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9th June 2020

The Mayor
Local Council Gharb
Visitation Street,
Gharb,
Gozo

Dear Mayor,

RE: MANAGEMENT REPORT FOR THE YEAR ENDED 31 DECEMBER 2019

We have completed our audit of the financial statements of the Local Council Gharb 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 11 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

A handwritten signature in blue ink, appearing to read 'Conrad Borg', with a stylized flourish extending to the right.

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

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Local Council Gharb

Management Report for the year ended 31 December 2019

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1.0 FOLLOW-UP TO LAST YEAR'S REPORT

1.1 Property, Plant and Equipment

Last year the following points had been highlighted:

- The fixed assets register as at the end of the year was not agreeing with the nominal ledger.
- No detailed workings were provided showing the breakdown of the grants and how they were allocated against the cost of the fixed assets.
- Grants received were allocated to several items of property plant and equipment rather than to the items they intended to cover.
- Grants were released against property, plant and equipment before projects were completed.
- Grants were capitalised under property, plant and equipment despite they were not related to projects of a capital nature.
- Depreciation was not worked out on the remaining useful lives of the assets.
- Items of property, plant and equipment whose useful life expired were not written off.
- Costs relating to computer software and website were capitalised under property, plant and equipment rather than under intangible assets.

From the above it was noted that only the last issue was resolved. All the other issues were noted again this year.

1.2 Receivables

In last year's management letter, we pointed out the below issues:

- We found a receivable that was still shown as outstanding despite it was already received.
- We found instances where the receivable balances in the accounts were not matching with the third-party confirmations.
- In the accrued income, we found two amounts that were overstated.
- No adequate supporting document was provided for an accrued income from Water Services Corporation that has been outstanding for years.
- The funds receivable for the Creativity Hub were under accrued.
- The aged debtors' list was not agreeing with the control account.

Apart from the first two weaknesses, the other weaknesses listed above were encountered again this year.

1.3 Bank and Cash

With respect to bank and cash, the following weaknesses were encountered last year:

- Not all the petty cash boxes were accounted for.
- The Local Council opened bank accounts with the Central Bank of Malta which were not recorded in the books.
- Stale cheques were found in the list of unrepresented cheques.
- Some bank accounts had tax being withheld on interest.

Other than the last point, the other issues were not encountered during the current audit.

1.4 Payables

During last year's audit, we had noted the below issues:

- Interest due on the bank loan and works carried out during the year on capital projects, were not accrued for.
- Grants were allocated against property, plant and equipment before carrying out the related projects.
- The Council posted a proforma invoice rather than the actual invoices, which proforma invoice was higher than the actual invoice.
- Unexplained variances between the suppliers' statements received and the payables' balances as per books were noted.
- Debit balances were found in the aged payables' list that were not classified under the receivables.

The last two weaknesses were found once again during the current year.

1.5 Income

When testing the income, the following weaknesses were noticed last year:

- Certain items of income were classified under the wrong income accounts.
- We noticed that an income was accounted for twice, once through an invoice and then through the receipt of funds that were posted directly into the income account.

The first weakness was encountered also during the current audit.

1.6 Expenditure

The issues we came across while testing the expenditure were:

- Purchase requests and purchase orders are not always prepared.
- Certain procurement procedures were not properly followed.
- The actual expenditure exceeded the budgeted costs in several categories.
- When the Council paid for travelling expenses, no travel report was prepared.
- Agreements with the childcare workers was not made.
- A rental agreement for the garage was not available.
- Cases were found where a VAT fiscal receipt was not obtained.

During the year under review, all the above issues were again noted.

