

Audit Certificate

To the House of Assembly of the Turks and Caicos Islands

The Auditor General is legally required to examine, audit and certify, in accordance with internationally recognized auditing standards, where appropriate, whether or not the Government's annual public accounts and statements presented by the Accountant General conform to the requirements of the Public Financial Management Ordinance (PFMO) (and any framework document prepared thereunder), represent fairly its financial performance and financial position and that the financial affairs have been conducted with regularity and propriety.

Furthermore, the Auditor General must ensure that reasonable precautions have been taken to safeguard the proper collection of monies and for the receipt, custody, issue of and accounting for assets, to ensure that all receipts, assets, expenditure and other transactions to which such examination and audit relate have been lawfully incurred and that the law has been duly observed.

The Auditor General is also required to certify that the internal control system and provision of internal audit services is adequate and complies with any instructions issued by the Permanent Secretary, Finance and that satisfactory management measures have been taken to ensure that public or other resources are procured economically and utilized efficiently and effectively.

Management Responsibility for the Financial Statements

Management is responsible for ensuring that the financial position and performance of the Government is fully disclosed to the House of Assembly. Management is also responsible for the preparation and fair presentation of the annual statement of public accounts enumerated in Schedule 2 of the Public Finance Management Ordinance & Regulations (PFMO & PFMR) including any amendments and in accordance with generally accepted accounting practice (GAAP), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In this regard, management is responsible for ensuring transactions are recorded properly in the accounting system and for establishing and maintaining an internal control system sufficient to permit the preparation of the annual statement of public accounts in conformity with GAAP and the law. This audit of the annual statement of public accounts does not relieve management of this responsibility. Management is also responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us;

- about all known or suspected fraud affecting Government involving management, employees who have significant roles over financial reporting and others where fraud could have a material effect on the financial statements; and
- of its knowledge of any allegations of fraud or suspected fraud affecting Government received in communications from current employees, former employees, the public, or others; and
- of all significant deficiencies in the design or operation of internal controls over financial reporting that are reasonably likely to adversely affect the ability to record, process, summarize and report financial data externally on a reliable basis; and
- of any non-compliance with the laws and regulations applicable to its activities.

Auditor's Responsibility

My responsibility is to express an opinion on these statements based on my audit. An audit involves performing procedures to obtain evidence about the amounts and disclosures in the annual statement of public accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the annual statement of public accounts, 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 annual statement of public accounts 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 the accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Because of the matters described in the Bases for Disclaimer of Opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Bases for Disclaimer of Opinion

2.1. The NAO can retain auditors by either recruitment or by contracting and both processes are set out in law. As recruitment has been a challenge the NAO had utilized the short-term contracting option to supplement existing internal limited capacity as in carrying out my functions, I shall do so through the application of internationally recognized auditing standards (Section 7 (1) and (2) of the National Audit Office Ordinance (NAOO)). Two international audit standards, the International Standard on Auditing (ISA) Section 220.14 and International Standard for Quality Control (ISQC) Section 1.29 to 1.31 require that the team have the necessary capacity to conduct the audit to international standards. **Auditing is a regulated profession.** Since the NAO does not have an adequate complement of internal capacity due to recruitment challenges, the other option was to supplement existing capacity with short-term

contract auditors from the audit firms in order to fulfill my functions as Auditor General. However, in July 2016 the NIB Chair claimed (a) that the process used to engage the audit firms to conduct audits via a three-way letter of engagement (sanctioned and agreed to by the Auditor General) was not legally authorized, (b) that the process was in contravention of several of the TCI laws, (c) that there is no provision in the relevant ordinances for the NIB to pay a third party audit firm to conduct the audit of NIB and that no agreement between the parties as to that procedure can override or take precedence over statute and (d) that there may be perceived a conflict of interest between the Auditor General and the NIB's appointed auditors. These issues would apply not only to the audit of the NIB but to all other audits, including the TCIG audit. The NIB Chair did not authorize payment to the audit firm directly to conduct the audit on behalf of the Auditor General, in full knowledge that the funds were budgeted in the NIB's books, not the NAO's books. Pending any future engagement with any audit firms therefore, I have requested that the relevant authorities advise as to whether the form of an engagement letter is legally authorized and if not authorized, what is the legal process to engage the auditors and at the same time determine the legal process to avoid any perception of a conflict of interest. As at the date of the audit report, there had been no resolution to these matters and the NAO was not able to engage the audit firms to supplement existing internal capacity to audit the TCIG 2015/16 financial statements. As a result we have not been able to conduct our audit examinations around critical areas such as the internal controls within the Information Technology (IT) Systems that are used to generate financial reports. An IT audit has not been conducted for the last four years, perhaps more. Given that I was not able to supplement the existing capacity for this audit either by recruitment or by retaining contracted audit firms, I was unable to obtain sufficient appropriate audit evidence to form an opinion on the TCIG's financial statements and on TCIG's internal control environment, in particular its IT Systems which generate the financial reports used to prepare the financial statements presented to the Public. I was also unable to ensure that the audit work conducted was subject to a proper quality review.

