National Audit Office

FOREIGN AND COMMONWEALTH OFFICE

Managing risk in the Overseas Territories

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 4 Session 2007-2008 | 16 November 2007

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2 November 2007

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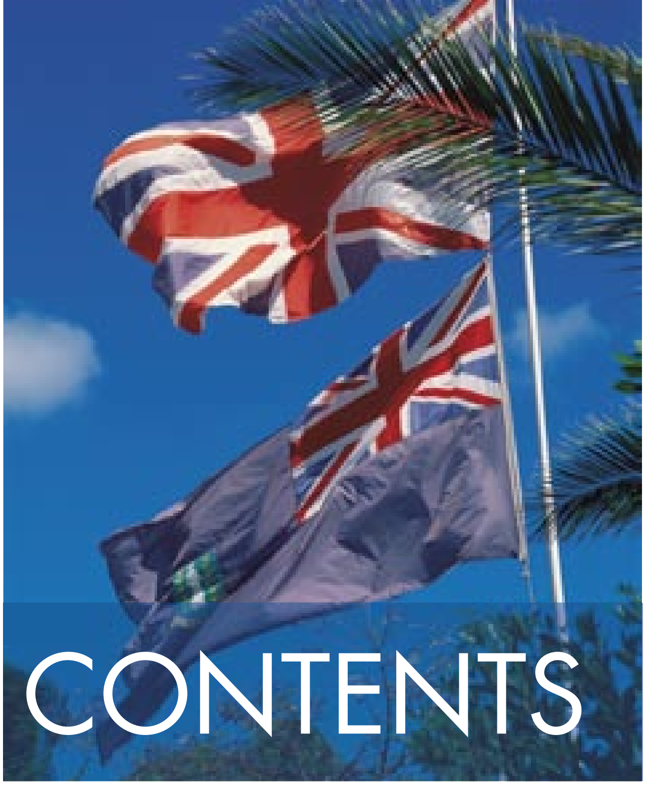

CONTENTS

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SUMMARY

1 The United Kingdom retains responsibility for 14 Overseas Territories, 11 of which are permanently populated and which opt to remain under British sovereignty rather than, where this is an option, seek independence (Appendix 2). The Territories are not constitutionally part of the UK. They have their own constitutions, legal systems and most have a democratically elected Government. The Territories are a diverse group, ranging from the uninhabited, environmentally sensitive British Antarctic Territory, to Bermuda which is home to over 65,000 people and is one of the world's leading financial centres. Though different in size, economic and social development and systems of governance, most of them share common features which include relative isolation, exposure to disasters and dependence on one or two key industries. Since 2002, the great majority of Territory citizens have been entitled to full British citizenship, carrying with it a right of abode in the UK.

2 The Territories are a UK Government-wide responsibility. The Foreign and Commonwealth Office, ("the Department"), leads overall policy and maintains the main UK presence in Territory, with other Government departments helping to discharge specific aspects of the UK responsibilities. The Department seeks to achieve a balance between allowing populated Territories the maximum autonomy they aspire to and ensuring that the UK can meet its responsibilities and minimise its exposure to potential liabilities. Over the years the UK's exposure to risk has been varied, including; contributing to the costs of natural disasters and of meeting various international obligations; funding liabilities and deficits in Territories' public finances; and the need to bolster regulation in vital areas like transport safety and security. Other areas, such as the regulation of offshore financial services, clearly pose important and growing risks, though these have not yet resulted in direct costs to the UK.

3 The National Audit Office last reported on the Overseas Territories in 1997.[1] This report reviews subsequent progress, recognising that the Territories have experienced many changes, including in most a trend towards greater local autonomy. It considers whether UK government departments work effectively, in conjunction with Territory governments, to manage and mitigate risk; if appropriate cross-cutting arrangements are in place across the UK Government to identify, prioritise and respond to risks, and; whether suitable and sufficient resources are available to, and deployed by, UK Government to manage the risks to the UK from its relationship with the Overseas Territories. Our overall conclusion is that since 1997, whilst progress has been made in managing and mitigating some risks; the degree of success in both individual Territories and across key risk areas has been mixed.

4 Assessing and managing the diverse range of risks facing the Territories is inherently difficult, and can be complicated if Territories or Governors use Territory Constitutions to exclude each other from their respective spheres. Though Territory Constitutions define areas of responsibility, in reality most risks are to an extent shared between Territories and the UK. Some pockets of good practice are emerging and modern risk management practices, such as the systematic grading of risks for probability and impact, and shared risk registers to monitor progress, could be more widely used.

5 There have been some important achievements;

- Standards of **Safety and Security in Transport** have been greatly enhanced, and robust arrangements are in place to avoid standards slipping back. The priority going forward is to help Territories assume the fullest responsibilities themselves, with the UK providing only periodic quality assurance to ensure that international standards are met.
- Progress has been made in developing the **Regulation of Offshore Financial Services**, though the four larger offshore financial centres are leaving in their wake the weaker regulatory capability of the three smaller centres[2] where the UK retains most direct responsibility. The main challenge across all Territories is to respond adequately to growing pressures to reinforce defences against money laundering and terrorist financing.

6 In other areas progress has been much more mixed.

- In **Government Finances**, risk to the UK has reduced in some Territories, (such as the British Virgin Islands, Gibraltar, Bermuda and the Cayman Islands), due to vigorous economic growth and/or sound financial management. The Department and the Department for International Development (DFID) therefore focus their monitoring and controls on economically weaker Territories. Controls on borrowing partially mitigate risks to the UK in these Territories. While Anguilla, the British Virgin Islands and the Turks and Caicos Islands have now graduated from DFID aid, St Helena and Montserrat continue to absorb over half of the UK's financial investment in the Territories, with £28 million bilateral aid received from DFID in 2005-06.
- There have been important achievements in **Disaster Management** since 1997, especially in the more heavily populated Territories of Bermuda, the Cayman Islands, Gibraltar and the British Virgin Islands. All Territories now have at least a draft National Disaster Plan to respond to their main risk events, supported by sector-specific plans. Many now have dedicated disaster management agencies staffed by full-time officials. However, there are still areas of weakness under scrutiny by a rolling Foreign and Commonwealth Office and DFID capability review programme. For example plans do not yet cover all elements of the disaster management cycle of preparedness, mitigation, response and recovery, and some local legislation and policies lag behind good practice.
- Though the UK retains responsibility through its Governors for **Law Enforcement and Internal Security**, the police and prison services depend on funding from Territorial governments. This split can work well where both parties share priorities, but there are instances where funding falls short of requirements.

7 The Department recognises that Overseas Territories work requires specialised administrative skills and knowledge beyond core diplomatic service competencies. It aims to develop this specialism as a career path; currently only 10–15 per cent of Governors, Deputy Governors and desk officers and managers in London had any prior experience with Overseas Territories before they took up post. The Department's funds to promote good governance and build capability in the Territories are small and thinly spread. When major liabilities do occur, the response has to be a UK Government one involving other government departments, most often DFID.

8 Local capacity to deliver timely public accounts, and sustain independent audit and parliamentary scrutiny of the executive, which can give the Department confidence that risks are being adequately managed, remains highly variable across the Territories.

Recommendations

More detailed recommendations are contained in Appendix 1.

1 Only a minority of UK Departments have significant involvement in the Overseas Territories, despite these being a UK-wide responsibility. **Other UK government departments should be required to set out their arrangements for dealing with Overseas Territory issues and to nominate a clear contact point to ensure that these responsibilities are being addressed.**

2 The UK and Territory Governments have no common framework for identifying, evaluating and monitoring risk, although in practice share risk should serious adverse events occur. **Governors should encourage and participate in modern risk management practices, taking the lead from Territories such as Bermuda and the Cayman Islands.**

3 Capacity limitations in the offshore financial sector have limited Territories' ability to investigate suspicious activity reports, and, in the case of the Turks and Caicos Islands, Anguilla and Montserrat, resources are below the critical mass necessary to keep up with increasingly sophisticated international standards and products in offshore financial services. **The Department, with the support of relevant UK agencies, *(Treasury, Financial Services Authority, Serious Organised Crime Agency)* should develop a strategy to ensure stronger investigative and prosecution capacity, bolster regulatory standards and support increased legislative drafting capacity.**

4 The UK Department for Transport set up Air Safety Support International in 2002 to restore safety standards in the Territories, on the understanding that it would have a finite life. Some Territories have built up their own capability to regulate aviation safety, but others have not and rely instead on regulation free of charge by the UK. **The Department for Transport should move to full cost recovery where it is regulating aviation safety on behalf of Territories, within five years.**

5 Key UK responsibilities in the Territories, such as for internal security and the police and prisons, depend on funding from local governments, which is not always sufficient. **Governors need to consider strategies such as measures to strengthen local ownership and participation in policing matters, and objective and independent assessment of the effectiveness and efficiency of Territory police forces, according to local circumstances.**

6 The majority of the UK aid programme to the Territories goes on meeting the recurring budgetary deficits in Montserrat, St Helena and Pitcairn. Little is left available to invest in new infrastructure or other development projects, which has retarded the pace of growth in these Territories. **DFID should roll out their revised mechanisms to meet budgetary deficits in St Helena, Montserrat and Pitcairn, so as to enable Territories to have a greater stake in savings through prudent fiscal management. DFID should also provide greater flexibility for development project funding.**

7 The core diplomatic service skills and prior experience in developing countries can have considerable value in Overseas Territories. But the work also brings additional high-level administrative challenges and direct responsibilities for public services and for the Civil Service. **The Department needs to make real progress in developing Territory administration and governance as a distinct specialism and career path.**

8 Currently the Foreign and Commonwealth Office and DFID each maintain separate teams, totalling some 60 staff, with responsibility for the Overseas Territories. In practice, the DFID team has limited involvement outside St Helena, Pitcairn and Montserrat. **We recommend additional pooling of resources at working level, with a further extension of joint working and use of mixed teams, deployed flexibly to meet needs across the Territories.**

9 Accountability and audit in the Territories tends to lag behind UK standards due to capacity limitations and a lack of suitably experienced local participants. Public Accounts Committees in many Territories struggle to provide effective, apolitical, and timely scrutiny of the executive. **The Department and DFID should promote the appointment of Ex Officio members with relevant skills, as in UK local government and in Montserrat.**

10 While the nature of the challenges faced by Governors and Territory government officials can vary between the Territories, there are opportunities for greater sharing of information and good practice. **The UK should promote and facilitate greater linkages between the Territories through further cross-Territory training and conferences, sharing of good practice and support for short term secondments and personnel exchange.**

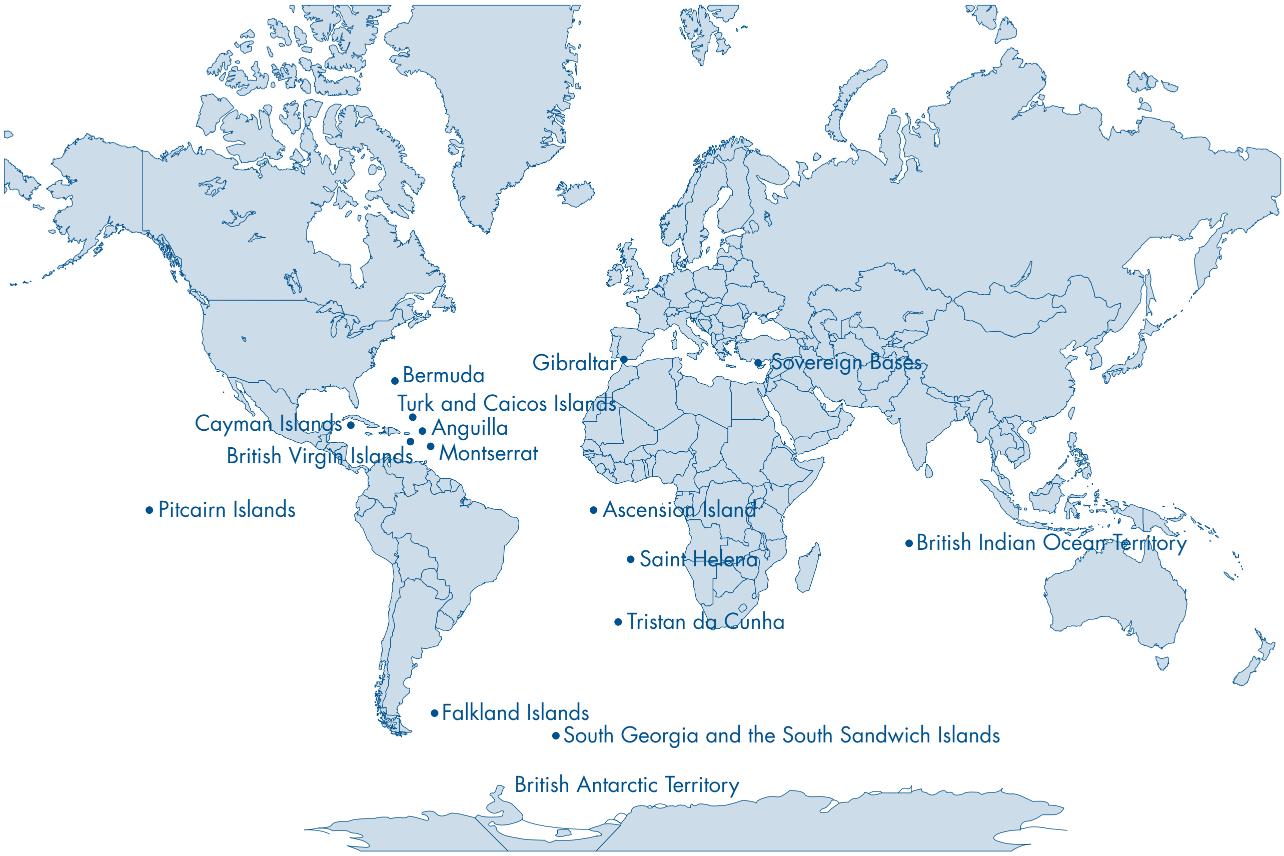
11 The Foreign and Commonwealth Office's initiatives have tended to focus on the Caribbean Territories. **The Department should identify its risk mitigation priorities for the non-Caribbean Territories and link them into the wider Overseas Territory network.**

PREFACE

1 The United Kingdom retains responsibility for 14 Overseas Territories **(Figure 1 overleaf)**, 11 of which are permanently populated and opt to remain under British sovereignty rather than, where this is an option, to seek independence. The Territories are not constitutionally part of the UK. They have their own constitutions, legal systems and most have a democratically elected government. However the great majority of citizens of Overseas Territories are entitled to full British citizenship carrying with it a right of abode in the UK.[3] The Territories are a diverse group, ranging from the uninhabited, environmentally sensitive British Antarctic Territory, to Bermuda which is home to over 65,000 people and is one of the world's leading financial centres (Appendix 2). Despite differences in size, economic and social development and systems of governance, the Territories share many commonalities; they are mainly relatively isolated, island communities often located in areas prone to natural disasters; and most depend on one or two key industries.

2 The scope of the study is confined to the Overseas Territories for which the Foreign and Commonwealth Office has the lead in Whitehall. The Crown Dependencies of Jersey, Guernsey and the Isle of Man, though also under the sovereignty of the British Crown, have a different constitutional relationship with the United Kingdom, and there is no track record of UK Government subsidy for matured risk as there is for the Overseas Territories. This report focuses on the civilian aspects of Overseas Territories with a permanent, settled population, so does not cover the Sovereign Base Areas in Cyprus nor how the Ministry of Defence meets its responsibility for defence of the Falkland Islands. It refers in the Annexes to unpopulated Territories where there are nonetheless significant UK responsibilities but does not deal with matters that are sub judice.[4]

1 The UK's Overseas Territories are predominantly remote island communities



Source: National Audit Office

NOTE
Ascension Island and Tristan da Cunha are dependencies of St Helena.

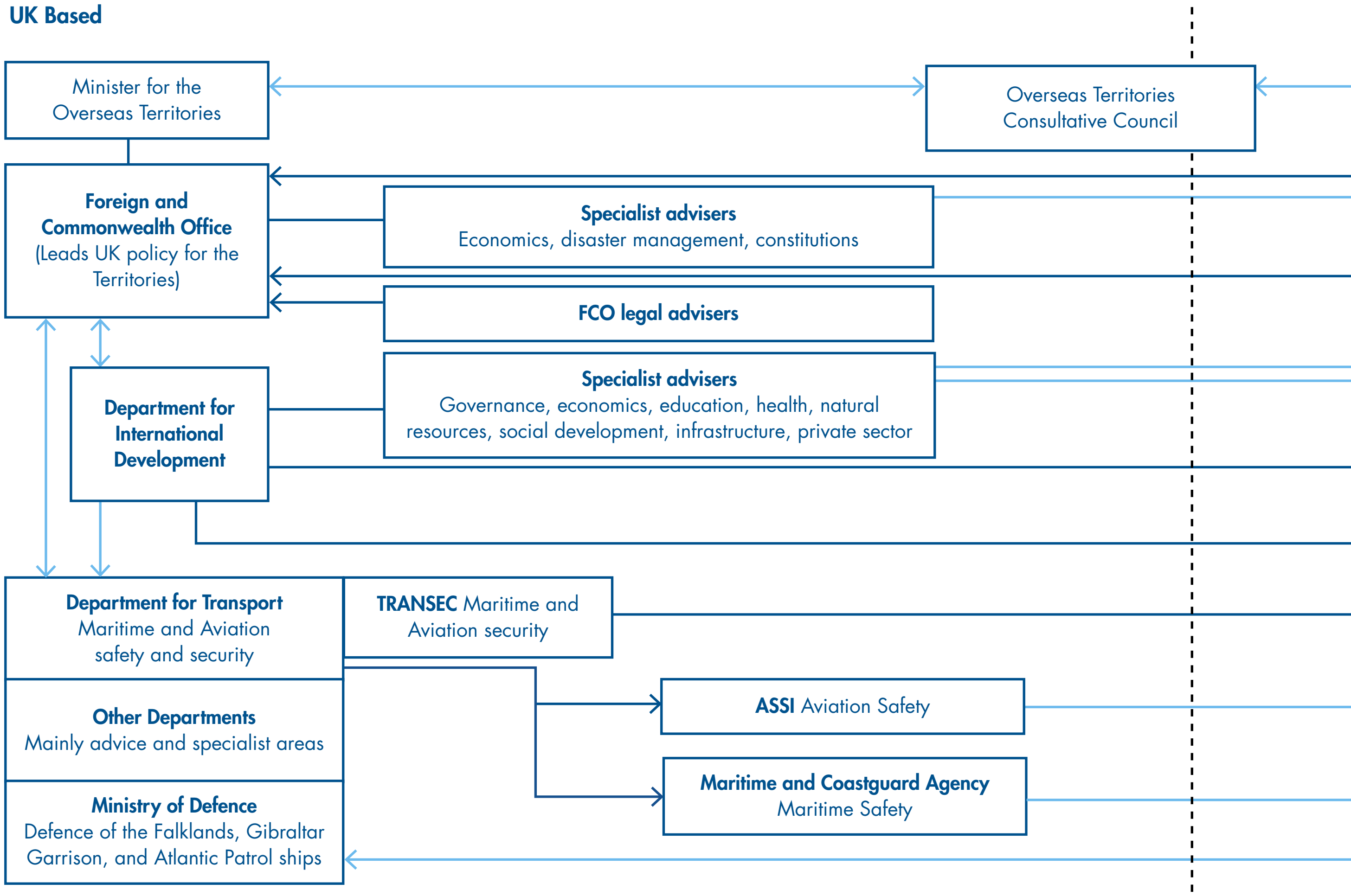
The UK has a commitment to the Overseas Territories which exposes it to potential liabilities

3 The UK has an obligation to "promote to the utmost, within the system of international peace and security…..the well-being of the inhabitants of [the Overseas] Territories…"[5] The 1999 White Paper *Partnership for Prosperity* laid down the future principles for the relationship between Britain and the Overseas Territories including:

- a right for the Territories to determine if and when they seek independence (where this is an option);
- mutual responsibilities: The UK has the right to expect the highest standards of probity, law and order and good government and observance of UK international commitments in return for defending the Territories, encouraging sustainable development and looking after their interests internationally;
- allowing Territories maximum autonomy to run their own affairs; and
- giving a firm commitment to assist them in economic development and in emergencies.

4 The Foreign and Commonwealth Office ("the Department") is the lead Department for coordinating UK Government policy for the Overseas Territories, although a minority of other UK departments also play important roles in discharging the UK's responsibilities. The Department aims to improve the governance, environment and security of the Overseas Territories; to encourage more diverse and sustainable economic development; to enable the Territories to better deal with international crime and natural disasters; and to manage the impact of international obligations. The Department set up its Overseas Territories team following the 1999 White Paper, to coordinate arrangements for all the Territories with the exceptions of Gibraltar and the Sovereign Base Areas of Cyprus.[6] While the Foreign and Commonwealth Office has lead responsibility for the Territories, the Department for International Development (DFID) directs development assistance. It concentrates its support on the three Territories with ongoing budget deficits; St Helena, Montserrat and Pitcairn. It has less involvement in the more prosperous Territories, except through regional programmes to help jurisdictions meet international obligations and conventions, for example, on child protection, human rights and environmental protection. **Figure 2 overleaf** shows key participants in the UK's relationship with the Overseas Territories.

