFL.
48. However, to be able to provide any meaningful commentary on Governments results requires credible and reliable financial statements. Due to the pervasive nature of the matters I have raised in my audit reports, leading to an adverse opinion on the EPS financial statements and a disclaimer of opinion on the Schedule of Appropriations, I am not able to provide any meaningful commentary on the Government's Financial Performance or Position, or whether it met the principles of responsible financial management as laid out in the PMFL.
49. Further I am not able to provide any analysis of whether Government was able to comply with the legal spending limits approved by the Legislative Assembly through the Budget process and the *Appropriations (July 2013 to June 2014) Law 2013*, and thus whether Government respected its accountability to, and the authority of the Legislative Assembly. However, it should be noted Government have reported that they breached a number of the appropriation limits authorised by the Legislative Assembly.

INTERNAL CONTROL AND GOVERNANCE

50. Audits of the financial statements are designed to provide opinions on the financial statements, and are not designed to identify all matters or deficiencies in the internal control environments of audited entities, or uncover instances of fraud and wrongdoing. However through our audit work, we have identified a number of concerns around governance, internal control, and financial management and reporting that should be brought to the attention of the Government and the Legislative Assembly.
51. The matters I highlight in this report relate solely to the EPS consolidated financial statements. This includes issues identified in respect of executive transactions, the financial results of which are only included in the EPS consolidated financial statements. Specific issues relating to subsidiary entities that have been consolidated have been reported in the relevant reports on entity financial statements and have therefore not been included here.

RISK MANAGEMENT

52. The Government does not have in place robust arrangements for managing risk. Risk management is a key element of a robust internal control environment as it enables senior management to effectively manage the risks to the achievement of the Governments objectives, and also take well informed decisions about the actions it needs to take. Good governance practices require those charged with governance is to understand the entities strategies and associated risks and to ensure that management's risk management practices are appropriate.
53. Without effective arrangements in place there is increased risk that the Government will fail in the achievement of objectives, that they will be delivered at much greater cost, or the fiduciary responsibilities of those placed in authority could be undermined. As the Government is exposed to a number of jurisdictions, currencies, laws and regulations there is a need for a robust strategic risk assessment and control framework in place.

AUDIT COMMITTEE

54. Generally accepted good practice in the management of public resources is the establishment of audit committees within entity's to provide assurance on risk management, governance and internal control to the chief executive, Board or accountable officer(s). Effective audit committees can provide objective advice and insights into a public entity's strategic and organizational risk management framework, as well as identifying potential improvements to governance and internal control practices.

55. At present core government does not have an audit committee. Putting in place an independent audit committee for core government could be a strong driver for continuous improvement in internal control, financial management and financial reporting across Government and provide the Deputy Governor with the required assurance on the arrangements in place through a process of constructive challenge.

CONSOLIDATION PROCESS

56. The consolidation and elimination processes designed and implemented to calculate the figures in the EPS consolidated financial statements did not properly satisfy the requirements under IPSAS 6, Consolidated and Separate Financial Statements. The issues noted during the course of our audit as it relates to the integrity of the consolidation process represented systemic weaknesses, especially the full elimination of intercompany figures (transactions within government and between government and its subsidiary entities). The following findings indicate that there are significant matters to be addressed:

- reliance placed solely on the trial balance figures of the individual entities, and lack of verification against the audited figures from subsidiaries' financial statements;
- reliance placed solely on the Inter-Organization Code (I/O Code) used in the general ledger (GL) module of IRIS, to identify intercompany balances and amounts that are required to be eliminated;
- lack of effective government-wide reconciliation procedures on intercompany balances and transactions for subsidiaries' individual reporting and for consolidation;
- forced eliminations based on an assumption of assigning revenues and assets to be correct in order to facilitate the elimination process;
- lack of a robust system in place to ensure that all material assets and liabilities associated with controlled entities were included in the consolidated results, as required by IPSAS 6. As noted in our audit opinion a material entity was omitted from consolidation with net assets of \$487.4 m.
- The process used to eliminate investments and underlying equities was not deemed appropriate and accurate. Management did not have an ongoing process in place to reconcile investments held in the parent organization to the net assets in the SAGCs, and requiring a balancing adjustment of \$13 million to be made in the EPS consolidated financial statements.
- Inconsistent accounting policies across the group in contravention of IPSAS 6, and no effective system in place to develop or ensure consistency. For example there was no assessment as to whether revenues and expenses throughout various entities are being recognized and measured in a consistent manner for similar transactions, and the valuation of PP&E is done inconsistently across the group.

COMPLIANCE WITH ACCOUNTING STANDARDS - IPSAS

57. Under the PMFL the financial reporting framework for the EPS consolidated financial statements are the International Public Sector Accounting Standards (IPSAS). The financial statements are therefore required to comply with the requirements prescribed in IPSAS in order for them to present fairly the underlying transactions incurred, and promote transparency and accountability in the public finances. The financial statements departed from the requirements of IPSAS in a number of material areas. Specific instances of non-compliance with IPSAS included:

- **IPSAS 6, Consolidation** - This standard prescribes the accounting and disclosure by public sector entities for the Consolidated and Separate Financial Statements.
- **IPSAS 18, Segment Reporting** - This standard prescribes the disclosure by public sector entities for business segments. Systems and processes required for the efficient and effective reporting on segments as required are not in place.
- **IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets** - This standard identifies circumstances where provisions are to be recognized.
- **IPSAS 20, Related Party Disclosures** - This standard prescribes the disclosure by public sector entities for related party transaction. Government has not established a system from which a complete and accurate listing of key management personnel transactions and corresponding amounts are reported.
- **IPSAS 25, Employee Benefits** - This standard prescribes the accounting and disclosure by public sector entities for employee benefits, including post-employment benefits such as medical care and pension plans.

