

29th April 2019

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

Dear Mayor,

RE: MANAGEMENT REPORT FOR THE YEAR ENDED 31 DECEMBER 2018

We have completed our audit of the financial statements of the Local Council Nadur for the year ended 31 December 2018. 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 9 of this report.

During the course of our audit for the year ended 31 December 2018, 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.



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

Local Council Nadur

Management Report for the year ended 31 December 2018

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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 that the fixed assets register did not agree with the accounts and that errors were found in the computation of the depreciation charge for the year.

The above weaknesses were still present during the current year.

1.2 Receivables

Last year we pointed out that the receivables that have been outstanding for more than two years, were not provided for as doubtful debts as per instructions given.

This issue was not resolved during the current year.

1.3 Bank and Cash

Whilst going through the list of unpresented cheques, two cheques were noted to have become stale and should have been reversed. Also, when carrying out the cut-off tests, we noted that the Local Council had received a cheque in December that was not accounted for as it was deposited in the following month.

The first issue was still present during the current year, while the second issue was not encountered again.

1.4 Payables

Last year some invoices dated in 2017 were accounted for as accruals rather than as accounts payable. Also, some expenses were under accrued for. It was also noted that funds received with respect to planters which were capitalised as property, plant and equipment were not included as part of the deferred income but were instead treated as income for the year.

The above weaknesses were not present in the current year.

1.5 Income

When testing income, last year we noted that the income from the distributions by LESA was accounted for in the wrong income account.

During this year's audit, no such instance was found.

1.6 Expenditure and Tenders

With regards to expenditure, last year we noted that the budgeted expenditure was exceeded in various categories. During our testing on the expenditure, we came across an instance where quotations were not obtained. It was also noticed that there were cases where the Local Council had to issue addendums to extend the contracts over the period allowed in the original agreements because new contracts were not entered into on time.

The above issues, except for the last one, were encountered again this year.

1.7 Personal Emoluments

Last year we noticed that the FS7 and the FS5s were not agreeing since the non-taxable fringe benefits were included in the FS5s when they should have not been included. When we enquired about the fringe benefit, we were told that a verbal approval was obtained from the Department and hence there was no correspondence that could be shown to us during our audit.

During this year, the above issues were not present.

1.8 Financial Situation Indicator

The Financial Situation Indicator of the Local Council as at 31st December 2017 stood at a negative 34.72% which fell well below the 10% threshold required by the Financial Provisions to the Local Councils Act.

As at 31st December 2018, the financial situation indicator was still negative.

1.9 Liquidity

As at 31st December 2017, the current liabilities exceeded the current assets by Euro 13,873 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 From the architect's letter that we received during the audit, it transpired that during the year ended 31 December 2018, the Local Council completed a project in relation to the new synthetic turf for the football pitch. The cost of this project as per the architect's letter was Euro 60,540. This capital expenditure was not reflected in these financial statements. This means that the accruals and the property, plant and equipment are understated by this amount. Depreciation should have also been calculated as from the date of completion of the project.
- 2.2 At the end of every financial year, the Local Council should obtain a report from its architect on the projects undertaken by the Council during the year, including the valuations thereof. The report should include both the projects that would have been completed during the year as well as the projects that would still be ongoing as at the end of the year. This would ensure that all projects that have been completed during the year or are in progress as at the end of the year, but for which invoices would have not been issued, are correctly reflected in the accounts as accruals.
- 2.3 When checking the depreciation charge for the year, under the second option suggested by the Department where no sufficient details on the property, plant and equipment is available, several errors were found since the estimated remaining useful life was not recomputed and the depreciation was not calculated on a monthly basis. An audit adjustment was passed to correct the depreciation charge for the year which was understated by Euro 87,086.
- 2.4 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.
- 2.5 Whilst testing the additions of property, plant and equipment for the year, we noticed that the acquisition of air-conditioners was classified as computer equipment. A reclassification adjustment was passed to reclassify their cost of Euro 1,096 to the correct assets' category.
- 2.6 Care should be taken whilst accounting for the additions of property, plant and equipment to make sure that every item acquired is classified under the correct category. This would then ensure that items of property, plant and equipment are properly presented in the notes to the financial statements and that the correct depreciation rates are being applied.
- 2.7 Variances were noted between the figures reported in the updated fixed assets register and the figures shown in the financial statements after excluding the assets under construction. The net book value of the fixed assets register amounted to Euro 737,384 while the net book value in the financial statements was Euro 739,652.
- 2.8 The Local Council should reconcile the difference and updates the fixed assets register to tally with the accounts and the financial statements. Moreover, it is important to keep the necessary workings to be able to reconcile the cost and accumulated depreciation up to 31 December 2017 as per fixed assets register with the figures disclosed in the financial statements and such workings should also include the details of all the assets whose useful life has expired since their details would not feature in the fixed assets register.

3.0 RECEIVABLES

- 3.1 When going through the aged receivables' list as at 31 December 2018, we noticed that balances amounting to Euro 5,063 were older than two years by the end of the financial year and the provision for doubtful debts reflected in the accounts amounted to only Euro 1,293. This means that the provision for doubtful debts is understated by Euro 3,770.
- 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 When going through the various receivables' accounts, we found a balance of Euro 7,900 that represented co-financing funds. Upon checking the relevant documentation, it transpired that this represented the co-financing funds that were transferred from the current bank account to the new Central Bank account of the Local Council. Therefore, an audit adjustment was passed to reclassify this amount from under the receivables to the Central Bank account under the cash and cash equivalents.
- 3.4 Every transaction should be well understood by referring to the relevant documentation before posting it in the accounts in order to ensure that it is properly reflected in the accounts and consequently reported in the financial statements.

