

RSM Malta

Mdina Road,
Zebbug ZBG 9015,
Malta.

T+356 2278 7000
F+356 2149 3318

www.rsm.com.mt

8th May 2020

The Mayor
Local Council Ghajnsielem
J.F Chambray,
Ghajnsielem GSM 1501,
Gozo

Dear Mayor,

RE: MANAGEMENT REPORT – FOR YEAR ENDED 31 DECEMBER 2019

We have completed our audit of the financial statements of the Local Council Ghajnsielem for the year ended 31 December 2019. The purpose of this report is to summarise our principal findings arising from this work.

Our audit was primarily based on verifying balances in the financial statements to ensure that they are free from material error and comply with relevant legislation. Consequently, the matters raised in this report cannot be regarded as a comprehensive statement of all weaknesses that exist or all improvements that might be made. Our aim is to offer guidance to the Local Council such that it would be in a better position to improve its internal controls, enhance its book-keeping function and consolidate its overall governance.

Our engagement obliges us to distribute copies of this report to (a) your Council; (b) the National Audit Office; and (c) the Local Councils' Department. Consequently, this report, in part or in full, may not be distributed, used or quoted except for the scope it is prepared, without our prior written consent.

This report has been prepared on the basis of the limitations set out in the Responsibility Statement as presented on page 12 of this report.

During the course of our audit for the year ended 31 December 2019, we examined the principal documents, systems and controls used by the Council, to help it ensure, as far as possible, the accuracy of these documents and to assess how much can one rely on these documents to safeguard the assets of the Council. We also examined whether or not your Council abided by the procedures as they are provided for in the Local Councils Act, 1993, the Financial Procedures and various Legal Notices issued to your Council.

The objective of this letter is to bring to your attention those divergences in the system that were noticed during our audit work and suggest ways of how these can be remedied.

We would like to take this opportunity to thank the Executive Secretary and the Council Staff for their assistance during the course of our audit.

Yours faithfully



Conrad Borg (Partner)
for and on behalf of
RSM Malta

THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

Local Council Ghajnsielem

Management Report for the year ended 31 December 2019

Contents	Page
Follow-up to last year's Management Report	3
Property, plant and equipment	5
Receivables	8
Payables	9
Income	9
Expenditure and Tenders	10
Personal Emoluments	11
Responsibility Statement	12

1.0 Follow-up to Last Year's Report

1.1 Property, plant and equipment

During the previous audit, several weaknesses relating to the property, plant and equipment had been identified namely:

- During the exercises carried out by the Local Council on the fixed assets register in 2012 and in 2017, variances were found that were simply written off without the necessary justifications. The method used for the building up of the new fixed assets registers was not reliable.
- The new fixed assets register lacked certain important details.
- The adoption of Directive 01/02017 was not properly carried out.
- Errors were found in the depreciation charge for the year.

During the year being reviewed, the issues mentioned above still existed, apart from the last one up to a certain extent in view of the other weaknesses that indirectly do affect the depreciation.

1.2 Receivables

With respect to receivables, the following weaknesses were found:

- From the five samples chosen for the testing of the accounts receivable, only two confirmations were received by the date we closed off our audit.
- Variances were noted between the confirmations received and the accounts.
- An accrued income was erroneously accounted for as a prepayment.
- Receipt of opening accrued income was accounted for as deferred income.

During the current audit, the first two weaknesses were encountered again.

1.3 Payables

When testing the payables, the below weaknesses were encountered:

- Variances were found between the balances as per suppliers' statements and the balances as per accounts.
- An accrual was found that was not accounted for.
- The report we requested from the architect about the projects carried out during the year was not received.
- Grants received relating to capital projects not completed were still capitalized under property, plant and equipment rather than shown under deferred income.
- We noticed that a supplier cashed a cheque that according to the minutes was approved in January 2019.
- A material invoice was found dated in 2018 that was not accounted for.

Apart from the last two weaknesses, the other weaknesses were encountered again this year.

1.4 Expenditure

During the previous audit, the following weaknesses had been highlighted:

- Actual expenditure in certain categories exceeded the budgeted expenditure.
- Purchase requests and purchase orders were not prepared regularly.
- There were instances where no VAT fiscal receipt was available.
- We came across an instance where the Local Council gave a donation.
- Instances were noted where the procurement procedures were not properly followed

All the above weaknesses except for the last one, were found again during the current year.