2 There are many key participants and stakeholders in the UK's complex relationship with the Overseas Territories



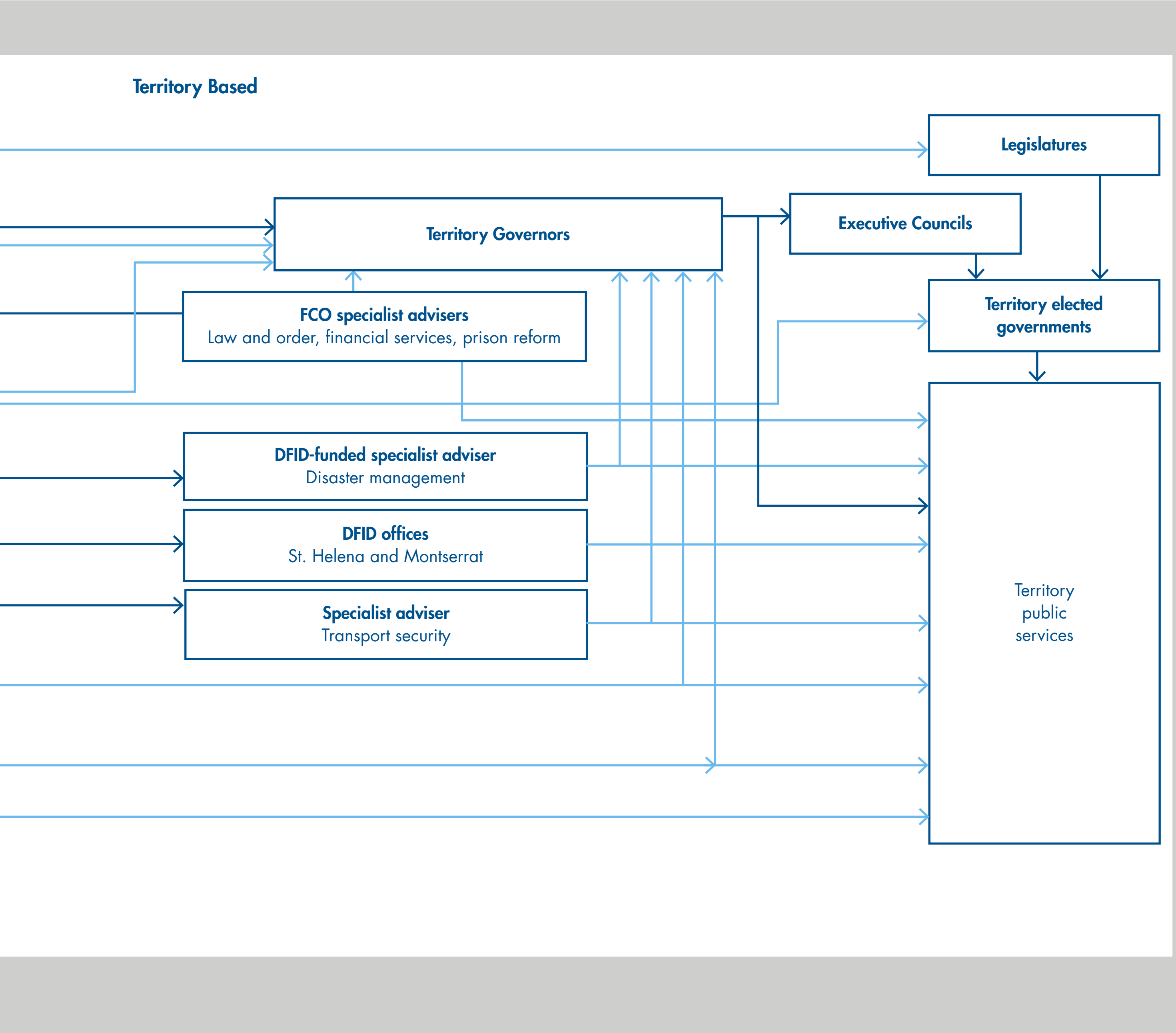
KEY

represent consultation and advice — represent lines of authority

Source: National Audit Office

NOTE

The diagram is not indicative of the relationship with Gibraltar, where Department advisers do not normally interact with the Governor and the Territory.


Territory Based
Legislatures
Territory Governors
Executive Councils
Territory elected governments
FCO specialist advisers
Law and order, financial services, prison reform
DFID-funded specialist adviser
Disaster management
DFID offices
St. Helena and Montserrat
Specialist adviser
Transport security
Territory public services

PART ONE

While progress has been made in managing and mitigating some risks, the degree of success in both individual Territories and across key risk areas has been mixed

1.1 The nature of the relationship between the UK and its Overseas Territories means that the UK has an ongoing commitment to the Territories and their citizens. While Territory governments remain responsible for their actions, the UK bears the ultimate risk from potential liabilities. The UK must therefore understand, monitor, and mitigate risks in the Territories in order to minimise costs falling to the UK. This section of the report examines the key risk areas which could impact on the UK, as identified by a National Audit Office survey of Territory Governors and governments, and the ways in which the UK and the Territories are attempting to address these risks, with varying degrees of success. The risk areas are: economic and fiscal trends; natural and man-made disasters; crime and justice; offshore financial services and transport safety and security.

The risk that Territories may become financially dependent on the UK is being partly mitigated by the limited levers available

Some Territories have become more resilient, though Territory public finances are inherently vulnerable

1.2 The economies of most Overseas Territories are typically based on one or two key industries, and this tends to bring more risk and volatility to public finances than is the case in larger, more diversified economies. Dependence on single "niche" revenue streams is particularly strong in the British Virgin Islands and the Falklands, which obtain over half their total revenues from registration fees for Offshore Companies and from issuing fishing licences, respectively (examined in greater depth in Appendices 3.3 and 3.5). Diversifying the Territories' economies is an important way to mitigate risk.

1.3 In recent years the economies and public finances of several UK Territories have shown encouraging resilience following external shocks that affected their key industries. Recovery from the severe downturn in tourism after the "9/11" 2001 terrorist attack has been swift, with travel to Anguilla, the Turks and Caicos and Cayman Islands exceeding pre-"9/11" levels by 2004-05. One way in which public finances can be insulated from wider economic shocks is by diversifying the taxation mechanisms and measures through which the government raises revenue across the economy. Most populated Overseas Territories are not yet robust in this respect. **Figure 3** shows that whilst progress has been made in some Territories, there is room for others to develop a more balanced system of taxation. Pressures in the region to liberalise trade by reducing tariff rates and eliminating cross border import duties poses a risk to Territory finances. Montserrat for example derives over half its revenue from import duties. Expertise from the UK to help Territory authorities design and implement alternative taxation systems may be helpful as needs arise.

3 Caribbean Overseas Territories have narrowly defined tax bases, with high reliance on import tariffs

Characteristic[1]	Anguilla	British Virgin Is.	Cayman Is.	Montserrat	Turks and Caicos Is.
A personal income tax	No	Yes[2]	No	Yes	No
A corporate income tax	No	Yes[3] (resident companies)	No	Yes[3]	No
A broad-based VAT type consumption tax	No Various licence fees are levied	No Mainly taxes on hotels and car rentals	No Mainly business licence fees and import duty	No	No Exceptionally a levy on outlets catering for tourists
A property tax with minimal exemptions, a reasonable tax rate to produce the equivalent of between one and two per cent of GDP	On occupied buildings. None on land	Yes	No	Yes	No
A system with minimal reliance on import tariffs, low and few import tax rates, and with no taxes on exports[4]	A wide range of tariffs between 5% and 35%	Tariffs range from 5% to 20%	Tariffs on all imports, range from 0% to 40%	A wide range. of tariffs between 0% and 40%. 60% applied on exceptional basis	A standard rate of 30%

Source: Survey of Caribbean Tax Systems, CARICOM 2004

NOTES

1 The survey defined best practice as a system which would include some of these features.

2 The lowest rate levied amongst the 15 Caribbean states or Territories who did apply an income tax at the time of the survey.

3 The lowest rates of Corporate Income tax among the 16 Caribbean states or Territories who applied such a tax.

4 Import tariffs can be efficient to administer in island economies, and have proven more politically acceptable than alternative taxes in the Caribbean territories.

The Department monitors Territories' public finances, according to their perceived risk

1.4 The Department's monitoring of Territory public finances is focused on the Territories considered to pose most risk due to their relatively weaker economies, or those with a history of weak financial control and governance. This includes Territories such as Anguilla that have only recently left dependence on DFID budgetary aid, and where Gross Domestic Product per capita remains lower than in other Territories. Such Territories are normally subject to annual inspection visits and detailed annual reports that are shared with the Territory government.[7] These cover the wider economy, government finances and indebtedness, standards of budgeting and financial control, and financial management of major programmes. The reviews also consider whether Territories appear to be making provision to meet long term pension liabilities. The last expert actuarial review covering all Territories was undertaken for the Department by the Government Actuary's Department in 2004, as a desk exercise without direct Territory government involvement.

The FCO partially mitigates fiscal risk, by limiting Territories' borrowing and aiding economic diversification

1.5 Territories (except Gibraltar) are required to obtain approval by the Secretary of State when seeking to borrow. This is to ensure that they evaluate borrowing proposals fully and do not take on commitments which would be burdensome or which might ultimately constitute a liability for the UK. The Department also requires Territory governments to keep within agreed levels of indebtedness and to maintain sufficient liquid reserves to cover 90 days of government spending, before it permits further borrowing. With the exception of Anguilla and Turks and Caicos Islands, which have not managed to meet the liquid reserve target, Territories are keeping within these guidelines.

1.6 As **Figure 4** shows, there are still areas of risk in oversight of government finances.

Territories have strengthened disaster management in the last ten years, but much remains to be done

1.7 Given their geographic location, natural disasters are an inescapable risk factor for many Overseas Territories.[8] Since 1997, seven have been affected by hurricanes or storm surges, and four by earthquakes.[9] Montserrat and Tristan da Cunha both have active volcanoes, although the latter's has not erupted since 1961. All Territories are also at risk from man-made disasters, such as oil spills and other pollution incidents, aviation and maritime accidents. Whatever the cause, disasters can severely affect even the best prepared of Territories due to their small size and topography, their relative isolation from external assistance and their often limited local resources. A serious event can also affect the tourist industry, which many Caribbean Territories rely on for a major source of income.

1.8 The Governor's constitutional responsibility for internal security requires the UK to ensure that the Territory is able to respond adequately to natural and man-made disasters. In practice, this is usually managed by the Territory's disaster management organisations, working closely with the Governor.[10] Territory governments have a responsibility to make the necessary resources available to achieve adequate standards of preparation against disasters. When disasters have occurred in the Territories, the Governor has normally led the immediate emergency response, and has co-ordinated any assistance from the UK, (such as emergency equipment sent to the Cayman Islands after Hurricane Ivan). Territory governments are responsible for leading the subsequent recovery phase, though in recovery too the UK has contributed, most substantially in aid to Montserrat (Appendix 3.7). In Gibraltar and the Falklands, locally-based UK forces would contribute to the response if necessary.

Most Territories now have partial threat and capability assessments

1.9 There are five key elements in preparing an effective disaster response;

- A realistic assessment of the threats affecting the Territory;
- Identification of the capabilities;
  - needed to respond to and recover from the threat, should it occur;
  - existing in Territory, and how any shortfalls will be met;
- Policy setting out the government's strategic direction in relation to disasters, underpinned by legislation which places a legal obligation on the various public and private services and agencies to respond;
- Strategies to reduce risks and plans to meet the identified threats should they occur; and
- Training and exercising plans, against a realistic range of disaster scenarios.

4 Ongoing threats to UK oversight of Territory government finances.

Risk	Example
Late and inaccurate government accounts can lead to borrowing decisions being made by the UK which may not have been agreed after viewing audited accounts	In 2006-07, the Department consented to up to $10 million of further borrowing by the Turks and Caicos Islands Government, given stated liquid reserves of $14.6 million. When the audited 2004-05 Accounts were published in July 2006, it was found that cash reserves had been overstated by $6.6 million due to failures to reconcile the government bank account. The Department has agreed with the Territory Government to obtain independent verification of their reserves in the future.
Maintaining government accounts on a cash basis means reserves can be increased by measures that are not sustainable indefinitely	In the Turks and Caicos Islands, a large programme of land sales and property deals with private sector developers have played a significant role in balancing government receipts and payments. The success of this strategy in the long term will depend on how far the resulting development in tourism and real estate will generate recurrent government income.
Some Territories are exploring more innovative forms of financing that would not fall within the current borrowing regime	The Turks and Caicos Island Government has been negotiating a Private Finance Initiative deal for two new hospitals totalling 80 beds, to be funded by an as yet unspecified level of debt.

Source: National Audit Office

1.10 Undertaking systematic threat assessments can provide a way for Territories to identify the key risks that they face **(see Figure 5)**. So far, most Territories have carried out some elements of the threat assessment process, for example the British Virgin Islands has completed a quantified risk and loss assessment for both hurricanes and earthquakes, and a rock fall risk assessment was carried out for St Helena in 2002. However there are few Territories which have consolidated these to cover all major risks and involving the key agencies tasked with mitigation, response, and recovery.[11]

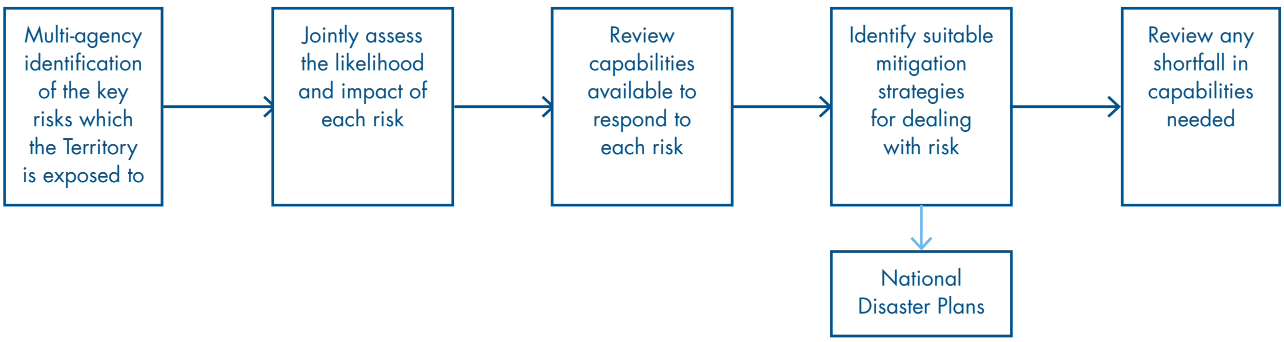
1.11 Since mid-2005, a joint DFID and Foreign and Commonwealth Office team has carried out capability reviews in seven Territories. While these reviews are not comprehensive threat assessments, they have identified key areas of risk, reviewed disaster plans and highlighted capability gaps. Territory Governors are required to provide a progress report within six months. However, recommendations arising from the reviews have not always been implemented by Territory governments. For example, a common issue highlighted by reviews is whether disaster advice is sufficiently taken into account by local authorities when giving consent to property development and construction. While the disaster management offices of Anguilla and the British Virgin Islands are represented on the planning board, the Turks and Caicos Island's Disaster Management Office is not, despite recommendations from the November 2005 Capability review.

1.12 The Department and DFID have directed a significant portion of their limited discretionary resources into improving standards of disaster preparedness in the Territories, almost entirely in the Caribbean.[12] Relatively little support has been given to the Atlantic Territories and none to Gibraltar, reflecting that these locations are much less prone to natural disasters and some have greater access to UK Defence resources and expertise. Since 2001, DFID has based a Disaster Management Adviser in the Caribbean to boost capacity in Territories there by providing advice and input into disaster planning, and encouraging more regional cooperation.[13] A 2004 meeting of disaster management personnel for the Caribbean Overseas Territories and Bermuda was viewed by Territory disaster management agencies as a useful forum for networking and sharing good practice; however such meetings are infrequent.

Disaster plans and testing have variable coverage, despite UK input

1.13 The Department expects Governors to ensure, as far as possible, that Territory governments have drawn up contingency plans for all types of disasters that might affect their Territory. Without systematic threat assessments, it is difficult for Territories to determine the risks that they face, and assess their capabilities to respond to such risks. Disaster planning has improved since the last NAO review in 1997, to the extent that all Territories now have at least draft plans covering the most obvious risk events.[14] Understandably, in the Caribbean, planning has focussed on hurricanes and storms at the expense of coverage of other natural and man-made scenarios. Some of the Territories have major incident plans setting out their emergency response to a variety of threats. In others, there are overarching National Plans in place, or in development, which cover all elements of the disaster cycle. However, none of the Territories yet have plans for all threats or all stages of the disaster management cycle.

5 Key components of a threat assessment



Source: National Audit Office

6 Summarises the current position of the Territories with regards to the components of a disaster management system

	Key Threats	Threat Assessments (para 1.10-1.11)		Disaster Management Legislation (para 1.14)
		Government-led	UK-led	
Anguilla	Hurricane, flooding	Hazard-specific	DFID/FCO Capability Review 2005 and 2007	Draft
Bermuda (Appendix 3.2)	Hurricane	In part (Element of a National Threat Assessment)	DFID hazard-specific capability review 2000	No disaster management specific[1]
British Virgin Islands (Appendix 3.3)	Hurricane, earthquake, flooding, Cruise Ship incident	Multi-hazard, and quantitative earthquake risk assessment	DFID/FCO Capability Review 2007	Yes
Cayman Islands (Appendix 3.4)	Hurricane, Earthquake, flooding, Cruise Ship incident	Risk profiling of the built environment. National Strategic Framework for risk reduction	National Threat Assessment, with Governor involvement	No disaster management specific[1] Draft
Falklands	Risks to shipping, Cruise Ship incident		DFID/FCO Capability Review 2007	No disaster management specific[1]
Gibraltar	Transport incidents, Civil contingencies	Hazard specific assessments		Civil contingencies legislation
Montserrat (Appendix 3.7)	Volcano, earthquake, hurricane	Multi-hazard and volcano assessments	DFID/FCO Capability Review 2006	Yes
St Helena	Rockfalls		DFID Capability review 2003 and rock fall assessment	No disaster management specific[1]
Turks and Caicos Islands	Hurricane, flooding, Cruise Ship incident	In part Multi-hazard	DFID/FCO Capability review 2005	Draft

Source: National Audit Office, with input from the DFID-funded Disaster Management Adviser

NOTES

1 Although there is no disaster-specific legislation currently in place, disasters are covered as part of some hazard- and sector-specific legislation e.g. fire ordinance and marine incidents.

2 This excludes the mandatory test of airport disaster plans, which have to be carried out every two years.

Disaster Plan (para 1.12)	Exercised disaster response in the last year? (para 1.15)[2]
Draft National Plan	Yes – hurricane
No (major incident and hazard specific plans)	Yes – multi-scenario
National Plan	Yes – multi-scenario
Not yet completed (existing plans include major incident, mass casualty, hurricane and oil spill)	Yes – transport disaster and hurricane plan
Draft Major Incident Plan	Yes – cruise ship disaster
Government Civil Contingencies plans	Yes – aviation incident
National Plan	Yes – multi-scenario
Draft Major Incident Plan	Yes
National Plan	Yes – multi-scenario

1.14 A contributory factor is that few Territories have based their plans on a clear disaster management policy, including a statement of how the government intends to ensure that the community is ready for the next disaster and how it will measure effectiveness. There is also a lack of supporting, up to date local legislation equivalent to the UK Civil Contingencies Act, which establishes clear roles and responsibilities for those involved in emergency preparation and response, and puts in place emergency powers based on assessment of current risks. Two notable exceptions are Montserrat and the British Virgin Islands, both of which have disaster management-specific legislation, setting out the roles and responsibilities of various agencies (see Appendix 3.7 and 3.3). And there are signs that other Territories are improving in this respect, with legislation at the draft stage in Anguilla, Cayman Islands and the Turks and Caicos Islands.

1.15 Regular testing is important to ensure that disaster plans are usable in an emergency, and that all agencies and key individuals are aware of their responsibilities. Most Territories run a variety of desk and field-exercises. While tests in the Caribbean have mainly focused on hurricanes, Territories are now expanding their scenarios to include a wider range of natural and man-made disasters. Bermuda has set a positive example by testing hijacks and other terrorist incidents, airport mass casualties, fire on a cruise ship, oil spills and protracted public disorder. Such tests invariably yield useful lessons.[15] While most Territories run annual tests, St Helena had not tested their plan since 2003, (although a test was scheduled for September 2007). There is currently no minimum Departmental requirement for the frequency of testing disaster plans,[16] and tests are not routinely observed by the Department, DFID or other outside Agencies, such as the Caribbean Disaster Emergency Response Agency, although the UK departments' capability reviews have observed tests as part of their programme.

The level of UK assistance following a disaster event depends on the severity of the incident, and the capabilities of the Territory affected

1.16 Any serious natural disaster is likely to affect the whole island, including those tasked with disaster response. As a result, it is likely that all Overseas Territories would require some UK input in a serious disaster event, although levels of assistance would vary depending on the Territory and the nature and severity of the incident.[17] The Department has set out the high level actions that the UK would consider in the event of a disaster, such as deploying UK support staff to the affected Territory, coordinating response from international agencies and putting a Consular Rapid Deployment Team on standby. The Ministry of Defence also has a role in responding to a disaster, supplying a ship which operates in the North Atlantic and the Caribbean throughout the hurricane season. The exact level of UK assistance would depend on the severity of the incident and the capacity of the affected Territory. However there remains uncertainty over how far Territories should be expected to contribute to fund such actions, especially in wealthier Territories such as Bermuda and the Cayman Islands.

1.17 Following Hurricane Ivan in 2004, the Department established a three-person Overseas Territories rapid response team to be deployed to affected areas in the event of a disaster. The primary purpose of the Team is to advise and assist the Governor on law enforcement and disaster management issues, rather than provide humanitarian aid or relief. However, the focus is on assisting the Caribbean Overseas Territories during the hurricane season, and it is not clear how the Team would respond to events in non-Caribbean Territories.

Improvements have been made in providing effective internal security

1.18 The internal security of the Territories is critical to their long-term stability. The locations of the Caribbean Territories expose them to international threats, including people and drugs trafficking. The isolation of non-Caribbean Territories means that Territory agencies have to be capable of providing the initial response to any incident.[18] The UK, through the Governor, maintains constitutional responsibility for internal security. Any major breakdown in public order, or a perceived failure to tackle criminal activities such as drugs trafficking and organised crime could have a reputational or financial impact on the UK. Costs arising from law and order issues, including funding for legal cases, are most likely to fall to the UK in the least prosperous Territories, as shown by UK expenditure of £3 million and £300,000 for criminal justice proceedings in Pitcairn and St Helena respectively (Appendix 3.8).

The split between government funding and Governor responsibility presents challenges to good risk management

1.19 Governors' responsibilities for internal security require them to exercise oversight of the police and prison services, and ensure that they are well briefed on potential threats.[19] Territory Police Chiefs report to Governors, typically on a weekly basis. In contrast, funding for the Territory's police, prison service, and other law enforcement agencies is provided by the Territory government. This split responsibility can be managed where Governor and government have shared priorities. For example since 2005 the Turks and Caicos Islands Government has increased police funding following crimes that posed a risk to expansion of the island tourist sector. But there are more examples where local resourcing of the police and prison services has been a point of contention:

- Capital projects tend to be deferred due to other government priorities, for example overdue replacement of the aged and unsuitable main police station in Bermuda (see Appendix 3.2).
- Where assets are provided, either by Territory governments, or exceptionally, by the UK, effective training in their use is a key priority. Critical examples include patrol boat handling and boarding procedures for police marine units combating illegal immigration to the Cayman Islands and the Turks and Caicos Islands.
- Resourcing of major police enquiries is hampered by lack of contingency funding; in the British Virgin Islands the annual budget to support major investigations is US$60,000, which when factoring in costs such as forensic sciences, can be exhausted by just one or two major investigations.

