LOCAL COUNCIL PEMBROKE

Report and Financial Statements

for the year ended 31 December 2017

3a
MALTA

24th April 2018

The Mayor
LOCAL COUNCIL PEMBROKE
Triq Alamein
PEMBROKE PBK 1776

Dear Sir,

REPORT TO MANAGEMENT

As you are well aware, our firm has been appointed by the National Audit Office to carry out the annual audit of the financial statements of your Council. Our engagement includes the obligation on our part to prepare a report addressed to the Council, explaining weaknesses and recommendations that emanate from the review of your systems as part of our audit. You will understand that our examination cannot be expected to disclose every weakness and therefore the matters dealt with in this report are not necessarily the only shortcomings which exist. This report is intended as a source of guidance for the Council to refine its systems for better compliance, internal controls and governance. The controls will also be used by the National Audit Office to compile its own report on Local Councils.

For clarity purposes, this report is distributed to your Council, the National Audit Office and the Department of Local Councils. The contents of this report shall not be quoted in part or in full or used in any way other than for the above-mentioned scope, without our prior written consent.

During the course of our audit for the period ended 31 December 2017, we have examined the principal accounting records, systems and controls in use by the Council to enable it to ensure as far as possible, the accuracy and reliability of its records and to safeguard its assets. Additionally, we also examined the level of your Council's compliance with the Local Councils Act (1993), the Financial Procedures (1996), the various Legal Notices and Local Councils Department Memos and Circulars globally issued to Local Councils in the Maltese Islands.

We remain at the Council's disposal for any clarification required regarding this report. We shall be happy to render assistance should you decide to implement any of the recommendations.

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3A is a civil partnership duly registered as an audit firm under
the Accountancy Profession Act with warrant number AB/26/84/62

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Finally, we take this opportunity to thank the Executive Secretary, Mr Kevin Borg and his Council's administrative team for their valuable assistance and co-operation rendered to us at all times during the course of our audit.

Yours faithfully

Neville Cutajar
Partner

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The Council does not have direct control on this matter as it is dependent on third party reports and therefore it could not address this issue. In this respect, we draw your attention to paragraph 2.1 of our management report.

1.2. Income from Bye Laws

The Council has addressed the matter during the year under review.

1.3. LES Post Regional 10% Commission

The Council has addressed the matter during the year under review.

1.4. System of Council Income Receipting and Invoicing

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 2.2 of our management report.

1.5. Income not recorded in the appropriate accounting period

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 2.3 of our management report.

1.6. Income recognized on a cash basis rather than on an accrual basis

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1.7. Classification of income

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1.8. Procurement procedures

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1.9. Categorization of assets and depreciation thereof

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1.10. Insurance policy

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1.14. Computer Software

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1.15. Assets donated in kind

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1.21. Disclosures required in respect of certain IFRSs

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1.23. Comparison of Actuals with the Annual Budget

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 8.1 of our management report.

2. INCOME

2.1. Income arising from the Local Enforcement System

Observations

By the date of conclusion of our audit work, the Council had still not received the audited annual report of the Joint Committee for the period ended 31st December 2017. During the year under review, the Council has been correctly recording any cash receipts received by the Joint Committee, as well as making the distinction between LES pooling and pre-pooling receipts. Income received in relation to the former amounted to €80.38.

One also has to note that the Joint Committee function ended in August 2011 in view that from September 2011 the Local Enforcement System was delegated to Regional Committees, which delegation has now been passed to LESA as from October 2015.

Issues Arising

In view of the absence of an audited annual report for the Joint Committee as at 31st December 2017, we could not rely on third party financial information as provided by the Joint Committee to provide reasonable assurance on the amounts being recorded in the financial statements as income from the Local Enforcement System. We have qualified our audit report in this respect.

Recommendations

The Council should pressure the Joint Committee to provide audited financial statements for every financial year in order to have a basis on which to recognise all LES income due to the Council.

2.2. System of Council Income Receipting and Invoicing

Observations

We noted that the Council issues proper official receipts for the income received. However, the system used by the Council is manual based, and therefore the system does not provide a proper electronic audit trail.