2.0 PROPERTY, PLANT AND EQUIPMENT

- 2.1 During 2012, the Local Council outsourced the exercise of building the fixed assets register from scratch. One of the problems encountered in this exercise was the fact that the Council had no Sage backups of the accounts prior to the year 2008 since there was a change in the Council's accountant and apparently, he had the backups on his personal computer which were never given to the Local Council. We were given to understand that the procedure adopted was that the Council staff went around the Council premises and the urban areas within the locality to take note of the assets and then gathered all the relevant documents that could be found about the items of property, plant and equipment of the Council. As for the road resurfacing, the executive secretary contacted the architect who was responsible for the roads which were resurfaced by the Council from 1994 onwards and the costs connected to such works were taken from the final architect certification obtained. As for the Council premises, the Council listed all the assets present in the new civic centre and agreed them to the nominal ledger.
- 2.2 The method used by the Council created discrepancies in relation to the 2011 audited financial statements and the difference between the register and the nominal ledger has been accounted for as impairments through a prior year adjustment. The following were the variances noted:
- 2.2.1 The closing cost of property, plant and equipment as per the audited financial statements for the year ended 31st December 2011 amounted to €1,046,654 whilst the new opening cost as at 1st January 2012 amounted to €889,317. This means a difference of €157,337 out of which €1,108 represented a reclassification to under intangible assets.
 - 2.2.2 The accumulated depreciation as per the audited financial statements for the year ended 31st December 2011 amounted to €464,800 whilst the new opening accumulated depreciation as at 1st January 2012 amounted to €361,049. This means a difference of €103,751 out of which €330 represented a reclassification to under intangible assets.
 - 2.2.3 The resulting net figure after removing the reclassified amounts was €52,808. This amount has been passed as a prior year adjustment without an indication as to which assets the amounts written off relate to.
- 2.3 Moreover, the new fixed assets register lacks important details in particular with respect to the new civic centre. A one-line item under the buildings' category shows the total balance of all the construction works, electrical works and other expenditure incurred in the building of the new civic centre. It is understood that the Council grouped all the assets together as one asset since the civic centre was capitalised wholly. During our audit visit, we were then provided with an itemised list on MS Excel.
- 2.4 The method used for the building of the new fixed assets register as described above, creates several problems. There is no assurance that the costs taken for the individual items of property, plant and equipment are all correct. It is very possible that items have been left out from the register even though they are still in existence and in good condition. There is no assurance that the new calculation of the depreciation of the assets was carried out correctly by commencing the

depreciation calculation from the correct date. The new register still lacks sufficient details to ease the traceability of the different assets.

- 2.5 Furthermore, since the above exercise was carried out, the fixed assets register was not being regularly updated. During 2017, another exercise to update the fixed assets register was carried out. Again, variances arose in both costs and depreciation that were written off without there being a real justification. The most material write offs related to the assets under construction as at 31 December 2016 amounting to €30,488 and the accumulated depreciation of the 'Special Programmes' category of €32,919. No justification was obtained for the former adjustment other than because no details were available about what the assets under construction were.
- 2.6 Due to the materiality of the amounts involved and the number of uncertainties in the new valuations of the Local Councils' property, plant and equipment, we had to qualify our audit report.
- 2.7 The current fixed assets register furthermore does not contain details of the costs, accumulated depreciation and grants of the assets fully written off. It only contains a description of some of these assets. Should the Local Council dispose of, or would need to write off, any of these fully depreciated assets, the information would not be available to pass the necessary adjustments in the accounts.
- 2.8 It is recommended that an exercise is carried out to identify the variances that arose between the accounts and the register during the two exercises that were carried out in 2012 and 2017, which variances were simply written off from the accounts. The register should include among other details, the detailed description of the assets, their identification codes, their locations and the category of the assets according to their nature. Assistance might be sought from the previous and current auditors of the Local Council, for any possible information that they might have which for some reason is not available at the Local Council. If the correct costs, accumulated depreciation and grants could not be recorded in the fixed assets register due to the change in the accounting policies in line with Directive 01/2017, then a separate register containing this information should be maintained that would then be used when reconciling the costs, accumulated depreciation and grants found in the fixed assets register with those found in the accounts and the financial statements.
- 2.9 Furthermore, we highly recommend that the Council obtains copies of the accounts' backups for the periods before the year 2008. Kindly note that the Council is obliged to have such backups available at its offices.
- 2.9 Following Directive 01/2017 issued by the Department for Local Government to Local Councils on the change in the accounting policies on depreciation, whereby the straight line method is to be applied instead of the reducing balance method and the accounting policy on government grants, whereby the capital approach is to be applied instead of the income approach, we noticed from the limited procedures that we could carry out that:
 - 2.9.1 Items of property, plant and equipment whose useful life expired were not written off upon the adoption of the new depreciation accounting policy.
 - 2.9.2 The depreciation is not being worked out on the remaining useful life of the assets.