1.20 In some Territories there have been innovations to enhance the oversight and local "ownership" of Territory police forces. In Gibraltar in January 2007 a statutory Police Authority was established bringing the Territory more in line with arrangements in the UK. The Governor and the Chief Minister each appoint one member, with others appointed on the advice of an independent public services commission. Although it is too early to be conclusive, we received views from the Department that these arrangements should provide much improved and more expert oversight than previous practices. Another established element of the approach in Gibraltar since 2002 has been periodic non-statutory review of the capability and efficiency of the police service by HM Inspectorate of Constabulary from the UK. The Inspectorate has only reviewed two other Territories; the Cayman Islands' force in 2002 and

Bermuda in 2003, both at the invitation of the Governor and the Territory government. While such inspections give a useful, independent assessment of capacity in the Territory's forces, they were considered to be expensive relative to the funds available, and usually Governors have instead relied on advice from the Department's own law enforcement adviser.

Capacity problems in the law enforcement agencies mean that Territories are unable to deal with serious threats to security without external assistance

1.21 Recruitment and retention difficulties mean that many Overseas Territories' law enforcement agencies operate below strength; the Turks and Caicos Islands' Police Force is running with over 37 vacancies (14 per cent). However, there have been some successes; Anguilla's Prison Service was working with 20 per cent vacancies, reflecting in part the perceived status of this work, and wider issues of public service pay and conditions. A Prisons Task Force has succeeded in securing support and funding from the Executive Council for ten new Officers, taking the Prison Service to almost full complement (Appendix 3.1). The challenge of providing effective law enforcement in a small community has resulted in Caribbean Territories having to recruit a high proportion of police and prison officers externally. Attorneys' General Chambers also find it difficult to recruit and retain suitably qualified staff, particularly locally. A shortage of skilled legal drafters and lack of resources in Attorneys' General Chambers impedes Territories' ability to pass new, up to date, legislation, notably in areas such as disaster management, human rights, criminal evidence and shipping, to ensure they are fully compliant with international standards. To help this, DFID, working with the Attorneys General of Anguilla, Montserrat and the Turks and Caicos Islands, and an FCO Legal Adviser, are providing seed funding of £300,000 over three years for a Law Revision Centre based in Anguilla. Opening in late 2007, this will undertake law revision work for the three Territories, thus hopefully freeing up some of the resources of the Attorneys General in Anguilla, the Turks and Caicos Islands and Montserrat. The intention is that other Territories, and, perhaps, independent countries in the Caribbean region will be able to contract the Centre to undertake law revision work once it is fully operational. A DFID-funded human rights project, to be managed by the Commonwealth Foundation, will also have a legislative drafting component, intended to build capacity in Attorneys General's chambers, particularly in relation to human rights issues.

1.22 Experienced law enforcement personnel from the UK have been key in building capacity, capability and self-sufficiency within Territory police forces.[20] The Department has built up a database of recently retired UK Police Officers which Territories can consult when filling vacancies. To enable local ownership, the Territory Police Commissioner plays a key role in the recruitment process and Officers are employed by the local government. However, the Department's support is vital in ensuring that the skills and expertise injected into Territory police forces are embedded, through funding for training initiatives, or linking the Officer into a wider support network.

More joined up working between the Territories can help mitigate capacity constraints

1.23 The Overseas Territories have limited capacity to deal with serious threats to their security or major crime incidents without external assistance.[21] To address this problem, the Caribbean Territories share resources between themselves and only call on costlier UK assistance as a last resort. The Department intends to build on this cooperation through a Law Enforcement Mutual Assistance Memorandum between the Caribbean Overseas Territories and Bermuda. In an emergency (including severe natural disasters), personnel will be made available to the affected Territory with the cost shared between the receiving and sending Territory. This formalises earlier ad hoc arrangements; for example, the Cayman Islands deployed police officers to the Turks and Caicos Islands after a police shooting incident, and three Territories between them provided 26 officers to the Cayman Islands after Hurricane Ivan.

1.24 Intra-regional arrangements are also being used to combat serious crime in the Caribbean. The Department set up the Overseas Territories Regional Crime Intelligence System (OTRICS) in 1997 as a one-stop information portal for the five Caribbean Territories.[22] Since 2003, the system has been fully funded by the Territories, although the Department has supported enhancements of the system through its Programme Fund. In 2006-07, the total annual cost was US$203,000. The system now includes 900,000 records and, as at March 2006, had been interrogated over 5.5 million times. However, usage of the system remains variable: In 2004-05, the Cayman Islands Police Force made over five times the number of OTRICS searches and input almost 12 times as many records as the Turks and Caicos Islands Police Force. Despite the volume of data entered onto OTRICS, variations in the type and categorisation of information means reliable crime statistics cannot be easily analysed to provide comparative data across the Territories.

1.25 The Department is developing a *Law and Order Criminal Justice Strategy for the Caribbean Overseas Territories and Bermuda*. Its goal is to improve the security of the Territories, involving all components of the Criminal Justice System. The Department also organises an annual Law Enforcement Conference for the Caribbean Territories and Bermuda. The February 2007 Conference was the first in which all law enforcement agencies attended, including Police, Prisons, Customs and Immigration services, and it ran alongside the annual conference of Territory Attorneys General. The Law Enforcement Conference provided the opportunity for law enforcement personnel to network with other Territories and debate regional issues such as financial crime, gun crime, witness protection and maritime interdiction. However contacts tended to break down between each Law Enforcement conference, and more follow-up would be welcomed by some law enforcement personnel. Though non-Caribbean Territories can, in principle, attend, it is rare for them to do so; the current St Helena Police Chief has never attended an Overseas Territory conference.

Measures to regulate financial services in the Overseas Territories have had variable success in keeping up with rising international standards

The UK has strong reasons to ensure that financial services in the Territories are well regulated

1.26 Weaknesses in financial supervision and safeguards, in onshore as well as offshore centres, could undermine global financial stability and increase vulnerability to abuses such as money laundering. The link between the UK and its Overseas Territories is often made internationally, and Britain is often judged on the basis of how its Territories perform against international standards. The Territories trade, in part, on their "Britishness", and this presents a reputational risk to the UK that needs to be managed.

1.27 Contingent liabilities are not a hypothetical risk in financial services. Regulators worldwide are open to legal challenge for their actions or inaction, if such actions can be shown to be in bad faith.[23] The victims of a crime or a financial collapse that can, in part, be attributable to weak oversight may seek financial compensation on the grounds that the authorities in the Overseas Territories knew about the weaknesses and failed to address them. The costs of such actions could be high, and would fall directly to the UK in jurisdictions such as Anguilla, Montserrat and the Turks and Caicos Island, where the Governor retains direct responsibility for regulation of international finance. In the wealthier Territories, responsibility for the financial services sector lies with the Territory government but the UK could still face reputational impacts, and, in a worst case scenario, be called to provide aid should the sector collapse. To date, no regulator in a UK Overseas Territory has been successfully sued, and currently their regulators express confidence of being able to defend any known disputes with complainants which might reach the courts.

Several Territories have important offshore financial centres

1.28 **Figure 7** shows that seven Territories have offshore financial centres, delivering financial services almost exclusively to non-residents. Three Territories, (Bermuda, Cayman Islands and British Virgin Islands) are of major importance in the global financial system.

1.29 Complexity is a growing challenge. For example, the Cayman Islands are home to 80 per cent of the world's hedge funds. Worldwide market turbulence in August 2007, relating to the US sub prime mortgage market, has been attributed in part to mispricing of complex financial instruments derived from sub prime mortgages. The global effects have been exacerbated by lack of transparency over the ownership and scale of risks. Hedge funds, which are heavily, though not exclusively, involved in investment in such instruments, have structures which split regulatory responsibility internationally. Typically, key intermediaries will be in onshore financial centres, while the funds' registration and administration will be offshore. As hedge funds are primarily intended for institutional and expert investors, they have traditionally been subject to lighter regulations. However, there are growing calls for more regulatory oversight in areas such as corporate governance, valuation of assets, disclosure and adherence to the fund prospectus. Such regulations would, to be completely effective, have to be imposed on the fund itself by offshore regulators. Even for the larger regulators worldwide it is a challenge to find enough skilled resources effectively to enforce such regulation.

Regulation in the Overseas Territories can be improved

1.30 Since 2001 offshore financial centres around the world have been subject to a cycle of assessments based on criteria developed by the recognised international standard-setting bodies and co-ordinated by the International Monetary Fund. Over the last five years the assessments have become increasingly demanding.[24]

Adverse International Monetary Fund reports can have serious consequences. The industry representative body for the Turks and Caicos Islands considers that the local industry will find it difficult to move forward unless the next International Monetary Fund assessment is positive, unlike the adverse report issued in 2005.

1.31 **Figure 8 overleaf** shows that, at the first round of assessments, there was scope for improvement in regulation across each of the four main industry sectors, before all Territories are seen as matching the more consistently high standards in the United Kingdom's Crown Dependencies; Jersey, Guernsey and the Isle of Man. Comparisons of this kind have to be treated with care. Developments in international standards mean that later assessments may be regarded as being against more demanding requirements. Some of the Territories have put in place substantial improvements in regulation since the assessments were conducted.

Limited regulatory capacity poses heightened risk in the smaller offshore centres

1.32 Regardless of the scale of activity in their area, regulators must discharge core responsibilities including keeping abreast with developments in international standards and their application in the local context; support for drafting of legislation and maintaining specialist investigative skills to respond to regulatory breaches and to deal with overseas requests for information.[25] Regulators in key centres of Bermuda, and the Cayman and British Virgin Islands have, thanks to fees levied on their flourishing financial sectors, achieved major improvements since 2000, with staffing rising to complements of around 100 staff each. The position in Anguilla, Montserrat and the Turks and Caicos Islands is quite different. For example, in Anguilla, there are only about 200 employees in the financial sector as a whole, and the fees from the industry are insufficient to fund a fully fledged regulatory function. At present,

7 The Overseas Territories include globally important offshore financial centres

Territory	Principal Niche	Estimated employed
Bermuda	World Leader in Captive Insurance, (where a group forms a subsidiary to insure or reinsure its own risks, cutting out the middle man and making tax savings). Also a leader in reinsurance, making Bermuda an insurance centre which sees itself as a major competitor of London and New York. Territory's main industry.	Over 4,000
Cayman Islands	A major banking centre with over $1 trillion in assets, making it fifth in the world by some measures. Home for 80 per cent of the world's hedge funds. Also an important centre for captive insurance and mutual funds. Popular with US investors. Territory's main industry, alongside tourism.	5,400
British Virgin Islands	World Leader in provision of Offshore Companies, with a register of over 600,000 such "International Business Corporations" (IBCs). These do not trade in their place of incorporation, and can provide their offshore owners with advantages of speed of incorporation, flexibility, very limited filing requirements and no or low local taxation. A limited banking sector, (since IBC assets tend to be held elsewhere).	1,500-1,700
Gibraltar	The financial sector is not large by international standards. But a broad range of services are provided including banking, insurance, fund management, trusts and advisory business. A stock exchange is planned to open.	c.1,500
Turks and Caicos Islands[1]	The financial sector is small in international terms though significant, behind tourism, within the local economy. It provides a range of financial services, including banks, specialised insurance, and trusts.	N/K
Anguilla[1]	Anguilla's financial sector contributes about 15 per cent of GDP and 7 per cent of employment, well behind tourism. It focuses primarily on incorporation and management of international business corporations, including fast online company registration from anywhere in the world.	c.200
Montserrat[1]	The smallest financial sector amongst Territories; offshore finance having reduced after the 1995 volcanic eruption to only 11 offshore banks, all owned and controlled from Latin America. Banking and insurance together accounted for less than 10 per cent of GDP in 2000; other sectors are negligible.	Under 100

Source: National Audit Office

NOTE

1 Regulation of financial services is the direct responsibility of the Governor/UK.

Anguilla has just four professional regulators and has fallen behind with important actions (Appendix 3.1). Regulator resources need to be broadly proportionate to the scale and nature of the industry that they regulate, but they also need a minimum critical mass to keep up with international standards. The Department has taken some steps to address limited capacity, by facilitating secondments and sharing of expertise, from Anguilla to the British Virgin Islands, from Gibraltar to Montserrat and from the British Virgin Islands to Jersey and the Isle of Man. It also held or supported various seminars or workshops in 2003 and 2005.

Arrangements to meet international standards to monitor money laundering and terrorist financing are critical

1.33 To protect against money-laundering and terrorist financing, international standards require financial institutions to establish information about their customers, including their true identity and their ultimate ownership, nature of business and the purpose of the account. Whilst progress in putting legislation and regulations in place to comply with the standards has been good in the Territories with larger financial centres, implementing them in practice has proved difficult. Customers of offshore centres are usually remote and checks can be costly and burdensome. The industry expresses concerns about

8 International Monetary Fund assessments regulation of offshore financial services in Overseas Territories[1, 2]

	Test assessment results, showing the extent of compliance with global standards	Gibraltar 2001 %	Anguilla 2003 %	Montserrat 2003 %	British Virgin Islands 2004 %	Bermuda 2005 %	Cayman Islands 2005 %	The three Crown Dependencies 2003[4] %
Banking	Compliant	73	19	12	36	62	63	63
	Largely compliant	27	33	19	14	38	37	34
	Materially non-compliant		33	54	39	–	–	2
	Non-compliant	–	15	15	11	–	–	–
Money Laundering	Compliant		41	38	53	59	65	81
	Largely compliant		34	28	38	19	29	19
	Materially non-compliant		22	31	6	22	6	–
	Non-compliant		3	3	3	–	–	–
Insurance[3]	Observed	76			76	38	47	70
	Largely observed	18			6	13	18	26
	Materially non-observed	6			18	44	35	2
	Non-observed	–			–	6	–	2
Securities[3]	Implemented	86			25	40	46	81
	Broadly Implemented	14			31	37	19	8
	Partly Implemented	–			44	23	31	11
	Not Implemented	–			–	–	4	–

Source: National Audit Office

NOTES

1 The table shows the first round of IMF assessments for each jurisdiction. At the time of this report, the first second round report, for Gibraltar, had been published, with highly favourable results. Assessments in Turks and Caicos Islands, Anguilla and the British Virgin Islands had been deferred at local request, and the reports on Bermuda and the Cayman Islands had not yet been published.

2 The table summarises compliance in six of the seven Offshore Financial Centres. Turks and Caicos Islands were excluded because the International Monetary Fund has not published its detailed breakdown of results. Percentages are rounded and may not always add to 100 per cent.

3 The smaller centres were not assessed for insurance and securities business.

4 The Crown dependencies are Jersey, Guernsey and the Isle of Man.

pressing customers or their agents for information, and the risk that passing on the cost of extensive checks could drive business away to competitor centres where standards and fees are lower.[26]

1.34 Reporting of suspicious activity is at the heart of anti-money laundering arrangements. International Monetary Fund reports on UK Overseas Territories have commented that the number of suspicious activity reports appears low, though numbers are increasing. **Figure 9** shows that, at least in the smaller financial centres, the number of reports is so low as to indicate that some financial institutions either do not know or monitor their customers sufficiently or are unaware of their obligations to report. The data needs to be interpreted with care. Trivial reporting of activity "to be on the safe side" can divert attention from genuinely serious cases. Also some lower-risk financial products, such as corporate reinsurance which predominates in Bermuda, would be expected to generate less suspicious activity than others, such as banking or offshore company formation which predominates in the Cayman or British Virgin Islands. Global experience shows that as tougher requirements are imposed and enforced, and effective awareness programmes implemented, the number of valid suspicious transaction reports rises substantially.

Limited capacity to investigate and prosecute financial crime is a risk in most Territories with financial centres

1.35 Where significant numbers of suspicious activity reports are generated, an increasing burden falls on law enforcement agencies to assess the substance of the reports, investigate those found to have substance and to support subsequent prosecutions. This burden has outstripped the capacity of law enforcement agencies in most Territories. Only the Cayman Islands has so far achieved successful prosecutions of local participants for offshore money laundering offences. For example, in Bermuda, very few of the 313 reports received in 2006 had been investigated to the extent of their potential for prosecution. In Anguilla, the Financial Intelligence Unit has no permanent full-time staff. Investigation work, and developing local officers to investigate financial crime there, fell to a contracted UK Detective Inspector, who also acquired criminal investigation and management responsibilities and was supported by one part-time local detective constable. There was a backlog of some 20 cases and the Inspector estimated that the staffing requirement to match the workload as three full time investigators and an administrator.[27]

9 Levels of monitoring and investigating suspicious financial activity in the Territories are variable

Territory	Number of suspicious activity reports (2005)	Estimated number employed in Financial Services	Reports per hundred employed[1]	Financial Intelligence and Investigative capability[2]	Number of successful local prosecutions[3]
Bermuda	313 (2006)	4,000	8	11	0
Cayman Is.	244	5,400	5	21	2
British Virgin Is	101	1,600	6	5.5	0
Gibraltar	108	1,500	7	8	0 (1 pending)
Turks and Caicos Islands	17	700	2.4	5	0 (3 pending)
Anguilla	2	200	1	1	0
Montserrat	1	150	1	1	0
External contexts					
Jersey	1,162	11,800	10	22 (2003)[4]	
Isle of Man	1,652	7,010	24	22	

Source: Summarisation by National Audit Office, and latest IMF assessment reports

NOTES

1 Very high levels of reporting can be indicative of defensive reporting of trivial cases, so the numbers here indicate relative reporting activity and not performance against a benchmark.

2 Full time equivalents. Professional staff.

3 In some cases investigations are ongoing and charges have been laid. Cayman authorities report five successful domestic prosecutions since 1997.

4 Included at the time seven staff seconded from the UK.

1.36 There have been some successes. Since 2004 in the British Virgin Islands an independent Financial Intelligence Agency, funded jointly by the regulator and the Territory government, has been sufficiently resourced to investigate well-founded suspicious transactions and take several to the point of prosecution. The Agency is hopeful that successful prosecutions in the USA will yield a share of proceeds from sequestered assets or fines levied there. Like other such Units elsewhere, this Agency also handles requests for financial intelligence from authorities overseas.[28] Bermuda has also assisted three successful prosecutions and convictions for money laundering, in the USA and in the UK.

HMG and the Territories have succeeded in mitigating risks to transport safety and security, and now need to embed this progress

The UK has international obligations for transport safety and security

1.37 The UK is responsible through a range of treaties, conventions and agreements for ensuring that its Overseas Territories keep up with rising international standards for transport safety and security. The principal obligations are applied through annexes to the Chicago Convention of 1944, which set standards and recommended practices for aviation safety and security; and through over forty maritime protocols and conventions, most overseen by the International Maritime Organisation. Standards for maritime and aviation security have also been tightened since "9/11", including a more exacting International Ship and Port Facility Security Code. Failure to adequately regulate standards can have severe consequences for both the UK and the Territories, including black-listing or imposing restrictions on transport links or specific carriers. There is also the potential for claims against the UK or the Governor by travellers affected by serious safety or security incidents.

Regulation of maritime safety is well-established

1.38 The nine Overseas Territories that register vessels are members of the Red Ensign Group, which promotes standards of maritime safety amongst vessels under their flags. The UK Secretary of State for Transport has delegated the Maritime and Coastguard Agency to ensure that members' registers maintain the highest international maritime standards, in accordance with their obligations under Conventions and UK policy. The Agency fulfils this role through well established monitoring visits to each Territory. Measures of the quality of Territory registers show good results for international shipping.

Arrangements for aviation safety have improved dramatically since 2000, but challenges remain

1.39 In July 2000 the International Civil Aviation Organisation produced a critical report on the UK's safety oversight of civil aviation in the Overseas Territories. It found that local legislation was out of date, and that Territories lacked adequate regulatory systems and procedures. The UK Department for Transport recognised that the UK was exposed to risk and in 2003 established Air Safety Support International (ASSI), a not-for-profit, wholly-owned subsidiary company of the Civil Aviation Authority, to help provide a more cohesive system of civil aviation safety regulation in the Territories. The cost of the Company's activities, (£3.2 million in 2006-07) is met by grants from the UK Department for Transport. The Company; has helped update legislation; developed a set of Overseas Territories Aviation Requirements; assists Governors in exercising aviation safety oversight and regulation[29]; audits the local regulator within each Territory, and sometimes acts as regulator itself where there is insufficient local specialist capacity. For example, difficulties in training and retaining a suitable local Chief Regulator in the British Virgin Islands has led to the Company providing the regulatory role itself, at a cost to the UK of some £600,000 per annum.

1.40 Regulators in the Territories consider that Air Safety Support International has transformed the UK's oversight. They perceive the Company as more accessible than previous UK oversight, more supportive in the way that it provides specialist technical and training services, and more consultative in the way that it applies standards in the Territories. Progress has been tangible: for example, since 2006, the US authorities have upgraded Turks and Caicos Islands, British Virgin Islands, Anguilla and Montserrat to freely operate aircraft into US airspace.

1.41 As **Figure 10** shows, most Territories are not able to provide a comprehensive civil aviation regulatory system without UK assistance. Reducing the Company's involvement to a "Quality Assurance" role will occur progressively as and when Territory regulators take on more responsibilities, either themselves or by contracting out to qualified regional or UK specialists.

Higher international standards in port and airport security are being addressed

1.42 The UK Department for Transport is active in raising standards of transport security in Territories. The main mechanisms applied have been:

- a rolling programme of inspections by Departmental advisers, of each Territories' principal ports or airports, backed by powers of Governors to set legally binding minimum standards;
- where inspections identify problems, the use of deficiency notices setting a timescale for rectification, with operating restrictions or closure as the ultimate sanction;
- latterly, working with the Department to pilot a new risk assessment methodology, MATRA, in the Turks and Caicos Islands, designed to foster multi-agency cooperation to address security issues; and
- a UK-funded training programme for Territory officials.

Most Territories now meet international regulations thanks to sustained application of these measures. The main area of sustained non-compliance relates to the government-owned cargo port in the Turks and Caicos Islands, which requires major investment or even relocation before it can meet modern standards. It is currently vulnerable to a range of threats including illegal immigration from Haiti. The Department for Transport continues to work with the Governor's office and with the Turks and Caicos Islands Government to improve the situation. An inspection of the Turks and Caicos Islands' port facilities was scheduled for October 2007.

1.43 The challenge remains to keep standards high at a time when traffic levels in the Territories are rapidly increasing. Common issues include segregating cargo and passenger traffic, providing sufficient closed circuit television or fencing, and training staff to follow basic good practice such as reliable port entry control, and badging of staff and visitors.