Issues Arising

The current system used by the Council is working well because no major issues were identified. However, it should be noted that this system could lead to errors in view of human intervention and requires more physical space to keep track and storage of the paper documents. Furthermore, more effort is needed to find information when required.

Recommendations

The Council may consider adopting an electronic based receipting system. Such system will help the Council to be more efficient in keeping its financial records and requires less storage space. Furthermore, this will prevent loss of data if backups of the system are done regularly.

2.3. Income not recorded in the appropriate accounting period

Observations

Following tests on the income of the Council, it transpired that income of €952.50 relating to online streaming maintenance for the period October 2016 to October 2017 was fully recognised in 2017 when a portion of this income amounting to €158.75 should have been accrued for in 2016. In addition, income of €952.50 relating to online streaming maintenance for the period October 2017 to October 2018 was deferred to 2018, when a portion of this income amounting to €158.25 relates to 2017.

Issues Arising

The Council is obliged to ensure that all revenue is properly accounted for and recognised in line with the requirements of IAS 18-Revenue Recognition. Income relating to a particular year, even though it is not yet received at year end, should be estimated and accounted for as accrued income. All such income should be accounted for appropriately in its financial statements, based on the requirements of the "accruals concept" of accounting and revenue recognition requirements arising from IAS 18-Revenue Recognition.

Recommendations

The Council should follow the provisions of IAS 18-Revenue Recognition and ensure that all income is properly recorded in the year in which it is generated as well as that all income is properly accounted for and properly categorised in the nominal ledger. Further to our recommendations, the necessary adjustments in relation to the online streaming maintenance income for the period October to December 2017 were included and the financial statements were rectified by the Council accordingly.

2.4. Income recognised as an increase in government grants

Observations

During our testing, we noted that income received by the Council from LESA amounting to €7,485.77 was recognised in the financial statements as an increase in grants for the period and recorded as a non-current grant. The Executive Secretary advised that these funds were not provided to the Council in connection with a particular project.

Issues Arising

The income received by the Council does not meet the recognition criteria of government grants as per IAS 20-Accounting for Government Grants and Disclosure of Government Assistance. Such income should therefore we recognised in the Statement of Comprehensive Income.

Recommendations

Income should be correctly recorded in the year to which it relates, and proper classification should be made in accordance with the requirements of IAS 1-Presentation of Financial Statements. Further to our recommendations, the necessary adjustments have been undertaken, and the financial statements were rectified by the Council accordingly.

3. EXPENDITURE

3.1. Classification of expenses

Observations

We noted an instance where inappropriate classification of expenses was presented in the financial statements.

Issues Arising

Expenses in relation to tipping fees for the month of May 2017 amounting to €2,470.92 were included in a separate expense account.

Recommendations

Expenses should be correctly recorded in the year to which they relate, and proper classification should be made in accordance with the requirements of IAS 1-Presentation of Financial Statements. Further to our recommendations, the necessary adjustments were included, and the financial statements were rectified by the Council accordingly.

3.2. Personal vehicle allowance

Observations

We noticed expenditure relating to reimbursement of fuel expenses made to the Executive Secretary. We noted an instance whereby the claim form that was submitted by the Executive Secretary was not signed by the Mayor.

Issues Arising

We understand that at present proper claim forms are being filled out with the necessary details of the mileage undertaken in respect to reimbursement for personal vehicle use. Such claim forms need to be approved and signed by the Mayor.

Recommendations

With reference to the Memo 109/2010, we bring to the attention of the Council the fact that the Council should not be paying such expenses without a duly approved and signed claim form. We therefore recommend that the Council ensures that reimbursements for personal vehicle use are made only if these are supported by proper claim forms which are approved by the Mayor.

4. PROPERTY, PLANT AND EQUIPMENT

4.1. Categorization of assets and depreciation thereof

Observations

The Council has categorised some assets in different incorrect asset categories, with the consequence that these are being depreciated with an incorrect depreciation rate.

For example, photovoltaic panels installed on the Council's roof in 2011 amounting to €10,141.71 and various vertical and micro blinds purchased in 2007 for the Council's administrative offices amounting to €1,232.24 have been recognised under the 'Construction' asset category when these should have been allocated under 'Buildings' asset category and 'Office Furniture & Fittings' asset category respectively.

