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11th June 2020

Local Council San Lawrenz
22A, Triq id-Duluri,
San Lawrenz SLZ1261,
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 San Lawrenz for the year ended 31 December 2019. The purpose of this report is to summarise your 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 might exist and/or of all improvements that might be made. Our aim is to offer guidance to the 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) the Council; (b) the National Audit Office; and (c) the Local Councils Department. Consequently, this report may not be distributed, used or quoted, in part or in full, 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, Legal Notices applicable to Local Councils and various Memos 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 Staff members for their assistance during the course of our audit.



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

Local Council San Lawrenz

Management Report for the year ended 31 December 2019

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1.0 FOLLOW-UP TO LAST YEAR'S MANAGEMENT REPORT

1.1 Property, plant & equipment

From the limited procedures we could perform, we noticed that the adoption of Directive 01/2017 was not properly carried out. Moreover, it was observed that there were no journal entries recorded to recognise the impact of the change in accounting policies as per Directive 01/2017.

We noted that certain assets were accounted for under the wrong assets' category.

When testing the additions, we noted that costs relating to a playing field project completed in 2017 were accounted for once again during 2018.

The first weakness was found again this year.

1.2 Receivables

While testing a sample of the accounts receivable, a difference was found between the balance as per books of accounts and the balance confirmed by the customer.

When testing the accrued income, we noted that 50% of a grant that was not received, was not accrued for, whilst in another case, the amount accrued for was understated.

Similar issues to the above were once again noticed.

1.3 Payables

Variations were found between the balances shown in the statements that we obtained from a sample of suppliers and the balances shown in the books of accounts.

We have requested a report from the architect about the projects that were carried out by the Council during the year ended 31 December 2018. This report was not received by the time of issuing this report. Consequently, we could not confirm whether there should have been any accruals with respect to such projects.

We noted that the Council had already received funds with respect to the project under Measure 4.3 which funds were deposited in a new bank account which was not reflected in the accounts.

Except for the last point, the other weaknesses were found again during the current audit.

1.4 Income

When testing the income of the Local Council from Wasteserv, it was noted that the rate used in the invoice for the month of July, per organic waste collection, was different from the agreed rate as per agreement with Wasteserv.

We noticed that income received from the government was allocated to the wrong income nominal account.

Grants received for a project that had not yet started, were recognised as income for the year.

The above issues, apart from the last one, were encountered again during this year's audit.

1.5 Expenditures and tenders

The Council did not draw up a purchase request or a purchase order in line with the Local Councils Financial Procedures. We also noted that the Local Council exceeded the budgeted expenditure for several categories of expenditure.

When testing a sample of the expenditure for the year, we noted instances where a VAT fiscal receipt was not available and instances where the transactions were recorded under the incorrect expense accounts.

All the above issues were found again during the current year.

1.6 Liquidity

As at 31 December 2018, the current liabilities of the company exceeded its current assets by €24,351. A similar situation existed as at 31 December 2019.

1.7 Financial Situation Indicator

The Financial Situation Indicator held by the Council at the statement of financial position date, stood at negative 34.25% which falls below the 10% threshold required by the Financial Provisions to the Local Councils Act. The Local Council still had a negative financial situation indicator as at 31 December 2019.