10 Most Territories are not able to fully regulate their civil aviation and the UK continues to bear significant costs

Territory	Current extent of delegation to Territory	Local Regulator Costs[1]	Local Regulators costs recovered	Annual costs ASSI £000	Estimated duration of continued ASSI support[2]
Anguilla and Montserrat	None. Regulation is by the Eastern Caribbean CAA (the regional regulatory body), supported by ASSI	Not known	No	105	Minimum 3–5 years
Bermuda	All activities devolved and locally funded	Not known	Yes	100	UK has a quality assurance role only
British Virgin Islands	Limited local capability, ASSI retains complete regulatory responsibility	Nil	No	600	Minimum 5–6 years
Cayman Islands	Full delegation	£2.1m	Yes	88	UK has a quality assurance role only
Falkland Islands	Civil aviation is split responsibility between local regulator and ASSI. MOD operates the Mount Pleasant airport as a military airfield	£200k	No	300	Indefinitely
Gibraltar	Currently operated as a Military aerodrome. ASSI involvement is mainly advisory except for civil air traffic control/airspace aspects where they are the regulator.	N/A[3]	No	81	1–2 years[3]
Turks and Caicos Islands	Split responsibility between local regulator and ASSI	£492k	Some recovery of costs – total unknown	339	Minimum five years

Source: Summarisation by National Audit Office, and latest IMF assessment reports

NOTES

1 Costs are approximate. Average annual exchange rates for 2005-06 have been applied, where necessary.

2 Estimates by ASSI, Air Safety Support International, a subsidiary of the Civil Aviation Authority.

3 ASSI involvement in Gibraltar is currently expected to cease within 1-2 years after new aviation legislation is passed and Gibraltar participates in the European regulatory regime.

PART TWO

The relationship between the UK and the Overseas Territories shapes the UK Government's ability to manage its risks and responsibilities

2.1 The relationship between the UK and the locally-elected Territory government is complex and varies from Territory to Territory. The UK's ability to manage the risks and opportunities that arise is constrained by the nature of that relationship. Territory governments are responsible for their own actions; however the UK can face moral, political or legal obligations to give support when a Territory's resources are insufficient to meet its commitments. The UK therefore seeks to achieve a balance between allowing Territories the fullest autonomy they aspire to, and ensuring that the UK can discharge its responsibilities and minimise its exposure to potential liabilities. **Figure 11** illustrates the diversity of risks and liabilities that the UK has faced.

The risks the Territories pose to the UK, and the UK's ability to manage those risks are not always aligned

2.2 The UK has various levers it can use to influence good governance and prudent management of risk in Territories. Governors' powers differ according to local constitutions, although they generally include responsibility for internal security, external affairs, defence, the administration of courts and the public service (Appendix 2). Constitutional changes negotiated between the Department and three Territories in recent years have reduced Governors' powers, for example their ability to make certain senior public service appointments at their discretion. In exceptional circumstances, Governors can disallow a Territory budget or require monies to ensure adequate funding is available to meet their constitutional responsibilities. Such action must be balanced against the importance of maintaining relations with democratically elected local governments. In practice Governors rely mainly on their influencing skills, and (where available), their role as the Chair of the Cabinet of Ministers or Territory Government Officials to encourage good governance and the prudent management of risks.[30] Governors have few intermediate levers between such influence on one hand and the constitutional powers on the other, despite the responsibilities that they must discharge.

Arrangements could be strengthened to encourage better risk management

Overseas Territories work is not a mainstream career path within the Department

2.3 The Department recognises that work with the Overseas Territories is very different to its mainstream diplomatic activities. The function can be seen as a "mini-Whitehall" which has to direct policy, guidance, and assistance on a wide range of issues, such as the implementation of diverse international obligations, leadership of the local public service, and prison building programmes. The Department advised us that it aims to build up Overseas Territories as a specialism or career anchor, and to increase the number of key officials with a background of direct administrative experience in Territories. While this is especially welcomed by Territory governments, there is still some way to go. Most Governors and deputies have a diplomatic service background, which brings useful experience of serving overseas; but as at May 2007, only four out of 11 Governors had previous experience working in the Overseas Territories (Appendix 4). The Department, DFID and the Department for Transport also employ several specialist advisers who provide valuable continuity and sector expertise; advising Governors, assessing and helping to meet local training needs, accessing UK resources where required and generally assisting in building local capacity.

11 Illustrations of UK risks and liabilities in the Overseas Territories

Territory	Description of risk	Potential Cost
Gibraltar	**Unfunded pension liabilities.** Following Spain's accession to the EU, the UK agreed in 1996 to meet the costs of pensions payable to Spanish pensioners who were unable to work in Gibraltar when the border was closed from 1969 to 1985. The matter has been identified in previous reports by the National Audit Office and the Committee of Public Accounts.[1] An agreement between the UK, Spain and Gibraltar in 2006 provides a basis to end the dispute. In 2007 the European Commission agreed to end legal proceedings against the UK for alleged discrimination against Spanish pensioners. Appendix 3.6 gives further detail, including the liabilities to the UK avoided by the settlement.	The extent of the cost will depend on the life span of those pensioners who took up the settlement in return for a lump sum payment. Total costs to the UK in the region of £100 million are estimated.
Montserrat	**Volcanic Eruption.** Volcanic activity since 1995 has rendered much of the south of the island uninhabitable and required relocation of the population to the north of the island. Damage and disruption to businesses, and depopulation – particularly of working age islanders – has severely affected the economy and required ongoing funding of the budget deficit (Appendix 3.7 refers).	£250m since 1995 plus ongoing UK programme funding of £15 million per year.
British Indian Ocean Territory	**Legal case:** In May 2007, the Court of Appeal held that 2004 Orders in Council preventing the unauthorised entry or settlement of the British Indian Ocean Territory should be partially struck down in relation to the Chagos Islanders. The Government is appealing against the decision. An independent study in 2002 into the feasibility of resettlement, concluded that resettlement of the islands on anything other than a short-term and purely subsistence basis would be highly precarious and would involve expensive underwriting by the British Government for an open-ended period, and probably permanently. Since the Islands are low-lying, any community would be vulnerable, particularly to flooding.	Legal costs to date, £600,000. The 2002 study estimated resettlement costs would be in the order of £40 million over ten years.
Pitcairn Island	**Decline of economic base:** A decline in stamp sales (the main source of government revenue) has pushed Pitcairn Island into budgetary aid.	Over £1million per year
South Georgia	**Environmental obligations:** Significant quantities of asbestos and other pollutants remain in disused industrial buildings in South Georgia. The main tourist port has been cleared at the cost of reducing local government reserves to £2 million, equivalent to a half year's expenditure. (The issue is examined in more detail in Appendix 3.9.)	£20 million – £30 million
Falkland Islands	**International Treaty obligations:** The UK accepted, through becoming party to the 1997 Ottawa Convention on Landmines, responsibility to remove all mines on its territory by 2009. In practice the estimated 15,000-20,000 mines remaining on the Falklands since the 1982 conflict represent minimal actual risk. (This issue is examined in more detail in Appendix 3.5.)	Actual costs would be subject to tender, but could be expected to be "many millions" of pounds.
All Territories	**International Treaty obligations.** In 2000, the International Civil Aviation Organisation censured the UK for not maintaining adequate standards of aviation safety within its Overseas Territories. Since then the Department for Transport has funded enhanced regulatory mechanisms (Paragraphs 1.39 to 1.41 refer.)	Risk mitigation machinery costing £3 million each year since 2003.
St Helena	**Legal case:** If a Territory is in budgetary aid, any unexpected expenditure can fall to the UK. Since 2004 the Department has provided funding for a murder trial on St Helena, which could not be met from the Islands own resources.	£300k
Tristan da Cunha	**Repair of essential infrastructure:** The harbour in Tristan da Cunha is the sole means of access for people and supplies to the Island. Damage to the harbour, and an inability to complete construction to the desired specification due to financial constraints, has left the harbour in danger of collapse. If the harbour becomes unusable, the UK could face obligations for emergency supplies or evacuation from the Island.	Repair and cost of evacuation plus £1.75m liability for aid.

Source: National Audit Office

NOTE

1 National Audit Office Gibraltar Pensions HC 227 February 1990, and Contingent Liabilities HC 13 May 1997.

2.4 The Department finds it difficult to train Governors or other officials taking up posts in the Overseas Territories, given the small numbers due to take up post at any one time. There is generic guidance, and general briefing by a retired Governor, though this cannot reflect the particular features and peculiarities of individual Territories. Incoming Governors are free to decide on their further training needs, usually based on recommendations from outgoing Governors, for example attending disaster management courses. Several Governors and other officials based in Territories reported feeling relatively unprepared when they took up post, noting initial learning curves with varying degrees of steepness according to the relevance of their prior experience.

2.5 Managing staff continuity and maximising the level of prior experience is also a challenge in London, where Foreign and Commonwealth Office Desk Officers for the Territories tend to remain in post for 18 months to two years, reflecting general practice within the Department as a whole, and to an extent, across Whitehall. The exception to this is Legal Advisers who have advised the Department for several years and who provide some continuity. As at May 2006, of the 30 staff within the Overseas Territories team, six had prior experience with the Territories, including three who had served in a Territory in some capacity. The team has had five heads in ten years. Although Department staff are familiar with a system of rapid rotation, the resulting lack of continuity and loss of Territory-specific knowledge has been a concern for some stakeholders. Rapid staff turnover makes good succession planning all the more important in ensuring that valuable knowledge is not lost. The impact is partly addressed in the Department through handover notes and document registers.

There is scope for deeper involvement in the Overseas Territories from other UK government departments

2.6 While the FCO is the lead policy Department and DFID is responsible for Territories receiving development assistance, active participation from other UK government departments is important to fully discharge the UK's responsibilities.[31] Currently there is limited involvement in Territory-related issues in many government departments; along with the Foreign and Commonwealth Office and DFID, only the Ministry of Defence and the Department for Transport commit expenditure to operations in the Territories on a recurrent basis.[32] Other government departments also have a duty to consider the Territories when planning and preparing legislation. When legislation is expected to apply in the Territories, local governments and law officers should be consulted through the Foreign and Commonwealth Office. The main challenges encountered in this area are allowing Territories sufficient time to comment on proposed legislation, and ensuring that the Territories have sufficient legislative and administrative capacity to implement new laws designed primarily with much larger communities in mind.

2.7 The involvement of other UK government departments brings real benefits to the Territories, and can help the UK to protect itself against potential liabilities. For example, the Ministry of Defence has an established role in ensuring the defence and security of the Territories, and the Department for Transport has played a key role in improving the regulation of transport safety and security in the Territories (paragraphs 1.37 to 1.43). The Foreign and Commonwealth Office aims to increase wider Whitehall involvement through liaison with other departments to provide advice in specialist areas (see also paragraph 2.15) and has written annually to departments at ministerial and senior official levels in recent years to reiterate their responsibilities. Seconded staff from UK government departments could also be a valuable asset in helping build capacity in the Territories, provide expertise, advice and training. In 2007, for the first time, there was a multi-departmental exercise in which representatives of eight UK departments rehearsed their co-ordinated response to a disaster in a Territory.

Limited UK resources are available to manage the risks

2.8 In 2005-06 the Department and DFID spent some £43 million on work for the Overseas Territories, **(Figure 12)**. Over half of this spend is directed through DFID to cover budget deficits and development assistance in Montserrat, Pitcairn and St Helena.

While the FCO has the lead responsibility, DFID provides most funding

2.9 The Foreign and Commonwealth Office leads on overall policy for the Territories, while DFID takes a lead in economic development. In practice this means that DFID's efforts are focused on Montserrat, St Helena and Pitcairn Island. Though it has a major interest in any Territory which may require financial support, such as Tristan da Cunha, DFID has no permanent presence on Territories other than Montserrat and St Helena. It is not as active in the other Territories due to resource limitations, and the Foreign and Commonwealth Office monitors financial and economic risks to the UK in these. In practice though, DFID is normally approached if major liabilities to the UK emerge in any Territory, since the Foreign and Commonwealth Office has more limited financial resources.

2.10 Both DFID and the Foreign and Commonwealth Office maintain Overseas Territory teams, and each retains specialist advisers, both in London and in the Territories (see Figure 2). The Department's Legal Advisers also advise DFID on Territory legal issues where appropriate. The teams complement each other rather than overlap; where they have similar skills they work together, for example in conducting joint assessments of disaster management capability. There is scope to pool resources still further, for example by deploying DFID's good governance expertise more widely outside Montserrat and St Helena.

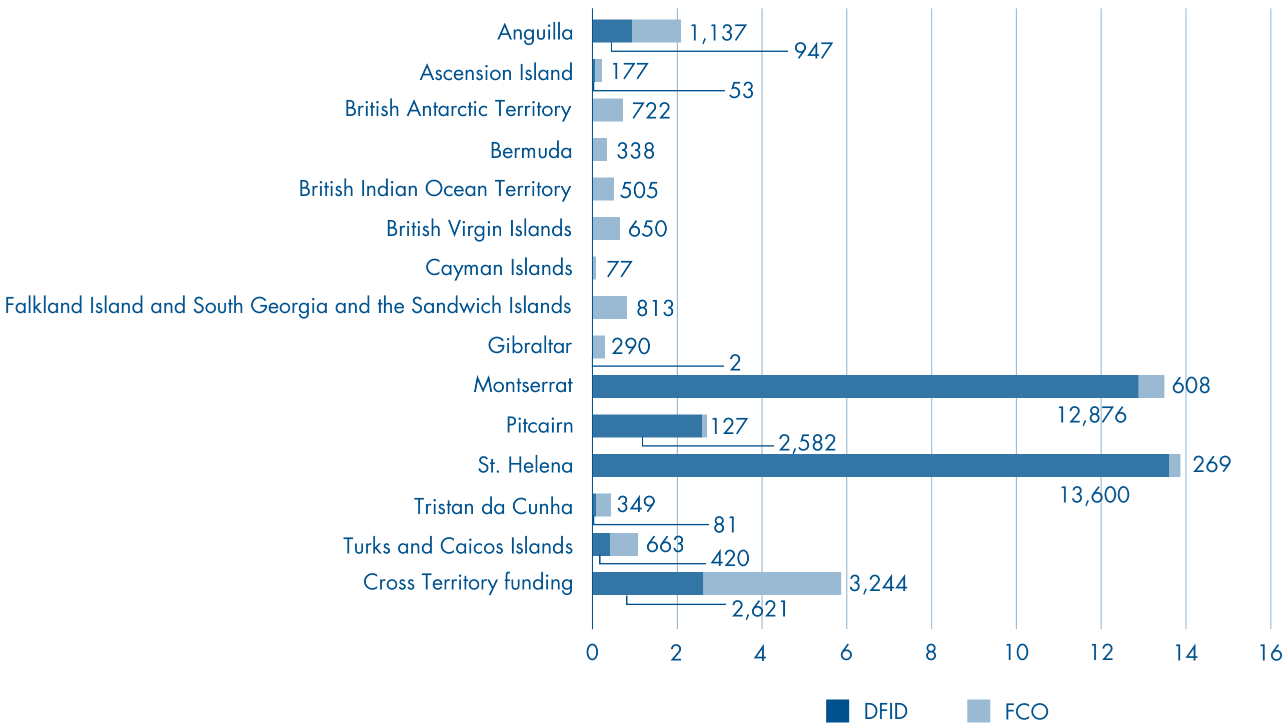
2.11 The possibility of transferring DFID's responsibilities to the FCO was considered as part of a review by the International Development Committee as early as 1997. The Committee considered the UK's responsibilities to citizens of the Overseas Territories to be of "a greater and different order to our more general humanitarian responsibilities to the developing world and involve different priorities". Territories are also a specific exception to DFID's poverty reduction remit due to the UK's specific obligations towards them under the International Development Act 2002. The Committee concluded that responsibilities and resources should go together, and that the FCO was the most appropriate Department to take this forward. But the Foreign and Commonwealth Office felt that their smaller provision for programme funding would not cope with any unexpected peak in the demand for funding, as occurred after the Montserrat volcanic eruption.

DFID assistance aims to help Territories achieve self sufficiency

2.12 Government policy is that the "reasonable assistance needs" of the Overseas Territories are the first call on the UK aid programme, though this is qualified in practice. DFID's 90:10 target prescribes that a maximum of 10 per cent of DFID's bilateral aid can to go to countries classed as "middle income", (the remaining 90 per cent going to low income countries). This means that the budget allocation to the Territories competes with resources allocated to other priority middle income countries (such as Iraq).

12 Allocation of resources across the Overseas Territories 2005-06 £000[1]

HMG Expenditure on the Territories 2005-06 (000s)



Source: National Audit Office

NOTE

1 Resources include all monies spent by the two Departments on Territory issues, including DFID bilateral aid, Programme Funding, and staff and admin costs in the UK and the Territories.

2.13 For all aided Territories, DFID's objective is to assist the Territory in reaching self sufficiency. Financial resource allocation focuses on this objective and supports the Territories' own budget processes. The aid available to the Territories is primarily to meet the budget deficits of St Helena and Montserrat. Any remaining resources are available for development projects such as providing infrastructure or generating additional income, however, as Territory public service costs rise, meeting the budgetary deficit leaves little left for such development projects. DFID-wide budget constraints contributed to the ending of aid to the middle-income Territories of Anguilla and the Turks and Caicos Islands in 2005; prematurely in the view of Anguillan Government officials. Another constraint has been that, historically, the UK has often recovered unspent funds when budget deficits are less than expected, giving Territories few incentives to reduce their costs or generate additional income. However, a new proposal in March 2007 sets out the basis for a new agreement between DFID and the St Helena Government. This would allow St Helena to retain and reallocate budgetary savings made through efficiencies or by increasing revenue. Conversely, overspends would be met by the St Helena Government through savings or reprioritisation. A further constraint to the allocation of additional financial resources is the limited capacity in Territories to absorb aid. Provision of resources needs to be matched with Territories' capacity to programme efficiently.

2.14 Funding constraints within DFID also present challenges when unexpected expenditure demands have to be met, for example to repair essential infrastructure. This has led to short term solutions which have not always presented good value for money. Tristan da Cunha's harbour (and sole means of access and supply route) was not completed to its original specification after the project exceeded the budget and timescale allocated by the Overseas Development Administration (as was). A 1998 DFID study estimated that the cost of restoration was between £2-4 million. Neither DFID nor Tristan da Cunha were able to fund the full cost of the work and a temporary solution was found. The partial refurbishment had the effect of worsening sea conditions in the harbour and after significant wave damage in 2004, DFID are now faced with substantial repair costs. They have also had to consider further rehabilitation of the harbour and breakwater, which addresses the previously incomplete work. Limited access to the Island is a constraint to economic activity and there now exists a potential £1.75 million liability from Tristan coming into budgetary aid.

The success of the Department's funding arrangements designed to build capacity and tackle wider priorities is unclear

2.15 The Foreign and Commonwealth Office spends some £11 million per annum on Overseas Territories work, of which just under £5 million relates to its Overseas Territories Programme Fund.[33] Aside from £1 million to meet international commitments in the Polar Regions, its aim is to promote sustainable development and build capacity. It signals a move away from UK funding of one-off equipment purchases and other capital projects towards training. It is used to demonstrate UK commitment to improvements in the Territories and helps to focus Territories on issues that would otherwise receive less local priority. The main issues needing to be addressed are that:

- Over half of bids from Territory authorities focus on crime and justice and disaster management, with few bids for good governance initiatives which are also UK priorities.
- The number of bids and projects, (118 applications and 65 approved in 2005-06), have been challenging for Governors' offices to monitor and evaluate. Data on the effectiveness of the programme is weak. In 2007 the Department appointed a regional projects officer, based in the Cayman Islands, to address this and has encouraged Territories to focus on fewer, larger projects.
- More use could be made of specialist advice from other government departments. The Department for Environment, Food and Rural Affairs has reviewed some bids for environmental projects and DFID now has a representative on the Programme Board, however the Department needs participation from across Whitehall (see paragraphs 2.6 to 2.7).

Weak governance and public accountability in Territories pose challenges for UK oversight of risk

2.16 The Foreign and Commonwealth Office is responsible for promoting good governance in the Overseas Territories, by which it means transparency of decisions by the executive and legislature in line with rules and regulations, and the accountability of government to the public and the legislature. Good governance is inherently difficult to sustain in small communities, and this weakens the UK's ability to identify potential risks. The Overseas Territories share many of the challenges faced by relatively small island communities worldwide in meeting the increasingly complex demands of modern government, for example close communities with personal or extended family relationships between officials and citizens, and small legislatures with a lack of separation of duties and membership between the executive and the elected assembly.

HMG has had some success in capacity building in the Territories, but persistent skills gaps hamper good risk management

2.17 Many Territory public service posts are important in enabling risks to be managed in-Territory. For example, Auditors General report on Territories' financial statements, and Attorneys General have a duty to ensure that Territory legislation is up to date and is meeting international requirements. It is in the UK's interest to ensure that posts are filled by suitably qualified personnel and the Department and DFID provide seed funding for training and other initiatives to promote good governance.[34] DFID spends a growing proportion of its funding in supporting gaps in Montserrat and St Helena's human capital, managing recruitment for key posts within their public service. However, there are difficulties in attracting suitably qualified applicants for senior permanent posts in these Territories. For example the post of Government Economist in St Helena has been vacant since 2005, and covered by temporary officers since August 2006. DFID felt that secondments from other UK Departments or local Government may provide a better solution to filling capacity gaps in Territories.

There are problems with late and deficient public accounts

2.18 Timely and accurate financial reporting allows greater transparency of Territory government finances, and promotes Ministerial accountability. It enables Territory governments, as well as the UK to make more informed decisions, and protect against fraud. Overseas Territories have difficulty producing timely, audited public accounts, (Appendix 5), and the situation appears much the same as it was ten years ago, when half of populated Territories were two years or more "behind".[35] The Auditor General of Bermuda reported in 2006 that though in this Territory, central government departments were up to date, other public bodies had not produced accounts since 2002 and 2003. Most serious were delays in the public pension and insurance funds which controlled assets of some $1 billion. In the Cayman Islands, a legitimate initiative to implement modern resource accounting has overstretched local capacity, and this, combined with the after-effects of Hurricane Ivan, has severely affected the timely delivery of accounts.

Public audit systems do not all constitute an adequate challenge function

2.19 Though there are examples of good practice in most Territories, a capable external audit function is not seen as a priority by all Territory governments. A common factor, found in most Territories, is an acute shortage of capability in bookkeeping and basic accounting skills, coupled with inertia or complacency on the part of responsible officials. The Acting Auditor General of the British Virgin Islands estimates her staffing levels are one third below complement; the accounts for 2006 were still being audited at the time of our report. The audited financial statements and audit reports for 2004 had not been laid before the Assembly by the Government.[36] The Falkland Islands and Anguilla have their accounts audited by external agencies.

2.20 In small communities, auditors are more directly exposed to pressures from auditees and local interests. Some audit offices express concerns with preserving their independence. The Auditor General of Bermuda has described it as a fragile privilege, not ensured by legislation alone. In 2006, constitutional changes in the Turks and Caicos Islands devolved public sector appointments to a new Public Service Commission. The Audit Office there has expressed concern with the candidates imposed on it through these arrangements.[37] None, except the Chief Auditor, are qualified in accountancy. In other Territories, the appointment of staff is expressly delegated to the Auditor General by local public service commissions.