During the year under review, a railing installed in Triq Burma amounting to €19,912.94 has been recognised under the 'New Street Signs' asset category when this should have been allocated under the 'Urban Improvements' asset category. Accordingly, the asset was fully depreciated rather than having been depreciated by the rate of 10% applicable to such assets.

Issues Arising

The calculation and posting of depreciation is regulated by the Financial Procedures (1996 – Finance) KLP 1/96 P1.01, h.07 (as amended by Legal Notice 323 of 2002). The measurement of depreciation undertaken by the Council is in conflict with the depreciation accounting policy of local councils as in fact stipulated in note 2 of the financial statements. We have qualified our audit report in this respect. With respect to the railing installed in Triq Burma, the necessary adjustments have been proposed which were duly rectified by the Council accordingly.

Recommendations

The Council should reclassify accordingly, in both the FAR and the financial statements, any assets wrongly categorised as well as undertake the necessary adjustments to the depreciation provision charged on such assets.

4.2. Insurance Policy

Observations

The Council is not properly insured in certain categories of property, plant and equipment held by the Council. In fact, the Council has an insurance policy covering the Council's furniture and fittings for the amount of €74,610, "property in the open" for the amount of €182,172, plant and machinery for €6,300 and Council's buildings for the amount of € 74,100.

The Council's total cost of fixed assets, excluding special programmes, as disclosed in its financial statements, amount to €1,250,454 of which €24,583 relate to furniture and fittings, €47,469 relate to office and computer equipment, €6,300 relate to plant and machinery, €11,787 relate to street signs, €17,307 relate to trees, and €530,651 and €612,447 relate to urban improvements and construction works respectively.

Issues Arising

The Council is exposed to a risk of theft and fire or damage for assets held by the Council. This is mainly evident with respect to office and computer equipment and plant and machinery, and to a certain extent urban improvements.

The Council's insurance policy in respect of assets insured needs to be reviewed on an annual basis to avoid having over and under insurance in different categories of property, plant and equipment.

Recommendations

The Council should ensure that the actual value of all insurable and material non-current assets held and maintained by the Council are provided to the insurance company for an adequate cover.

The Council should review the insurance policy on an ongoing basis to avoid unnecessary over and under insurance cover for each respective applicable asset categories and to ensure that the Council is properly insured.

It would be appropriate that the insurance policy details better those assets to be covered under each asset category. In this manner, it will be easier to carry out a claim in case of damage to any particular asset.

4.3. The Upkeep of the Fixed Asset Register (FAR)

Observations

The Fixed Asset Register (FAR) is not being entirely maintained in the appropriate manner as stipulated by the Local Council Procedures (1996 – Finance) KLP 1/96, P1.16b.

Some descriptions lack fundamental details about the asset being capitalised. In some cases, the description of the FAR card only includes a very generic description thus not providing relevant information about the asset and its location, example 'URBAN054 – Wrought iron hand railing', 'URBAN003 – General works' and 'SPFUN031 – Road Resurfacing'.

Issues Arising

Proper asset description as well as its specified location is of particular importance to tighten controls on physical existence and eventual asset disposals. There may be cases where the assets, especially those located in the outer environment, may be exposed to theft, vandalism, arson or extreme nature elements and one would need to identify them to be able to correctly dispose of them.

Recommendations

The Council should undertake an exercise so that the description of the asset in the FAR card should contain the highest degree of detail possible. The detail should not be of a generic nature, such as 'road resurfacing' and 'general works'. Furthermore, the FAR card should contain the exact location of the asset so that in case when the asset is subject to theft, vandalism, fire or any other damage, these can be identified easily. This would be useful for insurance claims and asset disposal adjustments.

4.4. Reconciliation of the Fixed Asset Register (FAR) to the Financial Statements

Observations

We noted that the accumulated depreciation as per FAR for certain fixed asset categories is not in agreement to the accumulated depreciation in the financial statements. The below variances were identified:

Category of assets	Depreciation as per FAR	Depreciation as per FS	Variance
	€	€	€
Construction	430,842.68	436,220.00	(5,377.32)
Office equipment	42,170.50	42,752.00	(581.50)
Furniture and fittings	14,529.30	14,693.00	(163.70)
Plant and Machinery	5,972.21	6,007.00	(34.79)
Urban improvements	378,326.28	378,798.00	(471.72)

The Council explained that these variances are arising due to a different software programme being used for depreciation. The monthly depreciation charges are being passed automatically on Sage Evolution, and when these are being integrated with Sage Pastel Partner, the above variances are arising.

