



**TREASURY DEPARTMENT
ENVIRONMENTAL PROTECTION FUND
Audit Report**

NOVEMBER 2013

**INTERNAL AUDIT UNIT
CAYMAN ISLANDS GOVERNMENT**

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ENVIRONMENTAL PROTECTION FUND
TREASURY DEPARTMENT

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I. EXECUTIVE SUMMARY

Under the Public Management and Finance Law, the Internal Audit (IAU) is required to review the management systems of all ministries, portfolios, statutory authorities and government companies.

In accordance with the 2012-2013 Audit Plan, we recently concluded an audit of the management of the Environmental Protection Fund (EPF) by the Treasury Department.

Summary of Major Findings

During the audit, we identified weaknesses which impacted negatively the assessment and collection of the EPF fees. These findings are summarised below with our recommendations and management responses.

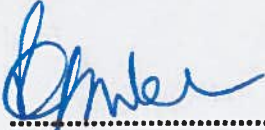
Finding	Recommendation	Management Responses
We found no indication that independent reviews were carried out on EPF transactions and noted the risk of undetected errors or omissions.	Establish appropriate procedures to effectively monitor all EPF transactions and identify an alternate employee to perform the necessary processes in the absence of the Financial Administrator.	Treasury Management agrees with the recommendation. Verification procedures were implemented on June 10, 2013.
We have noted a deficiency within the assessment of EPF revenue, which limits the assurance that can be placed on the accuracy of EPF invoices. This is owing to the circumstances that results in the key control within the EPF fee assessment and billing process effectively being a reliance on the customers reporting to the Treasury in the event of invoices being incorrect.	Cost-effective options to ensure that the Treasury Department establishes appropriate controls to safeguard government revenues should continue to be explored. As the Department currently receives and utilizes manifests from the Immigration Department for cruise lines we further recommend that a similar arrangement be established to obtain the manifests for airlines as well.	Treasury Management agrees with the risks and have met with immigration and CIAA to discuss the issues. Further discussion with CIAA and relevant agencies will take place to explore an effective internal control process that can be relied upon to mitigate the risks identified. These meetings will take place before January 31, 2014.

Audit Conclusion

Based on our audit it is our conclusion that the Environmental Protection Fund fund is being administered satisfactorily by the Treasury Department. We have noted significant improvements in the timeliness of the assessment and collection of EPF fees since our last audit. We are however concerned that the Treasury Department is unable to validate the accuracy of passenger data received from the CIAA and used for the generation of EPF invoices. Although our audit did not evaluate the CIAA's processes for the generation of the passenger data, we have noted the risk of errors in the Treasury generated invoices in the event that

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there are errors in the data received from the CIAA. The Department has acknowledged this deficiency and have noted that whilst this is not the ideal, the affected airlines would report any errors. However the Accountant General advised that they are continuing to explore cost effective options that will ensure accurate fee assessment and invoicing.



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Deloris E. Gordon
Director, Internal Audit Unit

November 6, 2013

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II. INTRODUCTION

Background

The Environmental Protection Fund (EPF) was established in December 1997 through Government Motion 14/97. The Fund's source of revenue is the environmental protection fees collected from passengers who enter the two main ports of entry in the Islands via commercial airlines or cruise vessels as authorized by the Travel (Departure Tax and Environmental Protection Fee) Law. This fee is collected as part of an overall tax payable by airline and cruise ship passengers.

Based on the motion 14/97, the purpose of the EPF Fund is to finance expenditure incurred in the protection and preservation of the environment of the Cayman Islands. Disbursements from the Fund may be made only in accordance with resolutions made by the Finance Committee and under the authority of the Financial Secretary. On the average, more than CI\$4M in EPF fees is collected annually. The amount of the Fund as at February 28, 2013 is approximately CI\$42.60M, with over CI\$23M been disbursed since inception.

Currently, only inbound passengers on cruise vessels are charged the environmental fee. The fees are classified into two categories; namely, yearly and seasonal cruise ships and are charged \$1.60 and \$3.20 per passenger respectively.

It should be noted that from inception, the Travel (Departure Tax and Environmental Protection Fee) Law required environmental fees of \$4.00 to be levied on outward bound cruise vessels. This fee has not been implemented as previous representations made by the then Ministry with responsibility for Tourism had indicated that law makers intended for the fees to be charged for inbound passengers only and not for both ways as stated in the law. In order to ratify the current intent a Cabinet Paper has already been drafted to initiate the amendment to the Law.

With regards to airline passengers, an outward bound environmental fee of \$4.00 is levied.

