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26/04/16

The Mayor  
Local Council Nadur  
North Street,  
Nadur NDR 1222,  
Gozo

Dear Mayor,

**RE: MANAGEMENT REPORT FOR THE YEAR ENDED 31 DECEMBER 2015**

We have completed our audit of the financial statements of the Local Council Nadur for the year ended 31 December 2015. 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 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 10 of this report.

During the course of our audit for the year ended 31 December 2015, 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 clerks for their assistance during the course of our audit.

A blue ink signature of Conrad Borg, written in a cursive style.

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



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## **Local Council Nadur**

### **Management Report for the year ended 31 December 2015**

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

### 1.1 Property, plant and equipment

With regards to property, plant and equipment, last year we had pointed out the following issues:

- The fixed assets register did not agree with the accounts;
- The insurance policy did not cover all items of property, plant and equipment;
- Certain items of property, plant and equipment were capitalised under the wrong category;
- Errors were found in the computation of the depreciation charge for the year;
- Incorrect analysis between expenditure of a capital and that of a revenue nature;
- Works on capital project carried out during the year but not invoiced, were not accrued for; and
- Invoices which were already accrued for in previous years were being entered as additions for the year.

Most of these issues have been encountered again this year. In fact, only the last two weaknesses were not encountered this year.

### 1.2 Receivables

Last year we pointed out that accrued income was not being accounted for correctly and also that no provision was being made for receivables which were deemed not to be fully recoverable.

Whilst the first weakness was properly tackled, the Council did not provide for any doubtful debts.

### 1.3 Bank and Cash

Last year we come across two cheques which were considered stale but which were still in the list of unpresented cheques as at the end of the year. We also come across two expenses paid from the petty cash even though their values exceeded the limit set by the regulations governing Local Councils of Euro 23.29. Both instances were present again this year.

### 1.4 Payables

Last year we had mentioned various issues relating to the payables of the Local Council, mainly:

- Invoices being posted with the wrong dates;
- Incorrect analysis between current and non-current liabilities;
- Expenses not being accrued for;
- Incorrect calculation and treatment of the release of deferred income; and
- No regular reconciliations being carried out between suppliers' ledgers in the accounts and the suppliers' statements received.

Apart from the first two weaknesses, all the other issues have been encountered again this year.

### 1.5 Income

When testing income, last year we noted that there were several items of income posted in the wrong nominal account. A case was also encountered whereby the amount of income taken was net of an expenditure item. A variance was also found between the theoretical LES

administrative fees computed on the total contraventions paid at the Council and the related income in the accounts. These weaknesses have not been tackled during the year under review.

1.6 Expenditure and Tenders

With regards to expenditure and tenders, last year we noted that the budgeted expenditure was exceeded in various categories. This issue was encountered again this year.

1.7 Personal Emoluments

Various reclassifications had to be passed in order to ensure the proper presentation of personal emoluments in the financial statements. Although this issue was not encountered this year, other weaknesses were noted with respect to personal emoluments.

1.8 Financial Situation Indicator

The Financial Situation Indicator of the Local Council as at 31<sup>st</sup> December 2014 stood at a negative 109.94% which fell well below the 10% threshold required by the Financial Provisions to the Local Councils Act. As at 31<sup>st</sup> December 2015, the financial situation indicator was still negative.

1.9 Liquidity

As at 31<sup>st</sup> December 2014, the current liabilities exceeded the current assets by Euro 364,966 indicating possible liquidity problems. As at the end of the financial year under review, the Local Council had a similar situation.



