

Our Ref: NAO 107/2021/54
Your Ref:

24 August 2022

The Mayor
San Lawrenz Local Council
San Lawrenz

Dear Sir/Madam,

**AUDIT REPORT and FINANCIAL STATEMENTS
YEAR ENDING 31 DECEMBER 2021**

In terms of Section P2.06 (c.02) of the Local Councils (Audit) Procedures 2006, I am forwarding a copy of the Audit Report and Financial Statements, together with the Management Letter for the financial year ending 31 December 2021.

After seeking the Local Council's approval, you are kindly requested to submit your response to the Director (Monitoring & Support) Local Government Division, the Local Government Auditor, and to this Office as stipulated in Section P2.06 (d) of the same Procedures, by not later than six weeks following receipt of this letter.

Yours faithfully,



Tanya Mercieca
Asst. Auditor General

Encls.

11 August 2022

Local Council San Lawrenz
22A, Triq id-Duluri,
San Lawrenz SLZ 1261,
Gozo

Dear Mayor,

RSM Malta

Mdina Road,
Żebbuġ ŻBG 9015,
Malta.
T +356 2278 7000

www.rsm.com.mt

RE: MANAGEMENT REPORT – FOR YEAR ENDED 31 DECEMBER 2021

We have completed our audit of the financial statements of the Local Council San Lawrenz for the year ended 31 December 2021. 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 9 of this Report.

During the course of our audit for the year ended 31 December 2021, 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.

A handwritten signature in blue ink, appearing to read 'Conrad Borg'.

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

Local Council San Lawrenz

Management Report for the year ended 31 December 2021

| Contents | Page |
|--|-------------|
| Follow-up to last year's report | 3 |
| Property, plant and equipment | 5 |
| Receivables | 6 |
| Payables | 7 |
| Income | 7 |
| Expenditure and tenders | 7 |
| Financial Situation Indicator | 8 |
| Responsibility Statement | 9 |

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. We noted that two additions were entered twice in the fixed assets register and yet the net book value agreed to the financial statements before any audit adjustments.
- d. A VAT fiscal receipt was not available for one of the samples of additions tested.
- e. Deferred income was capitalised upon the adoption of Directive 01/2017 despite the projects have not been done to date.
- f. No documentation was provided to us during our audit for the grants received under Measure 4.3.
- g. We noted instances where items of property, plant & equipment were purchased through direct orders.
- h. An accrual was reversed in a different account from where it was originally accounted for.

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

1.2 Receivables

In the prior year, the following issues were noted:

- a. There was long outstanding accrued income.
- b. The accrued income for one of the events was overstated.
- c. 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.
- d. Income received in 2020, was posted against the accrued income when there was no such accrued income brought forward.

Weaknesses (a) and (b) were found again this year.

1.3 Payables

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

- a. We did not receive the report requested from the architect about the projects that were carried out by the Council during the year.
- b. We noted that the amount due to Maltapost plc did not tally with the balance in the bank account used solely for this activity.
- c. We noted that funds capitalised with respect to a road resurfacing project were higher than the costs incurred.
- d. We noted that UIF funds and the MEPA planning gain fund were capitalised under property, plant & equipment when the related projects were not carried out.
- e. No accrual was accounted for the 2020 performance bonus payable to the deputy executive secretary.
- f. 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.
- g. We did not receive confirmations from all the samples chosen for the testing of the accounts payable, and variances were noted between the balances as per books of accounts and the balances shown in the confirmations received.

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

1.4 Income

Last year, we noticed the following weakness:

- a. The accrued income accounted for in relation to a grant receivable for the Christmas Concert was overstated.

This weakness was not noted again this year.

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. The Local Council exceeded the budgeted expenditure for several categories of expenditure.
- c. We were not provided with sufficient evidence that the Council abided with the Directive 03/2017 where it comes to obtaining quotations rather than giving direct orders.
- d. We noted instances where a VAT fiscal receipt was not available.

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

1.6 Personal Emoluments

Last year, we noticed the following weaknesses:

- a. Variances were noted between the FS5s and the FS7.
- b. The Mayor's allowance for the year was understated.

These weaknesses were not noted again this year.

1.7 Liquidity

As at 31 December 2020, the current liabilities of the Local Council exceeded its current assets by €794. As at 31 December 2021, the Council had a net current assets position.

