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21<sup>st</sup> June 2017

The Mayor  
Local Council Ghajnsielem  
J.F Chambray,  
Ghajnsielem GSM 1501,  
Gozo

Dear Mayor,

**RE: MANAGEMENT REPORT – FOR YEAR ENDED 31 DECEMBER 2016**

We have completed our audit of the financial statements of the Local Council Ghajnsielem for the year ended 31 December 2016. 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 12 of this report.

During the course of our audit for the year ended 31 December 2016, 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.

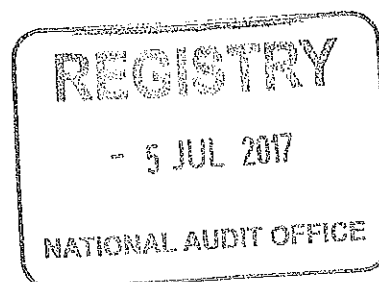
The objective of this letter is to bring to your attention those divergences in the system that were noticed during our audit work and suggest ways of how these can be remedied.

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



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



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**Local Council Ghajnsielem**

**Management Report for the year ended 31 December 2016**

<b>Contents</b>	<b>Page</b>
<b>Follow-up to last year's Management Report</b>	<b>3</b>
<b>Property, plant and equipment</b>	<b>5</b>
<b>Receivables</b>	<b>6</b>
<b>Cash and Bank</b>	<b>8</b>
<b>Payables</b>	<b>8</b>
<b>Income</b>	<b>9</b>
<b>Expenditure and Tenders</b>	<b>9</b>
<b>Personal Emoluments</b>	<b>10</b>
<b>Opening Balances</b>	<b>11</b>
<b>Other Matters</b>	<b>11</b>
<b>Responsibility Statement</b>	<b>12</b>

## **1.0 Follow-up to Last Year's Report**

### **1.1 Property, plant and equipment**

During the previous audit, several weaknesses relating to the fixed assets register had been identified namely:

- In 2012 an exercise was performed to build the fixed assets register from scratch. Following the completion of this exercise, due to lack of Sage backups, several discrepancies arose between the fixed assets register and the accounts such as variances in the opening cost of the assets, variances in the opening accumulated depreciation and lack of important details. Variances in these amounts were just written off through a prior year adjustment.
- The totals of the new fixed assets register did not agree with the totals shown in the nominal ledger and in the financial statements.

During the year being reviewed, the fixed assets register which was built in 2012 was still being used. This resulted in all the discrepancies noted during the previous year being inherently carried forward to the year being reviewed.

During the previous year, following the report received from the architect we noticed that a project was still being classified as under construction when it was completed during 2015. In another case, a project completed during 2015 was not being depreciated. We also noted that the costs of a particular project were completely omitted from the accounts. All these errors had an impact on the depreciation charge for the year. No such errors were found during the 2016 audit.

The property, plant and equipment of the Local Council were under insured. This issue has been resolved following the guidance issued through Circular 33 of 2016.

### **1.2 Receivables**

When testing the receivables, we had noted several discrepancies between the balances in the Council's books and the balances confirmed by the debtors. No provision for doubtful debts has been made for the balances that were older than two years as instructed by the Department. Funds received in settlement of existing accounts receivable balances were accounted for as income for the year instead of posted in the respective receivables account. Errors were also found in the accrued income and prepayments. These issues were noted again during the audit for the year ended 31<sup>st</sup> December 2016.

### **1.3 Cash and Bank**

Minor variances were found in the bank reconciliations provided to us. Similar minor variances were found this year.

We also came across two instances whereby the petty cash payments exceeded the limit of Euro 23.29. No similar instances were encountered during the current year.

### **1.4 Payables**

In last year's management letter, we pointed out that there were instances where invoices that were issued in the year being reviewed but which were received in the following year were not accounted for as accounts payable and other instances where invoices were issued in the

following year but related to the year being reviewed which were not accrued for. The problem of accruals not accounted for was noted again this year.

Several errors were found in the calculations of the amortisation for the year of the deferred income. Issues had also been noted in relation to the classification of the deferred income between current and non-current. These issues were not encountered during the year under reviewed.

#### 1.5 Income

Funds received in respect to capitalised costs was being shown as income for the year instead of being deferred and amortised over the life of the asset. The income from the administrative fees on contraventions paid at the Local Council was understated as the amounts not received were not accrued for. No such errors were found during the year ended 31<sup>st</sup> December 2016.

Income was not always being accounted for in the correct nominal account. The payment made by the Department to WasteServ Malta Limited was not reflected in the accounts affecting the income from the Government. The main Central Government allocation income was being accounted for net of expenses deducted therefrom. Similar weaknesses were found during the year under review.