GENERAL INFORMATION TECHNOLOGY (IT) CONTROL ENVIRONMENT

58. We undertook a general IT control assessment as part of our audit to obtain assurance about the overall IT control environment. This covered key systems that impacted on the financial management of government, and other key operational systems. This assessment considered:

- System change control;
- disaster recovery planning;
- data centre and network operations;
- information security; and
- managing third party service providers.

59. Our assessment identified a number of issues that impacted on the effectiveness of the IT control environment and presented a number of risks. These have been included in a detailed action plan to management within the relevant areas of government. The keys risks identified were:

- New application systems, system software, network and communication software and hardware acquired or developed, are inconsistent with management's intention.
- Modifications to existing application systems, data structures, systems software, network hardware and communications software are not implemented timely, are implemented inappropriately and/or do not function consistent with management's intention.
- When new systems are implemented, existing data that is converted to the new system is incomplete, inaccurate or invalid.
- Application systems, systems software and network and communication software are not maintainable or supportable.
- Data is inappropriately managed and does not provide reasonable assurance that financial data remains complete, accurate, and valid during the update and storage process.
- Users do not receive appropriate training in the use of application systems.
- Facilities are inappropriately managed and do not protect the integrity of financial information as it is managed by the relevant components of the IT infrastructure.
- Information resources are not protected against environmental hazards and related damage.
- In the event of a disaster, essential business processes and information systems cannot be recovered timely.
- Service level agreements and vendor support levels do not meet agreed or expected levels.
- The selection of outsourced vendors is inconsistent with management's intentions.

IRIS UPGRADE

60. As part of our audit we carried out an assessment of the upgrade the government undertook of its main accounting system IRIS, covering the main modules that are currently being used to manage and report on the Government financial results. The scope of the assessment was to review:

- the activities and controls performed during the upgrade to determine whether there were any controls gaps during the change management process; and
- the application controls for the modules in scope to identify whether there were any application control deficiencies and/or functionalities that were not enabled within the system.

61. At a strategic level the majority of issues we have identified relate to the governance arrangements for the development of IRIS. We noted that the IRIS team is striving to effectively manage the development of the system, but there is no clear business owner for the system, leading to confusion of roles and responsibilities. Additionally the systems and practices for approving changes and developments are not clearly established to enable the development of the system in a clear coherent manner, which also leads to frustration of key business partners and users.
62. With respect to system change control, our assessment identified a number of gaps which create risks that application systems are: implemented inappropriately; do not function as intended; not maintainable or supportable; and modifications are not implemented timely. For example we found that:
- the business case for the upgrade did not effectively examine the options and consider other solutions for the main accounting system. It appeared to be prepared to justify the decision to upgrade IRIS rather than actually consider the best option for government;
 - whilst the upgrade was managed and effectively implemented there were gaps in the evidence for the completeness of system testing and some user acceptance test;
 - no formal process to monitor IRIS to ensure supported versions of the system are being used and new releases implemented in a timely manner;
 - no formal management process in place to approve user and other requests for modifications to the IRIS system and database; and
 - there were no standards approved by management to ensure consistency in the development and maintenance activities for application systems with the Government.
63. Finally it was noted that management was not able to provide us with evidence that the development of IRIS upgrade was monitored to ensure the project met the objectives specified and the budget.

64. For the application controls across the IRIS modules our assessment identified a number of functionalities within IRIS that were not fully implemented and as a result control deficiencies impacting the effectiveness of the control environment. There were a significant number of findings which mainly related to controls within the system not being implemented to ensure the effective segregation of duties and appropriate approval of transactions. For example we identified that:

- segregation of duty issues which enable a small number of users to enter fictitious payments and subsequently manipulate the cash position;
- sequential numbering not automatically set within IRIS for accounts receivable, accounts payable and journal entries;
- the ability for users to override or disable matching between purchase orders, goods received and invoices;
- the ability for users to modify goods receipt, purchase orders and accounts payable invoices;
- authorization limits for journals have not been set in IRIS and a large number of users with the ability to enter and post manual journals into IRIS without independent approval;
- users outside the HR strategic team with access to enter and edit the master payroll file, with a number violations of access identified; and
- a large number of users with access to create/modify suppliers within IRIS.

65. As a result there are some significant risks to the complete and accurate recording of transactions, recording transactions in the correct accounting period, and ultimately the potential for recording inappropriate, invalid or fraudulent transactions.

MANAGEMENT OF REVENUES

66. We recently conducted a performance audit of the management and collection of government revenues which will be reported separately. This audit was designed to address our requirements for the audit of coercive government revenues reported in the 2013-14 EPS consolidated financial statements.