- 2.2. There are material transactions entered into between the TCIG and Statutory Bodies which may have certain financial and other impacts. Due to the NAO's inability to engage audit firms to conduct audits on several of the larger statutory bodies, we were unable employ a few basic audit procedures to confirm that the transactions represented on the TCIG accounts were reflected in a few of the Statutory Bodies' financial statements, among other procedures. Given that I was not able to obtain sufficient evidence on the accuracy, completeness and occurrence of various inter-governmental transactions, I was unable to form an opinion on the TCIG's financial statements.
- 2.3. The Consolidated Fund is the general operating fund of the TCIG, which records the financial transactions of the House of Assembly, all Ministries and departments, other Offices, Courts etc. It is into this fund that taxpayers pay revenue. Government uses this revenue to pay for its

many programs such as health, education, public safety, infrastructure and public transportation. Further, the laws clearly mandate defined requirements of accountability for the Consolidated Fund, Development Fund and other funds. Specific legal guidelines in the Consolidated Fund's use are set out in the TCI Constitution and accountability requirements are outlined in the PFMO because the Consolidated Fund is TCIG's most important account through which all transactions are entered. In **all** instances between 2007 and 2016 the Consolidated Fund Accumulated Deficit (CFAD) in the general ledger and the figures represented to the Public in the Annual Statement of Public Accounts (ASPA) were materially different. For example in 2011 the CFAD figure was \$22.3 million while the ASPA for the same period was \$183.7 million. In 2014, the CFAD was \$132.2 million while the ASPA figure was \$180.4 million. In 2016, the CFAD was either \$76.4 million or \$66.7 million while the ASPA was an imputed \$10.9 million. As a consequence of this material misstatement, the current financial statements as a whole do not represent fairly the financial position of the TCIG.

Further, **there is no reported financial position in the ASPA** submitted for audit on July 31, 2016 for audit. This was revised in the updated financial statements submitted on February 6, 2017. A further review was conducted.

- i. For 2006/07 the Consolidated Fund (CF) Balance generated from the Trial Balance (TB) through IDEA (audit analysis software) was (\$776,569) while the Fin Stats for the same period was (\$77.5 million) [brackets are denoted as deficits].
- ii. For 2007/08 the CF was (\$24.5 million) while the Fin Stats presented was (\$98.2 million).
- iii. For 2008/09 the CF was same as ii above while the Fin Stats presented was (\$98.3 million).
- iv. For 2009/10 the CF was same as ii above while the Fin Stats presented was (\$118.5 million).
- v. For 2010/11 the CF was (\$22.0 million) while the Fin Stats presented (\$183.7 million).

I also noted the Consolidated Fund balance reported from 4 sources for the year ended March 31, 2012 are noticeably different.

- i. In a statement (submitted on Feb 1, 2017), it noted that in the year ended March 31, 2012 there was a deficit of \$205.8 million (but no Trial Balance data was provided). The TB pulled from IDEA was checked which shows for the same period a deficit of \$183.4 million.
- ii. The Financial Statements presented for that same period showed a deficit of \$186.6 million.

- iii. The Financial Statements presented for the year ended March 31, 2013 showed a comparative of \$205.8 million as different from the \$186.6 million when the 2011/12 financials were presented.

In addition;

- i. Comparative figures in the 2012/13 fin stat for the 2011/12 column was - \$205,763,848 which is different from the 2011/12 fin stats reported a year earlier.
- ii. The comparative figures in the 2013/14 fin stats for 2012/13 column was -\$188,837,519 which is different from the fin stats presented in 2012/13.
- iii. The comparative figures in the 2014/15 fin stats for 2013/14 column showed - \$180,403,000 (rounded) which is different from the fin states presented in 2013/14.

The MoF explained that the \$66. 7 million is the pre incorporation of the net surplus for the year.

Given the inconsistencies in the reported consolidated fund balance for several periods, I am not confident that the CF balance provided for the year ended March 31, 2016 is accurate.