2.0 PROPERTY, PLANT AND EQUIPMENT

- 2.1 While reviewing the fixed assets register, it was noted that the figures in the fixed assets register did not tally to the figures shown in the unaudited financial statements. The following variances before passing audit adjustments have been noted:
- 2.1.1 Total cost as per the fixed asset register amounted to €3,220,402 whilst the total cost as per financial statements, excluding the assets under construction, amounted to €3,299,666.
 - 2.1.2 The total accumulated depreciation as per the fixed asset register amounted to €173,370 whilst the depreciation and grants as per financial statements amounted to €3,076,740.
 - 2.1.3 The net book value as per the fixed asset register amounted to €221,858 whilst the net book value as per financial statements, excluding the assets under construction, amounted to €222,926.
- 2.2 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 now 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:
- 2.2.1 Items of property, plant and equipment whose useful life expired were not written off upon the adoption of the new depreciation accounting policy.
 - 2.2.2 The depreciation is not being worked out on the remaining useful life of the assets.
 - 2.2.3 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.
- 2.3 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, we recommend that a proper fixed assets register is built that would contain complete details of every item of property, plant and equipment of the Local Council, including the grants allocated to certain assets. Fixed assets should be properly coded to facilitate the identification of the assets. Periodic inspections should be conducted to check the completeness and validity of the items in the fixed assets register, thereby increasing control over the assets and maintaining the integrity of the data in the fixed assets register. If the correct costs and accumulated depreciation could not be recorded in the fixed assets register due to the change in the accounting policy for the depreciation, 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 financial statements.
- 2.4 In the financial statements, the electric bikes bought during the year at a cost of €34,627 were classified under plant and machinery instead of under motor vehicles. In the accounts, the transaction was recorded correctly. The Council received €31,500 in grants to cover such costs that were also classified under plant and machinery.
- 2.5 The Local Council should ensure that the assets are correctly presented in the notes to the financial statements to give a correct picture of the type of property, plant and equipment held by the Council. We highly suggest that the necessary reclassifications are made in the note on property, plant and equipment in the financial statements.
- 2.6 When testing the depreciation charge for the year, we noted that the depreciation is being calculated on a yearly basis rather than on a monthly basis in line with the accounting policy applicable to the Local Council as disclosed in the financial statements. Due to the limited available information mentioned in point 2.2 above, we could not properly check the

correctness of the depreciation calculation for the year. Yet, we noticed that for example the electric bikes bought during the year mentioned in the previous point, should have had a carrying value of €3,127 after you deduct the grant from the cost. Yet, in the fixed assets register, this asset was included with a carrying value of €4,627 and depreciation was calculated on this value.

- 2.7 The Local Council should ensure that any assets added to the fixed assets register are properly recorded and supporting workings are to be kept that explain how the values taken in the fixed assets register have been arrived at. The same applies for an explanation of the depreciation amounts being taken on all items of property, plant and equipment.
- 2.8 The Council could not provide a breakdown of the grants allocated to each asset item from 1 January 2018 to 31 December 2019. As such we could not verify the correctness of the change in accounting treatment.
- 2.9 As at 31 December 2017, the Local Council had received grants amounting to €364,035 relating to various capital projects that were not yet carried out and also had a balance of €6,275 representing funds received in excess of the costs incurred on a capital project carried out in the previous years. 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. From these projects, only one was capitalized during the year ended 31 December 2018 with a cost of €120,112. Furthermore, during the year ended 31 December 2018, new grants amounting to €68,592 were capitalised under property, plant and equipment. It transpired that this was made up of grants received less the reversal of accrued income with respect to grants. In the grants received, there were also grants not related to capital projects. No information was provided to us on these grants and on whether the projects to which the above grants related, were completed during the years ended 31 December 2018 and 31 December 2019.
- 2.10 The Local Council should carry out a detailed exercise whereby every grant received by the Local Council over time is properly identified and allocated to the correct item of property, plant and equipment which it intended to cover. This exercise is to be properly documented so that the correction thereof can be checked during the audit. Any allocations that have not been done correctly, should be adjusted in the accounts and in the fixed assets register and the depreciation recalculated on the assets affected. Any grants capitalised that related to non-capital projects are to be transferred to the retained earnings if these projects were already carried out. Any grants relating to projects not yet carried out should be allocated under the deferred income until the respective projects are carried out.

3.0 RECEIVABLES

- 3.1 During our cut-off procedures, it was noted that the last 4 receipts of 2019 were not recorded. The aggregate amount of these receipts was immaterial as they amounted to only €40. However, these receipts could have had higher values and therefore the Local Council should always ensure that the receipts are recorded in the year to which they relate.
- 3.2 While going through the receivables' aged list we noted that the Council has receivables older than two years amounting to €3,855 but the provision for doubtful debts in the accounts amounted only to €3,160. The provision is therefore understated by €695.
- 3.3 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.
- 3.4 When testing the accrued income, we noticed that the income relating to funds receivable from Transport Malta with respect to the European Mobility Week grant was understated by €1,500 whilst in the community services income account we found an accrued income of €1,000 for which no explanation was obtained. It was agreed to adjust both accrued income amounts during our audit.