2.0 PROPERTY, PLANT & EQUIPMENT

- 2.1 While checking the opening balances and following the Directive 01/2017 issued by the Department for Local Government to Local Councils regarding the change in the accounting policies on depreciation, we noticed that the Council has not yet performed the following:
- 2.1.1 Items of property, plant and equipment whose useful life expired were not written off upon the adoption of the new depreciation accounting policy.
 - 2.1.2 The depreciation is not being worked out on the remaining useful life of the assets.
 - 2.1.3 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.
- 2.2 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. When doing such an exercise, it is important to keep all the necessary workings to be able to understand the transition, the accounting entries passed with respect to such transition and be able to reconcile the costs, accumulated depreciation and grants as previously reported in the financial statements with the updated figures.
- 2.3 No proper fixed assets register was provided to us during our audit and hence we could not perform any checks on the existence and completeness of the property, plant and equipment. The fixed assets register provided included one line item with the net book value of all the assets up to 1 January 2018 when there was the adoption of Directive 01/2017 and then included the details of the items of property, plant and equipment that were acquired from 2018 onwards. No financial information was included of the items that were covered by funds.
- 2.4 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. 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.
- 2.5 As at 31 December 2017, the Local Council had deferred income amounting to €53,140 relating to 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. It transpired that these projects have not been done by 31 December 2019. Consequently, the deferred income and the property, plant and equipment are understated.
- 2.6 We recommend that the Local Council prepares a proper analysis of all the funds it have received over time and allocate them to the costs of the projects they were intended to cover. This should be made as part of the exercise mentioned further above on the proper adoption of Directive 01/2017. The funds not yet utilised would be clearly identified and could then be transferred under the deferred income until such time, these projects are carried out.

- 2.7 When checking the payments made for the assets purchased during the year, we noted that a VAT fiscal receipt was not always available. From the samples tested, the expenditure for which no VAT fiscal receipt was available amounted to €9,606.
- 2.8 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.
- 2.9 During our testing on the additions for the year, we noticed that the Local Council is using the services of an architect through direct orders. The total amount invoiced to the Local Council during the year for such services, amounted to €5,890.
- 2.10 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.
- 2.11 Upon checking the depreciation charge for the year, it was noted that the depreciation is being calculated on a yearly basis rather than on a monthly basis.
- 2.12 Kindly note that the accounting policy applicable to the Local Council, as disclosed in the financial statements, clearly stipulates that the depreciation is to be calculated on a monthly basis. We therefore suggest that the Local Council follows the accounting policy in its entirety.
- 2.13 When checking the insurance cover, we noted that the furniture and fittings of the Local Council that have a carrying value of €28,290, are only covered for an amount of €7,792.
- 2.14 In case of fire, theft or any other accident, the Local Council would not be able to recover all the losses incurred. We suggest that the Council should revise its insurance policy to ensure all category of assets are adequately covered.
- 2.15 We noted that one of the grants capitalised under property, plant and equipment during the year, was net of bank charges incurred amounting to €142.
- 2.16 Kindly note that there should be no netting off of expenses with income unless permitted by an International Financial Reporting Standard.

3.0 RECEIVABLES

- 3.1 While testing a sample of the accounts receivable, a difference was found between the balance as per books of accounts and the balance confirmed by the main customer. The difference was of €2,708. The customer did not send a statement with the confirmation letter and therefore a reconciliation of the variance was not carried out.
- 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 checking the accrued income as at the end of the year, we noted that the Council was entitled to receive further funds with respect to the project concluded during the year under Measure 4.3. These funds yet to be received, amounting to €17,365, were not accrued for.
- 3.4 The Local Council should be aware of the funding agreements that it would have entered into and if any funds relating to the projects completed during the year would have not been received by the end of the year, these should be accrued for based on such agreements. This would ensure that the correct amount of funds are capitalised under the property, plant and equipment in the same year when the project costs are capitalised.