- 2.9.1 Grants received for specific projects, were allocated to several items of property, plant and equipment rather than those specific projects, clearly indicating that the allocation of grants to the respective assets was not properly carried out.
- 2.9.2 As at 31 December 2017, the Local Council had deferred income amounting to €101,363 relating to three different projects that were not yet carried out as of that date. Yet, we noticed that when the comparative figures were restated following the change in the accounting policy on government grants, these grants were still allocated against property, plant and equipment rather than left under deferred income.
- 2.10 We highly suggest that the exercise of applying the changes in the accounting policies is redone diligently and the necessary corrections made to the accounts through a prior year adjustment. Once the exercise is completed, the fixed assets register would need to be updated as well. When doing such an exercise, it is important to keep all the necessary workings to be able to reconcile the costs and accumulated depreciation as per updated fixed assets register to the figures shown in the note to the financial statements on property, plant and equipment. It is also to be ensured that grants are allocated to the correct projects given that some grants were capitalised before the projects were actually carried out and hence were allocated to projects which they did not intend to cover.
- 2.11 During the year ended 31 December 2018, the Local Council received two government grants amounting to €120,996 and €138,363 respectively for two projects that were not yet carried out. Yet these grants have been netted off against the property, plant and equipment in the financial statements rather than classified as deferred income, and they were allocated to project which they do not relate to. During the year ended 31 December 2019, one of these projects was completed. The total costs amounted to €198,629 and 90% therefore should have been covered by grants. This means that the total grants receivable for this project amount to €178,766 when only €138,363 are reflected in the accounts. The remaining balance has not been accrued for. The other project relating to the funds amounting to €120,996, was commenced during 2019 but was not completed according to the Local Council. The part invoice received, amounting to €67,905, was still capitalized under special programmes rather than under assets under construction. Given that grants are allocated to incorrect projects and assets are being treated as complete when they are not, the depreciation charge for the year is misstated, as are the property, plant and equipment, the accrued income and the deferred income.
- 2.12 As at 31 December 2017, the Local Council had deferred income amounting to €101,363 relating to three different projects that were not yet carried out as of that date. Yet, we noticed that when the comparative figures were restated following the change in the accounting policy on government grants in accordance with Directive 01/2017, these grants were still allocated against property, plant and equipment rather than left under deferred income. One of the projects for which there were funds amounting to €9,615, was then carried out during 2018 whilst the other two projects were carried out during 2019. We have also noticed that the grants received for one of the projects amounted to €81,748 when the actual costs of this project amounted to €74,127 meaning that part of the grants capitalized should have been presented under other payables as these extra funds should be refunded back. Furthermore, we noticed for the second project done during 2019, the full funds were accrued for during the current year when €10,000 thereof were received during 2017. Therefore, the other payables, the accrued income and the property, plant and equipment are misstated.

- 2.13 The Local Council should ensure that every item of property, plant and equipment is correctly classified. If a project is not yet completed, any related costs should be classified as assets under construction and no depreciation should be calculated thereon until such time when the project is completed and available for use. Furthermore, the Local Council should be aware of what the funds received relate to and what funds are available for every project. It then has to monitor what has been received and what is still to be received, and for completed projects, any amounts not yet received should be accrued for so that the depreciation is commenced on the total costs less the total grants receivable. Until such time that the project is completed, any grants that would have already been received should be classified under deferred income. Any funds received in excess of what the Local Council is entitled to, should be shown as other payables as those funds are to be refunded.