#### 1.6 Expenditure

During the previous audit, the following weaknesses had been highlighted:

- Purchase requests and purchase orders were not prepared regularly.
- Actual expenditure in certain categories exceeded the budgeted expenditure within those particular categories.
- The Local Council was making use of an expired contract for street lighting.
- In some cases, VAT fiscal receipts were not obtained for payments affected.
- No call for tenders was issued for waste disposal.
- In two cases, no quotations were requested.

Similar cases to the first three weaknesses were encountered again during the year being audited.

#### 1.7 Personal emoluments

During the previous year, it has been noted that the FSS documents included several errors were details are concerned. Some payroll costs were posted in the incorrect nominal account. The latter issue was noted again during the year being reviewed, while different errors were found in the FSS forms.

## **2.0 PROPERTY, PLANT AND EQUIPMENT**

- 2.1 During 2012, the Local Council outsourced the exercise of building the fixed assets register from scratch. One of the problems encountered in this exercise was the fact that the Council had no Sage backups of the accounts prior to the year 2008 since there was a change in the Council's accountant and apparently he had the backups on his personal computer. We were given to understand that the procedure adopted was that the Council staff went around the Council premises and the urban areas within the locality and gathered all relevant documents about the items of property, plant and equipment of the Council. As for the road resurfacing, the executive secretary contacted the architect who was responsible for the roads which were resurfaced by the Council from 1994 onwards and the expenses connected to such works were taken from the final architect certification. As for the Council premises, the Council listed all the assets present in the new civic centre and agreed them to the nominal ledger.
- 2.2 The method used by the Council created discrepancies in relation to the 2011 audited financial statements and the difference between the register and the nominal ledger has been accounted for as impairments through a prior year adjustment. The following were the variances noted:
- 2.2.1 The closing cost of property, plant and equipment as per the audited financial statements for the year ended 31<sup>st</sup> December 2011 amounted to Euro 1,046,654 whilst the new opening cost as at 1<sup>st</sup> January 2012 amounted to Euro 889,317. This means a difference of Euro 157,337 out of which Euro 1,108 represented a reclassification to under intangible assets.
- 2.2.2 The accumulated depreciation as per the audited financial statements for the year ended 31<sup>st</sup> December 2011 amounted to Euro 464,800 whilst the new opening accumulated depreciation as at 1<sup>st</sup> January 2012 amounted to Euro 361,049. This means a difference of Euro 103,751 out of which Euro 330 represented a reclassification to under intangible assets.
- 2.2.3 The resulting net figure after removing the reclassified amounts was Euro 52,808. This amount has been passed as a prior year adjustment without an indication as to which assets the amounts written off relate to.
- 2.3 Moreover, the new fixed assets register lacks important details in particular with respect to the new civic centre. A one-line item under the buildings category shows the total balance of all the construction works, electrical works and other expenditure incurred in the building of the new civic centre. It is understood that the Council grouped all the assets together as one asset since the civic centre was capitalised wholly. During our audit visit, we were then provided with an itemised list on MS Excel.
- 2.4 The method used for the building of the new fixed assets register as described above, creates several problems. There is no assurance that the costs taken for the individual items of property, plant and equipment are all correct. It is very possible that items have been left out from the register even though they are still in existence and in good condition. There is no assurance that the new calculation of the depreciation of the assets was carried out correctly by commencing the depreciation calculation from the correct date. The new register still lacks sufficient details to ease the traceability of the different assets.

- 2.5 Due to the materiality of the amounts involved and the number of uncertainties in the new valuations of the Local Councils' property, plant and equipment, we had to qualify our audit report.
- 2.6 It was also noted that the fixed assets register figures did not agree with those shown in the nominal ledger and the financial statements as at 31<sup>st</sup> December 2016 prior to any audit adjustments as follows:
- 2.6.1 A variance of Euro 517,559 arose in the total cost between the fixed assets register which was showing an amount of Euro 1,020,286 and the financial statements which were showing an amount of Euro 1,537,845.
  - 2.6.2 A variance of Euro 146,391 arose in the total accumulated depreciation in the fixed assets register which was showing an amount of Euro 500,916 and the financial statements which were showing an amount of Euro 647,307 including the government grants.
- 2.7 It is recommended that an adequate and detailed register is built at the earliest possible as this will help the Council to keep track of all the assets under its ownership and responsibility. It is important that variances between the accounts and the register are traced and adjusted for. The register is to be reviewed and updated in a timely manner and it should include among other details, the detailed description of the assets, their identification codes, their locations and the category of the assets according to their nature.
- 2.8 Furthermore, we highly recommend that the Council obtains copies of the accounts backups for the periods before the year 2008. Kindly note that the Council is obliged to have such backups available at its offices.
- 2.9 When testing the additions for the year of property, plant and equipment, we noticed that an amount of Euro 28,169 was posted as architect's fees when this was actually a bill of quantities that was already accounted for under the respective supplier in the previous year. We therefore had to pass an audit adjustment to reverse this addition and also correct the balance in the creditors' account. This also had an impact on the depreciation charge for the year of Euro 1,408 which we adjusted for as well.
- 2.10 Care should be taken when posting transactions in the accounts. Bills of quantities should be used to check the correctness of the invoices issued by the contractor and to accrue for any work performed by the contractor for which no invoices would have been issued by the end of the financial year. Bills of quantities should not be accounted for as invoices.