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

- 2.1 The fixed assets register's figures do not agree with those shown in the nominal ledger and financial statements prior to any audit adjustments, as follows:
- 2.1.1 The cost as per fixed asset register of Euro 3,448,196 does not tally with the cost in the nominal ledger as at 31 December 2014 amounting to Euro 3,354,803. The variance amounts to Euro 93,393.
  - 2.1.2 The total accumulated depreciation as per fixed asset register amounting to Euro 1,754,612 was not agreeing with the total depreciation plus grants in the nominal ledger which amounted to Euro 1,707,395, a variance of Euro 47,217.
  - 2.1.3 The net book value disclosed in the financial statements was less than that shown in the fixed assets register by Euro 46,176.
- 2.2 It is recommended that the Council updates its fixed assets register so that the totals of each asset category match those in the nominal ledger in all respects, that is, cost, accumulated depreciation, grants and net book value. The more time is allowed to pass the more complex the exercise will become.
- 2.3 A reclassification of Euro 399,262 was passed in relation to works carried out in Nadur Main Square and Nadur Nature Trails from the category construction to the category assets under construction since these projects were not yet completed by the end of the year under review. Similarly, a reclassification was made for an amount of Euro 73,903 which was accrued for in 2014 and which was accounted for by the Council under the category construction when it should have been under the category assets under construction.
- 2.4 It is important that when accounting for the additions of property, plant and equipment, the correct assets' category is used. Until a project is still in progress, the related expenditure should be classified in the category assets under construction. Then once completed, it should be reclassified under the appropriate category. Using an incorrect category, might lead to the depreciation being started from the wrong date or being calculated using the wrong rates, apart from the not providing exact information in the financial statements.
- 2.5 When checking the depreciation charge for the year several errors were found. An audit adjustment of Euro 2,297 was passed in relation to the depreciation on urban improvements, while with regards to the construction we had to pass an adjustment of Euro 56,685. The latter includes the affect of the reclassification mentioned above. In both cases, the depreciation charge for the year was reduced.
- 2.6 It is to be ensured that the depreciation is correctly calculated by applying the correct depreciation rates and taking the correct opening net book values and additions for the year.
- 2.7 The insurance policy in place does not cover all the assets owned by the Local Council. The policy covers Euro 158,400 with respect to buildings, Euro 20,970 with respect to the lift, Euro 8,000 with respect to electronic equipment and Euro 11,650 with respect to furniture and fittings. The net book value of the assets of the Local Council as at 31<sup>st</sup> December 2015 amounted in total to Euro 1,703,355. This is made up of Euro 12,202 furniture and fittings, Euro 7,504 electronic equipment, Euro 3,618 plant and machinery, Euro 399,262 assets under construction, Euro 131,997 Local Council premises and Euro 1,148,772 assets in the open.
- 2.8 In the case of theft, fire or any other accident, the Local Council will not be in a position to recover all the losses incurred. We therefore highly suggest that the Local Council takes the necessary steps to ensure that an insurance policy is taken that adequately covers all the items of property, plant and equipment.
- 2.9 It was also noted that certain expenditure was capitalised when it was of a revenue nature as it related to patching works. An adjustment was passed to rectify this. This expenditure amounted to Euro 3,019.

- 2.10 When posting the invoices, it has to be ensured that any expenditure of a revenue nature is to be immediately written off to the statement of comprehensive income and only expenditure of a capital nature is capitalised under property, plant and equipment.

### **3.0 RECEIVABLES**

- 3.1 The list of receivables as at the end of the year included a balance which has been outstanding for more than three years and therefore creates doubt as to whether this balance would ever be recovered. This balance amounted to Euro 200 and related to a wine festival.
- 3.2 We recommend that at least at the end of each financial year, the Local Council goes through the list of receivables and checks whether there are any balances which are deemed doubtful to collect. If such balances are found, then a provision for doubtful debts should be accounted for immediately. Any balances older than two years should be considered as doubtful as per instructions received from the Department for Local Government.
- 3.3 A reclassification adjustment was passed during the audit to transfer the credit balances which were noted in the receivables' list to under the payables. These credit balances amounted to Euro 1,025.
- 3.4 Negative balances in the receivables' list should, after being properly investigated, be transferred under the payables for proper presentation in the financial statements as these balances do not really represent receivable balances.

### **4.0 BANK AND CASH**

- 4.1 This year we came across two cheques which at the end of the year were considered to have become stale and should have thus been reversed from the list of unrepresented cheques. Given that the amounts totalled to Euro 4,007, these have been adjusted for and transferred under the accounts payable.
- 4.2 As already recommended last year, the Council should regularly review the list of unrepresented cheques and any cheques which result to have become stale, are investigated. These cheques should be reversed and if necessary replaced with new ones unless they would have already been replaced and the previous cheque not reversed.
- 4.3 Similarly to last year, when testing the petty cash transactions, we noted that there were twelve particular expenses paid from the petty cash whose amount exceeded slightly the limit set by the regulations governing Local Councils of Euro 23.29.
- 4.4 For any expense in excess of Euro 23.29, the Council should issue a cheque and should not affect the payment through the petty cash.

### **5.0 PAYABLES**

- 5.1 No regular reconciliations are being carried out between the balances in the suppliers' ledgers in the books of accounts and the balances as shown in the suppliers' statements.
- 5.2 We strongly suggest that the Local Councils regularly asks for statements from its suppliers and reconciles the balances shown on these statements with the respective balances shown in the accounts. Any variances noticed should be immediately investigated and the necessary actions taken thereon.
- 5.3 The amount released by way of amortisation of the deferred income had to be adjusted in respect of Live Streaming and PPP Funds. The adjustments amounted to Euro 388 and Euro 715 respectively. It was also noted that the amortisation with respect to Open Markets was



classified to the wrong income account. A reclassification of Euro 1,125 was made to rectify this. Following the adjustments related to the property, plant and equipment, further adjustments were passed to reverse the release of deferred income for the year amounting in total to Euro 36,834.

- 5.4 In accordance with IAS 20, Government Grants should be matched to the expense they intend to cover, whether the expense is of a capital nature or of a revenue nature. It is important that funds received are allocated to the deferred income until the respective works are completed. Moreover care should be taken to ensure that the amortisation for the year is correctly calculated.
- 5.5 Whilst going through the accruals list, it was noted that the Council did not accrue for street lighting maintenance costs amounting to Euro 4,888.
- 5.6 We strongly recommend that the accruals concept is embraced by the Council and effectively records expenses as and when they accrue.