4.0 PAYABLES

- 4.1 When checking the balance of one of the suppliers, a variance was found that related to works on water culverts carried out in 2012. An amount of Euro 31,350 was accrued for in 2012 out of which Euro 20,000 were paid during 2013 leaving a balance of Euro 11,350 in the accruals at the end of 2013. In 2014, this balance was reclassified to the accounts payable. It seems that no official invoice was issued by the supplier to date for this amount, which means that this amount should be still shown as an accrual. No action whatsoever has been taken on this matter despite having pointed it out in the previous years' management letters.
- 4.2 This matter should be further investigated to conclude whether this balance is payable to the supplier or not given all the time that has passed. If it is confirmed that it is payable, an invoice should be requested to settle the amount once and for all. If it is confirmed that the amount is not due, meaning that the works carried out were less than the tendered for amount for which an accrual was originally accounted for, then the amount should be reversed, and the respective depreciation adjusted.
- 4.3 From the samples chosen for the testing of the accounts' payable, we only received statements/confirmations from three of them. For another four, we carried out alternative procedures but for remaining three, there were no adequate procedures that we could carry out. One of them is the supplier mentioned in point 4.1 above whilst the other two had a balance as at the end of the year of €2,907 and €5,510, respectively.
- 4.4 We recommend that each statement received from the suppliers is immediately reconciled. In cases where the suppliers do not send statements, the Council should ask for one especially at the end of the year. Any variances resulting from this exercise should be investigated immediately and appropriate action taken. This would ensure that the Local Council has a more accurate picture of its liabilities at any point in time which would help it in monitoring better its cash flows and monitor its debts.
- 4.5 Upon checking the payments made by the Council after the end of the year as part of our cut-of testing, we noted that there was no accrual for some invoices received in 2020 that pertained to services rendered during 2019. The total amount of the invoices that came to our attention was €2,334.
- 4.6 When discussing the projects carried out by the Local Council during the year, it transpired that resurfacing works in Triq il-Merill with a value of €36,246 were completed but this project was not reflected in the accounts since the invoice was not yet received. It has been agreed to pass an audit adjustment to reflect this project.
- 4.7 The Local Council should be fully aware of the services obtained and projects carried out for which no invoices would have been received. An accrual for such services and projects 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.
- 4.8 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 there should have been any accruals as at 31 December 2019 relating to such projects that have not been reflected in the accounts, which would result in an understatement of the accruals and of the property, plant and equipment.
- 4.9 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.

5.0 INCOME

- 5.1 When testing the income of the Local Council from Wasteserv, it was observed that the rate used in recording the revenue transaction (per organic collection waste) was different from the agreed rate as per agreement with Wasteserv. The rates per collection used by the Local Council for the invoicing were €58.44 for the months of January and February, €61.64 for the month of March, €65.18 for the months from April till October and €71.92 for the months of November and December. The agreement stipulates the rate per collection of €68.44 for the period January till October and €75.52 for November and December. Although, the differences are not material, the Council should follow and invoice an entity in line with the agreed rates.
- 5.2 When analysing the various supplementary government income, we noted a mistake in the recording of the income received for the event named "San Lawrenz Jiccelebra" The amount recorded amounted to €225 when the correct income amount was €1,225. An audit adjustment of €1,000 was passed to correct this error.
- 5.3 In addition, we also noted two items of government income one relating to the library scheme amounting to €2,786 and the other one relating to a cultural event held by the Local Council amounting to €2,000, that were allocated in the wrong income nominal accounts. Reclassification adjustments were passed to correct these wrong allocations.
- 5.4 It is to be ensured that every item of income is accounted for in the correct nominal account to ensure that the income is then properly and consistently presented in the financial statements.

6.0 EXPENDITURE AND TENDERS

- 6.1 The Council did not draw up a purchase request or a purchase order in line with the Local Councils Financial Procedures. The matter was discussed with the Council and we were informed that usually an e-mail is sent rather than a purchase order. We are still of the opinion that the Council should adhere to the procedures applicable to Local Councils. Moreover, the proper use of purchase orders would also help the Council to identify all liabilities at period-end.
- 6.2 When testing a sample of the expenditure for the year, we noticed that three of the samples chosen, which amounted to €3,596, were not covered by a VAT fiscal receipt.
- 6.3 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.
- 6.4 While browsing through the expenditure nominal accounts, we noted that there were certain transactions that were recorded under the wrong expense account. One such case for which an audit adjustment was passed, related to tipping fees that were posted in the refuse collection account rather in the specific nominal account available for tipping fees. The tipping fees reallocated amounted to €4,402.
- 6.5 Care should be taken when posting transactions in the books of accounts to ensure that the proper nominal accounts are chosen. This would ensure consistency and correctness in the information presented in the notes to the financial statements.
- 6.6 It was noted that the Council has exceeded the budgeted expenditure for several categories, namely:
- 6.6.1 Materials and supplies (Category 2200) by €1,091
 - 6.6.2 Repairs and upkeep (Category 2300) by €4,439
 - 6.6.3 Transport (Category 2700) by €36