1.8 Financial Situation Indicator

The financial situation indicator held by the Council at 31 December 2020, stood at negative 28.63% which fell below the 10% threshold required by the Financial Provisions to the Local Councils Act. The Local Council financial situation indicator was positive but still under the 10% threshold at 31 December 2021.

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 €13,827.
- 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 regularise itself on this matter and to ensure that such occurrences are not repeated in the future.

- 2.8 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. Since then, €26,026 were reclassified back to deferred income. It transpired that these projects have not been done by 31 December 2021. Consequently, the deferred income and the property, plant and equipment are understated by €27,114.
- 2.9 We recommend that the Local Council prepares a proper analysis of all the funds it has received over time and allocates 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 should be clearly identified and should be transferred under the deferred income until such time, these projects are carried out.
- 2.10 During the year, the Local Council accrued for works relating to pots and plants which project was completed in 2022. The costs capitalised amounted to €28,313 and the respective grant capitalised amounted to €31,000 which was higher than the costs incurred. Both entries were adjusted for accordingly.
- 2.11 The Local Council should account for costs and grants in the financial period in which the project is completed and certified. Furthermore, it is to be ensured that the amount of grants capitalised is in line with the terms of the funding agreement and in no case should it exceed the actual costs incurred.

3.0 RECEIVABLES

- 3.1 When checking the accrued income as at the end of the year, we noted that the Council has long outstanding accrued income amounting to €41,816. €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 2021. €23,294 pertains to MEPA Planning Gain Fund which were not yet received by the Local Council as at 31 December 2021 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.
- 3.2 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.
- 3.3 When testing the accounts receivable, we noted that there were receivable balances amounting to €435 which were older than two years and that have not been provided for. An adjustment was passed during the audit to provide for these balances.
- 3.4 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.
- 3.5 We noted that there was an amount within the accrued income of €4,000 which related to an EMV grant for which the Local Council had no evidence that it would be received. It was agreed to reverse this balance in view of the lack of documentation and evidence.
- 3.6 The Local Council should only accrue for income by referring to agreements signed, or other documentation received, to ensure that the correct amount is accrued for. Such evidence is to be provided to the auditors.

4.0 PAYABLES

- 4.1 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 deferred income.
- 4.2 Any grants that would have been received in excess of the costs that the Council would have incurred on a 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.
- 4.3 We have requested a report from the architect of the Council about the projects that were completed during the year ended 31 December 2021 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 2021 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.
- 4.4 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.
- 4.5 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 €2,539.
- 4.6 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 When testing the funds received from the central government in terms of Article 55 of the Local Councils Act (Cap. 363), we noted a difference of €22,293. The difference resulted from the fact that the amounts allocated to the Local Council relating to tourism zones and income adjustments were being accounted for in the same nominal account. A reclassification adjustment was passed for presentation purposes.
- 5.2 The Local Council should make sure that income falling under Article 55 of the Local Councils Act (Cap. 363) is accounted for in a separate account to ensure proper presentation in the financial statements.
- 5.3 During our audit, we asked for an invoice to support an income item carrying the description 'reimbursement of mobility' amounting to €4,478. However, this was not provided to us.
- 5.4 We recommend that the Local Council keeps copies of all invoices issued and ensures that they are readily available when requested for audit purposes.

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. This matter was discussed with the Council, and we were informed that usually an e-mail is sent rather than issuing a purchase order.

- 6.2 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.
- 6.3 The total actual expenditure exceeded the budgeted expenditure in several categories, as follows:
- 6.3.1 Repairs & Upkeep (Category 2300) by €3,532
 - 6.3.2 Rent (Category 2400) by €699
 - 6.3.3 Memberships (Category 2500) by €350
 - 6.3.4 Information services (Category 2900) by €1,869
 - 6.3.5 Professional services (Category 3100) by €3,840
- 6.4 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.
- 6.5 We recommend that the Council makes use of the reporting tools in hand to take corrective measures in the budget every quarter.
- 6.6 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.
- 6.7 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 FINANCIAL SITUATION INDICATOR

- 7.1 The Financial Situation Indicator held by the Council at the statement of financial position date, stood at 7% 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.
- 7.2 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.
- 7.3 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.