67. Our audit concluded that the collection of revenues was being carried out in accordance with legislation. However we identified a number of significant weaknesses in the systems and controls in place to manage revenues, in particular in relation to ensuring the completeness of revenues and the use of revenue waivers.

68. **Completeness of Revenues** - Government does not approach the task of collecting revenue with a compliance verification mentality where receipts, returns, and supporting documentation received from the public are verified for completeness and enforcement action is taken for those who fail to remit or whose remittances are incomplete. Instead its strategy is to support voluntary compliance. Voluntary compliance means that individuals and businesses are responsible for enquiring about their compliance obligations, completely and accurately declaring the required information, accurately calculating applicable revenue due, and paying the amounts owing on the due date and in the required manner.
69. Systems and controls are not in place for all coercive revenue streams to ensure that all revenues are collected. Examples include:
- **Immigration** – challenges in effectively administering the work permits and enforcement e.g. ensuring those in the work force have an active work permit, and those with an active work permit are employed in the profession and industry they have indicated in their work permit application.
 - **Tourism Accommodation Tax** – controls are not in place to verify that the amounts remitted by hotels and other properties are complete. Reliance is placed solely on returns from the hotels.
 - **Environmental Protection Fees** - no controls were in place to verify whether the information received from the airlines is complete. Treasury simply uses the total number of passengers reported by the airlines and sends a monthly bill to the airlines to charge for the EPF fee.
 - **Revenues from Air and Cruise Arrivals** – Government places sole reliance on the information provided by Airlines and Cruise ships in terms of passenger arrivals. The information is not subject to independent verification and therefore government has no assurance over the completeness and accuracy of the information, and thus the revenues its receives. Starting in January 2015, Treasury is starting to receive reports from Immigration which they are comparing to the reports received from the Airlines, but this is still in the testing phase.
70. **Revenue Waivers** - We found that revenue waivers are not granted in a consistent and transparent manner. There is also an absence of policies and procedures for the processing of revenue waivers. As a result we were unable to assess how waivers are managed, processed, or tracked, nor were we able to assess the reasonableness of the dollar value of waivers granted.
71. **System integration** - We found that revenue and information systems were not well integrated between departments as well as centrally into IRIS. Apart from inefficiencies this creates in the management of revenues, the need for significant manual intervention and processing significantly increases the risks of errors in the recording of revenues.

72. Customs – We identified a number of weaknesses in the systems and control around the processing of goods by Customs. These included:

- **Harmonized Codes** - During our testing it was noted that Harmonized Codes were rarely used either in the Customs Import Entry Forms or Liability Forms. The Customs Import Entry Forms include the rate of duty charged but in most cases the “Tariff Heading” column which should contain the Harmonized Code corresponding to the rate, was left blank. With Harmonized Codes not being included on these forms, in some cases it may not be possible to determine the rationale for charging one rate over another.
- **Incorrect Rates within the Published Law** - During our testing it was noted that in some cases the published *Customs Tariff Law (Revised 2012)* included incorrect duty rates. An example is the rates of duty charged on Shell Fish imported. The published law noted that duty charged on the importation of Shell Fish is 17% of the value of goods imported. However it was intended to be 12% of the value of goods imported and arose due to a discrepancy in the drafting process. In our testing it was noted that the Customs Officers used the intended rate of 12% as this is the rate within the TRIPS system.
- **Verification of Goods Movement in Bonded Warehouse** - Due to staff shortages Customs Officers have been unable to visit many bonded warehouses to perform regular stock counts or stock checks on alcohol and tobacco products. In many cases the Customs Officers are only able to verify stock at these warehouses once a year and they attempt to perform a few random stock checks at some warehouses. In order, to record stock levels on a monthly basis to determine the duties to be charged, Customs Officers contact the Inventory Managers at the individual warehouses who provide Customs Officers with evidence of the stock levels as well as stock sold during the month which may include duty paid and duty free sales invoices. However due to the lack of physical verification by Customs Officers, there is an increased risk that Customs may not be charging and collecting the correct duties.
- **Refund of Duties** - It was noted in one instance within our sample testing that a refund of duties was made to a supplier relating to duties paid on items which were later sold to a church duty free. The supplier then requested a reimbursement of duties paid. Customs was unable to provide evidence that the items were actually sold to a church e.g. sales invoice from the supplier to the church. It was noted by Customs that an Elder of the church can transact business on behalf of the church. However, a risk exists of these individuals receiving goods duty free and goods are held for personal use as no evidence of a sale to an organization instead of an individual could be seen. At a minimum Customs should require and keep evidence of a sale being made to the organization.