Issues Arising

The upkeep of a proper Fixed Asset Register is of utmost importance to the Council. A Fixed Asset Register is deemed as one of the principal accounting ledgers of a Council, which enables the Council to maintain its control of its capital expenditure by recording the value, depreciation as well as the location of the particular asset being recorded.

Recommendations

The Council should ensure that any such variances in the depreciation provision of these asset categories within the FAR is duly reconciled and adjusted so that they agree with the amounts as per nominal ledger.

4.5. Assets no longer used by the Council

Observations

We noted that certain fixed assets such as 'COMP012 -Scanner and Zip Drive' purchased in 1998 at a cost price of €743.07 and 'COMP023 – New Computer/Tel /Fax Network' purchased in 2000 at a cost price of €391.33 are included in the Fixed Asset Register and in the financial statements. The Executive Secretary stated that these assets were discarded when replaced some years ago.

Issues Arising

IAS 16-Property, Plant and Equipment and IAS 36-Impairment of Assets require that assets are assessed for impairment on an annual basis and any asset which is no longer in use should be duly disposed of accordingly in the accounts of the Council and such disposal duly reflected in its FAR.

Recommendations

The Council should undertake an exercise whereby all Council's assets are reviewed to confirm whether any impairment provision should be undertaken and to dispose of assets which are no longer in use in line with the requirements of IAS 16 and IAS 36.

4.6. Accounting for Intangible Assets

Observations

The Council does not have any computer software recognised in its financial statements even though during the year under review the Council incurred an expense of €796.50 with respect to Sage Evolution Pro, an accounting software. The Council also owns and uses other computer software.

Issues Arising

Computer software falls under the definition of "Intangible assets" and has to be accounted for in line with the requirements of IAS 38-Intangible Assets. This class of assets needs to be disclosed separately in the financial statements.

Recommendation

The Council should ensure that the requirements of IAS 38 are properly applied with respect to any computer software purchased by the Council.

4.7. Fixed Assets Labelling

Observations

The markings and labels of certain fixed assets included in the FAR such as 'COMP080 – HP Computer – Executive', 'COMP081 – HP Computer – Clerk', and 'COMP082 – HP Computer – Clerk' were not updated on the physical assets.

Issues Arising

The marking and labelling of Fixed Assets is stipulated by the Local Council Procedures (1996 – Finance) KLP 1/96, P1.16b.

Recommendations

We recommend the Council to carry out an exercise of updating the labelling all the fixed assets shown in the Fixed Asset Register (FAR) wherever practicable, so that apart from being in compliance with the financial procedures, whenever an asset is disposed, it would be easier to trace to its FAR card.

4.8. Capital Commitments

Observations

The financial statements disclose capital expenditure that has been approved but not provided for amounting to €7,920 was disclosed. However, this capital expenditure was not reflected in the Annual Budget for 2018 that the Council approved.

Issues Arising

Capital commitments need to be disclosed in their entirety in line with the requirements of IAS 16- Property, Plant and Equipment. Furthermore, it is important that a proper reconciliation is provided, which should tally with both the capital commitments as per financial statements and those as per the forthcoming Annual Budget. In this way financial reports issued by the Council would be comparable and consistent.

Recommendations

The Council should ensure that capital commitments are properly assessed and disclosed, and a proper reconciliation provided to ensure that capital commitments as disclosed in the Council's budget are in line with those being disclosed in the financial statements.

4.9. Capital Expenditure accounted for as Revenue Expenditure

Observations

We identified an instance where expenditure of a capital nature was recorded as expenditure of a revenue nature. This relates to a crash barrier in Triq Tunis amounting to €1,272.52 which was recognised under the nominal code "road markings".

Issues Arising

This item should have been capitalised rather than expensed directly to the Statement of Comprehensive Income in line with the requirements of IAS 16 - Property, Plant and Equipment.