The responsibility for the assessment, collection, recording, investment and disbursement of EPF fees lies within the Treasury Department, which falls under the Ministry of Finance and Economic Development. The collection of this fund is therefore done mainly by the Treasury Department, which invoices commercial airlines and cruise lines in arrears. The Cayman Islands Airports Authority (CIAA) assists with the collection process by collecting EPF fees from private airlines and remitting these funds to the Treasury Department. The CIAA also collects the passenger manifests from the commercial airlines and extrapolates the passenger numbers which in turn is forwarded to the Treasury Department monthly from which invoices are issued to the airlines.

Administrative Processes

The daily administrative functions of the Fund are conducted by the Financial Administrator, who is responsible for; assessing, billing, receipting of payments by incoming wire remittances and verifying the deposits to the remittance batch which would include cheques/drafts received by the Treasury Cashier in relation to EPF fees payable by all cruise vessels and commercial aircrafts that use the ports of entry. It

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was however observed that, the Treasury Department relies greatly on the CIAA to perform the passenger data assessment which is used to bill the airlines. Treasury's assessment is done on information which has already been compiled by the CIAA, as such; if there is a break-down in CIAA data collection and assessment process this may significantly impact the Treasury Department's legal mandate to collect the fees.

a. Cruise ships - Immigration Department

In addition to boarding each cruise ship that arrives, the Immigration Department is also responsible for the collection and verification of the cruise ship manifests which shows the number of passengers and crew members. Once verified and accurate, the officer stamps each manifest with an Immigration stamp certifying the manifest is correct. The manifests are then sent to the Treasury Department on a weekly basis.

b. Commercial aircraft - Cayman Islands Airports Authority (CIAA)

The CIAA collects the passenger manifests from the airlines and the personnel assigned, then make a list for taxation purposes on a monthly basis and forward same to the Treasury Department. This list shows the month, the carrier, total passengers and taxable passengers (as not all categories of passengers are deemed taxable as stated in the Law).

Occasionally, fees for commercial aircraft are paid over to CIAA instead of to Treasury. These are later submitted to Treasury.

Once fees are assessed, invoices are sent to the relevant cruise ship and airline companies. Fees are typically remitted via wire transfers. Receipts are then issued for monies received.

To record all EPF transactions, the Treasury Department uses IRIS; the government's financial reporting system.

Prior Audit

The Environmental Protection Fund was previously audited in 2002. The following findings from that report which remained outstanding were assessed during this audit.

- Lack of compliance with the fee structure established by the Law as outbound cruise passengers were not being assessed as required – We were able to determine that a Cabinet Paper has been drafted to recommend amendment to the Law.
- A number of deficiencies were noted regarding the assessment of EPF fees – This audit has also determined that the assessment process is still in need of further improvement.
- Delays in the collection and recording of fees – There have been improvement in the collection of fees; however Cayman Airways Ltd. (CAL) currently has a large outstanding balance.

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Audit Objectives and Scope

The objectives of the audit were to determine whether:

- Controls are in place to ensure that the EPF fees are accurately assessed and collected by Government from airline and cruise ship companies in accordance with the Travel (Departure Tax and Environmental Protection Fee) Law;
- There is adequate segregation of duties over the Department's revenue collections, deposit and associated processes;
- Management systems are in compliance with laws, regulations and documented policies and procedures and generally accepted accounting principles; and,
- Withdrawals from the Fund are appropriately approved and are in accordance with the requirements of the Law.

The scope of the audit covered transactions processed from January 2012 to March 2013. The scope did not include the controls operated at the CIAA and the Port Authority.

Audit Methodology

The audit methodology involved understanding and documenting the processes under review and the internal controls governing those processes, performing risk assessment to identify and evaluate potential risks and key controls, and testing whether those controls were operating as intended.

Only findings of internal control weaknesses that could affect the adequacy and effectiveness of management systems are reported; however, the audit conclusion will be based on our overall assessment of the control procedures against the audit objectives.

Audit Criteria

The internal control activities for the Environmental Protection Fund were measured against the following audit criteria:

- Travel (Departure Tax and Environmental Protection Fee) Law The Public Management and Finance Law and Financial Regulations; and,
- Generally accepted accounting and business best practices.

In addition to evaluating the internal control activities, other fundamentals of the internal control framework were also assessed, where applicable. The audit criteria utilized was obtained from the COSO audit model which identifies other elements of good internal controls as:

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- **The control environment** which is the foundation for the effectiveness of all the other internal control components and reflects management's commitment and attitude towards the control structure.
- **Ongoing risk assessment** which should be performed by management and involves identifying and analyzing the significance and likelihood of potential risks that may adversely affect the entity's ability to meet its objectives.
- **Information and communication systems** ensure that pertinent information is identified, captured and communicated in a form and within a timeframe that enable the achievement of objectives.
- **Ongoing monitoring and review** of activities and processes is necessary in order to assess their performance over time and against pre-determined requirements.