EXECUTIVE EXPENSES

73. As part of our audit we reviewed the framework for the management and control of executive expenses to assess whether they were appropriately managed, in particular for Transfer Payments and funding provided to non-governmental organizations. Transfer payments and non-governmental organizations expenses amounted to \$57.6 million, while total executive expenses were over \$100m. We also took account of the performance audit work we recently reported in our report on the “Government Programmes Supporting those in Need”.
74. We found that these expenses are managed differently across the various ministries of Government and that there are weaknesses in systems and controls to manage these programmes. In three of the more significant Ministries we identified varying control issues which included:
- a lack of clear documented policies and procedures for the management of executive expenses;
 - weak or no documented policies or criteria to guide the assessment or eligibility of individuals or organisations for funding;
 - the role of ministers in the selection and approval of recipients;
 - no properly documented basis for the selection of suppliers to provide programmes, compounded by non-compliance with the procurement regulations;
 - no clear documented methodologies or policies for determining the amounts required to fund transfer payments or payments to NGOs;
 - limited, weak or no controls in place to obtain assurance that funds were used for the purposes intended or complied with any terms and conditions of award; and
 - no clear evidence of evaluation of programmes to measure against the achievement of the desired goals or objectives.
75. As a result the weaknesses in the systems and controls for these programmes and expenses there is an increased risk of inappropriate transactions, and the potential for the abuse and misuse of funds.

HERITAGE ASSETS

76. The accounting and reporting for heritage assets is inconsistent and unclear at present, and without a clear and robust accounting policy. At present the lines are blurred between what is and what isn't a heritage asset, and there is a risk that the classification of heritage assets could be manipulated to help achieve specific financial results.

77. For example we found that assets classified as heritage assets by core government were not classified as such by other entities within the group, and have consequently not been included as heritage assets in the EPS consolidated financial statement. Examples of such assets include the Museum land and building and monuments like Fort George.
78. Another example of inconsistency is seen in the accounting for artworks. The Cayman National Cultural Foundation attaches a value to its artworks, whilst the National Gallery does not.

OTHER ISSUES/PUBLIC INTEREST

SAVE THE MORTGAGE

79. Under the Save the Mortgage Programme, which originally started in the year 2012, the Government issued interest free loans up to \$20,000 and over terms up to 50 years, to eligible Caymanians, who had financial challenges with the payment of their mortgages. The loans were paid directly to the banks to mitigate mortgage arrears of the recipients and a second charge was placed on the relevant properties. Total loans of \$2.1 million were issued.
80. Apart from an amount of \$18 thousand for pending amounts that was expensed, no amounts associated with these funds were recorded in the current year. Further enquiry revealed that the balances receivable amount of \$2.1 million was originally set up as loans. However, after considering the net present value of loan portfolio was likely to be very minimal given the zero interest rate and length of repayment period (50 years), the loans were expensed as transfer payments. This is appropriate accounting treatment although we have not been provided with a formal assessment of the net present value.
81. Despite the expensing of these loans, the loans receivable continue to be tracked in a sub-ledger system and demand letters are sent on a quarterly basis. However the repayment of these loans has been low and there has been a very high level of delinquency, which further supports the decision to expense the loans. We obtained a master list which detailed activity over the programme and noted that based on the current master list that as at 30 June 2014, \$84.6 thousand out of \$144 thousand due had been paid (58.8%). The level of repayment started to decline in 2013-14 and as at 30 June 2014, 116 out of 138 (84%) of the loans were delinquent to some degree. For 52 (38%) loans no repayment was received at all during 2013-14.
82. The information for 2014-15 showed further decline in repayment levels and increasing levels of delinquency with only \$25 thousand out of the \$72 thousand due for the period repaid (33.3%), and the number of loans for which no payment was received during 2014-15 increasing to 78 (57%). Looking at the substance of these transactions the reality is that the loans were closer to grants or transfer payments.

83. Finally we examined the governance of this programme when we were conducting our governance performance audit and we identified significant issues with the arrangements, systems and control to ensure that the programme was managed with due regard to value for money and fairness.

COMPENSATION PAYMENTS

84. We noted \$4.6 million was paid to third parties including staff members for claims brought against the entities in the EPS. These claims relate to actions taken against the Government by third parties and staff for issues ranging from medical to employment related matters. The amounts expensed should be read in conjunction with Note 31 of the financial statements which outlines other unsettled cases against entities in the EPS.

VOLUNTARY SEPARATION

85. Amounts totaling \$456 thousand relate to voluntary separation payments during the year under review. This package was established by the Cayman Island Government in an effort to reduce the size of the civil service; it was also seen as a cost cutting measure and is offered to civil servants who wish to terminate their services. Employees who opt for this package are required to complete an application letter which gives a justifiable reason for the termination of their services. The application and letter is reviewed and approved by a Voluntary Separation Committee, upon approval a Discharge of Employment Contract is prepared and signed by both parties to the contract both parties to the contract mutually agree to discharge the employment contract on the agreed separation date, this is the interest of both the employee and the civil service. With this agreement the employee is not eligible to be hired into any position with the Cayman Islands Civil Service for a period of 5 years after the agreed separation date.

86. During the audit, we noted that personnel files were not always updated with the relevant information reflecting salary increases of employees.

REQUIRED LEAVE

87. The Personnel Regulations 2013 Revision under Schedule 1 indicates that the appointing officer (with the approval of the Head of the Civil Service if the period of leave is to be more than 30 days) may require an employee to go on Required Leave where the appointing officer deems it to be in the public interest for the employee to do so, and that leave shall be leave on full pay for such period as the appointing officer deems necessary.

We were unable to receive information as requested on the total expenses incurred for persons on required leave from the Portfolio of Civil Service for the year ended June 30, 2014 by the end of the audit. It was reported however that the salaries paid for heads of department or higher amounted to \$292K for two employees.