## **6.0 INCOME**

- 6.1 It was noted that the actual Central Government allocation received differed from the Central Government allocation recorded in the accounts. This resulted due to expenditure items being netted off against such income. An adjustment of Euro 50 was passed to gross up the income.
- 6.2 No items of expenditure should be netted off against any income unless a particular International Financial Reporting Standard permits such netting off. Income should always be presented gross.
- 6.3 We also noted that the income from LES administrative fees as shown in the accounts varied by Euro 217 when compared to the 10% computed on the total amount of contraventions paid during the year at the Local Council as per the report generated from the LES system.
- 6.4 Even though the amount of administrative fees is immaterial we do recommend that monthly reconciliations are carried out to ensure that all potential income is invoiced.
- 6.5 During our review of the income accounts, it was noted that an amount of Euro 2,300 received to cover the equipment with regards to live streaming was not being deferred and amortised in line with the depreciation on the respective asset. An adjustment was passed to rectify this error.
- 6.6 It is important that any funds received specifically to cover the cost of a particular item of property, plant and equipment is deferred and then amortised over the useful life of the asset to match the income with the respective depreciation that it intends to cover.

## **7.0 EXPENDITURE AND TENDERS**

- 7.1 The Council has exceeded the budgeted expenditure under the following categories:

- 7.1.1 Rent (Category 2400) by Euro 404;
- 7.1.2 Transport (Category 2700) by Euro 2,632;
- 7.1.3 Travel (Category 2800) by Euro 1,838;
- 7.1.4 Professional fees (Category 3100) by Euro 24,277;
- 7.1.5 Contractual services (Category 3000) by Euro 23,434;
- 7.1.6 Community and hospitality (Category 3300) by Euro 15,771; and
- 7.1.7 Sundry Minor Expenses (Category 3400) by Euro 448.

- 7.2 The Financial Procedures applicable for Local Councils require Councils to draw up twelve (12) months budgets, three (3) year 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 help the Council revise the budgets in line with actual expenditure.
- 7.3 We recommend that the Council makes use of these reporting tools in hand to take corrective measures in the budget every quarter such that by the end of the accounting period such discrepancies would not materialise.
- 7.4 The street lighting contract used by the Council was entered into by the Joint Committee. It originally expired on 3 April 2008 but was then extended for another year until 3 April 2009. However, no proof of further formal extensions was ever traced. During the year under review, the Local Council was still using the services of the same supplier with the same terms and conditions set out in the original contract.
- 7.5 Memo 34/2013 instructed Local Councils using expired contracts for street lighting to issue a call for new offers either individually or jointly with other Local Councils, given that discussions were still underway to eventually transfer the maintenance of street lighting to the Regional Committees. These instructions were not followed as mentioned above.

## **8.0 PERSONAL EMOLUMENTS**

- 8.1 Whilst performing the reconciliation of the personal emoluments costs, we noted that there is an unexplained variance between the emoluments declared in the FS7 and the amounts shown in the financial statements. Such difference amounts to Euro 1,293.
- 8.2 A difference was also noted between the FS7 and FS5s. The gross emoluments as per FS7 amount to Euro 57,679 while the gross emoluments as per FS5s amount to Euro 57,048, a variance of Euro 631. The total tax deductions as per FS7 amount to Euro 7,129 while the total tax deductions as per FS5s amount to Euro 7,179. The total social security contributions as per FS7 amount to Euro 6,140 while the total social security contributions as per FS5s amount to Euro 5,889.
- 8.3 It is highly recommended that particular care is taken when preparing the FSS forms and when affecting payments. When compiling the FSS forms it is important to ensure that these are properly filled in and that all the required information is disclosed correctly. Furthermore 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.

## **9.0 FINANCIAL SITUATION INDICATOR**

- 9.1 The Financial Situation Indicator of the Local Council at the Statement of Financial Position date stood at a negative 69.38% which falls well below the 10% threshold required by the Financial Provisions to the Local Councils Act. A Financial Situation Indicator which falls below the 10% margin implies that the Council is possibly 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).
- 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 Councils if it anticipates a Financial Situation Indicator level which will fall below the 10% threshold in future years.



## 10.0 LIQUIDITY

- 10.1 The Statement of Financial Position on page 4 of the Financial Statements indicates that the current liabilities exceeded the current assets by Euro 351,108. This implies that the Council does not have enough current assets to support its current liabilities.
- 10.2 The current ratio is Euro 0.21 of current assets for every Euro 1.00 of current liabilities, indicating that the Council may be in a situation of 'overtrading'. The acid test ratio is in fact only Euro 0.11 of cash and cash equivalents for every Euro 1.00 of current liabilities.
- 10.3 We recommend that the Council curtails its current expenditure and does not enter into further capital expenditure until the cash deficit situation is remedied.