

5th November 2021

Local Council San Lawrenz
22A, Triq id-Duluri,
San Lawrenz SLZ1261,
Gozo

Dear Mayor,

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RE: MANAGEMENT REPORT – FOR YEAR ENDED 31 DECEMBER 2020

We have completed our audit of the financial statements of the Local Council San Lawrenz for the year ended 31 December 2020. 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 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.

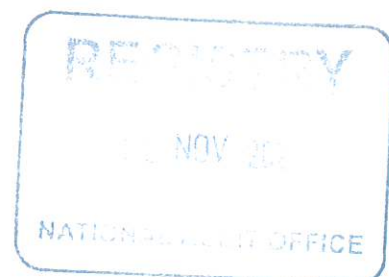
During the course of our audit for the year ended 31 December 2020, we examined the principal documents, systems and controls used by the Council, to help it ensure, as far as possible, the accuracy of these documents and to assess how much can one rely on these documents to safeguard the assets of the 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 (Principal)
for and on behalf of
RSM Malta



Local Council San Lawrenz

Management Report for the year ended 31 December 2020

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1.0 FOLLOW-UP TO LAST YEAR'S MANAGEMENT REPORT

1.1 Property, plant & equipment

The management letter of the previous year pointed out the following issues in relation to the Council's property, plant and equipment:

- a. From the limited procedures we could perform, we noticed that the adoption of Directive 01/2017 was not properly carried out.
- b. No proper fixed asset register was provided to us during our audit.
- c. Deferred income was capitalised upon the adoption of Directive 01/2017 despite the projects have not been done to date.
- d. VAT fiscal receipts were not always available for the sample of additions of property, plant and equipment tested.
- e. The Local Council used the services of an architect through direct orders.
- f. Depreciation is being calculated on a yearly basis rather than monthly.
- g. Furniture and fittings were under insured.
- h. Bank charges incurred were netted against grants capitalised under property, plant and equipment.

Weaknesses (a) to (d) were found again this year.

1.2 Receivables

In the prior year, the following issues were noted:

- a. 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.
- b. We noted that funds not yet received with respect to a project concluded during the year under Measure 4.3, were not accrued for.

Similar weaknesses to the above were noted again this year.

1.3 Payables

Last year, we noted the following weaknesses with respect to the payables:

- a. An accrual for works related to water culverts done during 2012, was reclassified to under the accounts payable in 2014 despite no invoice was ever received from the supplier.
- b. Balance confirmations were not received from several suppliers chosen for our testing.
- c. No accrual was made for certain invoices received after year-end, which pertained to the year being audited.
- d. We have requested a report from the architect about the projects that were carried out by the Council during the year. This report was not received by the time we issued our report. Consequently, we could not confirm whether there should have been any accruals with respect to such projects.
- e. The costs of a project relating to resurfacing works that was completed during the year, were not reflected in the accounts as the invoice was not yet received.

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

1.4 Income

Last year, we noticed the following weakness:

- a. When testing the income from organic waste collection, it was noted that the rate used when issuing the invoices for certain months, was different from the agreed rate as per agreement with WasteServ Malta Limited.
- b. One of the income items was posted with the wrong amount causing an understatement of €1,000.
- c. We noticed that certain items of income were recorded in the wrong nominal account.

A weakness similar to point (b) was encountered again during this year's audit.

1.5 Expenditures and tenders

When performing our tests on the expenditure, last year we noted that:

- a. The Council did not draw up a purchase request or a purchase order in line with the Local Councils Financial Procedures.
- b. When testing samples of the expenditure, we noted instances where a VAT fiscal receipt was not available.
- c. There were instances where expense transactions were recorded under the incorrect expense accounts.
- d. The Local Council exceeded the budgeted expenditure for several categories of expenditure.
- e. We noticed instances where the Council did not abide with the new regulations where some services were acquired through direct orders.

Apart from the weakness mentioned in point (c), all other weaknesses were encountered again during this year's audit.

1.6 Personal Emoluments

Last year, we noticed the following weaknesses:

- a. Variances were noted between the FS5s and the FS7.
- b. Part of the Mayor's allowance was incorrectly posted in the Mayor's honoraria account.
- c. Minor discrepancies were noted in the calculation of the Mayor's honoraria following the changes that took place during the year.

The first weakness was noted again this year.

1.7 Liquidity

As at 31 December 2019, the current liabilities of the Local Council exceeded its current assets by €14,248. There was a similar situation as at 31 December 2020.

1.8 Financial Situation Indicator

The financial situation indicator held by the Council at 31 December 2019, stood at negative 28.05% which fell below the 10% threshold required by the Financial Provisions to the Local Councils Act. The Local Council still had a negative financial situation indicator at 31 December 2020.