EX-GRATIA PAYMENTS

88. Ex-gratia payments are made under the provisions of the Public Service Pensions (Ex-Gratia Pensions) Regulations. These payments are made to Caymanians who are above 60 years and have held an office in the Public Service or the Other Public Service for any period of at least four or more years in the aggregate and was not entitled to a pension or did not receive a contracted officer's supplement or similar compensation. The regulation also makes provisions for civil servants who have not attained the age of sixty years of age, but have been certified by the Chief Medical Officer as being permanently disabled. The amount of \$1.2 million was appropriated and expensed during the year under review by the Portfolio of the Civil Service for ex-gratia payments, these amounts were paid on a quarterly basis to the Public Service Pension Board who then pays monthly amounts to persons that apply for ex-gratia and satisfy the stipulations of the regulations.

OTHER MATTERS

89. Under auditing standards I am required to report certain other matters to those charged with governance, which in the case of the EPS consolidated financial statements, is the Government's senior management.

SIGNIFICANT ACCOUNTING PRACTICES

90. We are responsible for providing our views about qualitative aspects of the Entity's significant accounting practices, including accounting policies, accounting estimates and financial statement disclosures. Generally accepted accounting principles provide for the Entity to make accounting estimates and judgments about accounting policies and financial statement disclosures. We are aware of a number of areas where the significant accounting practices are not consistent with general industry practice. These were outlined in our audit opinion and further detailed in our internal control findings to those charged with governance.

MANAGEMENT'S JUDGMENTS AND ACCOUNTING ESTIMATES

91. There were significant matters which required management to make significant judgments or which required significant estimates. In the following cases management did not properly account for the following estimates in the financial statements:

- IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets - There is no provision in the financial statements for two matters that are likely to be material to the financial statements. These are the remediation or clean-up of the George Town landfill and Frank Sound.
- IPSAS 25 Employee benefits - Post-employment medical care and pension plans have not been accounted for in line with IPSAS 25.

GOING CONCERN DOUBTS

92. Whilst we have reported some concerns for a number of subsidiary entities in the relevant audit reports, we did not become aware of any material uncertainties related to events and conditions that may cast significant doubt on the Government's ability to continue as a going concern as a result of our audit.

FRAUD OR ILLEGAL ACTS

93. Applicable auditing standards recognize that the primary responsibility for the prevention and detection of fraud and compliance with applicable laws and regulations rests with both those charged with governance of the entity and with management. It is important that management, with the oversight of those charged with governance; place a strong emphasis on fraud prevention, and fraud deterrence. They are also responsible for establishing and maintaining controls pertaining to the entity's objective of preparing financial statements that are presented fairly, in all material respects, in accordance with the applicable financial reporting framework and managing risks that may give rise to material misstatements in those financial statements. In exercising oversight responsibility, those charged with governance should consider the potential for management override of controls or other inappropriate influence over the financial reporting process.
94. As auditors, in planning and performing the audit, we are required to reduce audit risk to an acceptably low level, including the risk of undetected misstatements in the financial statements due to fraud. However, we cannot obtain absolute assurance that material misstatements in the financial statements will be detected because of such factors as the use of judgment, the use of testing, the inherent limitations of internal control and the fact that much of the audit evidence available to the auditor is persuasive rather than conclusive in nature.
95. No fraud or illegal acts came to our attention as a result of our audit of the EPS consolidated financial statements. With respect to compliance with legislation apart from matters raised in the Audit Report and this report no other material matters relating to the EPS consolidated financial statements were identified.
96. However, the Government does not have well developed governance and risk management arrangements for the identification and management of fraud risks. As part of the development of its risk management arrangements the Government needs to consider the risk of fraud, and the systems and controls it has for preventing, detecting and responding to fraud risk. This includes the implementation of a fraud policy and fraud response plan, and developing a framework for the proactive reporting of fraud and suspected fraud.

SIGNIFICANT DIFFICULTIES ENCOUNTERED DURING THE COURSE OF OUR AUDIT

97. No serious difficulties were encountered in the performance of our audit except for some ongoing challenges to finalize the financial statements for some material subsidiary entities consolidated within the EPS consolidated financial statements and delays in obtaining information from the Customs Department.

98. During our testing we faced delays in with Customs providing supporting documentation for the items selected for testing. From further discussion regarding these delays it was noted that the delays were a result of the following reasons:

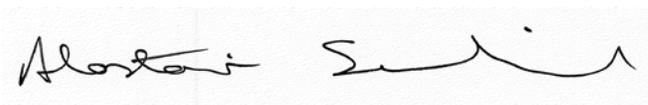
- lack of human resources;
- poor filing resulting in difficulties to locate the documentation requested speedily;
- inappropriate personnel assigned who were not familiar with the filing and had difficulty locating documents; and
- poor source information on records which in some instances was vague and unclear and made it challenging to track down the underlying supporting documentation.

DISAGREEMENTS WITH MANAGEMENT

99. Management has omitted a number of material transactions from the financial statements. These have been reported in our audit opinion and detailed as applicable in our internal control deficiencies.

