

07/09/16**Local Council San Lawrenz**
22A, Triq id-Duluri,
San Lawrenz SLZ1261,
Gozo

Dear Mayor,

RE: MANAGEMENT REPORT – FOR YEAR ENDED 31 DECEMBER 2015

We have completed our audit of the financial statements of the Local Council San Lawrenz 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 might exist and/or of all improvements that might be made. Our aim is to offer guidance to the Council such that it would be in a better position to improve its internal controls, enhance its book keeping function and consolidate its overall governance.

Our engagement obliges us to distribute copies of this report to (a) the Council; (b) the National Audit Office; and (c) the Local Councils Department. Consequently, this report may not be distributed, used or quoted, in part or in full, except for the scope it is prepared, without our prior written consent.

This report has been prepared on the basis of the limitations set out in the Responsibility Statement as presented on page 11 of this Report.

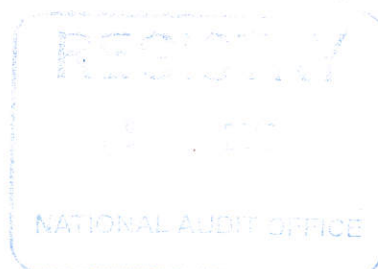
During the course of our audit for the year ended 31 December 2015, we examined the principal documents, systems and controls used by the Council, to help it ensure, as far as possible, the accuracy of these documents and to assess how much can one rely on these documents to safeguard the assets of the 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, Legal Notices applicable to Local Councils and various Memos issued to your Council.

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

We would like to take this opportunity to thank the Executive Secretary and Staff members for their assistance during the course of our audit.



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



Local Council San Lawrenz

Management Report for the year ended 31 December 2015

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1.0 FOLLOW-UP TO LAST YEAR'S MANAGEMENT REPORT

1.1 Property, Plant & Equipment

In last year's management letter, we pointed out the following issues with regards to the property, plant and equipment:

- Certain qualifying costs such as architects' fees were not being capitalised as part of the cost of the assets;
- Certain capital expenditure was written off to the statement of comprehensive income;
- Works carried out but not yet billed, were not being accrued for;
- Projects previously classified as under construction were not reclassified at the date when they were finalised. This resulted in incorrect calculation of depreciation;
- The fixed assets register was not agreeing with the figures shown in the financial statements;
- Assets were being under insured; and
- We noticed that plants were being capitalised when these should be written off immediately.

All the above issues, apart from the fixed assets register not being updated and the assets being under insured, have been tackled by the Local Council during the year being reviewed.

1.2 Receivables

During the previous year, a fund received which was accrued for in prior years has been accounted for as income for the year. During the current year, no similar issues have been identified.

1.3 Bank and Cash

Last year, two petty cash payments exceeded the limit of Euro 23.29 set by the regulations governing the Local Councils. During the current year, no petty cash payments were made which exceeded this limit.

1.4 Payables

While performing last year's audit, it was noted that the Local Council was not accruing for all the street lighting jobs performed till the end of year. This was not noted again during the current year.

Minor errors had been noted with regards to the deferred income amortisation. Similar errors were again noted during the current year audit.

Last year it had been noted that the Local Council was not being consistent in the policy used in relation to funds received/promised. This issue was not resolved during the year under review.

The money received in relation to MaltaPost service was recorded as income of the Local Council and the payments made to MaltaPost were being accounted for as an expense of the Local Council. The only income of the Local Council from this service should only be the commission receivable. This issue was rectified during the current year.

1.5 Income

Last year, income not backed by a bye-law relating to the Panacea Centre was noted. No such income was encountered during 2015.

1.6 Expenditure

During the previous year's audit, the following weaknesses had been noted:

- No purchase requests or purchase orders were drawn in line with the Local Councils Financial Procedures;
- Expired service contracts were still being used and no renewal or fresh calls were made;
- Expenses were not always backed by a proper VAT fiscal receipt;
- A case was encountered where no tender was issued even though the threshold was exceeded;
- The actual expenditure in certain categories exceeded the budget;
- Minor gifts were given to the people in the locality; and
- Certain deficiencies were noted in the payment vouchers prepared by the Local Council.

All the above issues have not been tackled by the Local Council.