2.0 PROPERTY, PLANT & EQUIPMENT

- 2.1 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:
- 2.1.1 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 When browsing the fixed assets register, we noted that two additions made in 2019 totalling to €426, were entered twice under furniture and fittings. Yet, the net book value of the category, as well as the total net book value, agreed to the financial statements before any audit adjustments, which is very strange. This clearly shows that some other figures are incorrect.
- 2.5 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.
- 2.6 When checking the payments made for the assets purchased during the year, we noted that a VAT fiscal receipt was not available for one of the samples. The value of the asset was €5,192. We also noticed instances, where items of property, plant and equipment were purchased through direct orders. The value of these assets was €15,048.
- 2.7 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.

- 2.8 When checking the nominal ledger accounts relating to property, plant and equipment, we noted that an amount of €11,350 previously accrued for, was reversed in account "7505 Resurfacing". This amount pertained to water culverts which costs were originally recorded in account "7245 Pjazza Culvert". Therefore, a reclassification adjustment was passed.
- 2.9 Care should be taken before accounting for any transactions to ensure that the proper nominal account is used. In the case of reversal entries, it is to be ensured that the transaction being reversed is posted in the same nominal account where the original transaction would have been posted.
- 2.10 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 2020. Consequently, the deferred income and the property, plant and equipment are understated.
- 2.11 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.
- 2.12 During the year, the Council received funds amounting to €14,447 that were capitalised with respect to the project carried out under Measure 4.3. No documentation was provided to us during our audit in relation to such funds received other than the bank statement which shows the deposit made.
- 2.13 The Local Council should keep all documentation and correspondence relating to grants received or receivable, whether they are EU grants or grants from Central Government. The Local Council should also keep proper records to monitor the costs of the projects for which grants are received or receivable, and of the grants received or receivable. These will assist the Council to know what grants are yet to be received and to ensure that grants are allocated to the projects they are intended for. These documents are to be made available to the auditors during the performance of their audit.

3.0 RECEIVABLES

- 3.1 While testing a sample of the accounts receivable, a difference of €638 was found between the balance as per books of accounts and the balance confirmed by the main customer. No reconciliation for the difference was provided to us during our audit.
- 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 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 has long outstanding accrued income amounting to €44,687. €8,907 pertains to a completed project "Improvement of Farm Access Roads in San Lawrenz" which amount is still receivable from the Government as at 31 December 2020. €139 relates to LES income dating back to 2014. €2,732 pertains to UIF grants which were not yet received by the Council because no project has yet been identified to be carried out using such funds. €23,294 pertains to MEPA Planning Gain Fund which were not yet received by the Local Council as at 31 December 2020 due to pending submission of proposed projects by the Local Council. €9,615 pertains to a grant in relation to Triq-Il Wied road resurfacing. This amount will be received upon completion of the project. No documentation was provided to us to confirm the recoverability of these long outstanding amounts.

- 3.4 The Local Council should make use of the grants available by submitting projects for which such grants could be utilised. Otherwise, it will risk losing such available funds. At the end of each financial year, the Local Council should obtain confirmations from the relevant authorities of the amounts of funds it is entitled to and till when they will remain available. Any funds that may no longer be used, should be reversed from the accounts.
- 3.5 We noted that an amount of €3,000 was accrued with respect to grants yet to be received for an event held during 2019. When we checked the respective agreement, it was noted that the amount of the grant receivable was €2,000. Hence the accrued income for this even was overstated by €1,000. In another instance, we noted that an amount of income received, amounting to €2,000, was posted against the accrued income when there was no such accrued income brought forward. Audit adjustments were passed to correct these errors.
- 3.6 The Local Council should at all times be aware of what the balance in the accrued income account represents and only funds received relating to such recognised accrued income should be posted in this account. Furthermore, when accruing for income earned but not yet received, reference should be made to any agreements signed or documentation received to ensure that the correct amount is accrued for.

4.0 PAYABLES

- 4.1 In previous years, when checking the balance of one of the suppliers, a variance was found that related to works on water culverts carried out in 2012. €31,350 was accrued for in 2012 out of which €20,000 were paid during 2013 leaving a balance of €11,350 in the accruals at the end of 2013. In 2014, this balance was reclassified to the accounts payable, despite no official invoice was issued by the supplier to date for this amount. In 2020, the Council then reversed this payable amount against the property, plant and equipment without properly investigating the matter. The basis for this decision was that the supplier never claimed this balance that goes back a number of years now. When testing the balance of the same supplier this year, we noted that the balance of €36,246 related to a completed project in 2019 and the respective invoice was dated in August 2021. Therefore, as at 31 December 2020, this amount should have been presented as an accrual. A reclassification adjustment was passed to show this balance under the accruals.
- 4.2 The Council should ensure that liabilities are classified under the appropriate categories to ensure proper presentation in the financial statements. Amounts are to be shown under the accounts' payable only when the respective invoices are issued. We also suggest that the Local Council gets a declaration from the supplier that there are no further balances payable to it in relation to projects done till the end of 2020 to confirm that the balance shown in the accounts as payable to this supplier is final and correct.
- 4.3 When checking the amounts released from the deferred income to be capitalised under property, plant and equipment, we noted that the funds so transferred with respect to a completed project "Resurfacing of part of Triq iL-Wileg and Triq id-Duluri in San Lawrenz" were €37,716 in excess of the costs incurred for this project. The difference of €37,716 was adjusted during the audit and transferred back to under the deferred income. These funds will now be utilised by the Local Council in 2022 for another project. We also noted that €2,732 relating to UIF funds and €23,294 relating to MEPA planning gain fund, which funds were not yet utilised for any capital projects, were also capitalised under property, plant and equipment during the year. Adjustments were passed to reclassify these two amounts to under deferred income.
- 4.4 Before capitalising any grants, the Council should ensure that the related project has been carried out. For projects completed, the Council should then analyse the costs incurred with respect to the relevant project. It should look at the terms and conditions listed in the funding agreement and understand the capping of the amounts it is entitled to which are either the full costs incurred or a percentage thereof. Any grants that would have been