CONCLUSION

100. This report provides a summary of our audits of the Cayman Islands Government Entire Public Sector consolidated financial statements and the associated Schedule of Appropriations for the year ending 30 June 2014.
101. Whilst the Government has made progress in presenting these financial statements, as evidenced by the fact that I have been able to place an opinion on the EPS consolidated financial statements for the first time since the introduction of the PMFL, the Government still faces some significant challenges to report credible and reliable financial information for the whole of government, and report to the Legislative Assembly on its compliance with the legislated spending limits in the *Appropriation Law*.
102. More needs to be done in regards to the development and improvement of systemic processes and controls. The underlying systemic weaknesses which resulted in many of the issues and areas of non-compliance with standards must be addressed to enable the presentation of information that is reliable and ultimately provide accountability and transparency in the use of public resources. At a strategic level, there is a need to further address issues that have been raised in my previous reports to develop a strong government finance function. Imperative in this is strong leadership of the Government finance function to effectively engage and mobilize support towards attaining the financial reporting objectives.
103. In conclusion the Government has much work to do to achieve a position where Entire Public Sector consolidated financial statements and the associated Schedule of Appropriations present reliable and credible information. I am seeing evidence that further improvements will occur in the coming year as the EPS team are enhancing the systems and processes for the preparation of the financial information, but for progress to continue towards the ultimate objective of restoring financial accountability, the Government needs to clearly lay out its plans and goals for materially achieving accountability as required by the PMFL, in both the short and medium term, and provide regular reports to the Legislative Assembly on the progress that has been made on achieving those targets.



Alastair Swarbrick MA(Hons), CPFA, CFE
Auditor General
George Town, Grand Cayman
Cayman Islands

28 September 2015

APPENDIX A – EPS DRAFT AUDIT REPORT

TO THE MEMBERS OF THE LEGISLATIVE ASSEMBLY

I have audited the accompanying financial statements of Cayman Island Government “Government”, which comprise the consolidated statement of financial position as at 30 June 2014 and the consolidated statement of financial performance, consolidated statement of changes in net worth and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages 22 to 101 in accordance with the provisions of Section 60(1)(a) of the *Public Management and Finance Law (2013 Revision)*.

Management’s Responsibilities for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Public Sector Accounting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

My responsibility is to express an opinion on these consolidated financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my adverse audit opinion.

Basis for Adverse Opinion

Pervasive inaccuracies arising from improper elimination

Because of the significant deficiencies in the design and implementation of the consolidation and elimination process involved in the consolidated financial reporting, I believe that it is likely that total assets, total liabilities, total net worth, total revenues and total expenses are pervasively affected by multiple misstatements.

Subsidiary and parent entities within the single economic reporting entity have not consistently implemented the controls to ensure proper consolidation and elimination. Particularly, system coding that identifies intercompany balances and transactions were not consistently used. In addition, periodic reconciliations were not in place to detect and rectify any misstatements or coding errors.

The compensating controls implemented by the Treasury Department during the consolidation process were not adequately designed to achieve proper consolidated figures at year-end. For example, the procedure for non-matching balances transactions and balances at year-end was to treat the receivables and revenues as accurate figures, and thereby adjust the related payables and expenses in the other entity.

Exclusion of the Public Service Pensions Board from consolidation

I disagree with management's assertion that the assets, liabilities, revenues and expenses of the Public Service Pensions Board ("Pensions Board") should be excluded from the Government consolidated financial statements. As a result, I believe that the following are understated, as of and for the year ended 30 June 2014:

- Consolidated total assets: \$487.6 million
- Consolidated total liabilities: \$2.8 million
- Consolidated revenues: \$67.0 million
- Consolidated expenses: \$8.0 million

The consolidated financial statements exclude components relating to the Pensions Board as management concludes that the assets are being held in trust. I believe however that the Government has achieved and maintained control over the Pensions Board as defined by IPSAS 6 – *Consolidated and Separate Financial Statements*.

Pervasive inaccuracies arising from subsequent adjustment in subsidiaries

Current and prior year financial statements most likely would have been subjected to inaccuracies because of ongoing financial statements audits. I have not been able to estimate the impact of those adjustments, if any, including those that may have arisen from subsidiary audits completed prior to the issuance of the consolidated financial statements for both 30 June 2014 and 2013.

Receivables affected by revenue completeness

I have not been able to conclude on the fairness of trade and other receivables at 30 June 2014 and 2013 because of the effects of the uncertainties in coercive and other revenues as discussed further below.

Road network completeness and valuation

I have not been able to conclude on the fairness of property, plant & equipment because management has not provided any assertions on the fairness of the carrying amount of Roads and Sidewalks, arising from the lack of detailed inventory and reliable valuation.

Revaluation of SAGC property, plant & equipment

I believe that the consolidated figure for property, plant & equipment are materially misstated due to the lack of revalued carrying amounts for certain classes of property, plant & equipment owned by the statutory authorities and government companies (“SAGC”) that have not been revalued. The total carrying amount of these SAGC assets in the financial statements not revalued is \$186 million.

No asset listing and impairment testing

Turtle Farm failed to properly implement the annual impairment testing required by the financial reporting framework on property, plant and equipment amounting to \$31 million.

The Government’s inventory also assigned a \$Nil value to the land component of the George Town Landfill, which is an inappropriate netting of values with any make-good liabilities arising from the property. In addition, certain subsidiaries’ financial statements have been qualified due to lack of detailed listing of property, plant & equipment, reported with carrying values totaling \$2.5 million.