- 6.6.4 Information services (Category 2900) by €52
- 6.6.5 Contractual services (Category 3000) by €1,779
- 6.6.6 Professional and management services (Category 3100) by €10,710
- 6.6.7 Hospitality and community (Category 3300) by €7,364
- 6.6.8 Local enforcement expenses (Category 3600) by €34

- 6.7 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.
- 6.8 We recommend that the Council makes use of the reporting tools in hand to take corrective measures in the budget every quarter.
- 6.9 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 used the services of an individual for the attendance at the Dwejra Centre through a direct order. The total amount invoiced during the year for this service amounted to €21,535. Similar instance of director orders included maintenance services for which the Local Council was invoiced €6,426 during the year.
- 6.10 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.

7.0 PERSONAL EMOLUMENTS

- 7.1 When reconciling the FS7 with the FS5s, we noted some variances. The gross emoluments in the FS7 amounted to €70,019 whilst the total gross emoluments in the FS5s amounted to €69,886, resulting in a variance of €133. The tax deductions as per FS7 amounted to €10,494 whilst the tax deductions in the FS5s amounted to €10,446, a variance of €48. The total security contributions as per FS7 amounted to €8,200 whilst the total security contributions in the FS5s amounted to €8,196, resulting in a variance of €4.
- 7.2 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 FSS forms to ensure that all the information therein tally.
- 7.3 While browsing the payroll accounts, we noted that €400 of the Mayor's allowance was posted in the account for the Mayor's honoraria instead of in the account for the Mayor's and Councillor's allowances. A reclassification adjustment was passed to correct this wrong allocation.
- 7.4 Care should be taken when recording transactions to ensure that they are posted in the correct nominal account. This would ensure that the payroll expenses are properly and consistently presented in the financial statements.
- 7.5 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.
- 7.6 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.

8.0 LIQUIDITY

- 8.1 The Statement of Financial Position on page 5 of the financial statements indicates that the current liabilities exceeded the current assets by €14,248. This implies that the Council does not have enough current assets to support its current liabilities.
- 8.2 The current ratio is €0.95 of current assets for every €1.00 of current liabilities indicating that the Council may be in a situation of 'overtrading'. The acid test ratio is in fact only €0.51 of cash and cash equivalents for every €1.00 of current liabilities.
- 8.3 We recommend that the Council curtails its current expenditure and does not enter into capital projects until the cash deficit situation is remedied.

9.0 FINANCIAL SITUATION INDICATOR

- 9.1 The Financial Situation Indicator held by the Council at the statement of financial position date, stood at negative 28.05% which falls below the 10% threshold required by the Financial Provisions to the Local Councils Act. Kindly note that a Financial Situation Indicator which falls below the 10% margin implies that the Council is not effectively managing its payables and cash flows, venturing into activities which are not budgeted for.
- 9.2 Kindly note that the Financial Situation Indicator has been calculated as the non-restricted current assets less current liabilities (excluding the deferred income) as a percentage of the Central Government allocation received in terms of Section 55 of the Local Councils Act (Chap. 363) after providing for cash and cash equivalents that are restricted to specific projects not yet carried out.
- 9.3 The Council should manage the working capital more attentively, in order to avoid such a negative Financial Situation Indicator. Moreover, it is recommended that the Council obtains the necessary clearance from the Department for Local Government if it anticipates a Financial Situation Indicator level which will fall below the 10% threshold in future years.

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.