3.0 RECEIVABLES

- 3.1 From the five samples chosen to test the accounts receivable as at the end of the year, which sample covered 98% of the total accounts receivable before deducting the provision for doubtful debts, only two confirmations were obtained. Furthermore, variances were found in the two confirmations received amounting to €919 and €840 respectively. During the audit, we found that the €919 variance was the result of two receipts that were posted against the income accounts rather than against the receivable's account. An audit adjustment was passed to correct this mistake.
- 3.2 At the end of each financial year, during the process of closing off the accounts, the Local Council should ask for statements or confirmations from its customers in order to be able to reconcile the balances in the books of accounts with the balances confirmed by the customers and any variances found should be investigated.
- 3.3 When analysing the prepayments account, we noticed that there was no prepayment for the insurance. Upon inquiry and inspection of the nominal ledger and the insurance policy renewal document, it transpired that there was a prepayment of the insurance, just that it was not accounted for. An adjusting entry was passed during our audit to reflect the prepaid insurance that amounted to €1,161.
- 3.4 It is important that at the end of the year, the Local Council should review all the prepayments so that it is then ensured that the presentation of the balances in the notes to the financial statements is correct.
- 3.5 While going through the receivables' aged list we noted that the Council has receivables older than two years amounting to €8,019 but the provision for doubtful debts in the accounts amounted only to €6,757. The provision is the same of last year.
- 3.6 We recommend that the Council goes through the receivables' balances at the end of every financial year and makes a provision against any balances which it thinks will not be recovered. In any case, the Local Council should make a provision for doubtful debts for any balances older than two years as instructed by the Department.
- 3.7 When checking the accrued income, we noticed that income relating to the activity 'Bethlem in Ghajnsielem' was under accrued by €1,500. It was agreed to adjust this error during the audit.
- 3.8 When accruing for income, the Local Council should refer to either receipts after the end of the financial year, or invoices issued in the following year or agreements that would have been entered into. This would ensure that the correct amounts are accrued for when closing off the

accounts. The Local Council should be aware of all the income relating to the year that it is entitled to but which it would have not yet invoiced and received.

4.0 PAYABLES

- 4.1 From the samples chosen for the testing of the accounts payable, an instance was encountered where a variance of €3,957 resulted between the balance in the supplier's statement and the balance found in the books of accounts. From our investigation, it transpired that there are two un-presented cheques amounting in total to €3,812, but the difference of €145 remained unexplained. The variance is coming from previous years. Also, for one of the samples chosen, being the main contractor for road resurfacing, no statement or confirmation was received by the time we closed off our audit despite the regular chasing.
- 4.2 We recommend that the Local Council regularly carries out the necessary reconciliations between the suppliers' statements and the balances in the books of accounts of the Local Council, as this would avoid the weaknesses mentioned above. If need be, the Local Council itself should ask its suppliers to provide it with statements at least at the end of the financial year, as we were given to understand that most of them do not send statements. These statements are to be made available to the auditors during their audit.
- 4.3 When carrying out the cut-off tests, we noted that two invoices dated in 2020 and amounting to €982 in total, related to services provided in 2019. These invoices were not accrued for.
- 4.4 The Local Council should be fully aware of the services obtained for which no invoices would have been received. An accrual for such services should be accounted for when closing off the accounts, to ensure that the expenditure is reflected in the year to which it relates and that the liabilities are not understated.
- 4.5 We have requested a report from the architect about the projects that were completed during the year ended 31 December 2019 and the projects that were ongoing as of that date. This report was not received by the time we concluded our audit. Consequently, we could not confirm whether all the projects carried out by the Local Council during the year were properly reflected in the books of accounts.
- 4.6 The Local Council should ensure that this specific report is asked for during the closure of the accounts to make sure that all possible accruals are properly reflected in the accounts, and that the property, plant and equipment are correct. This report is to be made available to the auditors during their testing.
- 4.7 During the year ended 31 December 2019, the Local Council received two government grants. One of these, amounting to €65,685, related to the project under Measure 4.4 that has not been commenced by the end of the year. Therefore, this grant should have been classified as deferred income under the liabilities. However, this grant has been netted off against the property, plant and equipment in the financial statements.
- 4.8 IAS 20 – Accounting for Government Grants and Disclosures of Government Assistance should be properly adopted using the capital approach as per Directive 01/2017. Until a capital project is carried out, grants are to be classified as deferred income.

5.0 INCOME

- 5.1 During our testing on income, we noticed that included under other government income there were funds relating to an irrigation system project, amounting to €10,631, which project was not yet carried out by the end of the year. Moreover, this project is of a capital nature and therefore,

once it is done, the funds are to be capitalised under property, plant and equipment to match the costs they intend to cover.

- 5.2 When accounting for the income of the Local Council, it is important to obtain the supporting document or agreement before posting the transaction. The document is to be carefully read so that the purpose of the income or grant is well understood. Where grants are concerned, the principles of IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance, are to be correctly applied.
- 5.3 When analysing the different income accounts, we also noticed that certain items of income were classified under the wrong nominal account. Income coming from the central government of €3,000 for library services and €5,000 for an activity held by the Local Council, were classified as general income.
- 5.4 It is important that every item of income is accounted for in the correct income account so that it is ensured that income is properly and consistently presented in the statement of comprehensive income and the notes to the financial statements. It would also ensure comparability from one year to the other.