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III. AUDIT REPORT

1. Lack of Independent Reviews on EPF Fee Assessments

Section 29 of the Financial Regulations (2010 Revision) states that, "a Chief Officer of a prescribed entity shall ensure that an appropriate system of internal control operates within the entity and that that system is adequate to safeguard the entity or executive resources for which the prescribed entity is responsible". Periodic monitoring of activities and processes is considered to be a key internal control procedure.

During the audit we saw no indication that independent reviews were carried out on a sample of 251 transactions selected from the period January 2012 to December 2012. Of the 251 transactions tested, we identified errors in two (2) EPF invoices; in one instance on 31st Dec 2012 an invoice in respect of Carnival Cruise Line was over stated by \$3,200.00, while in another instance in June 2012 the amount on invoice for United Airline was short by \$424.00. The overcharge occurred as a result of a transposition error where the number of passengers indicated on the invoice was 3,645 instead of 2,645; while the undercharging was because of an undetected invoice adjustment.

Given that all procedures are performed by the Financial Administrator, the non-existence of monitoring and review of transactions exposes the Department to the risk of undetected errors or omissions.

Recommendation

The Accountant General should establish appropriate procedures to effectively monitor all EPF transactions.

Management's Response

Treasury management agrees with the recommendations made by Internal Audit and have implemented appropriate procedures to effectively monitor all EPF transactions.

Implementation Date:

Treasury management implemented verification procedures on June 10, 2013.

2. Data Used to Compute EPF Fees Not Independently Verified

Section 31 of the Financial Regulations (2010) states that a Chief Officer of a prescribed entity is responsible for (a) identifying the risks to which his entity is exposed, (b) establishing strategies to mitigate or manage those risks, and (c) ensuring those strategies are implemented.

Section 6 (1-b) of the Travel (Departure Tax and Environmental Protection Fee) Law (2003 Revision) states that "every agent shall collect from every traveller and tourist in every outbound aircraft an environmental protection fee of four (\$4.00) dollars."

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In the assessment of EPF fees and the preparation of invoices for airlines, we noted that the Financial Administrator within the Treasury Department did not carry out independent validation of the passenger numbers used in the assessment. Instead, the passenger data compiled by the Cayman Islands Airports Authority (CIAA) was accepted and used to prepare the invoices. In the event that there are errors in the data received from the CIAA this would automatically be translated into the invoices generated by the Treasury Department.

The Treasury Department advised that various options for obtaining the passenger data, including directly from the manifests, have been explored, however the data on the manifests does not provide the level of details and is not in a format that facilitates proper assessment of revenue. In addition we were advised that the Treasury Department had previously considered using the airline manifest to verify the numbers but determined after reviewing the process that working directly from the manifests can be time consuming and could not be justified with the benefits to be gained from the process. The Department has however stated that in the event of errors on the invoices the airlines usually report this and any necessary adjustments are then made in subsequent invoices.

Whilst we understand the difficulty in obtaining appropriate data, it is of concern to us that the key control within this process is therefore reliance on the customers to notify the Treasury in the event of invoices being incorrect. This deficiency within the assessment of EPF revenue, limits the assurance that can be placed on the accuracy of EPF invoices. The Department has however stated that should there be errors in the invoices the airlines will relay this and adjustments can be made to subsequent invoices.

Recommendation

The Accountant General should continue to pursue cost-effective options to ensure that the Treasury Department establishes appropriate controls to safeguard EPF revenues. We have noted that the Department currently receives and utilizes manifests from the Immigration Department for cruise lines and recommend that a similar arrangement be established to obtain the manifests for airlines as well.

Management's Response

Given that passenger log/manifest is outside the Treasury's scope and control the Treasury is hoping that sometime in the near future Immigration Department system could be modified to the extent where Treasury could extract the data to ascertain some level of comfort in the numbers provided by CIAA. Notwithstanding this, the Treasury will continue to seek and explore more cost effective options of safeguarding the EPF revenues as other more accessible and less cumbersome and resource driven avenues/systems come on line. In addition, further meetings with CIAA and related agencies will take place to explore an effective internal control process that can be relied upon to mitigate the risks identified. These meetings will take place before January 31, 2014.

Implementation Date:

January 31, 2014