### **3.0 RECEIVABLES**

- 3.1 As part of our testing on the receivables, we obtained a confirmation from the Water Services Corporations (WSC). Similar to the previous years, the statement showed that the WSC had no amounts due to the Council as at 31<sup>st</sup> December 2016 whilst the Council's records were showing a balance of Euro 2,054. This variance was investigated in the previous year and at that time WSC confirmed that they were not receiving any invoices from the Council relating to permits issued. No actions were taken on this variance and the Council insisted that the invoices are

- being issued on a regular basis and that the full amount is due to the Council and therefore should not be written off.
- 3.2 It is once again recommended that this issue is tackled with WSC to check why these invoices are not being received and also to confirm whether the recoverability of the amount shown in the Council's records is probable or not. Any receivables which are doubtful should then be provided for or be written off in future periods to ensure that the prudence concept is followed.
- 3.3 Furthermore, it was noted that no provision for doubtful debts was made in the accounts for receivables relating to the LES administrative fees which have been due for more than two years. These amounted to Euro 3,955.
- 3.4 Any receivables older than two years are to be considered as doubtful as instructed by the Department for Local Government and should therefore be provided for. It is important that at the end of each financial year, the Local Council goes through the full receivables list and any balances, whatever their aging, whose collection is doubtful, should also be provided for.
- 3.5 Another discrepancy which was noted whilst testing receivables, related to the amounts due with respect to the CIES scheme. It was noted that the Council was accounting for all the receipts during the year in relation to the CIES scheme as income for the year instead of setting off the respective receivable account created. An audit adjustment amounting to Euro 4,177 was passed to reverse the respective receivables and reduce the income for the year.
- 3.6 Such treatment will be overstating both the income for the year and the receivables. Every receipt should be carefully analysed and if it is known that it relates to a receivable, it should be accounted for against that particular receivable.
- 3.7 When performing audit procedures on the accrued income, several errors have been noted and audit adjustments were passed to correct these errors. These included:
- 3.7.1 When analysing the report of the contraventions paid at the Local Council during the year, it transpired that there is Euro 533 worth of administrative fees that have neither been received nor invoiced during the year. Consequently, such income had to be accrued for.
- 3.7.2 Whilst going through the receipts after year-end we noted that the Council received Euro 392 in relation to the CIES Scheme – December 2016 payment. Even though this related to 2016, it has been omitted from the accounts.
- 3.8 It is important for the Local Council to keep an updated record of the funds which are still to be received with respect to activities already held or projects completed by the Council and at the end of the year accrue for such funds, in order to ensure that the income is matched with the expenditure that it intends to cover. When such funds, or part thereof, are eventually received, these are then to be netted off against the opening amounts receivable and not treated as income of that particular year.
- 3.9 When testing the prepayments, it was noted that there was no movement in the prepaid amount relating to the rent paid for the use of the football ground, despite Euro 500 of the prepayment related to the year under review.
- 3.10 The Local Council should have full details of what the prepayments are made up of and should ensure that any amounts therefrom relating to the year under review are written off to the statement of comprehensive income.
- 3.11 Within the accrued income, there was an amount of Euro 119,825 relating to the Belvedere in Soil Street project which has been brought forward from the previous year. No audit evidence was

obtained during the performance of our audit to confirm the correctness and recoverability of such accrued income. We were only provided with the agreement entered into back in 2014 whereby the terms and conditions were established and the unsigned letter claiming the costs incurred. One of the conditions stipulated that the project had to be completed by 28<sup>th</sup> February 2015 which was not the case. No evidence was made available that the claim was accepted.