As a result, I have not been able to determine the fairness of those items identified, and their impact on the overall balance of property, plant & equipment.

Understatement of long-term employee benefits liabilities and omission of disclosures

I have determined that the consolidated liabilities of the Government are understated by \$1.39 billion in total. Government has not recognized \$1.18 billion of liabilities arising from its post-retirement healthcare obligations. On the other hand, it did not recognize its full pension liability resulting into an understatement of \$213 million.

The consolidated financial statements are also materially misstated because of the omission of several requirements regarding long-term employee benefits from IPSAS 25 – *Employee Benefits*.

Provisions completeness

Based on limited scope, I have reviewed provisions and found two matters likely material to the financial statements that have not been identified in the Government’s listing.

No listing for other current liabilities

I have not been able to conclude on the fairness of other current liabilities amounting to \$8 million as I have not been provided with the listing of the details of this account.

Coercive revenues completeness

I have not been able to conclude on the fairness of the amount reported as coercive revenues for the year ended 30 June 2014 amounting to \$612 million. Management does not make an assertion on the fairness of this figure, citing significant control deficiencies.

Based on audit examinations, it was noted that the Tourism Accommodation Taxes collected from hotel owners are not being examined for the accuracy of the amount received against the actual operation of the taxable property.

Sales of goods and services completeness

I was not able to conclude on the fairness of the Sales of Good and Services amounting to \$234 million because the controls set-up to ensure completeness of patient revenues are not effective to provide sufficient evidence that the reported revenues are complete. In the absence of properly designed and effective controls, I was unable to satisfy myself that such reported patient services fees are not complete.

Personnel cost understatement

I was not able to conclude on the fairness of Personnel Costs amounting to \$350 million because of the understatement of the liabilities from post-retirement pension and healthcare employee benefits.

Total expenses reported for the year ended 30 June 2014 by the Government's actuary are:

- \$116 million in respect of post-retirement healthcare; and
- \$24 million in respect of post-retirement pensions.

However, the understatements on both costs are not practical to quantify because

- of the co-mingling of pension expenses attributed to defined benefit and defined contribution participants accounts, in respect of the pension.
- of the co-mingling of current year healthcare premiums and premium payments for current beneficiaries.

Depreciation and amortization expenses accuracy

I was not able to conclude on the fairness of depreciation and amortization expenses amounting to \$43.7 million because of the multiple issues affecting property, plant & equipment discussed above.

Statement of cash flow as a whole

I was not able to conclude on the fairness of the amounts reported in the statement of cash flows due to the matters discussed affecting the statements of financial position and of financial performance.

Adverse Opinion

In my opinion, because of the significance of the matters discussed in the Basis for Adverse Opinion paragraph the consolidated financial statements do not present fairly the consolidated financial position of Cayman Islands Government ("Government") as at 30 June 2014 and its financial performance and its cash flows for the year then ended in accordance with International Public Sector Accounting Standards.

Other Matter

I draw the attention of the reader of the Government's consolidated financial statements that due to the adverse opinion, no further consideration was given on the overall presentation of the financial statements, including fitness for issue to the wider public. Sufficiency in accordance with and compliance with IPSAS and accounting policies required by laws and regulations have not been thoroughly explored to achieve an agreeable presentation of these consolidated financial statements.

Alastair Swarbrick, MA (Hons), CPFA, CFE
Auditor General

[DATE]
Cayman Islands

APPENDIX B – SCHEDULE OF APPROPRIATIONS DRAFT AUDIT REPORT

TO THE MEMBERS OF THE LEGISLATIVE ASSEMBLY

I have been engaged to provide assurance services on the Cayman Islands Government's ("Government") schedule of appropriations for the year ended 30 June 2014. The terms of the engagement requires that it be carried out in accordance with the International Standard on Assurance Engagements 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* ("ISAE 3000").

Scope

The objective of this engagement is to provide an opinion on whether the schedule of appropriations presents fairly the actual and budgeted figures as authorized in the *Appropriation Law (July 2013 to June 2014) Law, 2013*.

Management's responsibilities

The Government is required by the *Public Management and Finance Law (2013 Revision)* ("PMFL") to include in its annual report an audited annual schedule of appropriations used for the year compared with the appropriations granted under the *Appropriation Law* (together with any supplementary Appropriation Law) for the financial year.

Responsibility of the Auditor General

My responsibility in accordance with the ISAE 3000 is to report whether the schedule of appropriation presents fairly a comparison of the appropriations used and appropriations granted. Because of the significance of the matter described in the basis for a disclaimer of opinion paragraph, I was not able to obtain sufficient, appropriate evidence to provide a basis for an opinion.

Basis for Disclaimer of Opinion

Management is not able to make assertions on the fairness of the reported figures and comparison of the appropriations used and appropriations granted that makes up the annual schedule of appropriations. As an illustration, there were instances where the appropriations used are based solely on appropriations granted.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, I have not been able to obtain sufficient appropriate evidence to provide a basis for an opinion under ISAE 3000. Accordingly, I do not express an opinion on the schedule of appropriations.