2.21 Under half of Territory Audit bodies currently sustain a programme of work to review and report publicly on value for money in the public sector. Good practice in Gibraltar and Cayman Islands show that it is possible for small audit teams in relatively small communities to deliver several substantive reports each year on aspects of government services and activities. But such activity is patchy across the Territories. In Montserrat and St Helena, auditors have started to perform individual value for money reviews, but have struggled to develop, from a low base, the necessary methodologies and skills to deliver high quality products.

Parliamentary scrutiny appears weak in most Territories

2.22 Most Territories' Constitutions reflect the Westminster model of Parliamentary scrutiny, including the key role of a Committee of Public Accounts. But in practice Territories cannot always apply the model effectively in their own very different and diverse local contexts. Formal scrutiny is generally infrequent and much less comprehensive than in the UK (Appendix 5). The main limiting factors are that:

- Most legislatures are too small to provide enough "back-bench" members to staff scrutiny committees, besides the essential Ministerial posts. Options to overcome this problem are rare. One example of good practice is Montserrat's use of an ex officio member on the Public Accounts Committee, drawn from outside the legislature to provide financial management experience. Use of ex officio members is increasingly being considered in local government in the UK.
- Members of Committees drawn from governing parties can be concerned not to appear disloyal to their government, which can prevent the achievement of Committee quora and the production of agreed reports. Politicisation of Committee proceedings is often perceived where Public Accounts Committees are chaired by Leaders of the Opposition, or where politically sensitive topics are chosen, and where the distinction between ministerial policy and administration by officials is blurred or not well understood.
- Expertise and awareness of how to conduct Scrutiny Committee proceedings can be low. Two Auditor Generals cited to us the experience of taking on questioning at a Public Accounts Committee session themselves, when the hearing had lost momentum.
- Not all Territories have a Committee of Public Accounts or similar scrutiny body, and some that do meet only in private.

Existing methods for identifying and evaluating risk to the UK do not inform best use of limited resources

2.23 As Part 1 highlights, the Overseas Territories face a diverse range of risks. However formal risk management techniques, including grading risks for probability and impact, and allocating them to agencies or individuals to manage, are not yet widely understood and applied in the Territories. There are currently no structured mechanisms for UK Departments and Territory governments to jointly assess the impact and likelihood of risks, both within and between Territories. In 2005 the Department compiled a list of contingent liabilities to the UK, but has not repeated this exercise subsequently. And in 2006 it collated the views of Governors on "Strengths, Weaknesses, Opportunities and Threats" in each Territory. We conducted a more comprehensive survey of Governors and governments to provide a systematic overview of risk, the probability of occurrence and likely impact.[38] The main points to emerge were:

- The nature and severity of the identified risks varies from Territory to Territory. While few risk areas are rated as "red" or "amber", this obscures differences between the Territories. For example, between them, Montserrat and the Turks and Caicos Islands have three red risks and seven amber risks existing after mitigation measures have been applied.
- Despite their differences in size, geographic location and economic position, the Territory Governor returns had many risks in common. The risks most often cited and given high impact and likelihood scores were; natural disasters such as hurricanes and earthquakes; population movements (large-scale immigration or emigration); mass casualty incidents involving a plane or cruise ship; inadequate regulations in the financial services industry or transport sector; and downturn in a key industry, such as tourism.
- Even where risks are rated as having a medium to low likelihood or impact, many Governors and government returns stated that their Territory would be likely to require some form of UK support, either in mitigating against the risk, or in responding should it occur. The need most often cited was for UK personnel and other technical assistance, though any incident with a severe impact, for example a hurricane or decline of a major industry, could require considerable and sustained UK financial aid.
- Where completed government surveys were received, there was some limited consensus between Governors and Territory governments over the risks which were seen as posing the greatest threat to their Territories. For example, both Governor and government surveys identified the continued dependency on UK aid as a key risk to Montserrat. However in half of the Territories returning both Governor and government surveys, the top three risks according to the Governor and the government had no commonalities.

2.24 There are nevertheless, emergent examples of good practice in risk management. The governments in Bermuda and Cayman Islands are collating their risks in a risk register, based on contributions from a range of government departments and agencies. The UK Department for Transport, in conjunction with the Department, is piloting MATRA, a tool to assess and manage security risks in ports and airports in the Turks and Caicos Islands. Initial results in bringing agencies together in a common purpose have been promising.[39]

Further resources

The following additional information is available on the National Audit Office website at http://www.nao.org.uk/publications/index.htm under "Managing Risk in the Overseas Territories".

Annex A: National Audit Office Methodology.

Annex B: The UK's main levers and powers in Territories.

Annex C: Foreign and Commonwealth Office and DFID Funding in Territories.

Annex D: National Audit Office Survey of risk.

APPENDIX ONE

Detailed recommendations

Current Position	Expanded Recommendations	Benefit
Only a minority of UK Departments have significant involvement in the Overseas Territories, despite these being a UK-wide responsibility.	**Other UK government departments should be required to set out their arrangements for dealing with Overseas Territory issues and to nominate a clear contact point to ensure that these responsibilities are being addressed.** ■ All Departments need to ensure that they consult with the Foreign and Commonwealth Office and the Territories at the earliest possible stage of extending legislation to the Territories. ■ All Departments need to ensure that, where relevant, their legislation and programmes are developed and delivered with the practicalities of their application in the Territories in mind. ■ Departments should be responsive in providing specialist advice and other input into FCO and DFID development projects in Territories, where necessary.	As the Department for Transport has shown, Home Departments have a valuable part to play in ensuring that the UK meets its responsibilities for the Territories and minimises risk. To ensure that the application of law to the Territories takes account of their different contexts, and limited capabilities to implement complex legislation.
The UK and Territory Governments have no common framework for identifying, evaluating and monitoring risk, although in practice share risk should serious adverse events occur.	**Governors should encourage and participate in modern risk management practices, taking the lead from Territories such as Bermuda and the Cayman Islands.** ■ Maintain joint risk registers which assess the risks to the Territory and clarify the ways in which the UK can work with Territories to mitigate them ■ Ensure that key risks are assigned to suitably responsible bodies or individuals ■ Consider rolling out the system for assessing and managing risk in transport security across the Territories, and extending it to wider threats to the Territory	Risks are best managed where both key stakeholders understand the issues and mitigate them through partnership, transparency, dialogue and cooperation. Generally accepted rules for the efficient allocation of risks between parties usually incorporate two main principles: ■ Which party is best placed to influence the occurrence of the risk; ■ Which party would incur the consequences of the risk should it transpire, and is therefore best incentivised to prepare and mitigate. In practice, determination is complicated due to "moral hazard", the possibility that the party best placed to prepare will not in fact do so, expecting that the other party would meet any future costs of rectification or restoration. Clearly the balance will vary between Territories according to their circumstances. But our overall conclusion is that in populated Territories, most risks are inherently shared between the local community and the UK.

Current Position	Expanded Recommendations	Benefit
Capacity limitations in the offshore financial sector have limited Territories' ability to investigate suspicious activity reports, and, in the case of the Turks and Caicos Islands, Anguilla and Montserrat, resources are below the critical mass necessary to keep up with increasingly sophisticated international standards and products in offshore financial services.	**The Department, with the support of relevant UK agencies, *(Treasury, Financial Services Authority, Serious Organised Crime Agency)* should develop a strategy to:** ■ Ensure stronger investigative and prosecution capacity in the seven Territories with offshore financial sectors; ■ bolster regulatory standards in the three Territories with smaller offshore financial centres or to constrain the range of financial services licensed there; ■ support increased legislative drafting capacity to assist in updating financial services legislation, primarily in the Territories where regulation is a direct Governor responsibility.	Continuing with the status quo involves significant risk. Offshore financial services are the most significant contributor to the economy of four Territories, and are significant secondary industries in Anguilla and the Turks and Caicos Islands. Damage to this sector, either through negative reputation or regulatory failure, could lead to increased UK liabilities.
The UK Department for Transport directed the Civil Aviation Authority to set up Air Safety Support International in 2002 to restore safety standards in the Territories, on the understanding that it would have a finite life. Some Territories have built up their own capability to regulate aviation safety, but others have not and rely instead on regulation free of charge by the UK.	**The Department for Transport should move to full cost recovery where it is regulating aviation safety on behalf of Territories, within five years.** ■ The UK will have a lasting responsibility to ensure that regulation in its Territories is adequate. This quality assurance role is rightly paid for by the UK, but it does not follow that the UK should also provide regulation free of charge on an indefinite basis. ■ The Foreign and Commonwealth Office should encourage Territory governments to fund regulation on the "consumer pays" principle long adopted in the UK, through modern charging schemes levied on the Industry. Territories dependent on UK budgetary aid may be exempted from this requirement. ■ The Foreign and Commonwealth Office, and the Department for Transport, should consider how to further enhance Territories' compliance with international standards, such as by providing a rolling, centrally-updated register of transport regulations and conventions, accessible by all Territories.	The UK Department for Transport has met its responsibility for the Overseas Territories by committing substantial expertise and resources to enhance maritime and aviation safety and security. Moving towards full cost recovery is timely and will promote self-sufficiency among the Territories.
Key UK responsibilities in the Territories, such as for internal security and the police and prisons, depend on funding from local governments, which is not always sufficient.	**Governors need to consider use of the following strategies, according to local circumstances:** ■ Measures to strengthen local ownership and participation in policing matters, such as establishment of a police authority chaired by the Governor; ■ More recourse to objective and independent assessment of Territory police forces' effectiveness and efficiency, possibly through HM Inspectorate of Constabulary; ■ As a last resort in cases of consistent failure, and where needs are urgent, use of Governors' reserve constitutional powers to require funding.	To enable Governors to make stronger, well evidenced cases for appropriate funding of Police and prison services, to reduce risks to Territory security.

Current Position	Expanded Recommendations	Benefit
The majority of the UK aid programme to the Territories goes on meeting the recurring budgetary deficits in Montserrat, St Helena and Pitcairn. Little is left available to invest in new infrastructure or other development projects, which has retarded the pace of growth in these Territories.	**DFID should roll out its revised mechanisms to meet budgetary deficits in St Helena, Montserrat and Pitcairn so as to enable Territories to have a greater stake in savings through prudent fiscal management,** to be invested as per a plan agreed between DFID and the Territory. **DFID should also provide greater flexibility for development project funding** to enable DFID to meet short term peaks in demand, for example to repair essential infrastructure, and prevent problems intensifying at cost to the UK. The new approach has been agreed in principal, but DFID should use the initial three year agreement with St Helena to monitor how the revised funding structure translates into changes in the behaviour of Territory governments.	The primary aim of budgetary support to the Territories is to promote graduation from aid. To incentivise the local administrations in St Helena, Montserrat and Pitcairn to maximise their income and minimise their expenditure. To ensure value for money by tackling urgent development projects as soon as possible, before the problem intensifies.
Core diplomatic service skills, including prior experience in developing countries, can have considerable value in Overseas Territories. But the work also poses additional high-level administrative challenges and responsibilities for public services and for the Civil Service.	**The Department needs to develop Territory administration and governance as a distinct specialism and career path;** ■ including greater continuity of staff in the role, and further recruitment of relevant expertise from outside the diplomatic service, such as UK local government; ■ the Department should take a more programmed approach to the training of staff, including a minimum four weeks work shadowing, before they are deployed in Territory, and ensure that staff get specialist training where required e.g. in disaster management.	Recruitment and utilisation of a wider base of relevant expertise, to enable more informed management of risk and increased added value in dealing with Territory governments.
Currently the Foreign and Commonwealth Office and DFID each maintain separate teams, totalling some 60 staff, with responsibility for the Overseas Territories. In practice, the DFID team has had limited involvement outside St Helena, Pitcairn and Montserrat.	We considered the case for combining the FCO and DFID teams in a single entity to ensure that limited resources are used to best effect. But since a combined team would still need access to FCO constitutional powers, and to DFID's greater financial resources, it could not sit exclusively in either Department. **We recommend instead additional pooling of resources at working level, with a further extension of joint working and use of mixed teams deployed flexibly to meet needs across the Territories.**	

Current Position	Expanded Recommendations	Benefit
Accountability and audit in the Territories tends to lag behind UK standards due to capacity limitations and a lack of suitably experienced local participants.	Public Accounts Committees in many Territories struggle to provide effective, apolitical, and timely scrutiny of the executive. **The Department and DFID should promote the appointment of Ex Officio members with relevant skills, as in UK local government and in Montserrat.** The Department could also consider; ■ how it may assist in meeting the training needs of scrutiny committee members; ■ whether needs of the Caribbean Territories' Public Accountability function could be met through membership of a regional, rotating pool of expertise; ■ more active promotion of the governance objective for deploying its Overseas Territories Programme Funding, making greater use of the governance expertise within DFID; ■ further measures to assess compliance with borrowing guidelines when Territory accounts are late or qualified, or when Territories expand into new areas of financing, for example PFI; ■ use of the World Bank's PEFA framework, using criteria directly comparable with those used to assess developing countries, to benchmark public accountability in the Territories.	UK resources cannot be expected to exact sufficient scrutiny over all aspects of Territory Government finances. By assisting local scrutiny mechanisms to be more effective, the UK can maximise its ability to identify and manage risk.
While the nature of the challenges faced by Governors and government officials can vary between the Territories, there are opportunities for greater sharing of information and good practice.	**The UK should promote and facilitate greater linkages between the Territories in order to make the best use of Territories limited resources and build capacity.** Opportunities include; ■ greater use of cross-Territory training and conferences in the regulation of offshore financial services; ■ more sharing of good practice in developing and testing disaster management plans, for example through a web forum and peer review of disaster plans; ■ regional training for law enforcement agencies. Support for short term secondments and personnel exchange through the Overseas Territories Programme Fund.	Extending the benefits of the Inter-Territory cooperation seen in some areas, for example Caribbean law and order conferences, will promote sharing of good practice, and the efficient use of UK resources, for example where these are used for training.
The Foreign and Commonwealth Office's initiatives have tended to focus on the Caribbean Territories.	**The Department should identify its risk mitigation priorities for the non-Caribbean Territories and link them into the wider Overseas Territory network, currently focused on the Caribbean.**	While non-Caribbean Territories do not face the same degree of risk, for example in their exposure to natural disasters, most are smaller, more isolated communities, requiring economic diversification, and two of which are reliant on UK financial aid.

APPENDIX TWO

Key characteristics of the United Kingdom's Overseas Territories

Territory	Population	GDP per Head[1]	Key Developments since the last NAO report in 1997-98
Bermuda	63,571	$76,403 (£42.636)	GDP has risen to the highest in the world. *[UK GDP per head in 2005 was $30,300]*, though some parts of the population remain economically disadvantaged.
Cayman Islands	48,353	$48,704 (£27,179)	Rapid economic growth. Badly hit by Hurricane Ivan in 2004 but has shown resilience in recovery.
Turks and Caicos Islands	30,602	$15,683 (£8,752)	Rapid economic growth based mainly on property development on Providenciales Island. The Islands have received many Haitians fleeing economic and civil disorder. Experienced fluctuations in US tourism post "9/11".
Gibraltar	28,779	$36,756 (£20,511)	Continued reduction in UK military presence, and enhancement of the private sector economy; with financial services, tourism and shipping now each contributing about a third of activity. A tripartite agreement with Spain and the UK in 2006 led to a further easing of border restrictions and greater cross-border activity.
British Virgin Islands	27,000	$38,000 (£21,205)	Rapid economic growth, mainly in niche financial services such as Offshore Companies. Economy closely tied to adjacent US Virgin Islands.
Anguilla	13,638	$9,711 (£5,419)	Rapid economic growth, mainly in high-end tourism. Government has imposed a moratorium on new tourism development to avoid "overheating". DFID funding has substantially withdrawn since 2003.
St Helena (inc. Tristan, Ascension)	5,326	St Helena - $5,622 (£3,137)	**St Helena**: Continued dependency on the UK. DFID initiated a major project for an airport in 2005, to open in 2012. Tendering is in progress and estimated costs are confidential. **Ascension**: In 2005 the Department halted moves towards granting permanent rights of abode on the Island for contract workers. Public and private agencies that provide all employment on the Island had refused to accept liability for the future cost of social infrastructure to support a settled population.
Montserrat	4,785	$7,696 (£4,295)	Continued dependency on the UK. The volcano remains active, and work continues to provide facilities in the "safe" north of the Island. After the volcanic eruption, the population declined from 11,000 to some 3,000, but has since recovered to 5,000.
Falklands	2,955	$46,124 (£25,350)	Economic growth, mainly from fishing licences, has made the island self-financing other than for defence. Fluctuation in fishing stocks and yields has been a growing problem over the period. Exploration for oil has continued but commercially viable reserves are still to be confirmed. Tourism, mainly from cruise-ships, has increased rapidly and steep growth is expected to continue.

Governance	Areas of Governor responsibility
Large measure of internal self-government. Most executive powers have been devolved to the head of Government.	The Governor retains few direct powers other than for internal and external security.
Large measure of internal self-government. There is no Chief Minister; instead there is a Leader of Government Business.	Civil service, defence, external affairs and security.
Governor chairs Cabinet, selected by Premier from majority party in mainly-elected 19-strong Legislature. Attorney General is also a member of Cabinet and the House of Assembly.	External affairs, regulation of offshore finance, defence and internal security (including the police force) and the public service.
Council of Ministers is appointed from among the 17 elected members of the Parliament by the Governor on the advice of the chief minister – normally leader of majority party.	Reduced under a new Constitution in early 2007. Direct Governor responsibilities are now external affairs; defence; internal security including some aspects of policing; and some public service matters.
Large measure of internal self-government. Governor chairs Cabinet. Government drawn from majority party in elected 13-strong House of Assembly plus the Attorney General and the Speaker.	External affairs, defence and internal security (including the police force) and the public service.
Large measure of internal self-government. Governor appoints and chairs Executive Council, drawn from the majority party in the mainly-elected 11-strong Assembly.	External affairs, regulation of offshore finance, defence and internal security (including the police force) and the public service.
Governor appoints and chairs St Helena's Executive Council, composed of the Governor, three ex-officio officers and five elected members of the Legislative Council. There is a Unicameral Legislative assembly of 15 members. On Ascension Island, most Councillors have resigned in protest at the UK's decision not to grant a right of abode.	External affairs, defence, internal security (including the police force), the public service, shipping and finance. Liaison with DFID on development aid and budget support.
Governor appoints and chairs Executive Council, drawn from majority party in elected 9-strong Assembly.	External affairs, regulation of offshore finance, defence and internal security (including the police force) and the public service. Liaison with DFID on development aid and budget support.
Executive Council comprises three members elected by an elected eight member Legislative Council, two ex officio members (chief executive and the financial secretary), and the Governor. In addition, the Attorney General and the Commander of the British Forces in the Falkland Islands attend by invitation. No political parties.	Not specifically defined in the Constitution as in other Territories. In practice, external affairs and aspects of internal security (including the police force), and senior appointments in the public service. Liaison with Commander British Forces on defence.

Territory	Population	GDP per Head[1]	Key Developments since the last NAO report in 1997-98
Pitcairn	45	$3,385 (£1,889)	As a result of the continued downturn in postage stamp sales, Pitcairn's financial reserves were exhausted in October 2004. They applied for, and have been in receipt of since, DFID budgetary aid. The long-running sexual abuses trial process was concluded in late 2006, and five Pitcairn residents were imprisoned in early 2007.
British Indian Ocean Territory	c. 4,000 military personnel	N/A	Diego Garcia continues as a military base of strategic importance. Successive court rulings and orders in council have disputed the right of displaced Chagossian natives to return to the Territory.
British Antarctic Territory	200 staff	N/A	The UK operates two year-round research stations, and is one of seven 1959 Antarctic Treaty signatories that claim portions of Antarctica as national territory.
South Georgia and South Sandwich	11–26 staff	N/A	The military garrison on South Georgia withdrew in March 2001, replaced by a permanent group of scientists of the British Antarctic Survey. Tourism from specialized cruise ships is increasing rapidly. Income from this source and from fishing licences is devoted to conservation of the natural environment and resources.

NOTE

1 Figures are Overseas Territories' best estimate of GDP per capita for 2005 (2004 for the Falkland Islands). Sterling/US Dollar exchange rate is at 1 July of the relevant year.

Governance	Areas of Governor responsibility
The Governor is the British High Commissioner based in New Zealand, who works through a locally based FCO representative on Pitcairn and is assisted by the Pitcairn Island Administration Office in Auckland, headed by the Commissioner for Pitcairn. Ten-strong elected Island Council	
No settled population. A Commissioner runs the Territory. Series of UK/US Agreements regulate matters relating to the use of the Territory for defence purposes, such as jurisdiction over US military and other personnel.	N/A
No settled population. A Commissioner (the Head of the Department's Overseas Territories Team) runs the Territory.	N/A
No settled population. The South Sandwich Islands are uninhabited.	Administered from the Falkland Islands by a Commissioner, who is concurrently Governor of the Falkland Islands.

APPENDIX THREE

Territory issues

This appendix provides an overview of the range of the risk issues being faced across the Territories as a whole. As such it is not intended to give comprehensive coverage of each of the 14 Territories.

3.1 Anguilla

Population:13,638

GDP: $132.4 million

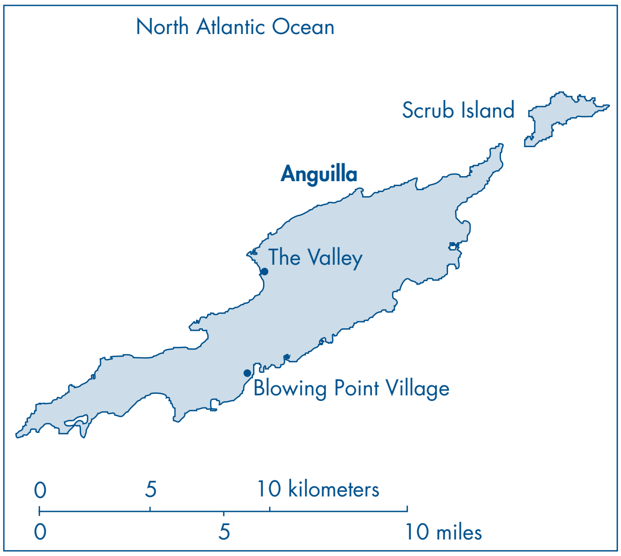
GDP per head: $9,711

Key Industries: Tourism, financial services

Land Area: 102sq km

Government Receipts 2005: $126.6m

Government Expenditure 2005: $108.6m



Key areas of risk identified by

Governor	✘
Government	✘
NAO	✔

1) Financial Services

Anguilla's financial services industry contributes some 15 per cent of GDP, making it the second, albeit minor sector in Anguilla's economy, after tourism. Regulation of the industry remains the direct responsibility of the Governor under the Constitution, and so any failure could have direct implications as well as wider reputational impact on the UK. The financial services sector is small compared to that in Bermuda, Cayman Islands and the British Virgin Islands; it employs some 200 people and its licence fees are insufficient to finance substantial regulatory capacity. Currently, Anguilla has only four professional regulatory staff, which limits its ability to keep up to date with fast moving international standards and implementing recommendations from previous Reviews of the Sector. For example:

- Recommendations made by UK-appointed consultants in 2000 in respect of companies and credit union legislation have not been implemented.
- Anguilla has not created a separate agency to market its financial services overseas, freeing the regulator from involvement in this potentially conflicting activity.
- An International Monetary Fund Report in 2003 referred to the need to broaden the professional and managerial capacity of the Anguilla Commission, and to the absence of sufficient skilled persons to analyse and investigate suspicious transaction reports.