Recommendations

Appropriate distinction should be made between items of revenue and capital expenditure throughout the bookkeeping process. Further to our recommendations, the necessary adjustments were included and the financial statements were rectified by the Council accordingly.

5. RECEIVABLES

5.1. Collection of Local Enforcement fines outstanding

Observations

The Local Council's unaudited financial statements show that as at year-end the Council had LES Debtors amounting to €8,582.62 against which it has provided a full provision for bad debts.

However, when we extracted LES report 622 titled "Tribunal Pending Payments" with a date range for fines issued from 1st January 2000 till 31st August 2011 and tribunal period 1st January 2000 till 31st December 2017, the amount of LES contraventions payable to the Council amounted to €7,965.15.

Issues Arising

Although the net effect is nil, since a full provision for doubtful debts is still required to be provided for, it is important that an amount is recognised and provided for in agreement to the actual LES contraventions payable to the Council, which are based on reports emanating from the LES system.

Recommendations

The Council should take note to ensure the amount recognised and fully provided for should be equal to the tribunal pending payments amount as per LES report 622. Further to our recommendations, the necessary adjustments were included and the financial statements were rectified by the Council accordingly.

5.2. Accounting for Prepayments and Accrued Income

Observations

We noted that a prepayment with respect to rental fees for the period January to June 2018 was understated by €461.85.

Furthermore, we noted that no accrued income was accounted for in relation to the 2017 tipping fees amounting to €16,188.61.

Issues Arising

In order for the Council to comply with the requirements of International Financial Reporting Standards, it needs to account for prepayments and accrued income correctly and completely.

Recommendations

It is important that the Council makes a proper assessment of its prepaid expenses and accrued income at the end of every financial reporting period. Further to our recommendations, the necessary adjustments were included and the financial statements were rectified by the Council accordingly.

6. PAYABLES

6.1. Accounting for Accruals

Observations

Following cut-off tests on creditors and accruals recognised in the financial statements, it transpired that invoices amounting to €1,033.21 were incorrectly accounted for as accruals when in actual fact these should have been recognized as creditors.

Furthermore, we noted the following errors/omissions in relation to the accruals recognized by the Council:

- The accrual for street lighting payable to Mica Med Limited is overstated by €37.35.
- The accrual for cash collection services payable to Signal 8 Security Limited is overstated by €41.30.
- The accrual for the 2017 performance bonus payable to the executive secretary is understated by €59.30.
- The accrual for tipping fees for the month of December 2017 payable to WasteServ Malta Ltd is overstated by €118.83.
- The accrual for refuse collection for the month of December 2017 payable to Christian Galea is overstated by €1,650.

Issues Arising

In line with the concept of accrual accounting, accruals should be estimated and accounted for correctly and completely. This also entail that payables are properly recognised in the financial period in which they arise.

Recommendations

The Council should prepare accounts in compliance with the "accruals concept" of accounting in line with the generally accepted accounting principles and International Financial Reporting Standards. Invoices received and dated after year end should be checked carefully to determine if any amounts should be accrued for and included in the correct accounting period. Further to our recommendations, the necessary adjustments were included and the financial statements were rectified by the Council accordingly.

6.2. Supplier balances reconciliation

Observations

We noted a situation whereby the Council's supplier balance did not agree with the balance maintained by the supplier. A variance of €109.89 was noted between the balance in the books of the Council and the balance as per the supplier statement of WasteServ Malta Ltd.

Issues Arising

Such variances may distort the amounts due by the Council at any point in time to its suppliers. Therefore, supplier balances need to be reconciled on a periodic basis. Such a reconciliation should entail the investigation of any variances and, if adjustments are required, these should be reflected in the books of accounts,

Recommendations

On a regular basis, the Council should request the necessary supplier statements and confirmations from its creditors to ensure that its balances are correct and adequately reconciled.

7. OTHER DISCLOSURES IN THE FINANCIAL STATEMENTS

7.1. Disclosures required in respect of certain IFRS

Observations

The Local Council (Financial) Procedures, 1996, require that the financial statements should be prepared in accordance with International Financial Reporting Standards. These financial statements are not compliant in all respects with the requirements of these standards and in fact disclosures emanating from certain accounting standards are missing or not in line with the relevant accounting standard.