6.0 EXPENDITURE AND TENDERS

- 6.1 It was noted that the Council has exceeded the budgeted expenditure for several categories, namely:
 - 6.1.1 Repairs & upkeep (Category 2300) by €5,163
 - 6.1.2 Rent (Category 2400) by €2,050
 - 6.1.3 National & international memberships (Category 2500) by €130
 - 6.1.4 Office services (Category 2600) by €6,658
 - 6.1.5 Transport (Category 2700) by €700
 - 6.1.6 Information services (Category 2900) by €3,125
 - 6.1.7 Contractual services (Category 3000) by €9,623
 - 6.1.8 Professional and management services (Category 3100) by €6,003
 - 6.1.9 Hospitality and community (Category 3300) by €2,276
 - 6.1.10 Incidental expenses (Category 3400) by €1,200
- 6.2 The Financial Procedures applicable for Local Councils require Councils to draw up twelve (12) months budgets, three (3) years business plans, quarterly reports and eventually yearly administrative reports at the end of the year. The Council is also allowed to revise budgets in line with actual requirements and there are enough reporting tools to note which areas in the budget need revising.
- 6.3 We recommend that the Council makes use of the reporting tools in hand to take corrective measures in the budget every quarter such that by the end of the accounting period/year such discrepancies would not materialise.
- 6.4 When checking the expenses accounts, we noticed that the Local Council opened new nominal accounts in the wrong categories of expenditure. A new account for penalties incurred was opened within the category of law enforcement expenses. Similarly, a new street lighting expenses account was opened under the category EU projects.
- 6.5 When opening new nominal accounts, the Local Council should ensure that the nominal code given to the new account falls within the range where the particular expenditure item belongs to, in order to ensure correct presentation of that account in the notes to the financial statements.

- 6.6 We noticed that the Council does not draw up purchase requests in line with the Local Councils Financial Procedures. With regards to the purchase orders, these are prepared for most of the purchases but there are still cases where these are not prepared. There appears to be no specific reason behind this practice. It is understood that at times the urgency of matters might require that bureaucracy is reduced to the minimum possible, however we are still of the opinion that the necessary paperwork should have been done in line with the financial procedures.
- 6.7 The above issues go against the Local Councils Financial Procedures that the Council should abide with. Therefore, we strongly recommend that the Council takes immediate action to regularize itself on these matters and to ensure that such occurrences are not repeated in the future.
- 6.8 When browsing the expenditure accounts, we came across one instance whereby the Local Council gave a donation of €30.
- 6.9 Article 63A of the Local Councils Act states that any donation whether of money or in kind by a Local Council is prohibited.

7.0 PERSONAL EMOLUMENTS

- 7.1 When reconciling the FS7 with the FS5s, we noted some variances. The gross emoluments in the FS7 amounted to €91,712 whilst the total gross emoluments in the FS5s amounted to €91,577, resulting in a variance of €135. The tax deductions as per FS7 amounted to €10,992 whilst the tax deductions in the FS5s amounted to €10,957, a variance of €35.
- 7.2 When we were provided with copies of the FS3s, we noted that all the forms were not signed. Furthermore, we noted that for 2 of the Councillors, we were provided with two FS3s that contained different information. Whichever version of the FS3s is taken for the reconciliation with the FS7, variances would arise in the gross emoluments and in the tax deductions once again.
- 7.3 The Local Council should keep copies of the original forms sent to the Commissioner of Inland Revenue. At the end of the financial year, before sending the annual forms and the FS5 for the month of December, a reconciliation should be carried out between the 3 types of forms to ensure that all the information therein tally.
- 7.4 When checking the computation of the Mayor, we noted that in the month of April, he was paid €37 whilst in the month of December, he was paid €83 more. The errors resulted from the fact that the changes in the honoraria as instructed in the Circulars were applied from the wrong effective dates.
- 7.5 Kindly note that the Mayor's honoraria should be calculated as stipulated in the Local Councils Regulations and the Circulars issued from time to time by the Department.

Responsibility Statement

While our report includes suggestions for improving accounting procedures, internal controls and other aspects of the Local Council arising out of our audit, we emphasise that our consideration of the Local Council's system of internal financial control was conducted solely for the purpose of our audit having regard to our responsibilities under International Standards on Auditing.

We make these suggestions in the context of our audit but they do not in any way modify our audit opinion which relates to the financial statements as a whole. Equally, we would need to perform a more extensive study if you wanted us to make a comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.