- 3.12 The Local Council should constantly seek comfort from the other party that the amount being accrued for as receivable in its accounts is correct and truly receivable, in particular at the end of every financial year. Where any doubts about its recoverability start to arise, a provision should then be immediately made in order to write off the asset to the recoverable amount. The Council should also continuously chase to ensure funds are received as early as possible to ensure better liquidity.

#### **4.0 CASH AND BANK**

- 4.1 The bank reconciliations submitted during our fieldwork contained minor discrepancies that were not investigated by the Council. Unless variances are immediately investigated as and when they arise, it would eventually become more difficult to solve and leaving them outstanding is not good practice.
- 4.2 The bank reconciliation statement should at all times identify the variances between the book balance and the actual balance as per bank statement without leaving any unsolved variances. We recommend that the Council keeps the reconciliation clean of any discrepancies by investigating and resolving the issues as they arise.
- 4.3 When we carried out the petty cash count and added back the payments and receipts that took place after the end of the year, we arrived to a difference of Euro 325. Upon investigating the variance, it transpired that a number of petty cash payments were not reflected in the books of accounts.
- 4.4 The Council should carry out cash counts on a regular basis and reconcile the figure arrived at to the balances shown in the accounts. Any variances should be immediately investigated and the necessary actions taken.

#### **5.0 PAYABLES**

- 5.1 When testing the accruals, we noted that the accrual for the performance bonuses was understated by Euro 2,033. An audit adjustment was passed to correct this error.
- 5.2 We strongly recommend the accruals concept is embraced by the Council and effectively record expenses as and when they accrue and that errors similar to that noted above is not repeated in the future.
- 5.3 In the samples chosen for the testing of the accounts payable, variances arose between the balances in the suppliers' statements and the balances found in the books of accounts. As already mentioned in the property, plant and equipment section of this letter, in the architect's account we found erroneously posted a bill of quantity of a particular project. When we reversed this bill of quantity amounting to Euro 28,169, the resulting balance in the supplier's account was a negative amount of Euro 4,877. Other variances were found in three other samples tested.
- 5.4 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, as this would avoid many of the weaknesses mentioned above. If need be, the Local Council itself



should ask its suppliers to provide it with statements, as we were given to understand that most of them do not send statements.

- 5.5 When we requested from the accountant the breakdown of the accruals as at year end which according to the trial balance amounted to Euro 15,453, we were given a list of just Euro 5,155. No explanation could be given of the remaining figure. Following the adjustment to the opening balance, given to us by the accountant, the revised accruals account balance amounted to Euro 7,574.
- 5.6 It is of utmost importance that details and workings are kept supporting every figure in the trial balance when closing off the accounts at the end of the financial year. The auditors are to be provided with a breakdown of the figures that tally with the trial balance at the commencement of the audit so that they can check the correctness thereof.

## **6.0 INCOME**

- 6.1 When analysing the supplementary Government income account, we noticed therein an amount of Euro 1,014 which represented additional Central Government allocation income. Consequently, we reclassified such amount into the proper nominal account to ensure correct presentation of such income in the financial statements. Another reclassification amounting to Euro 2,305, relating to the CIES scheme income, had to be made between the supplementary Government income account and the other Government income account.
- 6.2 It is important that income is properly categorised in the accounts to ensure that it is then properly presented in the financial statements and also ensure comparability from one year to the other.
- 6.3 During last year's audit, it was noted that during the year the Department for Local Government had paid Euro 3,269 directly to WasteServ Malta Limited on behalf of the Council to make good for the discrepancy between the amounts being invoiced to the Council and the amounts from the Central Government allocation given for tipping fees. Such payment was not accounted for by the Council. This year, the balance payable to WasteServ Malta Limited as at 31<sup>st</sup> December 2016 was overstated to Euro 1,149. This variance could not be traced but it could represent a situation similar to that of the previous year.
- 6.4 A variance similar to the above would have easily been resolved if regular reconciliations with the suppliers' statements are carried out as suggested earlier on. Furthermore, the Local Council should have received a receipt for such payment from the supplier and at that point it should have enquired about it.
- 6.5 Whilst reviewing the main Central Government allocation for the year, we noted that the figure in the financial statements did not agree exactly with the relevant allocation schedule. Upon further investigation, we identified a deduction made by the Department for Local Government which was being account for as an expense to gross up the income, but was taken at a higher amount than the actual deduction.
- 6.6 Care should be taken to ensure that the correct amounts are taken when grossing up the income and reference should be made to the correspondence sent to the Local Council by the Department explaining every deduction made from the allocation.