- There are doubts over the extent of compliance with "know your customer" requirements. The International Monetary Fund's 2003 review of Anguilla identified difficulties obtaining customer information from overseas sub agents and recommended a tightening of procedures. When the Anguillan Regulator conducted on-site checks in 2004 most agents did not have copies of the code of practice issued by the professional association, and there were numerous instances of deficient or incomplete documentation.
- The Anguillan regulator's policy towards non-compliance in anti-money-laundering practice has been to encourage raised standards through education, rather than to apply sanctions on the most deficient agents. It is not evident that this has been a successful strategy. Police and Industry sources in Anguilla expressed the view to us that there are still a minority of financial service providers in the Territory which they believed would accept "any business".

NAO Conclusion: The Department, supported by other UK Departments, needs an integrated approach to addressing regulatory under-capacity in Anguilla, the Turks and Caicos Islands, and Montserrat. Options that can be considered include developing a shared regulatory resource across the three Territories, use of Governors' powers to raise regulators' licence income, and more placements of staff from the UK, focusing on industry compliance with anti-money laundering measures.

2) Law and Order

Anguilla is heavily dependent on tourism. Real or perceived increases in crime can have negative effects on the tourist industry, which trades on Anguilla's reputation as an upmarket, low crime destination. In late 2006 and 2007, a spate of property offences and robberies caused concern among the expatriate community and nationals. While a number of offences were attributed to one man, some 186 crimes were recorded by the Royal Anguillan Police Force in the first three months of 2007 and led to the Chief Minister convening an emergency meeting in April 2007, establishing a Multidisciplinary Committee on Crime and pledging to increase the number of police officers to 100. Some 20 new recruits are now in training but recruitment remains a major problem.

Anguilla's Prison was built in 1996 with UK funding. However, it currently fails to meet minimum standards of security and segregation. A serious assault led to the death of a remand prisoner in 2006. The prison's town centre location and its basic perimeter fence enables contraband goods to enter the site. There have been three break outs in the last two years, with the latest, in August 2006, leading to the creation of a prison Task Force, attended by the Head of the Governor's Office, to review the security situation.

Conclusion: The main problem for the Anguillan Police and Prison service is the ongoing difficulty in recruiting and retaining staff.

In March 2006, a Drugs and Firearms Task Force was set up with joint funding by the Government of Anguilla and the Department's Overseas Territories Programme Fund. The aim was to combat a rise in drugs-related crime, including several murders, which threatened Anguilla's status as an upmarket tourist destination (from a very low base; in 2005, there were only 16 firearms offences). During its first six months of operation, the Task Force arrested over 40 people, discovered 230kg of cannabis and 22kg of cocaine. With UK support, Anguilla has introduced a number of measures to prevent firearms from being imported, including training of customs, immigration and police officers to recognise suspicious behaviour, and installing an X-ray machine to scan baggage entering Anguilla.

The UK has provided funds for a Prison Officer to be seconded from the Cayman Islands. They have been instrumental in training local prison staff, and raising standards. However, the inherent inadequacy of the prison infrastructure remains.

3.2 Bermuda

Population: 63,571

GDP: $4.9 billion

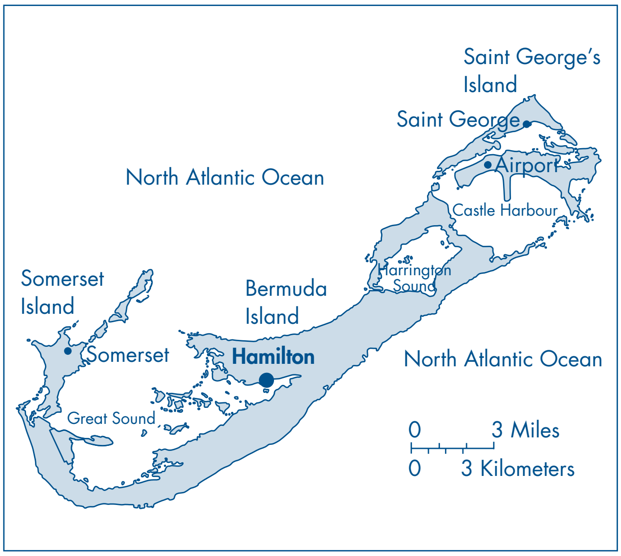
GDP per head: $76,400 = 1st in World Ranking

Key Industries: Financial Services, Tourism

Land Area: 53 sq km

Government Receipts 2005-06 $814 million

Government Expenditure 2005-06: $721 million



Key areas of risk identified by

Governor	✔
Government	✔
NAO	✔

Economic Risk

As one of the most prosperous Territories in the World, Bermuda faces mainly risks arising from its background of commercial success. Over a period of years it could become less attractive to expatriate workers and foreign companies and less competitive as a financial centre, due to the rising cost of living and doing business there. Restrictions on entry by expatriate workers, who can take a year to receive work permits, can lead to protracted vacancies in key and specialist posts, in both the public and private sectors.

NAO Conclusion: Sustained efforts will be needed to ensure that the jurisdiction maintains its positive international reputation and its competitive edge through which such notable success has been achieved, recognising that other centres are becoming increasingly attractive business locations and increasingly positioned to compete directly with Bermuda.

Hurricane or Tsunami Risk

Bermuda's exposure to natural disaster risks is amplified by a number of special factors:

- At over 600 miles from the nearest mainland, it is more isolated than Caribbean Territories, and disaster plans must assume no significant external assistance for at least the first 24 hours.
- Bermuda is extremely densely occupied and many disaster scenarios would quickly affect thousands of people.
- Bermuda's topography raises a number of vulnerabilities; for example the international airport is linked to the main island by a single causeway which has been repeatedly breached, latterly by Hurricane Fabian in 2003. Fabian was the most severe storm to hit the Islands in 50 years.
- The risk of a Tsunami, caused by lateral collapse of Cumbre Viejo volcano in Cape Verde Islands is considered to be extremely remote. Though potentially cataclysmic, impact would be lessened by the surrounding reefs and sea shelf.

Main areas of UK involvement: The Governor has played a leading role in disaster planning and in tests against a diverse range of scenarios, including natural disasters, transportation emergencies, pollution incidents and civil or terrorist events. Tests have included scenarios on key vulnerabilities, such as the airport causeway. In 2003, following Hurricane Fabian, assistance and relief supplies from the Royal Navy were declined by the government.

The Bermuda Regiment is the home defence unit of the Island, under the control of the Governor but funded by the Bermudan government, and with day-to-day management in Bermudan hands. Some 500 strong, the majority of the strength is made up of conscripts, uniquely among forces under the British Crown. As a trained and organised body, its primary role has become disaster relief, such as deployment to the Cayman Islands following Hurricane Ivan in 2004. The Cayman Island authorities have since considered how they could obtain a similar organised body for disaster relief. Though the Regiment is not part of the UK's order of battle, close links with the UK include exchanges of personnel with the Royal Anglian Regiment, and periodic Ministry of Defence inspections of the Unit's capability.

3.3 The British Virgin Islands

Population: 27,000

GDP: $1.03 billion

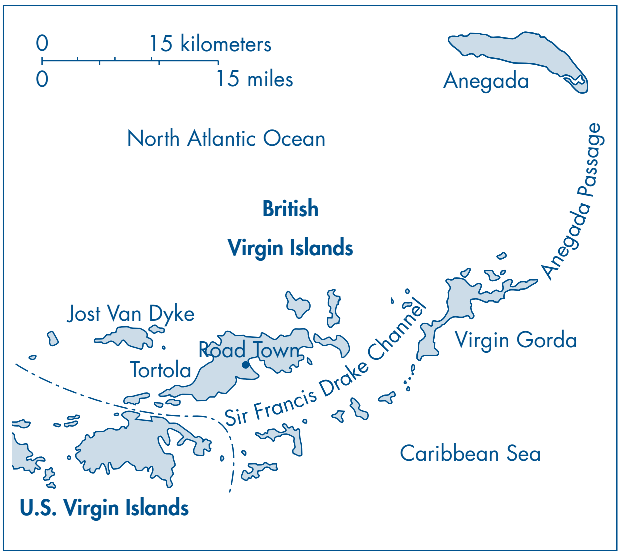
GDP per head: $38,000 = 11th in World Ranking

Key Industries: Financial Services, Tourism

Land Area: 153 sq km

Government Receipts 2006: $233 million (est)

Government Expenditure 2006: $203 million, plus capital spending $81million



Key areas of risk identified by

Governor	✔
Government	✘
NAO	✔

Vulnerability from heavy economic dependence on two key sectors: 1) Financial Services and 2) Tourism.

1) Financial Services

Over half of local government income is derived from fees for registering International Business Companies, (IBCs, known colloquially in other parts of the world as "Offshore Companies"). BVI is a world leader in this business, with over 600,000 such companies registered. Continued strong performance depends upon BVI maintaining its competitive edge through high regulatory standards and modern legislation; balancing the demands of international private finance customers against increasingly demanding international standards. The BVI authorities told us that they had assessed risks to their IBC industry from competition by rival jurisdictions, and considered them low. They considered the main risk would be any discriminatory action by international standard-setting bodies that could disadvantage BVI compared to its competitors. Since registration fees are relatively low ($350), there is little margin to support onerous regulation, such as increased obligations to maintain in BVI extensive details on the ownership, purposes and activities of the Companies.

Mitigating the key risk: In response to international pressure to comply with OECD and EU standards for sound business practices, the Government has made policy and legislative changes which have not driven business elsewhere.

NAO Conclusion: The main areas where the UK can help lies in fostering co-operation between regulators, and in ensuring that suspected financial crime is investigated, and potential crime, such as money laundering, deterred. On cooperation, the BVI's regulator of financial services felt the UK could do more in bringing regulators together to address common issues, and to ensure equal sharing of intelligence such as the UK FSA's Financial Fraud Information Network.

On financial crime, BVI is better equipped, (through its Financial Investigation Agency established in 2004), to investigate financial crime than other UK Overseas Territories we visited. But here too we found weak capacity in the police to complement Agency efforts. At the time of our fieldwork few prosecutions in BVI had come to court, though BVI had contributed to some prosecutions overseas, chiefly in the USA. The Agency hoped that a share in confiscated funds would be forthcoming.

2) Hurricane Risk

Hurricanes as well as earthquakes present a major risk to BVI because of their potential to inflict major damage. The extent of the impact depends on the severity of the occurrence. Hurricane Frederick in 1979 was the first storm to hit BVI with severity in 55 years. As a result of the lessons learnt from Frederick, the Deputy Governor assumed responsibility for disaster management operations. In 1989 the Territory suffered US$40 million worth of damage as a result of Hurricane Hugo. As the Cayman Islands' experience during Hurricane Ivan demonstrates, this type of natural disaster need not necessarily damage the stability of the financial services sector but is likely to impact on tourism. There are both short term and long term risks: the former to deal with any casualties and possible necessary evacuation measures; the latter to rebuild the Territory's infrastructure and capacity to cope with mass tourism.

Disaster planning is seen as a high priority by both the Governor and the Government, and the Territory has a well developed disaster management regime which has been rated highly by the Caribbean Disaster Emergency Response Agency. It has a well-resourced Department of Disaster Management, with nine full time officers and two technical support staff. It also has a well-equipped Emergency Operations Centre and a focus on educating the public on how to respond to disasters. At the time of our work FCO and DFID advisers in disaster management were due to undertake a capability review of the Territory's disaster management programme later in 2007.

One issue is that, though there are strong planning regulations which apply disaster management criteria to proposals for new property developments, enforcement is subject to pressures from developers. With land in scarce supply, high risk sites are be liable to be built on.

NAO Conclusion/What more the UK can do to help:
This is a well established area of good practice where the UK can continue to support BVI's development in this area of risk management since Governors have specific responsibilities in terms of internal security. It may consider providing technical support to enable BVI to build on its recent efforts in scientific research into preventing the worst effects of disasters rather than dealing with their consequences after they occur.

3.4 The Cayman Islands

Population: 48,353

GDP: $2.35 billion

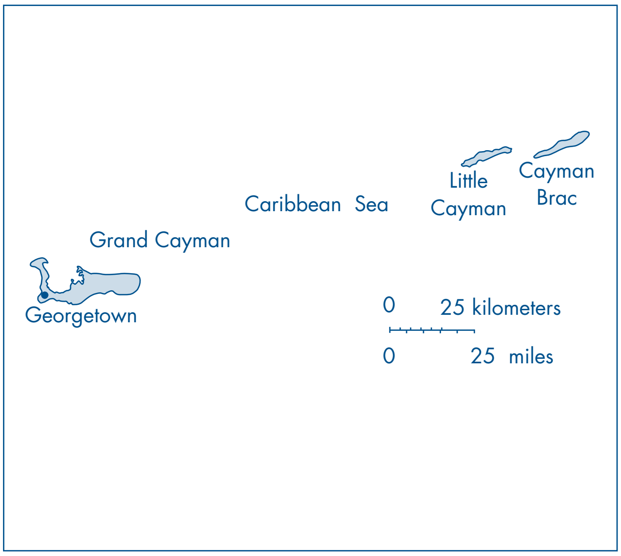
GDP per head: $48,704 = 2nd in world ranking

Key Industries: Financial Services, Tourism

Land Area: 262 sq km

Government Receipts 2006:

Government Expenditure 2006:



Key areas of risk identified by

Governor	✔
Government	✘
NAO	✔

1) Exposure to natural disasters

Natural Disaster Risk: The Cayman Islands are vulnerable to hurricanes, earthquakes, tsunami and flooding due to the low lying nature of the islands. In September 2004, the Cayman Islands were hit by Hurricane Ivan, the most severe hurricane for over 80 years. Ivan caused two fatalities, over US $2.5 billion in damage and disrupted power, water and communications for several days. The UK provided assistance by airlifting 5,000 tarpaulins and telecommunications equipment into Grand Cayman, as well as providing 40 tonnes of bottled water, 500 cots, water purification tablets and assistance to deploy the Bermuda Regiment. While the financial services industry showed a quick recovery and was operating business as usual after a matter of days, over half of all hotel rooms were still uninhabitable several months after the hurricane hit, and air arrivals were still only two-thirds of pre-Ivan levels at the end of 2005. Internal security in the aftermath of the hurricane also posed further challenges for the Cayman Island Authorities.

Mitigating the key risk: Progress has already been made in identifying the key natural disasters and other security risks which may affect the Cayman Islands through a multi-agency, national Threat Assessment. This was championed by the Governor and forms a sound basis on which to build future risk analysis by the new Hazard Management Agency. The next step for this process will be to prioritise the risks and assign them to appropriate responsible Departments for developing mitigation strategies.

One lesson to come from Ivan was the importance of spreading risks by insuring through more than one insurance company. At the time of Ivan, the Cayman Islands Government was insured through Cayman General Insurance as the sole provider. The Government had to accept shares in lieu of payout, and write off $20 million debt. They have now spread the risk across several insurance providers, which must meet minimum ratings.

NAO Conclusion/What more the UK can do to help: The Cayman Islands is expanding its focus on hurricanes to comprise a suite of disaster management initiatives under the direction of the Cayman Island Government and the Governor. It should also be recognised for its innovative Threat Assessment, which could usefully be shared as a good practice example with other Territories. However, there was some local resentment in the Ivan aftermath over the perceived lack of support from the UK (or uncertainty as to what the UK would provide in terms of humanitarian assistance). The UK could set clearer guidance over what assistance it will provide in a disaster, which would vary with the severity of the incident.

2) Immigration

The location of the Cayman Islands places it at a high risk of human smuggling, or illegal migration. While the Cayman Islands may not be the intended final destination of the immigrants, there is evidence that it is used as a transhipment point with the final destination usually being the USA. Illegal immigration presents a humanitarian challenge and places pressure on public finances if immigrants have to be repatriated at the cost of the Cayman Islands Government. Detaining any illegal immigrants prior to deportation is also putting further pressure on the already over capacity prison facilities, and was a contributing factor in a prison riot in 1999.

Mitigating the key risk: The Cayman Islands Government has a strategic objective to improve Border Security, and recognises that a multi-agency response is needed to achieve this. The Immigration Department, Customs and the Police work together, with monthly meetings to discuss key issues. All three Agencies are represented at the Cayman Islands National Security Committee. There is also good liaison with the US Authorities. The Immigration Department has in place contingency plans to deal with any sudden, large influx of migrants. The Immigration Department is also carrying out intelligence-led enforcement activities in partnership with the Cayman Islands Police, for example visiting construction sites and investigation of possible sham marriages. However, staff shortages are limiting the success of these investigations. Cayman Islands Government funding has also been provided to reinforce the Police marine unit. The Cayman Islands Human Rights Committee is taking an increasing interest in prison issues, and those concerning detainees, to assist in preventing a recurrence of the 1999 riot.

NAO Conclusion/What more the UK can do to help: There is close working with the UK Immigration Department, including exchanges of staff and visits, (the Cayman Islands Government pays all travel and subsistence costs, and the UK pays the staff costs of visiting Officials). However the Cayman Islands has indicated scope for further data sharing between the two bodies. At present this is restricted, due to UK Data Protection requirements. The continued support of the British Embassy in Havana is also seen as being vital. In an extreme case with a large influx of immigrants, UK law enforcement assistance may be required, as well as deployment of Royal Navy maritime assets.

3.5 The Falkland Islands

Population: 2,955 (2,400 excluding military and ancillary personnel)

GDP: $77.1 million (2004)

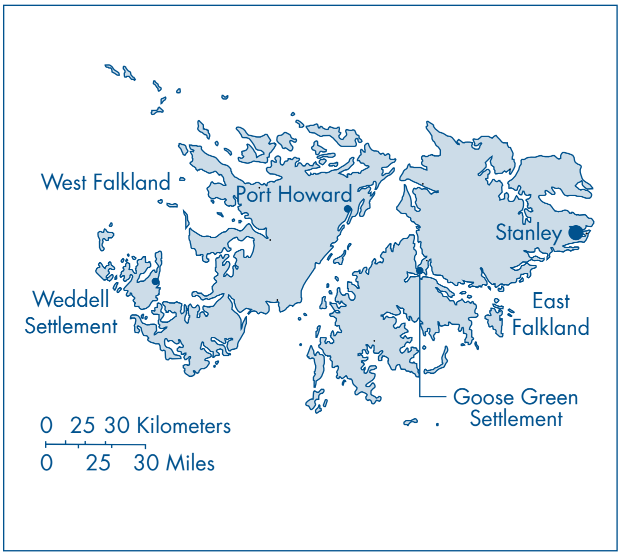
GDP per head: $26,125 (2004)

Key Industries: Fisheries, Livestock Agriculture, Tourism

Land Area: 12,173 sq km

Government Income 2005-06: £43.5 million

Government Expenditure 2005-06: £43.9 million



Key areas of risk identified by

Governor	✔
Government	✘
NAO	✔

Economic Risk

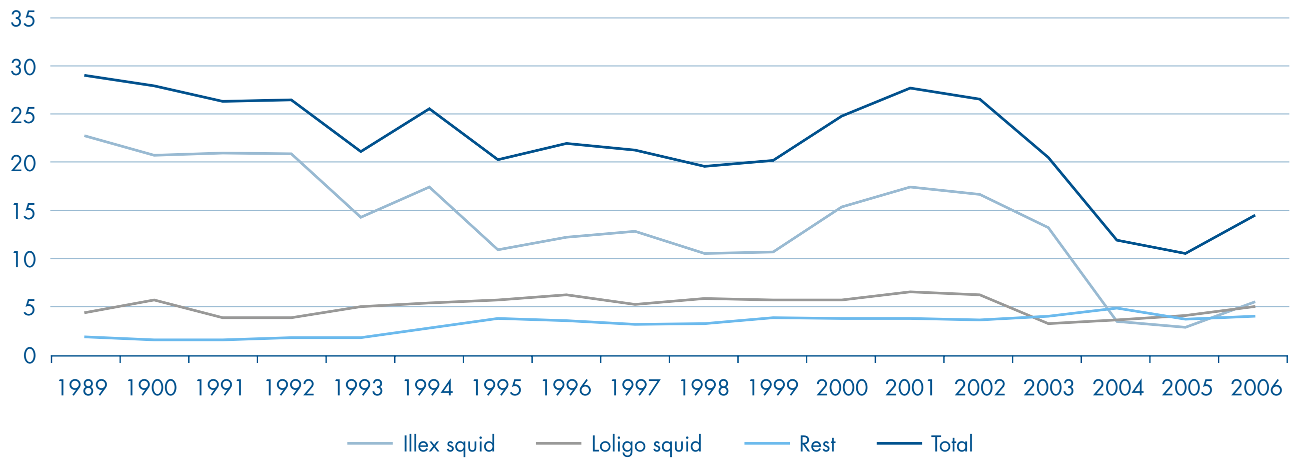
The Islands have enjoyed relative prosperity since enforcing a 200 mile fishing exclusion zone in the mid-1980s. Besides direct economic activity, this has generated annual licensing income of up to £26 million for the Falklands Government, which has used it to develop enhanced public services, particularly in health and education, and to build reserves. At peak, licence revenue exceeded half of government revenue. However, the main species, Ilex Squid, migrates around the South Atlantic and the catch can be highly variable from year to year. Since the early 1990s the long-term trend has been downwards, contributed to by climatic conditions and ocean currents, and total revenue has halved. The roles played by global climate change and exploitation outside the fishing zone are not yet well understood. A sudden increase in catch in 2007, which may not be sustained in the long term, had the effect of depressing prices; and government licence income is per vessel, not per tonne of catch.

Mitigating the key risks: The Falklands Government has shown commendable fiscal responsibility by building up its financial reserves to some £170 million by 2006, of which half are useable and uncommitted to meet future liabilities. It has no debt. So a continuing downturn in fishing revenue should have only limited direct effect on public finances for several years. However, it is clearly vital now to intensify efforts to diversify the Islands' economy. The main opportunities appear to be:

- Tourism, where cruise-ship visitors are projected to treble but current spend per passenger is low. In contrast land-based tourists arriving by air spend more, but are few and can be deterred by the journey and by shortage of accommodation in peak season. Also, the Ministry of Defence operates the only direct air service to the UK, with the only alternative a weekly commercial route via Madrid and Chile.
- Oil exploration, where possible fields have been identified, but where more exploration is needed by private companies before exploitation is proven to be commercially viable.