1.7 Payroll

Whilst testing the payroll section, the following shortcomings had been noted:

- Reclassification errors between the payroll accounts; and
- Differences between FS3s and FS7s

These issues were not encountered during the year under review.

1.8 Liquidity

As at 31 December 2014, the current liabilities of the Local Council exceeded its current assets. The same situation existed as at 31 December 2015.

1.9 Financial Situation Indicator

Last year the Local Council had a negative financial situation indicator. This year, the situation did not change.

2.0 PROPERTY, PLANT & EQUIPMENT

- 2.1 Whilst performing procedures on the additions during the year, it was noted that a request for payment for the amount of Euro 2,301 was included as an addition under the category special programs when the same amount formed part of an invoice already posted. An audit adjustment was passed to reverse such entry.
- 2.2 It is important that request for payments are not accounted for as invoices, as then when the actual invoices are issued, there would be double postings. Request for payments may be used to calculate the accruals as at year-end if by that time the actual invoices would have not yet been issued.
- 2.3 When testing the fixed assets register, it was noted that the amounts found in it, do not agree with those shown in the nominal ledger and the financial statements submitted before any audit adjustments as follows:
- 2.3.1 The total cost in the fixed assets register amounting to Euro 798,079 was not agreeing with the total cost in the nominal ledger which amounted to Euro 1,802,424.
 - 2.3.2 The total accumulated depreciation in the fixed assets register amounting to Euro 410,241 was not agreeing with the total depreciation plus grants in the nominal ledger which amounted to Euro 626,922.
 - 2.3.3 The net book value in the financial statements also exceeds that disclosed in the fixed assets register by Euro 787,661. The net book value as per fixed assets register amounted to Euro 387,838, while the net book value as per financial statements amounted to Euro 1,175,502.
- 2.4 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, i.e. cost, accumulated depreciation, grants and net book value. The more time is allowed to pass, the more complex the exercise will become.
- 2.5 When testing the depreciation, it was noted that the depreciation for the construction category was not being calculated correctly. Depreciation as per accounts amounted to Euro 2,409 when it should have been Euro 9,646. An audit adjustment with the difference of Euro 7,237 has been passed to rectify this error.
- 2.6 It is recommended that care should be taken to ensure that the depreciation charge for the year is calculated for every month of each calendar year. Depreciation should always be calculated as from the date the asset is actually completed and ready for use. It is also important that all additions for the year are taken into account.
- 2.7 When inspecting the insurance coverage policy document, we noticed that the net book value of the Local Council's assets is not adequately covered. The insurance policy covers property, furniture and fittings and equipment with a value of up to Euro 192,832; while the net book value of the property, plant and equipment of the Local Council amounted to Euro 1,165,963 as at 31 December 2015. This means that an amount of Euro 973,131 is not covered by an insurance policy.
- 2.8 In case of theft, fire or any other accident, the Local Council would not be in a position to recover all the losses that might be incurred. Therefore, the Local Council should consider revising its insurance policy in order to ensure that all the items of property, plant and equipment falling under its responsibility are adequately covered.

3.0 BANK AND CASH

- 3.1 When testing the petty cash transactions, we noted that a cheque issued during the year to top up the petty cash balance, amounting to Euro 98.57, was posted in the stationery expenses account rather than in the petty cash account. We also noted that certain petty cash payments amounting in total to Euro 61.74 were not recorded in the books of accounts. Audit adjustments were passed to correct these errors.
- 3.2 Care should be taken to ensure that the correct nominal accounts are chosen while doing the postings, and also to ensure that all transactions undertaken by the Local Council are reflected in the accounts. Monthly petty cash reconciliations should be carried out in order to tally the actual cash in hand with the petty cash balance shown in the accounts. Any discrepancies found should be immediately investigated and resolved. If such reconciliations were carried out, errors such as those mentioned above would have been traced immediately.