received in excess of the grants to which the Council would be entitled for that project, should remain under deferred income if those grants may be used for another project, or transferred under other payables if they are to be refunded.

- 4.5 From the samples chosen for the testing of the accounts' payable, we did not receive confirmations from four of them. For these samples, we had to carry out alternative audit procedures. A variance of €1,607 was noted between the balance as per accounts and the balance as per statement received from one of the suppliers. It transpired that part of this variance resulted from payments made by the Local Council that were not reflected in the accounts of the supplier.
- 4.6 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.
- 4.7 We have requested architect's report from the Council about the projects that were completed during the year ended 31 December 2020 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 2020 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.
- 4.8 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.
- 4.9 When checking the 2020 performance bonus, we noted that there was no accrual for the performance bonus payable to the deputy executive secretary for whom a performance bonus of 10% was approved, amounting to €107. An adjustment was passed to account for the unrecognised performance bonus.
- 4.10 Care should be taken when working out the accruals as at the end of the financial year to ensure that all liabilities relating to the year under review, for which no invoice would have been received or for which no payment would have been affected, are properly accrued for and reflected in the period to which they relate.
- 4.11 When checking the amounts due to Maltapost plc, we noted that the liability does not tally with the balance in the bank account used solely for this activity and hence representing amounts yet to be passed on to Maltapost plc. The difference amounted to €1,775.
- 4.12 The Local Council should investigate this difference and make the necessary adjustments. If the balance in the bank account reflects commissions accumulated over time, then such balance may be transferred to the current bank account that the Local Council uses for its operations. Before doing such a transfer, a proper reconciliation of the amounts due to Maltapost plc should be carried out.

5.0 INCOME

- 5.1 During our testing on the income, we noted that the grant in relation to 3D Mapping - Xmas Concert 2020, that was not yet received by the end of the year, was recorded with the wrong amount. The amount accrued for was €7,050 when the amount receivable as per agreement was €4,650. An adjustment was recorded to reverse the difference of €2,400.
- 5.2 When accruing for grants receivable, the Local Council should base the amounts on the agreements signed after taking into consideration the applicable terms and conditions, including capping on the amount receivable.

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 €3,5, were not covered by a VAT fiscal receipt.
- 6.3 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.
- 6.4 Overall, total actual expenditures are within the budget. However, for certain class of expenses, it was noted that the Council has exceeded the budgeted expenditure for several categories, namely:
- 6.4.1 Materials and supplies (Category 2200) by €1,082
 - 6.4.2 Rent (Category 2400) by €240
 - 6.4.3 Office services (Category 2600) by €7,616
 - 6.4.4 Information services (Category 2900) by €859
 - 6.4.5 Training (Category 3200) by €225
 - 6.4.6 Hospitality and community (Category 3300) by €5,267
- 6.5 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.
- 6.6 We recommend that the Council makes use of the reporting tools in hand to take corrective measures in the budget every quarter.
- 6.7 We were not provided with sufficient supporting evidence to confirm whether the Local Council abided with Directive 03/2017 issued by the Department for Local Government to Local Councils on the change in the public procurement regulations, where it comes to obtaining quotations rather than giving direct orders.
- 6.8 The Local Council should keep evidence of quotations obtained for each expenditure incurred that falls within the limits for quotations and should make such evidence available to the auditors during the carrying out of their audit procedures.

7.0 PERSONAL EMOLUMENTS

- 7.1 When reconciling the FS7 with the FS5s, we noted a variance in the gross emoluments. The gross emoluments in the FS7 amounted to €76,555 whilst the total gross emoluments in the FS5s amounted to €76,490, resulting in a variance of €65.
- 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 When checking the Mayor's allowance for 2020, it was noted that it was understated by €400. The Council did not properly apply the new Circular on the Mayor's allowance. An adjustment was passed to accrue for this underpayment.
- 7.4 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.

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 €794. This implies that the Council does not have enough current assets to support its current liabilities.
- 8.2 The current ratio is €0.99 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 €0.62 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 28.63% 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, 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.