NAO conclusion/What more the UK can do to help: The Falklands Government retains lead responsibility for economic development, but UK agencies also have an important role to play. Falkland authorities noted in particular support from the UK Department for Trade and Industry and from the British Geographic Survey on licensing oil exploration. The main constraint identified repeatedly to us by Falkland Islands agencies is the perceived cost and unreliability of the "airbridge" into the Islands. The flights from RAF Brize Norton to Mount Pleasant airbase exist primarily to sustain the military garrison, but have become still more vital to the civil

Falklands Government: Income from fishing licences (£ million)



Source: Foreign and Commonwealth Office

economy since Argentina withheld permission for Charter flights through its airspace in 2003. Falkland agencies emphasized to us the need for more certain booking arrangements, more reliable flights, and the ability to offer a business class service, to help them sustain economic development initiatives with external partners. The Ministry of Defence intends that a new contract with a civilian operator starting in October 2007 will provide improved reliability, and options for the Falklands Government to ensure a business class service. At present, the Falklands Government does not underwrite any of the cost of running the airbridge, though civilian passengers pay for their own travel. It appears that a more equitable sharing of risk and reward, in which the Falklands Government commits to a set number of seats, in return for enhanced influence and guarantees concerning the service, is the best way forward.

Contingent Liabilities: Some 25,000 landmines were laid in the Falklands by Argentine forces during the conflict of 1982, and most remain in place. The affected areas, some 13 square kilometres, are well defined and fenced off, and since 1982 when immediate clearance work was halted there have been no recorded civilian casualties.

The economic value of these areas is negligible, and the Falklands Government has expressed no wish to have them "de-mined"; indeed it has emphasized their value as wildlife conservation areas. However, the UK is a signatory to the Ottawa Convention of 1997 which requires governments within ten years "...to ensure the destruction of all anti-personnel mines in mined areas under (their) jurisdiction or control..." A 2007 evaluation on behalf of the UK and Argentine Governments has identified that although challenging to clear, a range of clearance options are available. Most options to fully clear the mined areas in the Falklands could be expected to cost many millions of pounds. But a clearer estimate of likely costs will not be available until a trial phase has been completed. The Ottawa Treaty does not provide for funds allocated for removal of mines in low risk areas to be "vired" to instead fund the removal of mines in higher risk areas, such as in developing countries, where they cause much higher casualties and loss.

3.6 Gibraltar

Population: 28,779

GDP: $1,058 million

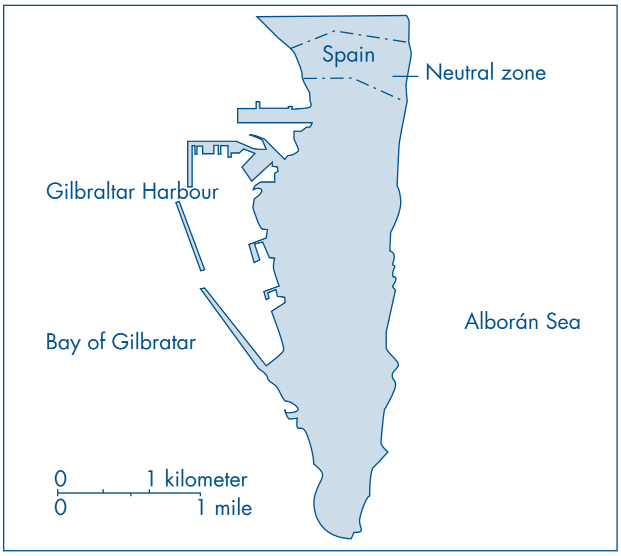
GDP per head: $36,756

Key Industries: Financial Services, Shipping, Tourism

Land Area: 6.5 sq km

Government Receipts 2006-07: £270m (est)

Government Expenditure 2006-07: £253m (est)



Key areas of risk identified by

Governor	✘
Government	✘
NAO	✔

Legislation

Within the European Union, the United Kingdom is ultimately responsible for the implementation of European law in Gibraltar. Any long-term failure to implement Union legislation could result in infraction proceedings by the Commission against the UK and hence a contingent liability. In 1997 the Committee of Public Accounts noted that progress had been unsatisfactory, with local legislation on some 101 Directives being drafted and with the status of a further 350 in dispute with the European Commission.

The 2006 Gibraltar Constitution recognises the United Kingdom's responsibility for Gibraltar's compliance with European Union law, but also that matters which are the responsibility of Ministers shall remain so even though they arise in the context of the European Union.

Progress made in managing this risk: Since 1997 the Government of Gibraltar and the UK have worked together to reduce the backlog of Directives, from some 180-200 in 1997, to about 18 infraction proceedings with a Gibraltar dimension as at March 2007. Only two were at the advanced Article 228 stage, and both were UK-wide. Key risk management measures now include:

- Increased capacity in the Gibraltar Government's Legislative Support Unit, and in the Governor's Office.
- Six-monthly meetings of the joint Whitehall/Gibraltar Tracking Group for EU Compliance.
- Centralised liaison points within those UK Departments dealing with most EU legislation.
- Since December 2006, an improved tracking system in FCO London.

No EU fines have been levied on the UK in respect of Gibraltar but the risk will increase if EU plans to levy fines earlier in the transposition process come to fruition. There is no mechanism to transfer any fine from the UK to Gibraltar.

Contingent Liabilities: Previous reports by the National Audit Office and the Committee of Public Accounts have noted the liability of the UK taxpayer to the continuing cost of payments to Spanish Pensioners who worked in Gibraltar before the border was closed by Spain between 1969 and 1985. In 1986 Spain joined the EU and affected Spanish pensioners obtained the right to claim payments from the Gibraltar scheme from that point onwards at the same rate as other Gibraltar pensioners. As a result of this the fund became financially unsustainable and was eventually wound up in 1993. Subsequently, in 1996 a settlement was reached under which all pensioners would receive 100 per cent of their accrued rights and payments would continue to be frozen at 1988 levels, with the UK Government funding the frozen payments made to Spanish pensioners. Over the years the real value of payments eroded and therefore the Trilateral forum agreed to look at the issue again. Under the Cordoba settlement the UK agreed to make lump sum payments to Spanish pensioners whose frozen pensions it already funded in return for them leaving the Gibraltar Fund. From April 2007 the UK Government have uprated the pensions of Spanish pensioners and the Government of Gibraltar have uprated pensions of pensioners who remain in the Gibraltar scheme. In June 2007, following the settlement, the European Commission closed infraction proceedings against the UK for alleged discrimination against Spanish pensioners.

Costs to be borne by the UK are still subject to assumptions, including the lifespan of pensioners, but estimates in the region of £100 million have been made. At the time of the Cordoba agreement the Department estimated the costs of uprating pensions to be £49 million. The cost of continuing to fund the frozen pensions was estimated at £48 million. Also, as part of the pensions settlement the Spanish Government agreed not to claim from the UK healthcare costs for the affected Spanish pensioners, which would be a significant liability. European law allows for an insured person with a pension from one member state but living in another member state to receive healthcare in their place of residence, at the expense of the state paying the pension.

3.7 Montserrat

Population: 4,785

GDP: $36.8million

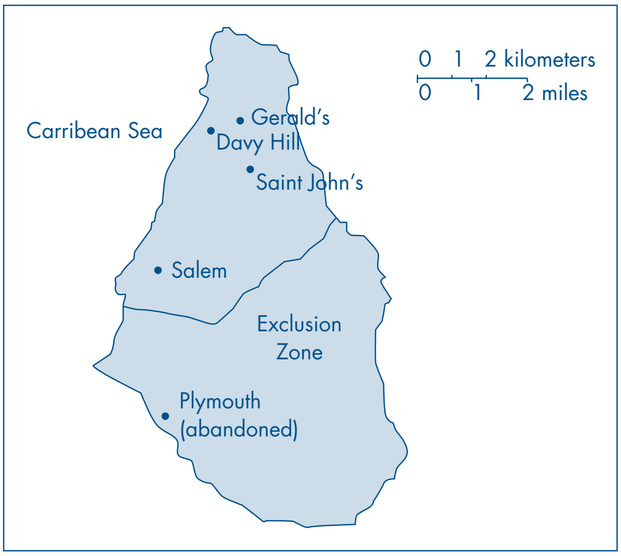
GDP per head $7,696

Key Industries: Reliant on UK budgetary Aid, Tourism

Land Area: 102 sq km

Government Receipts 2006: Eastern Carribean $34,493,587 (excluding aid and grants)

Government Expenditure 2006: EC$83,967,529



Key areas of risk identified by

Governor	✔
Government	✔
NAO	✔

Volcanic activity: The Soufrière Hills Volcano in Montserrat erupted in July 1995 after a long period of dormancy. By April 1996, increased volcanic activity had forced the evacuation of the capital, Plymouth, and much of the south of the island, and on 25 June 1997 a large pyroclastic flow led to the deaths of 19 people. The south of the Island has now been declared an exclusion zone, and there is also an international maritime exclusion zone covering 10 nautical miles offshore.

Since 2003, there have been several collapses of the volcanic dome resulting in heavy ash fall and physical damage. Since the start of the volcanic activity, the population of Montserrat has declined from over 11,000 to about 3,000. Continued volcanic activity has also caused a decline in tourist numbers and difficulty in attracting businesses back to Montserrat. The UK has provided over £250 million in aid since the start of the crisis, and DFID continues to provide Montserrat with budgetary support of over £10 million per year.

Mitigating the key risk: The Soufrière Hills Volcano is widely cited as one of the most closely monitored volcanoes in the world. The Montserrat Volcano Observatory (MVO) carry out monitoring and, along with the Scientific Advisory Committee advise the Governor and Government on levels of volcanic activity and associated risk. Recent dome growth has posed a heightened threat to occupied areas in the Belham Valley, and led to the Governor expanding the evacuation zone in early 2007. This has placed increasing pressure on the Government to provide suitable shelter accommodation for those who require it.

What more the UK can do to help: In a worst case scenario (i.e. a severe hurricane, or further volcanic eruption), substantial UK assistance would be required, both emergency humanitarian aid and longer term financial support. The UK currently provides budgetary support which in turn funds the activities of the MVO. The Scientific Advisory Committee is funded by the Department. Our fieldwork noted confusion and conflicting views among the Montserrat residents regarding the possible expansion of the exclusion zone. This was fed by differing reports in the media from Government, Governor and MVO sources. The Department is working with the Disaster Management Agency to develop a communication strategy to help ensure that the public are given one message.

Lasting Aid Dependency: Montserrat has been reliant on UK assistance since the 1995 eruption, which destroyed much of Montserrat's infrastructure and economy. Gross domestic product (GDP) fell from £38.7 million in 1994 to £24.2 million in 1998. Much of the UK aid since 1995 has been spent on replacing basic infrastructure and maintaining essential public services. The economy is dominated by government spending and is reliant on DFID aid to make up the annual shortfall between revenue and expenditure. In 2004, 64 per cent of government recurrent expenditure was directly financed by DFID.[40]

Mitigating the key risk: Montserrat is likely to need UK financial assistance for at least the next ten years. Any future graduation from aid is reliant on the development of a private sector. Key areas for development include tourism, population growth, infrastructure improvements and a new capital at Little Bay. However, progress towards a sustained reduction in the budget deficit has met with more difficulties than anticipated; tourist numbers in the first ten months of 2006 were 30 per cent lower than the same period in 2005, despite the opening of the UK funded airport, and progress on the Little Bay development had been slow. Positively, Montserrat did see its population grow to over 5,000 for the first time since the eruption.

The UK maintains close scrutiny of Montserrat's fiscal position through an annual budget review to determine aid levels and a mid year economic review. Scrutiny of public finance management is carried out every three years through a Fiduciary Risk Assessment and updated on an annual basis through a statement monitoring progress against key risks.

What more the UK can do to help: The aim of UK aid is to promote improved self sufficiency for Montserrat, leading to reduced dependence on (and eventual graduation from), budgetary aid. The main focus of aid is on bridging the gap between government revenue and expenditure, with any remaining aid allocation being put towards development assistance, which could then generate investment. During 2004-05 – 2006-07, DFID have provided some funding for long term projects linked in with the Government of Montserrat's Sustainable Development plan, for example, £1.5million was pledged for a Tourist Development Project. This aims to deliver a new tourism strategy and to develop basic tourism infrastructure.

Contingent Liabilities: DFID estimates the ongoing aid liability to Montserrat at £149 million over the next ten years, more if volcanic activity becomes serious.

3.8 St Helena

Population: 4,100 (5,326 including Ascension and Tristan da Cunha)

GDP: $23.1 million (£12.8million)

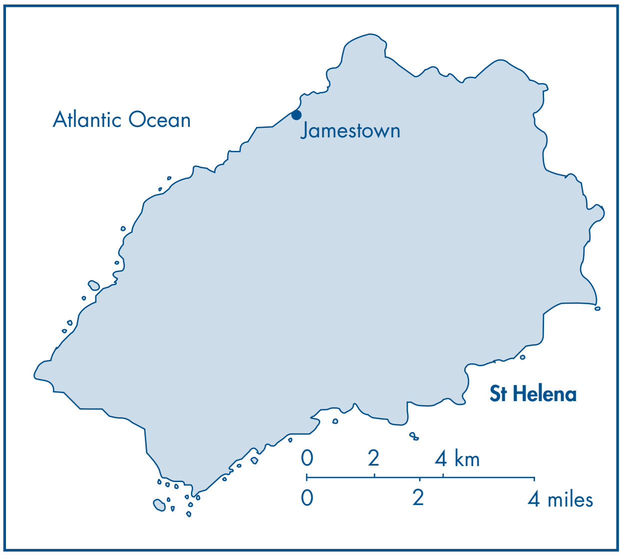
GDP per head: $5,622 (£3,137)

Key Industries: Reliant on UK budgetary Aid, Agriculture, Tourism, Fisheries, Remittances

Land Area: 122 sq km

Government Receipts 2006: $28,695,380 (£16,011,635)

Government Expenditure 2006: $27,381,435 (£15,278,471)



Key areas of risk identified by

Governor ✔
Government ✔
NAO ✔

St Helena has two interlinked risks; its isolated geography makes attracting inward investment difficult. This results in aid dependency due to a narrow economic base. The ability to graduate from aid dependency is in turn impeded by its isolation and capacity constraints due to population out-migration.

1) Isolation and resulting aid dependency due to a narrow economic base

St Helena lies over 2,000 km from its nearest major neighbour, making it one of the most isolated populated islands in the world. Currently, St Helena is only accessible by ship; the RMS St Helena provides the main link to Ascension Island, Walvis Bay in Namibia, Cape Town and the UK, and is heavily subsidised by DFID. There are few private sector employers on the Island; the St Helena Government is the main employer and the population is declining as citizens increasingly find work in the Falklands, Ascension Island and other places. Off-island remittances now average around £1,000 per head and provide an important contribution to local economic activity.

St Helena is reliant on UK assistance. DFID's approach to the Overseas Territories has historically been dictated by HMG rules which forbid borrowing by any Territory in receipt of budgetary aid, and the keeping of reserves for asset replacement or other contingencies (although St Helena did keep a small reserve for their bulk fuel installation). The DFID practice of calculating budgetary aid as the difference between predicted increases in expenditure and revenue, and clawing back any savings left little incentive for aid recipients to maximise their revenue sources and act prudently to minimise Territory Government expenditure. While St Helena Government and DFID together identified a potential £100,000 cost saving by rationalisation of St Helena's three primary schools, following public consultation the decision was made to take intermediate steps towards rationalisation, rather than all in one go.

Mitigating the risk: DFID are moving away from aid frameworks which restrict incentives, and will instead allow Territories greater ownership of any savings they achieve, linked to a system of performance assessment against mutually agreed objectives. The new approach has been agreed in principal. DFID also needs to work out the central funding mechanism to ensure that future aid allocations are based on need rather than just availability of resources.

2) The Air Access Project

The UK is providing funding for construction of an airport on St Helena, rather than continuing to subsidise the RMS ship service. Consultants advised that the ship was not encouraging inward investment or tourism on a necessary scale, whereas with air access, St Helena could be economically self-sufficient within 25 years, providing supporting infrastructure is put in place.

The aim of the air access project is to enable St Helena to graduate from aid dependency, through attracting inward investment, stimulating tourism and halting the current population decline. Estimated capital costs are confidential at present. The runway will be long enough to accommodate medium size, medium range aircraft up to the size of a Boeing 737-800, which would most likely serve St Helena via stops in Africa rather than direct from Europe. However as an air service provider has not yet been selected, the possibility of direct European flights has not yet been ruled out.

In May 2006, DFID issued an Invitation to Tender to three companies to design, build and operate the airport. In late 2006 however all three bidders withdrew due to concerns over their exposure to risk. A new Invitation to Tender was issued in May 2007, with DFID agreeing to pay a contribution towards design costs and taking on more of the risk. Bids are due in November 2007 and the planned completion date has shifted from 2010 to 2012-13, when the RMS St Helena is due to be retired.

NAO Conclusion: The scale and complexity of the project is beyond local capacity and depends on leadership by DFID and involvement from a variety of other Agencies and companies. The airport alone will not be enough: DFID are coordinating further investment to support a wider programme to increase the capacity of key infrastructure, such as road improvements and hotel construction.

Ascension Island: Key areas of risk: Ascension is a dependency of St Helena, from where most of the circa 1,000 people living and working there originate. Nearly all work for the main employing organisations; the UK Ministry of Defence, United States Forces, the BBC and Cable and Wireless. The Island's economic viability is dependent on the major employing organisations remaining on the Island, contributing to the provision of local services and personal (employee) and property taxes. Should one of the major employing organisations leave or reduce staff dramatically, there is a risk that this could have a significant negative impact on the Island's economy, possibly including pushing the budget into deficit. The workforce is essentially transient, required to leave within 30 days of their contracts of employment coming to an end. However, a minority have been there for more than twenty years, some having run businesses considered essential to operations on the Island, such as retail outlets and a hotel.

Between 1999 and 2005, the Department investigated ways to modernise the UK's relationship with Ascension, and consulted there on matters such as representation, immigration and the ownership of land and property. On representation, an Island Council was established in 2002. On the remainder of the matters referred to above, the UK decided not to expand these rights. Some people on Ascension, including Elected Councillors, contended that the Department's process fostered an expectation that these matters would be developed. The Department does not accept this to be the case.

The reason not to develop immigration and ownership of land and property was due to concerns raised in 2004 and 2005 during the Department's consultations that the UK would be exposed to an unacceptably high level of contingent liabilities if these rights were expanded. Liabilities could include the costs of additional welfare and health costs to meet the needs of a "settled population." There are currently no dedicated facilities to care for the elderly or incapacitated, the unemployed or seriously ill. An economic study completed in October 2005 cast doubts over the scope to diversify the Island economy through fishing or tourism. Both the Department and DFID concluded that the prospects of developing a self-sustaining economy were remote and that the UK should not expose itself to the risk of being required to provide budgetary aid should Ascension move into deficit in the future.

The Department has never sought to place a precise value on the extent of contingent liabilities on Ascension. Many highly uncertain variables would feature in any calculation. These would include; the number of people who might choose to remain, the number of dependants (young and old) they would bring, and the extent to which local public utilities and other infrastructure would have to be expanded to support a settled community. The future level of economic activity and tax yield from the major users is another key uncertainty.

NAO Conclusion: Developments on Ascension Island since our last report demonstrate the importance of keeping contingent liability aspects in view when making key decisions with respect to Territories.

3.9 South Georgia & South Sandwich Islands

Population: No settled population. A permanent scientist team of the British Antarctic Survey.

GDP: £18-20 million (2006 est.)

Broadly the value of the fishing catch from Territorial waters, plus income from visiting cruise ships.

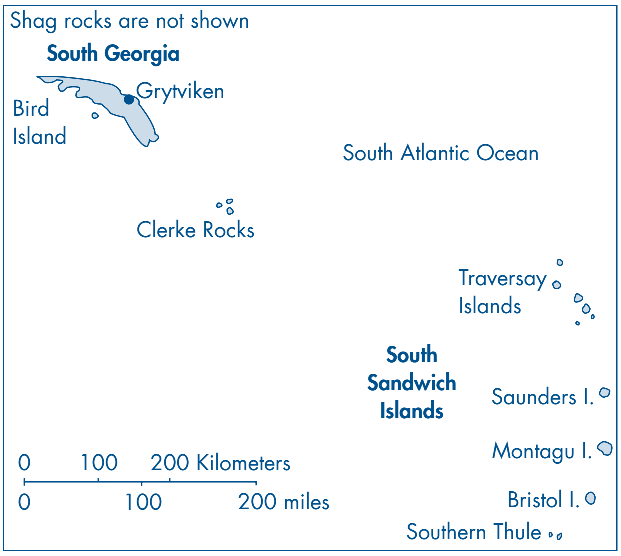
GDP per head: Not Applicable

Key Industries: Fisheries, Tourism

Land Area: 3,903 sq km

Government Income 2005-06: £3.5 million (mainly from fishing licenses). Reserves under £2 million.

Government Expenditure 2005-06: £3.3 million (almost entirely Fishery protection costs)



Key areas of risk identified by

Governor	✘
Government	✔
NAO	✔

- The natural environment of the Islands and their surrounding waters is one of the world's greatest wildlife resources. The UK has international obligations to protect the environment under a range of treaties, and over-fishing would have a severe effect on stocks and on government finances.
- A rising number of increasingly large cruise ships visit this very isolated location each year, paying £100 per passenger for the privilege of visiting the Islands. Responding to the needs of a major vessel in distress, with up to 2,000 passengers would overwhelm local resources and would require deployment of major military and civilian resources from the Falklands some 1,000 miles away.

Mitigating the key risks:

- Fishery and wildlife conservation is the main rationale of the SGSSI Government. Recognizing the importance of preserving the marine stocks, the UK, in 1993, extended the exclusive fishing zone from 12 nm to 200 nm around each island. The principal, (toothfish), fishery has received accreditation from the independent Marine Stewardship Council, as one of the best managed sustainable fisheries in the world. The key measures taken include a patrol ship on station at least 140 days a year, advanced satellite surveillance by Qinetic, advice from Imperial College London on the level of licensing fees, and severe penalties on unlicensed vessels including confiscation or destruction. Compared to Fishery Protection in the UK, the regime in South Georgia is resource-intensive and appears highly effective.
- In the event of a vessel or passengers in danger, patrol aircraft and ships could be mobilized from bases in the Falklands, but at the time of our fieldwork there was no disaster plan, and therefore no systematic tests of arrangements in recent years. Risks are partially mitigated by allowing permits only to selected, insured ships, most of whose operators are members of the relevant specialist association. Visitors are advised that there are no available search and rescue or medical facilities in the Territory. Though it is arguable that in law the South Georgia Government and the UK could not be held legally liable for any deficient response, this remains to be tested.