- 3.5 Within the accrued income, there was an amount of €34,040 receivable from the Water Services Corporation, that has been brought forward from the previous years. Similarly, there was an insurance claim of €5,944 that has also been brought forward from the previous year. No adequate audit evidence was obtained on these funds receivable to confirm the correctness and recoverability of such accrued income.
- 3.6 We also noted that within the accrued income, there were €304,412 representing the total funds receivable for the resurfacing of various roads in Gharb which project has not even commenced by the end of the year. Moreover, as noted in point 4.3 below, part of these funds was received during the year. An adjustment was passed to reverse such an accrual and to reflect the funds received that were not accounted for.
- 3.7 The Local Council should be aware of the funding agreements that it would have become a party to and if any funds relating to the activities held during the year would have not been received by the end of the year, these should be accrued for based on such documentation. Same principle applies to other income that the Local Council becomes entitled to, which it would have not yet received. No accrued income should be recognised for projects that have not yet been commenced. The Local Council should keep copies of all the funding agreements that it signs or other adequate documentation supporting the other income not yet received. The Council should continuously monitor and chase such funds and income to improve liquidity.
- 3.8 The aged debtors' list was not agreeing with the control account found in the books of accounts by €1,590. Upon investigating this variance, we noted that this resulted from an audit adjustment passed in 2014 to correct the balance of Green MT. The adjustment was passed through a journal entry directly in the control account.
- 3.9 Kindly note that no journal entries should be passed directly in the control account. Adjustments should be passed through the invoicing and receipts options in the debtors' ledgers.

4.0 BANK AND CASH

- 4.1 When going through the bank statements, we noticed that on one of the bank accounts withholding tax is being deducted on the interest receivable by the Local Council.
- 4.2 Given that the Local Council is not subject to tax, we suggest that the bank is informed not to withhold any tax.
- 4.3 From the cut-off tests carried out, we noted that two cheques issued by the Ministry for Gozo in December 2019, amounting to €254,654, were not record as unlogged deposits. These cheques related to funds for the resurfacing of various roads in Gharb. An adjustment was passed to reflect these amounts.
- 4.4 The above-mentioned cheques were deposited in the beginning of January and hence the Local Council should have been aware of their existence at the time of closing off the accounts. Hence, care should be taken to ensure that all transactions are posted in the year in which they occur.
- 4.5 During our petty cash testing, a variance of €50 was noted between the book balance and the petty cash counted after adjusting for the receipts and payments after the end of the year.
- 4.6 The Local Council should carry out periodical cash counts and should reconcile the amounts counted with the amounts shown in the accounts. Any resulting variances are to be immediately investigated.

5.0 PAYABLES

- 5.1 From the sample we selected from the creditors' list for our testing, we found variances in three of them that resulted in an overall understatement of €25,448, between the suppliers' confirmations and the amounts shown in the books of accounts. When we inquired with the Local Council, we were not presented with a reconciliation or any explanation. The Local Council has noted that for one of its suppliers, the Council makes payments based on certified works and not on the invoices that the supplier issues. Hence there could be differences between the invoices issued and the certification of the works carried out that could be creating the most material variance found. However, this was not proved to us to be the case here.
- 5.2 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. The Local Council should ask its suppliers to provide it with statements if the suppliers do not send regular statements, particularly when closing off the books of accounts. Furthermore, the Local Council should record all the invoices received from the contractors that are normally issued after the certification. If there are any disagreements, these should be discussed with the contractor and the necessary credit notes issued if that is the case. However, variances should not be left not tackled.
- 5.3 When browsing the creditors' list, we noted that four creditors had a debit balance in their account that together amounted to €1,641. These balances were not investigated by the Local Council even though they have been coming from the previous years. These balances were not reclassified to under the receivables for presentation purposes.
- 5.4 Kindly note that these balances should be investigated, and the necessary action taken thereon. Negative balances might indicate missing invoices or double payments.

6.0 INCOME

- 6.1 We noted that the income for the childcare services for the month of December 2019, amounting to €12,233. was not received and was not accrued for. An adjustment had been passed to reflect this income.
- 6.2 The Local Council should be aware of the income it is entitled to and which would have not yet been invoiced or received by the end of the financial year, and for any such income, an accrual should be made when closing off the accounts to ensure that the income is matched with the related costs in the year in which they are incurred.
- 6.3 A total income of €127,825 which was received from the government was posted in income accounts not related to government income. These included €93,325 relating to cultural activities, €26,500 relating to community services, €5,000 relating to sponsorships and €3,000 relating to library schemes. These items of income have been reclassified during our audit.
- 6.4 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.
- 6.5 When analysing the income accounts, we noticed that included under other government income there were funds relating to an irrigation system project, amounting to €6,460, 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.
- 6.6 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.