4.0 PAYABLES

- 4.1 While performing audit procedures on a sample of creditors' balances as at the end of the financial year, in one particular case, a discrepancy was found between the balance shown in the supplier's statement and the balance in the Local Council's records. An audit adjustment amounting Euro 3,505 has been passed in this respect.
- 4.2 We also noted that during the year, the Local Council carried out a clean-up exercise on the creditors' balances and wrote off several balances which amounted to Euro 4,991. Practically all these balances were coming from prior years and since these were not deemed as due by the Local Council and none of the suppliers chased the Local Council for any such payments over the years which further confirmed this fact, they were written off to the statement of comprehensive income as other income. One of the amounts making up the Euro 4,991, being Euro 1,351, was identified as being related to the street lighting and it was decided to pass a reclassification adjustment to net it off against the specific expense account.
- 4.3 On a regular basis, but in particular at the end of each financial year, the Local Council should obtain statements from its suppliers. Once the statements are received, a reconciliation is to be carried out between the balance shown on the statements and the balance shown in the books of accounts of the Local Council. Any discrepancies found, need to be investigated and where necessary, the accounts are updated or the supplier is contacted to resolve the matter as the case may be.
- 4.4 Whilst testing the deferred income, two minor errors were noted in the calculation of the amortisation for the year. An audit adjustment was passed in respect to Measure 323 deferred income amortisation amounting to Euro 1,746 and another adjustment was passed in respect to Measure 313 deferred income amortisation amounting to Euro 246. In both cases, the amortisation for the year was decreased.
- 4.5 The Council should ensure that the amortisation calculations are correctly carried out and accounted for.
- 4.6 When analysing the deferred income, it was noted that the Local Council has received funds that exceeded the costs incurred on the respective projects. A letter was received by the Local Council from the Agriculture and Rural Payments Agency requesting the refund of such excess amounts. Consequently, reclassification adjustments amounting to Euro 24,479 and Euro 22,964 with respect to Measure 323 and Measure 313 respectively, were passed to transfer such amounts from deferred income to other payables.

- 4.7 It is important that any excess funds received are classified separately from deferred income unless the Local Council obtains specific authorisation to keep those funds and use them for another project.
- 4.8 During the course of the audit, it was also noted that the Local Council was not being consistent in the policy used in relation to funds received/promised. Several different treatments were noted as described below:
- 4.8.1 For some projects, the Local Council accounted for the full amounts of funds receivable as deferred income once it entered into an agreement. Any amounts outstanding were accrued for immediately.
 - 4.8.2 For other projects the Local Council only deferred the actual funds received whilst it did not account for any amounts not yet received unless the project has been completed even though the costs already incurred exceeded the funds received.
 - 4.8.3 For other projects the Local Council deferred the actual funds received and accrued and deferred funds in line with the progress of the project.
- 4.9 Whilst one should note that all the above are acceptable, it is recommended that the Local Council uses a constant policy and applies it to all funds.

5.0 INCOME

- 5.1 When analysing the income, it was noted that income coming from the Central Government amounting to Euro 1,500 was posted in the cultural activities account. In order to ensure proper analysis and disclosures in the financial statements, a reclassification was passed to show this income as Other Government Income.
- 5.2 Furthermore, we noted that income representing reimbursement of travelling costs relating to a tour organised to Umberto Colle was posted in cultural events account while the corresponding costs were posted in the overseas tickets expenses account. This approach resulted in income which is not actually income of the Local Council and inflated overseas ticket expenditure which was surely not part of the budget of this expenditure category. It was agreed that the income should be reclassified to the expense account to set off these two related transactions.
- 5.3 When posting income in the books of the Local Council, it is to be ensured that the correct nominal account is used as this would eventually affect the classifications and disclosures made in the financial statements. Being consistent will also result in better comparability from one year to the other.

6.0 EXPENDITURE

- 6.1 The Local Council did not draw up a purchase request or a purchase order in line with the Local Councils Financial Procedures. The matter was discussed with the Local Council and we were informed that usually an e-mail is sent rather than a purchase order. We are still of the opinion that the Local Council should adhere to the procedures applicable to Local Councils. Moreover, the proper use of purchase orders would also help the Local Council to identify all liabilities at year-end.
- 6.2 It was also noted that expenses are not always backed by a VAT fiscal receipt, showing the VAT registration number of the person or company supplying the goods or services to the

Local Council, even though the Local Council tries its utmost to obtain such receipts. From the samples selected, expenses amounting to Euro 2,682 and capital expenditure amounting to Euro 918 were not backed by such receipts.