Contingent Liabilities: South Georgia has several derelict former whaling stations around its coastline. Inspection of buildings in the late 1990s identified large quantities of asbestos and other pollutants. A £15 million programme of remediation proved effective at Grytvikken, the main area visited by cruise passengers. But all the historic buildings at Prince Olav Harbour, Leith Harbour, Stromness and Husvik are in a dangerous state of disrepair and wind-blown debris including asbestos dust presents a significant health risk. Based on experience at Grytvikken, estimated costs for removing all remaining hazards would be some £25 million–£30 million. Unless the South Georgia Government is able to build up significant reserves from fishery or tourist income most or all of the costs would fall to the UK. Removal of asbestos from Grytvikken depleted government reserves to £2 million, the equivalent of a half-year's expenditure. Currently the risk is contained by excluding tourism from the affected areas.

3.10 The Turks and Caicos Islands

Population: 30,600 (estimate is subject to actual levels of legal & illegal immigration)

GDP: $480 million (est 2005)

GDP per head: $15,683

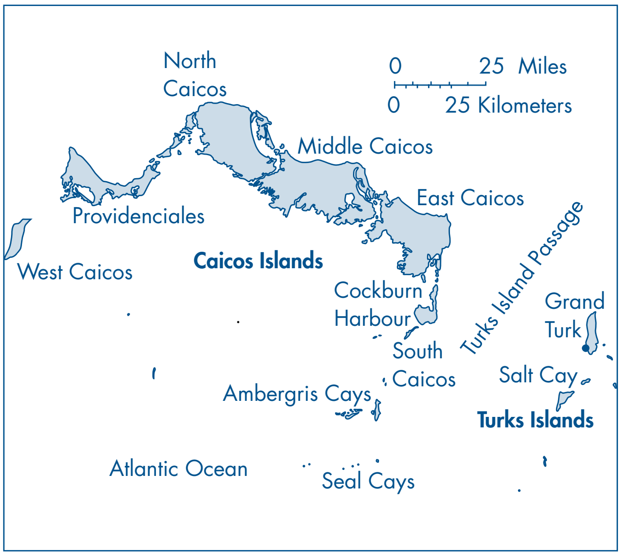
About 80th in world rankings (recognising uncertainty in the size of the population)

Key Industries: Tourism and real estate

Land Area: 430 sq km

Government Receipts 2006: $150 million (est)

Government Expenditure 2006: $143 million, excluding capital spending



Key areas of risk identified by

Governor	✔
Government	✘
NAO	✔

Proper conduct of public business, and managing public finances, in a context of very rapid economic growth

Since 2000 the Islands have experienced economic growth amongst the highest in the world, with double-digit annual percentage growth in Gross Domestic Product and equivalent growth in government spending and the public sector payroll. This has tested the capacity and capability of local government and local institutions. The key issues, identified following discussion with senior local officials, with the Governor's Office, and with the Department for International Development include:

- Expenditure consistently and repeatedly incurred in excess of annual budgets, across most government departments and without prior statutory authorization. Outturn government expenditure in 2004-05 was $123m compared to an estimate of $108m. Financial controls to prevent this are routinely overridden and projects and programmes are added informally throughout the year.
- Reliance on unplanned surpluses over budgeted revenue, with proceeds from sales of public land, to meet current account deficits. In 2004-05 land sale receipts represented 12 per cent of government income.
- Rising public sector debt, from $6 million in 2001 to $47 million in 2005.
- Registers of Interests for Ministers and officials exist but are not routinely used, despite the heightened risks of conducting public business in a small community, often with companies owned by family members.
- Widespread departures from competitive tendering and open award of contracts with private sector contractors and developers.
- Lack of criteria to establish the value for money of government major discretionary spending programmes.
  - The Scholarships programme, which pays grants to enable students to study overseas, has expanded from $1.4 million in 2000-01 to $13.3 million outturn in 2005-06, becoming government's largest single recurrent expenditure programme. Audit reports highlight serious deficiencies including overriding of decisions, insufficient monitoring of student attendance and examination results, and incomplete or missing records of awards, student grades, attendance and payments made. Nor is the programme clearly aligned with the Islands' labour market needs.
  - Medical programmes to enable Islanders to obtain treatment overseas, usually in the United States. Expenditure on overseas medical referrals is also running at record levels, rising to $12 million in 2005-06, in part due to a small number of very expensive chronic cases which despite negative prognoses, have been socially or politically difficult to refuse.

- Arrangements for public scrutiny of the Executive that do not function as they do in other countries. The tradition in the Islands is to interface directly with Ministers and officials rather than to use formal mechanisms of scrutiny or the media to hold the executive to account. An Office of Commissioner of Complaints exists, but had to be reconstructed and re-opened in 2006, having been seen as ineffective. Enfranchised Islanders ("Belongers") have benefited from unprecedented economic prosperity, and the ruling government was returned to power in the elections of February 2007.
- The resourcing of instruments of scrutiny such as the Attorney General and the Audit Office is not protected in the Constitution.
- The Committee of Public Accounts meets in private, focuses on historic financial statements and does not publish its own reports as a result.

Mitigating the key risks: The United Kingdom is seen locally as a guarantor of good governance in the islands and has sought to promote good governance through various means, including:

- As Chair of the Executive Council (Cabinet), the Governor scrutinises proposals for public spending that come before the Council and proposes rejection of those that appear ill-founded.
- The Governor has created a new Audit Committee which now considers recent internal audit reports on the procedures and controls applied by government departments. This to an extent compensates for the focus of the Committee of Public Accounts on historic accounts.
- UK Programmes such as training to stimulate a more independent and active local media.

What more the UK can do to help: The Department and DFID consider that the Turks and Caicos Islands is a unique challenge amongst the Territories, in terms of managing the UK's responsibilities, and of potential contingent liabilities from continuing fast-paced economic development should progress come off the rails. There are no quick and easy solutions. Two key themes will be:

- to promote ethics and integrity in the public service, bolstering the position of senior public servants and equipping them to drive through higher standards of financial management. Deployment of off-island expertise wherever necessary; and
- to promote risk management and risk awareness in the public service, including clarity about risk ownership. This should specify the limits of UK responsibility if risks transpire, and the limits of local government involvement on risks that are intrinsically the UK's to manage.

APPENDIX FOUR

FCO capacity in the Overseas Territories

Position as at May 2007	Anguilla	Bermuda	BVI	Cayman Is
Governor appointed	July 2006	April 2002	April 2006	November 2005
Governor's previous Overseas Territory experience	No	Some through previous role	Yes – was Desk Officer for Gibraltar	No
Deputy Governor appointed	Locally appointed	Oct 2006	Locally appointed	Locally appointed
Previous Overseas Territory experience		Yes		
Number of FCO UK based staff (excluding Governors)	3	2	3	3

Falklands	Gibraltar	Montserrat	Pitcairn	St Helena	TCI
July 2006	September 2006	2004	April 2006. High Commissioner, New Zealand	2004	July 2005
Substantial. In the UK and in Territories.	No	No	No	Yes – Chief Secretary in the St Helena Government	No
Jul 2003	2005	Locally appointed	Jan 2007	N/A	Locally appointed
Yes	Yes		No	N/A	
3	8	3, plus 4 DFID administrative staff also in territory.	2 (part-time, based in Wellington, New Zealand)	3 (in Ascension, St Helena and Tristan da Cunha)	3

APPENDIX FIVE

Public accounting and auditing in the Overseas Territories

Territories	Latest audited and published financial accounts (year ended)	Basis of accounts	Accounts qualified	Auditor regularly reports on VFM?
with settled populations				
Anguilla	December 2005	Cash	Yes	Yes[3]
Bermuda	March 2005	Accruals	No	No
British Virgin Islands	December 2005[2]	Cash	No	No
The Cayman Islands	June 2003[1]	Accruals since 2004-05	Yes	Yes
Falklands Islands	June 2006	Accruals		No
Gibraltar	March 2005	Cash	Yes	Yes
Turks and Caicos Islands	March 2005	Cash	Yes	Yes
Territories in UK Aid				
St Helena, Ascension	March 2005	Cash	No	Yes
Tristan da Cunha	December 2004	Cash	No	N/a
Montserrat	2003	Cash		Starting 2007
Pitcairn	2006	Cash	No	N/a

NOTES

1 Special factors have applied in the Cayman Islands. Reports are not released until after review by the Committee of Public Accounts. This report was released by the Public Accounts Committee in November 2006.

2 Though the auditor has completed the audits for 2006 and earlier years, at the time of our visit these were the latest accounts laid before Parliament by the government. The 2004 accounts have been audited but have not yet been laid before Parliament.

3 The Accounts of the Government of Anguilla are audited by the UK National Audit Office. A programme to examine Value for Money was initiated in 2006.

Summary of Parliamentary Scrutiny activity

A Committee of the whole Assembly has recently been established to consider the first Value for Money report by the Auditor General in Spring 2007.

PAC has met and produced reports on specific issues, such as the governance of the Island Further Education college. It has not considered and reported on the last three Annual Reports by the Auditor General.

The Government last submitted the Auditor General's Annual Reports to the Assembly in 2003. The Committee has reported mainly on cases of suspected impropriety in government business.

PAC meets periodically to consider Auditor General Reports, and is addressing a backlog of these from 2005.

No Committee. The eight elected Island Councillors are considering new constitutional arrangements which may include separate roles for executive and non-executive Councillors, allowing independent scrutiny of decisions and administration.

No Committee. In Gibraltar matters raised in the annual report of the Principal Auditor may be taken on the floor of the Parliament, though there is no annual debate on the Report as such.

The Committee has met several times in 2005-06, in private, and has submitted no reports to the Legislative Assembly.

Committee meets annually. A new Audit Committee has been formed to provide independent scrutiny of the audit function, and advise on governance issues.

Committee meets infrequently. The last meeting was in 2007.

APPENDIX SIX

Previous recommendations by the Committee of Public Accounts

The following table sets out the present position against the main conclusions and recommendations of our Report in 1997-98, and the Committee Report of the same session.

Conclusions and recommendations	Origin	Progress/Current Situation
General Risk Environment		
■ The Department did not maintain a systematic record of **contingent liabilities**, or weight **risks**.	PAC	■ There is no rolling central risk register maintained by the Department or conducted in the Territories which weights risk by likelihood and impact. The Department periodically lists key risks.
■ More needs to be done to assess the impact of **technical aid** provided by the Department, which brought about improvements in the key risk activities of police, customs and public administration.	NAO	■ Technical aid has been consolidated into one strategic programme, managed by the Department. This aims to provide capacity building, rather than funds for capital investment, however available discretionary funding is small (£4m annually) given the number and diversity of the Territories, and more needs to be done to assess post-project review procedures at the Department.
■ Not all Territories have adequate **insurance** for potential liabilities.	NAO	■ The Departments' Annual Economic Update programme advises Territories on the importance of insurance, but some have made more progress than others.
■ Country Policy Plans should be further developed to enable targets and policies to be more closely monitored.	NAO and PAC	■ Only Montserrat now has a DFID Country Policy Plan. Pitcairn and St Helena have short to medium-term development plans in place with DFID. DFID ties all of its development plans in with the Territory governments' own sustainable development plans.
Regulation and Money laundering		
■ The Department should set a target for clearing the backlog of **unadopted EC Directives** in Gibraltar.	PAC	■ Backlog has been significantly reduced and there are fewer infraction proceedings with a Gibraltar angle.
■ Enhanced **enforcement and regulatory activities** are needed by the police and Regulatory Authorities to complement the adoption of all crimes money laundering legislation. Local governments should be encouraged to provide Regulators with statutory independence.	NAO	■ The Regulatory framework is now in place in all Territories and Regulators have been given statutory independence. The staffing complement in all Caribbean Territories and Bermuda has increased but there are still concerns over the Territories' ability to report and act on suspicious transactions, (Paragraphs 1.30 to 1.36).
■ The Department should continue to closely monitor the regulatory regime in the Caribbean Territories, ensuring Governments provide adequate and skilled resources to implement and enforce legislation.	NAO and PAC	■ In 2000, the FCO and Territory Governments commissioned KPMG to review standards of regulation and supervision in the Caribbean Territories and Bermuda. The IMF also began an assessment programme in 2000. However the capability of regulators is variable (paragraphs 1.30 to 1.36).

Conclusions and recommendations	Origin	Progress/Current Situation
Regulation and Money laundering *continued*		
■ The **judicial systems** need adequate resources to be able to cope with increasingly complex financial cases.	NAO	■ Recruiting and retaining skilled judicial specialist is a continuing problem for the Territories.
Law and Order		
■ Consideration to be given to extending the powers of **magistrates**, and deploy good governance assistance to facilitate an equitable justice system.	NAO	■ The UK Attorney General, with the Department, is driving forward an Action Plan for reforms in the justice system and law enforcement agencies of the Territories.
■ **UK funded assets** are not always fully deployed and effectively used in the fight against drugs trafficking.	NAO	■ The Department are moving away from providing assets, towards support for training and other ways to ensure that assets are well utilised. There is evidence that replacement of essential assets reaching capacity or the end of their economic lives, is a problem since governments can be reluctant to fund replacements.
■ To facilitate international operations to improve **drug interdiction**, all Caribbean Territories should be encouraged to adopt agreements to allow US enforcement authorities access to territorial waters.	NAO and PAC	■ Agreements exist between Anguilla and St. Martin/Maarten, and the Cayman Islands and Jamaica. In July 2005 the UK signed up to the Aruba Agreement 2003 governing drug interdiction, on behalf of the Caribbean Overseas Territories. Since 1998, a UK/US agreement on maritime and aerial operations to suppress Drug trafficking in Caribbean/ Bermudan waters.
■ The new **Overseas Territories Regional Crime Intelligence System** (OTRCIS) needs to be used to its full capability.	PAC	■ The use of OTRICS is increasing, and it is now funded by the Territory governments; however it is not used consistently across all Caribbean Territories (or the Department). The Department is promoting OTRICS to Bermuda, as well as independent Caribbean nations (see 1.23).
Good Governance and Accountability		
■ The Departments' monitoring of the level and reasonableness of **borrowing** varies.	PAC	■ Anguilla and the Turks and Caicos, Cayman and British Virgin Islands are now subject to agreed borrowing guidelines. The extent of Department monitoring varies between Territories according to risk. There are some problems in applying the guidelines in practice; for example Anguilla maintains both a large overdraft and reserves.
■ The Territories did not always provide timely **audited accounts**, and accounts were often below recognised standards.	NAO	■ There have been improvements across the Territories with providing timely accounts; however many are still qualified and late. A common factor is lack of expertise and capacity in Accounts Departments (report paragraphs 2.16).
Natural and Civil Disasters		
■ Overseas Territories should be encouraged to develop **disaster preparedness plans**, and to set aside **contingency funds** to aid recovery in the event of a major disaster.	NAO	■ Disaster planning is now a key priority in the Overseas Territories and each Territory has a Disaster Preparedness Plan. However, plans remain of variable quality and depth, and not all have been tested (Report paragraphs 1.13 to 1.15). ■ Most Territory governments do not set aside large funds to cover a major disaster, and commercial insurance has proven inadequate (Cayman Islands 2004). Several Territories will be contributing to a new Caribbean Catastrophic risk insurance "pool".
Pensions		
■ The extent of **pensions liabilities** need to be kept under review.	NAO	■ The Department commissioned a desk exercise to review the pensions position in Territories in 2004, though this did not involve Territory authorities. The position on the UK's liability to fund pension costs in Gibraltar is recorded at Appendix 3.6.

ENDNOTES

1 *Contingent Liabilities in the Dependent Territories*, HC13 1997-98.

2 The four large Offshore Financial Centres are Bermuda, the British Virgin Islands, the Cayman Islands and Gibraltar. Anguilla, Montserrat and the Turks and Caicos Islands comprise the smaller three.

3 When the British Overseas Territories Act 2002 came into force, any citizens of the Overseas Territories (except those whose British Overseas Territories Citizen status derived solely from a connection with the Cyprus Sovereign Base Areas) became British Citizens. Anyone acquiring British Overseas Territories citizenship after this date can apply to be registered as a British Citizen at the Secretary of State's discretion.

4 For example the case brought against the UK government by former inhabitants of the Chagos islands of the British Indian Ocean Territory.

5 Article 73 of the UN Charter.

6 Given the close linkages with the UK's relations with Spain, responsibility for Gibraltar sits within the Department's Western Mediterranean Team. The Sovereign Base Areas in Cyprus are mainly administered by the Ministry of Defence.

7 A recent innovation in the Department and DFID's assessments of Territories has been adoption of elements of the Public Expenditure and Financial Accountability (PEFA) framework, a system developed by the World Bank, and used by aid donors around the World. This framework assesses and scores on a rigorous basis the effectiveness of arrangements for budgeting, expenditure control, accounting, reporting and external scrutiny and audit. We consider that the departments could usefully develop their use of the PEFA framework further, to score Territory systems against PEFA benchmarks. This would give Territory governments and legislatures a clearer and objective indication of how their financial management compares to standards elsewhere in the world.

8 National Audit Office survey of Territory Governors and governments, 2006.

9 Anguilla: Lenny and Jose in 1999, Bermuda: Fabian in 2003, British Virgin Islands: Georges in 1998 and Jose and Lenny in 1999, Cayman Islands: Ivan 2004, Montserrat: Georges, Jose and Lenny in 1999, Tristan da Cunha: 2001, Turks and Caicos Islands: Floyd in 1999.

10 Disaster Management Organisations usually report directly to the Governor. In Bermuda, Gibraltar and the Turks and Caicos Islands, a Government Minister has overall responsibility for disaster management. However Governors still have close involvement when their constitutional responsibilities e.g. for internal security, are engaged. In St Helena, the Police Commissioner is responsible for disaster management, reporting to the Governor.

11 The Cayman Islands National Security Committee, chaired by the Governor, has started to develop one (Appendix 3.4). Bermuda (and Gibraltar) also carry out Territory-led risk assessments.

12 Disaster management receives the second highest allocation of funding from the Overseas Territories Programme Fund (after law and order). The Department approved projects totalling £400,000 in 2006-07, however only £140,000 was actually disbursed as the £250,000 disaster contingency fund was not needed. Only one project related specifically to a non-Caribbean Territory.

13 In addition, the FCO retains part-time a former governor experienced in Crisis Management.

14 The clearest exception being the lack of a documented and agreed multi-agency plan for responding to an emergency affecting cruise ships and other vessels visiting South Georgian waters, (Appendix 3.9).

15 In December 2006 Montserrat ran a full, multi-agency exercise combining volcanic activity with an air crash due to poor visibility from the resulting ash plume. The exercise revealed deficiencies in command and communications, and an action plan has been developed to address these.

16 The exception to this is airport disaster tests, which have to be carried out every two years.

17 Despite the severity of Hurricane Ivan in the Cayman Islands, the UKs contribution was limited to personnel and equipment, with the bulk of response and recovery costs met by the Cayman Islands' Government (see Appendix 3.4).

18 The main exception being the conviction in 2004 of six men out of a total population of 47 on Pitcairn Island for child abuse offences, which required the involvement of Police Officers, judges and legal advisers from the UK, New Zealand and Australia. There is a need to ensure that there are adequate child protection measures in place, especially in isolated communities, and we saw evidence that some, such as the Falkland Islands Authorities, are placing enhanced emphasis on managing this risk, aided by DFID.

19 In Gibraltar, the Governor has not had oversight of the prison in recent times.

20 Under Section 26 of the Police and Crime Act, overseas deployments of serving UK Police Officers generally need to be approved by the Home Secretary. The receiving country would usually pay full cost reimbursement.

21 Governor responses to the NAO Risk Survey cited that the most likely type of assistance required in the event of a breakdown in law and order would be additional personnel and technical advice.

22 Anguilla, BVI, Cayman Islands, Montserrat and TCI.

23 Successful actions have been brought against regulators in St Vincent and Grenada. Nor are onshore regulators immune: until 2005 the Bank of England itself was unsuccessfully sued for regulatory failure by the Liquidators of the Bank of Credit and Commerce International.

24 Examples include the revised FATF recommendations on money laundering in 2003, stricter requirements for international information sharing by IOSCO and revised Basel Accord Core principles which will require much more sophisticated assessment of risk in banking.

25 The former head of Jersey's Financial Service Commission advised us that the minimum critical mass for all these core responsibilities, for banking, insurance, securities trading and anti-money laundering, would be some 10-20 professional staff, in addition to staff undertaking licensing or supervision. This is a broad indication; each jurisdiction would need to take account of its own industry's circumstances and range of services provided. DFID considers that Montserrat's regulatory oversight is proportionate to the lower scale of activity there.

26 Offshore Company registration is a competitive, high volume, low-margin business. Where no other services are provided fees may be as low as $300.

27 This officer returned to the UK at the end of his contract in early 2007. It is intended that another officer will be appointed with a sole Financial Crime portfolio.

28 In June 2007 Bermuda passed legislation to establish its own independent Financial Intelligence Agency. Cayman has had an independent Authority since 2003.

29 Territory Governors have a wide range of powers to grant or withdraw licences and approvals to civil aviation operators.

30 Governors chair the Executive Council in most Territories, exceptions being Bermuda and Gibraltar.

31 In 1997, the International Development Committee contended that greater inter-departmental coordination on the Overseas Territories was needed (HC 267). This was considered during the Foreign Affairs Select Committee's review of the Territories in 1998.

32 In 2005/06, the Department for Transport provided £3.4 million, mainly in grants to ASSI.

33 The residual expenditure goes on administrative costs, including the staff costs of FCO officials, both in London and in the Territories.

34 The Department provided £215,000 funding for good governance projects from its Overseas Territories Programme Fund in 2006-07.

35 NAO Report *Contingent Liabilities in the Dependent Territories*, May 1997. At this time six territories' latest audited accounts were for 1993-94 or earlier.

36 This is not a new issue. The NAO Report *Contingent Liabilities in the Dependent Territories* 1997, noted a UK NAO recommendation in 1994 that Chief Auditor reports, in that case for the Turks and Caicos Islands, should be submitted directly to the legislature rather than through the Executive.

37 Since 2006 a majority of the members of the Public Services Commission in the Turks and Caicos Islands have been nominated directly by the Premier and the Leader of the Opposition, or by the Governor after consultation with those local political leaders.

38 Available at National Audit Office website http://www.nao.org.uk/publications/vfmsublist/index.asp?type=vfm

39 Multi-Agency Threat Assessment. The technique has been particularly effective in terms of transparency, making individual agencies accountable for their actions, or lack of them.

40 Montserrat Country Policy Plan, 2004-05 – 2006-07.

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