4.0 BANK AND CASH

- 4.1 When checking the list of unpresented cheques in the bank reconciliation, we came across two cheques which at the end of the year were considered to have become stale and should have thus been reversed. Even though the amounts totalled to just Euro 459, it has been agreed that these are adjusted for. Both cheques were reversed against the respective expenditure account despite only one of them was cancelled whilst the other one was issued but not presented.
- 4.2 The Council should regularly review the list of unpresented 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 During our tests on the bank balances, it was noted that the Local Council opened a new bank account with Central Bank of Malta relating to the Rural Roads project which was not accounted for and which as at the end of the financial year, had a balance of Euro 305,375. Adjustments were passed during the audit to account for the movements in this bank account that mainly represented funds received in advance for the Rural Roads project that were accounted for as deferred income and the negative interest charged by the bank on a monthly basis.
- 4.4 The Local Council should be fully aware of all the bank accounts that it holds with all the banks in its own name and should ensure that all such bank accounts are reflected in its books of accounts. Transactions reflected therein are to be accounted for in a timely manner.
- 4.5 When we were doing the cut off tests on the bank accounts, we noticed that there were several cheques that were dated in 2019 but have been accounted for in 2018. These cheques amounted to Euro 8,257 and most of them related to payroll costs.
- 4.6 It is important that cheques are accounted for on the date on which they are really issued. Until that time, the respective costs should be shown under the liabilities, in this case under the accruals.

5.0 PAYABLES

- 5.1 Through the cut-off tests that we performed on the payables, we found two invoices amounting in total to Euro 79,006 that were received from a supplier in respect to road resurfacing works, that were not accounted for. An adjustment was passed to properly reflect this unrecorded liability against the assets under construction under the property, plant and equipment.
- 5.2 It is important that care is taken to ensure that all invoices received from the suppliers are reflected in the books of accounts in the correct accounting period. Obtaining statements from its suppliers during the closure of the accounts would assist in identifying possible invoices that would have not been accounted for.

- 5.3 The deferred income as at 31 December 2018 amounting to Euro 297,860, has been classified as non-current in the statement of financial position. From the information we have obtained during our audit, the related projects are to be completed in the following year and thus this deferred income should have been classified as current liabilities.
- 5.4 It is important to ensure that all liabilities are properly categorised as either current or non-current in accordance with IAS1 – Presentation of Financial Statements.
- 5.5 As at 31 December 2017, the Local Council had received grants amounting to Euro 143,407 relating to resurfacing works 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. This project was carried out during the year ended 31 December 2018.
- 5.6 The Local Council should only transfer deferred income to property, plant and equipment when the project the funds intend to cover has been completed in accordance with IAS 20 – Accounting for Government Grants and Disclosures of Government Assistance.
- 6.0 EXPENDITURE AND TENDERS**
- 6.1 The Council has exceeded the budgeted expenditure under the following categories:
- 6.1.1 Utilities (Category 2100) by Euro 2,764;
 - 6.1.2 Materials & Supplies (Category 2200) by Euro 1,359;
 - 6.1.3 Repairs & Upkeep (Category 2300) by Euro 1,802;
 - 6.1.4 Office Services (Category 2600) by Euro 362;
 - 6.1.5 Transport (Category 2700) by Euro 9,764;
 - 6.1.6 Travel (Category 2800) by Euro 2,524;
 - 6.1.7 Information Services (Category 2900) by Euro 9,655;
 - 6.1.8 Contractual Services (Category 3000) by Euro 11,127;
 - 6.1.9 Professional Services (Category 3100) by Euro 9,257;
 - 6.1.10 Training (Category 3200) by Euro 229;
 - 6.1.11 Community and Hospitality (Category 3300) by Euro 25,786;
 - 6.1.12 Local Enforcement Expenses (Category 3600) by Euro 18.
- 6.2 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.
- 6.3 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.
- 6.4 While testing a sample of the expenditure, it was noted that there were instances where the Local Council did not obtain the necessary quotations for one reason or another. The expenditure for which no quotations were obtained amounted to Euro 5,835. We also noticed that the Council does not always draw up purchase requests in line with the Local Councils Financial Procedures.
- 6.5 Kindly note that the above issues are 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. For any type of expenditure incurred by the Local Council, the Local Councils Financial Procedures should always be applied without any exceptions.

7.0 FINANCIAL SITUATION INDICATOR

- 7.1 The Financial Situation Indicator of the Local Council at the Statement of Financial Position date stood at a negative 27,06% which is below the 10% threshold required by the Financial Provisions to the Local Councils Act.
- 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).
- 7.3 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.

8.0 LIQUIDITY

- 8.1 The Statement of Financial Position on page 4 of the Financial Statements is showing a net current assets position. However, if one removes the restricted cash of Euro 218,854, representing funds received in advance for which no liabilities have yet been recognised, the current liabilities would exceed the current assets by Euro 127,698. This implies that the Council does not have enough current assets to support its current liabilities.
- 8.2 Based on the above adjustment, the current ratio would be Euro 0.66 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 0.53 of cash and cash equivalents for every Euro 1.00 of current liabilities.
- 8.3 We recommend that the Council curtails its current expenditure and does not enter into further capital expenditure until the cash deficit situation is remedied.

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.