## **7.0 EXPENDITURE AND TENDERS**

- 7.1 We noticed that the Council does not draw up purchase requests in line with the Local Councils Financial Procedures. With regards to the purchase orders, these are prepared for the majority of the purchases but there are still exceptional cases where these are not prepared. There appears to be no specific reason behind this practice. It is understood that at times the urgency of matters might require that bureaucracy is reduced to the minimum possible, however we are still of the

opinion that the necessary paperwork should have been done in line with the financial procedures.

7.2 The above issues are against the Local Councils Financial Procedures that the Council has to 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.

7.3 It was noted that the Council has exceeded the budgeted expenditure for several categories, namely:

- 7.3.1 Utilities (Category 2100) by Euro 1,617
- 7.3.2 Repair and Upkeep (Category 2300) by Euro 3,088
- 7.3.3 Office Services (Category 2600) by Euro 918
- 7.3.4 Transport (Category 2700) by Euro 3,018
- 7.3.5 Contractual services (Category 3000) by Euro 16,163
- 7.3.6 Training (Category 3200) by Euro 390
- 7.3.7 Community and Hospitality (Category 3300) by Euro 13,853
- 7.3.8 Others (Category 3400) by Euro 31

7.4 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.

7.5 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.

7.6 The contract for street cleaning expired in May 2016 and the Council continued using the service of the same supplier after its expiration. The total amount invoiced till the end of the year, following the expiry date, was Euro 13,663.

7.7 The above goes against the Local Councils Financial Procedures that the Council has to abide with. Therefore, we strongly recommend that the Council takes immediate action to regularize itself on this matter and ensure that such instance is not repeated in the future.

7.8 An instance was also noted were the Council incurred travelling expenses with respect to the Tolfa visit for which no travel report was drawn up in accordance with the MFEI Memo 05/2012.

7.9 The Local Council should ensure that a travelling expenses report is drawn in accordance with the MFEI Memo 05/2012 whenever it is applicable.

## **8.0 PERSONAL EMOLUMENTS**

8.1 Whilst performing the payroll reconciliation, we noted that there was an unexplained variance between the figures reported in the FS7 and the figures in the accounts. Such difference amounted to Euro 2,365.

8.2 Variances were also noted between the different FSS forms as follows:

- 8.2.1 The gross emoluments in per FS7 form amounted to Euro 78,147, the tax deductions amounted to Euro 9,907 while the social security contributions amounted to Euro 10,808.

8.2.2 The gross emoluments in per FS5 forms amounted to Euro 77,993, the tax deductions amounted to Euro 9,490 while the social security contributions amounted to Euro 11,739.

8.2.3 The gross emoluments in per FS3 forms amounted to Euro 79,746, the tax deductions amounted to Euro 10,05 while the social security contributions amounted to Euro 11,235.

8.3 It is important to regularly reconcile the FSS forms with the books of account, and to ensure that the payroll workings' records agree with the actual payments affected. At the end of the year, then it is important to also reconcile the annual FSS returns, as well as these returns with the figures shown in the accounts.

8.4 When going through the various nominal accounts, we noticed that there were account number 4400 named 'wages payable' and account number 4401 named 'FSS payable', being the part of the nominal accounts relating to liabilities, which in reality contained payroll related expenses for the year and not liabilities. A reclassification adjustment amounting to Euro 47,289 was passed to reallocate such payroll costs in the appropriate expenses accounts.

8.5 Every transaction being posted should be carefully analysed to clearly understand the exact nature of the transaction, ensure that the appropriate nominal account is chosen and that items are properly presented in the financial statements.

## **9.0 OPENING BALANCES**

9.1 During our review of the opening balances, it was noted that several audit adjustments of the previous financial year were not reflected in the accounts or were passed incorrectly. An audit adjustment was consequently passed to correct the opening balances.

9.2 It is of utmost importance that all the audit adjustments sent to the Local Council following the completion of the audit, are correctly reflected in the books of accounts. Once done, a reconciliation is to be carried out between the adjusted opening balances and the figures shown in the previous financial year's audited financial statements.

## **10.0 OTHER MATTERS**

10.1 We would finally like to bring to your attention the manner in which the adjustments were passed through a number of journal entries while closing off the accounts at the end of the financial period. During our audit, there were several instances whereby we enquired what a particular entry represented, or where the corresponding entry was posted since it was not found in the account it was expected to be and no similar amount was traced through the searches performed, and we were not provided with an answer or an explanation thereto.

10.2 In the future, it is important that each and every journal entry passed while closing the accounts is easily traceable, understandable and explainable. The use of separate journal entries with proper description in every one of them would be helpful.

### **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.