7.0 EXPENDITURE AND TENDERS

- 7.1 During the audit, we noticed that the Local Council does not always draw up a purchase request and a purchase order in line with the Local Councils Financial Procedures. There appears to be no specific reason behind this practice.
- 7.2 It is understood that at times, the urgency of matters might require the reduction of bureaucracy as much as possible, however we are still of the opinion that the necessary paperwork should have been done in line with the financial procedures.
- 7.3 Following Directive 03/2017 issued by the Department for Local Government to Local Councils on the change in the public procurement regulations, we noticed instances where the Council did not abide with the new regulations. The Local Council bought flight tickets through direct orders from the same agency during the year. The total amount of tickets purchased during 2019 amounted to €11,990. Another instance was noted where the Local Council bought transport services amounting to €11,363 through a direct order.
- 7.4 We understand that the bureaucratic requirements of the public procurement regulations may be cumbersome, however we highly suggest that the Council adopts these regulations to full effect.
- 7.5 When the Local Council paid for travelling expenses, no travel report was prepared in line with MFEI Memo 05/2012.
- 7.6 We came across instances whereby the Local Council was not provided with VAT fiscal receipts for services acquired and paid for during the year. These services amounted to €4,864.
- 7.7 The above issue goes 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 this matter and to ensure that such occurrences are not repeated in the future.
- 7.8 During our testing, we enquired whether the Local Council has agreements in place with the childcare services workers. It transpired that there are no agreements in place and that the call for such services was not done through the government e-procurement system but through a call on the local newspapers.
- 7.9 We highly suggest that the Local Council enters into a formal agreement in writing with the childcare services workers that would stipulate the conditions agreed to.
- 7.10 We also noted that the rental agreement for the garage used by the Local Council for storage purposes has expired and has not been renewed yet. It was noted that the invoice issued in 2019, that amounted to €5,460, covered the period from April 2018 to April 2019.
- 7.11 The Local Council should take immediate action to renew the rental agreement for the garage still being used by it, so that both parties are appropriately protected.
- 7.12 From the samples of expenditure tested, it was noted that the total actual expenditure exceeded the budgeted costs in several categories as follows:
- Materials & Supplies (Category 2200) by €13,356
 - Repairs & Upkeep (Category 2300) by €15,420
 - Transport (Category 2700) by €26,548
 - Information Services (Category 2800) by €5,656
 - Contractual Services (Category 3000) by €10,367
 - Training (Category 3200) by €889

- Hospitality and Community (Category 3300) by €130,178
- Local Enforcement Expenses (Category 3600) by €1,969

- 7.13 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.
- 7.14 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.

8.0 PERSONAL EMOLUMENTS

- 8.1 When reconciling the FS7 with the FS5s, we noted some variances. The gross emoluments in the FS7 amounted to €91,284 whilst the total gross emoluments in the FS5s amounted to €91,785, resulting in a variance of €501. The tax deductions as per FS7 amounted to €10,609 whilst the tax deductions in the FS5s amounted to €10,639, a variance of €30. The total security contributions as per FS7 amounted to €12,402 whilst the total security contributions in the FS5s amounted to €12,251, resulting in a variance of €151.
- 8.2 Variances were also found with the figures shown in the FS3s which in total amount to gross emoluments of €91,785, total tax deductions of €10,639 and total social security contributions of €12,402.
- 8.3 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.
- 8.4 When reconciling the personal emoluments as per accounts and financial statements with the amounts reported in the FS7, an unexplained variance of €451 resulted.
- 8.5 Apart from the above-mentioned reconciliations, the Local Council should also reconcile the payroll costs as per books of accounts with the figures disclosed in the forms submitted to the Commissioner for Revenue.
- 8.6 Whilst 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.
- 8.7 When computing the payroll, it is important that the Local Council follows the instructions issued by the Department through the Circulars from time to time. During the current year, Circular 14/2019 and Circular 20/2019 were issued with respect to the Mayor's honoraria and allowances, amongst other things. The effective dates of the changes should be abided with.

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.