2.4. Fixed Assets are not reported on in the Financial Statements. In our 2013/14 audit we reported 169 buildings which were not properly accounted for and the NAO pulled via its data analysis software, capital development projects spent of \$387.7 million from 2000 to the year ended March 31, 2016, most of which would have been expended in relation to assets with an estimated service potential of more than one year. A 2004 asset inventory and condition survey was undertaken by a private firm of consultants which estimated government assets (i.e. owned buildings, standby power, airfield and facilities, water supply) to be worth approximately \$111 million. It did not include monetary amounts for contents and equipment (e.g. medical and other electronic equipment) or new assets either constructed or acquired. A 2005/06 Audit Report made specific recommendations pertaining to the valuation of assets. The report recommended a risk management advisory committee be set up to develop an overall insurance strategy. It stated that the government must take overall responsibility and approve the level of risk it is willing to take; this can be done through a documented risk assessment process with complete and up-to-date information on value of assets (i.e. properties, contents, equipment etc.). Capital Expenditure means the acquisition, construction or development of any tangible capital asset in that it enhances the service potential of a capital asset and therefore consists of a betterment (enhancing the output of the asset, or extending its useful life). There are two types of capital expenditures— (a) Capital acquisitions include vehicles and heavy equipment, plant machinery and equipment, vessels and boats, furniture and fixtures, office equipment, computer hardware and equipment and computer software; and (b) Capital developments include land, building and infrastructure. There have been issues around the accuracy of the inventory (another asset) balances as well. Crown Land

leases and grants are also not disclosed in the financial statements as this is an extremely valuable finite resource (asset) and proper disclosures are required in the financials. There is a material weakness in the process of tracking, recording, and accounting for all assets and capital costs expended to enhance the service potential of these and other assets. Given that there are inadequate controls over reporting of TCIG's Assets, they therefore cannot be verified for accuracy, completeness and ownership. The Capital Expenditures also cannot be verified for accuracy, completeness, occurrence, classifications, in particular for land, building and infrastructure. The dollar value of Assets and Capital Expenditure including land, building, infrastructure, vehicles and heavy equipment, plant machinery and equipment, vessels and boats, furniture and fixtures, office equipment, computer hardware and equipment and computer software are more likely than not to be in the hundreds of millions of dollars, for which TCIG has no way of assuring the public that they have not been misappropriated and are safely accounted for. There is also no way to assure the public that capital spending has been efficiently, effectively and economically utilized. At a very minimum, disclosures should be made about these Fixed Assets which are encouraged under the IPSAS Cash Basis Standard or a listing of fixed assets. In addition, due to the NAO's inability to verify the accuracy, completeness and ownership of these assets, the financial statements presented for audit for 2015/16 do not achieve fair presentation.

- 2.5. A mandatory requirement of the IPSAS Cash Basis Standard is that accounts must be consolidated. The TCIG Financial Statements do not include Statutory Bodies and other public entities. Appendix 5, IPSAS Cash Basis Standard states that for the purposes of financial reporting, control stems from an entity's power to govern the financial and operating policies of another entity and does not necessarily require an entity to hold a majority shareholding or other equity interest in the other entity. The power to control must be presently exercisable. That is, the entity must already have had this power conferred upon it by legislation or some formal agreement. Users of the financial statements of a government or other public sector controlling entity are usually concerned with, and need to be informed about, the cash resources controlled by the economic entity as a whole. This need is served by consolidated financial statements that present financial information about the economic entity as a single entity, without regard for the legal boundaries of the separate legal entities. For financial reporting purposes of TCIG, currently only Ministries are consolidated under Central Government. However, it does not include other entities such as the statutory bodies so as to provide Whole-of-Government Accounts. The current IPSAS Cash Basis Standard requires consolidation of entities meeting the definition of a controlled entity. A note in the financial statements identifying the statutory bodies and the level of control does not comply with the requirements of the IPSAS Cash Basis Standard. Inappropriate accounting policies are not rectified either by disclosure of the accounting policies used or by notes or explanatory material [IPSAS Cash 1.3.35]. There is currently an Exposure Draft (ED) 61, which seeks to make the consolidation process optional rather than mandatory under the Cash Basis IPSAS Framework. ED 61 has to be reviewed in relation to the responses received and might change dependent on the review of responses. If they are approved, the amendments will likely become

effective in January 2019. In the meantime, the TCIG should comply with the IPSAS Cash Basis Standard and other GAAP (both mandatory and where appropriate, encouraged disclosures). The accounts do not reflect the consolidated financial statements for the Whole of Government. Non-consolidation will result in a modification to the audit opinion. In addition financial statements should be described as complying with IPSAS Cash *only* if they comply with *all* the requirements of Part 1 of the IPSAS [page 1 of the IPSAS Cash Basis Standard]. Until such time as the IPSAS Cash Basis Standard is changed, the current standard must be complied with (in conjunction with the laws). As a consequence of the non-consolidation of statutory bodies, the financial statements presented for audit for 2015/16 do not achieve fair presentation.