Alastair Swarbrick, MA(Hons), CPFA, CFE
Auditor General

[DATE]
Cayman Islands

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APPENDIX C - RECOMMENDATIONS

Recommendation	Management Response	Responsibility	Date of planned implementation
Financial and Performance Reporting			
<p>1. The Government should develop a clear plan and set goals for the material achievement of accountability as required by the PMFL, in both the short and medium term. The Government should report progress on a regular basis, on achieving those goals, and provide them to the Legislative Assembly.</p>	<p>Management agrees with this recommendation.</p>	<p>Financial Secretary & Chief Officer</p>	<p>A tentative Plan to be developed by December 4, 2015. This plan will be subject to change contingent on the proposed amendments to the PMFL (2013 Revision).</p>
<p>2. Government should prepare a Financial Statement Discussion and Analysis in line with the requirements of the IPSASB Recommended Practice Guide 2 to enhance accountability and transparency for the use of public resources.</p>	<p>Management agrees with this recommendation.</p>	<p>Financial Secretary & Chief Officer</p>	<p>The Financial Statement Discussion and Analysis was included in the 2013-14 Financial Statements and an expanded version will be incorporated in the 31 October 2015 EPS submission.</p>
<p>3. Government should consider implementing IPSASB Recommended Practice Guide 3 on Reporting Service Performance Information to further enhance accountability and transparency, and provide demonstrable information on the services that they are</p>	<p>Management will review this recommendation in line with the PMFL Review Committee recommendations accepted by Cabinet.</p>	<p>Financial Secretary & Chief Officer</p>	<p>Consideration will be given to the implementation along with the PMFL Review Committee recommendations which is currently</p>

Recommendation	Management Response	Responsibility	Date of planned implementation
providing to citizens.			proposed to be legislated by 31 December 2016.
<p>4. Management should review the requirements of IPSAS accounting standards and implement control processes that ensure that the objectives of the standards are met. We have outlined a number of areas in detailed in our report. There is a clear need for ownership in this entire process to minimize such issues as inconsistencies and non-compliance. Specifically:</p> <ul style="list-style-type: none"> • IPSAS 6 should be clearly analyzed and reviewed to ensure that the consolidation process is performed in compliance to this standard; and • Controls processes such as full intercompany balances reconciliation, proper identification and codification of transactions and balances that would require special adjustments during the consolidation process should be in place. 	Management agrees with these recommendations. However, in considering IPSAS 6 management needs to ensure that such consolidation does not result in information which could potentially be misleading.	Financial Secretary & Chief Officer	30 June 2016
<p>5. The Government needs to review whether the system of using outputs for reporting against appropriations reported in the Schedule of Appropriations is appropriate. It also needs to put in place systems that are consistently applied across government to ensure that they</p>	Management will review this recommendation in line with the PMFL Review Committee recommendations accepted by Cabinet.	Financial Secretary & Chief Officer	Consideration will be given to the implementation along with the PMFL Review Committee recommendations

Recommendation	Management Response	Responsibility	Date of planned implementation
can report on this fundamentally important accountability information.			which is currently proposed to be legislated by 31 December 2016.
Governance and Internal Control			
6. The Government should consider establishing an Audit Committee for core Government to act as a driver for continuous improvement in internal control, financial management and financial reporting across Government and provide the Deputy Governor with the required assurance on the arrangements in place through a process of constructive challenge.	Management agrees with this recommendation.	Deputy Governor	30 June 2016
7. The Government should drive the development of a risk management framework across the public sector to enable the effective management of the risks to the achievement of the Governments objectives, and inform decision making.	Management agrees with this recommendation.	Deputy Governor and Financial Secretary & Chief Officer	Consideration will be given to the implementation along with the PMFL Review Committee recommendations which is currently proposed to be legislated by 31 December 2016.
8. Government should be proactive in considering the risk of fraud, by establishing an appropriate management framework applicable across the public sector.	Management agrees with this recommendation.	Deputy Governor and Financial Secretary & Chief Officer	31 December 2016

Recommendation	Management Response	Responsibility	Date of planned implementation
<p>This should require mechanisms for identifying and responding to fraud risk factors, including the implementation of a fraud policy and fraud response plan, and developing a framework for the proactive reporting of fraud and suspected fraud to senior management and the Legislative Assembly.</p>			
<p>9. The Government should address the issues reported in our detailed reports on the General IT Control Environment and the IRIS upgrade as part of a coherent strategy for the management of IT resources.</p>	<p>Management agrees with this recommendation.</p>	<p>Financial Secretary & Chief Officer</p>	<p>31 December 2016</p>
<p>10. Management needs to develop robust systems of internal control which are consistently applied across the EPS for the effective management of executive revenues and expenses, that provide assurance regarding the stewardship of public money to senior management.</p>	<p>Management agrees with this recommendation.</p>	<p>Financial Secretary & Chief Officer</p>	<p>31 December 2016</p>

Contact us

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Complaints

To make a complaint about one of the organisations we audit or about the OAG itself, please contact Garnet Harrison at our address, telephone or fax number or alternatively email: garnet.harrison@oag.gov.ky

Freedom of Information

For freedom of information requests please contact Garnet Harrison at our address, telephone or fax number. Or alternatively email: foi.aud@gov.ky

Media enquiries

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