For example, omissions were noticed in relation to disclosure of new and revised IFRSs adopted by the EU that are not mandatorily effective (but allow early application) for the year ending 31 December 2017 in line with the requirements of IAS 1-Presentation of Financial Statements. Furthermore, the disclosure of new and amended standards adopted by the Local Council, and standards and interpretations issued by the IASB but not yet adapted by the EU are not complete.

Disclosure of related parties and related party transactions in note 20 is not complete in view that the requirements of articles 18, 25 and 26 of the said standard have not been complied with.

Other presentation and disclosure deficiencies have been duly noted in other areas of this management report.

Issues Arising

The financial statements should be prepared in a consistent manner, whereby all disclosures need to be undertaken in line with the requirements of International Financial Reporting Standards. These disclosures are not simply quantitative but also descriptive and we noted that the latter have sometimes been omitted as noted above. In this respect, we have qualified our audit report.

Recommendations

The financial statements should be prepared in accordance with International Financial Reporting Standards and that all necessary disclosures are undertaken as required.

7.2. Financial Statements presentation

Observations

During our review of the financial statements we noted a number of areas in the presentation of the financial statements which were incorrect or were not properly presented.

Issues Arising

- In the Statement of Cash Flows, the below issues were noted:-
  - The line item 'Loss on disposal of fixed assets' should have been removed since both current and prior year figures are 0
  - '(Increase)/Decrease in Trade and other receivables' should read 'Decrease/(Increase) in Trade and other receivables'
  - The section: Cash flows from financing activities should have been removed.

- In note 7 to the financial statements, the disclosure for average number of employees in the 2017 column should read 3 rather than 2.

- In note 9 to the financial statements, the line item 'Loss on Disposal' should have been removed

- In note 21 to the financial statements, under the heading 'Liquidity risk', the balance for cash and cash equivalents should read €419,378.
- In note 21 to the financial statements, under the heading 'Liquidity Risk', the sentence 'At 31 December 2017, the Council's financial liabilities have contractual maturities which are summarised below:' should be transferred to the next page.

Recommendations

The Council should ensure compliance with *International Financial Reporting Standards, respective Memos and Local Councils Procedures (2006 Audit)* in the preparation of the Financial Statements.

8. GENERAL

8.1. Comparison of Actuals with the Annual Budget*Observations*

During our review of the 2017 annual budget, it was noted that capital expenditure incurred in 2017 exceeded the budgeted amount. In fact, according to the 2017 annual budget no capital expenditure had to be incurred. However, as per financial statements, capital expenditure amounted to €31,411.

Issues Arising

We bring to the attention of the Council the fact that the Council is regulated by paragraph P1.07 (b.05) of the Local Councils Procedures (1996-Finance) KLP 1/96, which states that it should not spend more than its budgeted expenditure (usually based on the liquidity position and funds available). Furthermore, it is envisaged that if any expenditure category requires materially more funds than budgeted, an adjustment is undertaken to the said budget and is duly approved by the Council.

The Council should compile the annual budget with due care and diligence to use it as a guideline to control its expenditure during the year. Any projected variances should be adjusted at least on a quarterly basis to ensure that the Council would either have sufficient funds available to justify the increase in expenditure, or else reallocate excess funds where there are decreases in expenditure or increase in income received.

Recommendations

In compiling a budget, each item of income or expenditure should be scrutinised to determine whether there is some form of agreement which gives certainty of the projection being presented. In the absence of a contract or an agreement, the item should be extrapolated over historic data to approximate the desired projections for the entire consolidation of the official final draft of the budget.

8.2. Council minutes

Observations

We noted that the Council's minutes for meeting number 12/K7/2017 were not signed by the Mayor.

Issues Arising

The Sixth Schedule of the Local Councils Act requires in paragraphs 14(A)(6) and 14(A)(7) that the minutes become public once they have been approved and signed by the Chairman and the Executive Secretary and that these should be initialled by the Chairperson. Paragraph 14(A)(8) of the same schedule also obliges the Executive Secretary to ensure the proper and safe custody of these Council's records.

Recommendations

The Council should adhere to the requirements of these memos and Local Councils Act accordingly.