- 2.6. The NAO has received inaccurate and incomplete financial statements for the last four audits and transactions or events are not recorded or not disclosed appropriately in the Financial Statements. In all four submissions there were typographical errors, omission errors, casting errors, incomplete, inaccurate, inappropriate or inadequate disclosures/explanations, overstatements and understatements. For example net cash receipts in the statements are not reconciled by \$2.2 million, lease commitments possibly ranging around \$14 million are not disclosed, the actuarial assessment of the pension liabilities were not completed in time and the last actuarial assessment indicated an unfunded pension liability of \$85 million while the National Insurance Board (NIB) has an unfunded pension liability of approximately \$235 million for which the TCIG will likely have to fund should there be any temporary insufficiency to meet any pensionable payments at any time in the future. According to the Health Contracts Management senior officers, the commitments and liabilities for the hospitals which are recorded as close to \$1 billion are not accurate. They have indicated it should be less. As consolidation is not performed, the combined true operating cost of the hospitals are not accurately represented, the TCIG may not be aware of the impact on TCIG's finances of such pensions or healthcare liabilities, treasury management strategies may not be effective where TCIG can possibly use surplus cash to pay off high-interest debt which can reduce overall interest costs etc. As a consequence of several of these issues, the financial statements presented for audit for 2015/16 do not achieve fair presentation.

Risk Management & Internal Controls

- 2.7. The internal controls employed in the preparation and financial reporting processes are equally as important in assuring the integrity (reliability, accuracy, completeness etc.) of the financial statements. There have been several years of audit disclaimers or adverse opinions. TCIG should review findings and recommendations from the prior year and current year audits in order to address the continuing weaknesses over the last several years especially where ALL years have had to be reviewed for quality, post-issuance to the NAO and subsequent changes made due to errors, omissions and/or a lack of management review of the financial statements. There are several control deficiencies and material weaknesses such as in the

completeness/accuracy/recoverability of revenue arrears, inadequate accounting policies, ineffective controls around review of exposures arising from financial instruments (e.g. credit risk, interest rate risk, liquidity risk), consolidation of controlled entities are not performed, a lack of up to date approved manuals and operating procedures, overstatements and understatements of material figures etc. There are ineffective aspects of the control environment which imply that significant transactions within the financial statements in which management should be financially interested are not being appropriately scrutinized. There is also failure of the information and communication component of internal control to provide complete and accurate output because of deficiencies in timeliness, completeness and accuracy, for example, the failure to prepare timely and accurate statements. In general, enterprise wide risk management is weak and in particular fraud risk management is also weak and related party transactions and/or events, which pertain to those who control or have significant influence over the financial and operating policies is not fully disclosed or accounted for to prevent abuse and management override of the controls. As a consequence of the weak control environment, the financial statements presented for audit for 2015/16 do not achieve fair presentation.

EMPHASIS OF MATTER PARAGRAPH

Due to the existence of a material misstatement of the Consolidated Fund in the 2015/16 period, prior years will also be misstated from 2007 to 2015 and possibly earlier periods as well. The corresponding figures have not been properly restated or appropriate disclosures have not been made. My opinion on such prior period financial statements differ from the opinion previously expressed. Given the significant material misstatement, the prior year audit opinion for 2013/14 (unconsolidated) is revised from a qualified position to a disclaimer.

Several legal amendments of the PFMO were passed on/about 24 March, 2016. Key among those was to the requirements under Schedule 2 of the PFMO "Provision for the Submission of Accounts" to the Auditor General for audit. Requirements for (a) a consolidated cash flow statement for all public funds showing the revenues, expenditures and financing for the year, (b) a balance sheet showing the assets and liabilities of the Consolidated Fund and (c) a cash flow statement for the Consolidated Fund showing the revenues, expenditures and financing of the fund for the year, were replaced with general purpose financial statements in the form and layout of the International Public Sector Accounting Standards (IPSAS) adopted at the time of preparation under the Cash Basis of Accounting (CBoA). In particular, it must be noted that the IPSAS CBoA does not mandate a balance sheet showing the statement of assets and liabilities. Other sections of the PFMO and PFMR Regulations (PFMR) references "assets" and which mandate public accountability for these "assets". The finance laws outlined under the TCI Constitution, PFMO and PFMR require public accountability and transparency for all public resources and all public property. Refer to ISSAI 9160 – Good

Governance in Public Assets, Guiding Principles for Implementation. Pre-2012 and Post-2012 financial laws all had a requirement for a balance sheet. The MoF subsequently agreed to include this in the financial statements submitted on February 6, 2017. However, given the lateness of the inclusion this could not be fully audited.

Because of the significance of the matters identified in the Bases for Disclaimer of Opinion Paragraphs, I am unable to express an opinion on these financial statements.

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Anand Heeraman

Auditor General – 10 February, 2017