- 6.3 It is recommended that the Local Council should keep following up all suppliers to submit the required fiscal receipts or appropriate receipts as applicable under the VAT legislation. The Council might consider for those suppliers who are always in default, to not release their payments unless they go to the Local Council's offices with the VAT fiscal receipts book to collect the payment.
- 6.4 During the year, there was a significant increase in the legal fees. These fees relate to a court case opened against the 6 council members being Noel Formosa, Anthony Formosa, Giovanni Mercieca, Joseph Sultana, Luigia Grima and Lucia Anna Haber, during the year 2011. The case was opened due to alleged involvement in fraud related to the application with Malta Resources Authority on the installation of solar panels.
- 6.5 The court case was opened against the council members personally rather than the Local Council. Whilst understanding that this case relates to application for refunds being offered by the Local Council, the fact that the case was opened specifically against the council members personally cast doubt as to who should incur such expenses. Furthermore, there is no contingent liabilities disclosure in the financial statements on this matter.
- 6.6 The choice of the lawyer for the above-mentioned case was not done by going through a tendering process even though the amounts invoiced exceeded the thresholds. Also, the choice of the supplier for the provision of cleaning services during the village feast was not done through the collection of quotations but the supplier was chosen directly as well.
- 6.7 May we remind the Local Council that the Local Councils' Financial Procedures strictly oblige the Local Council to issue a call for tenders in respect of expenditure in excess of Euro 4,659 and a call for quotations in respect of expenditure in excess of Euro 1,165. It is therefore important that in such cases the tendering procedures are followed without any exceptions.
- 6.8 When browsing the nominal accounts for the year ended 31 December 2015, it was noted that the Local Council gave minor gifts to the people in the locality.
- 6.9 Whilst the kindness of the Local Council's gesture is noted, and whilst noting that the value of these items was immaterial, it is categorically forbidden by the Department to give any type of donations whether in cash or in kind. It is recommended that this regulation is abided with in future periods.
- 6.10 Whilst carrying out tests in this area, we also noticed the following deficiencies relating to payment vouchers:
 - 6.10.1 On certain payment vouchers the description only mentioned the invoice numbers being paid and no further details on the supplier or the good or service the payment relates to were being included; and
 - 6.10.2 In other instances the actual goods are indicated but the invoice numbers and details are omitted.
- 6.11 It is important that in the future, more details are recorded on the payment vouchers to ensure that one can easily understand and identify which invoices are being settled by any particular payment.

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

- 6.12.1 Utilities (Category 2100) by Euro 917
- 6.12.2 Materials and Supplies (Category 2200) by Euro 3,519
- 6.12.3 International Memberships (Category 2500) by Euro 400
- 6.12.4 Transport (Category 2700) by Euro 921
- 6.12.5 Travel (Category 2800) by Euro 857
- 6.12.6 Contractual Services (Category 3000) by Euro 6,735
- 6.12.7 Professional Services (Category 3100) by Euro 11,412
- 6.12.8 Community and Hospitality (Category 3300) by Euro 37,955
- 6.12.9 Other incidental costs (Category 3400) by Euro 62

- 6.13 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.

- 6.14 We recommend that the Council makes use of the reporting tools in hand to take corrective measures in the budget every quarter.

7.0 LIQUIDITY

- 7.1 The Statement of Financial Position on page 5 of the Financial Statements indicates that the current liabilities exceed the current assets by Euro 63,532. This implies that the Local Council does not have enough current assets to support its current liabilities.
- 7.2 The current ratio is Euro 0.74 of current assets for every Euro 1.00 of current liabilities indicating that the Local Council may be in a situation of 'overtrading'. The acid test ratio is in fact only Euro 0.58 of cash and cash equivalents for every Euro 1.00 of current liabilities.
- 7.3 The Local Council is also projecting further capital expenditure for the year 2016 as disclosed in the capital commitments note 16 to the Financial Statements. The said note indicates that there is Euro 85,000 worth of commitments which have been approved by the Local Council but not contracted for.
- 7.4 We recommend that the Local Council curtails its current expenditure and does not enter into further capital expenditure until the cash deficit situation is remedied.

8.0 FINANCIAL SITUATION INDICATOR

- 8.1 The Financial Situation Indicator held by the Local Council at the statement of financial position date, stood at negative 12.66% 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 Local Council is not effectively managing its payables and cash flows, venturing into activities which are not budgeted for.
- 8.2 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.

- 8.3 The Local Council should manage the working capital more attentively, in order to avoid such a negative Financial Situation Indicator. Moreover it is recommended that the Local 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.

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.