

13/02/17**Local Council San Lawrenz**22A, Triq id-Duluri,  
San Lawrenz SLZ1261,  
Gozo

Dear Mayor,

**RE: MANAGEMENT REPORT – FOR PERIOD ENDED 03 OCTOBER 2016**

We have completed our audit of the financial statements of the Local Council San Lawrenz for the period ended 03 October 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 might exist and/or of all improvements that might be made. Our aim is to offer guidance to the Council such that it would be in a better position to improve its internal controls, enhance its book keeping function and consolidate its overall governance.

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

This report has been prepared on the basis of the limitations set out in the Responsibility Statement as presented on page 9 of this Report.

During the course of our audit for the period ended 03 October 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, 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 period ended 03 October 2016**

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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:

- The fixed assets register was not agreeing with the figures shown in the financial statements;
- Assets were being under insured; and
- Depreciation on construction was not being calculated correctly.

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

### 1.2 Bank and Cash

Last year, it was noted that cash deposits were posted in another account rather than in the petty cash account and certain petty cash payments were not recorded. During the current period, no such instances were encountered although other weaknesses were noticed.

### 1.3 Payables

While performing last year's audit, it was noted that there was a discrepancy between the amounts payable to a particular supplier as per accounts and the balance shown in the supplier's statement. In the current period similar discrepancies were noted.

In the deferred income account, an audit adjustment has been passed last year with respect to the amortisation for the year. During the current period, no discrepancies have been found. Moreover, last year two adjustments have been passed with respect to additions of deferred income accounted for whereby excess funds have been received. The additions for the current period were correct.

### 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;
- The Council exceeded the budgeted expenditure for several categories during the period;
- Minor gifts were given to the people in the locality;
- Expenses were not always backed by a proper VAT fiscal receipt;
- An instance was encountered whereby quotations were not obtained; and
- Certain payment vouchers were missing Mayor and Executive Secretary signatures whilst other payment vouchers missed some details.

The first three issues have not been tackled by the Local Council while the last three were not encountered during the current period.

Last year there was a significant increase in legal costs due to a court case opened against the members of the local council personally due to allegations of being involved in fraud related to the applications with MRA on the installation of solar panels, the fees of which were paid by the

Council. This case was closed during 2016 and according to the Local Council's lawyer, the Local Council has a right to reclaim the legal fees incurred.

1.8 Payroll

Whilst testing the payroll, differences between the FS3s and the FS7 were noted during the 2015 audit.

During the current period, a discrepancy between the accounts and the FS5s was noted.

1.9 Liquidity

Last year the Local Council had a net current liabilities position. At the end of the period under review, a similar situation existed.

## **2.0 PROPERTY, PLANT & EQUIPMENT**

- 2.1 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:
- 2.1.1 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 1,807,415.
  - 2.1.2 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 715,166.
  - 2.1.3 The net book value in the financial statements also exceeds that disclosed in the fixed assets register by Euro 704,411. 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 1,092,249.
- 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, i.e. cost, accumulated depreciation, grants and net book value. The more time is allowed to pass, the more complex the exercise will become.
- 2.3 When testing the depreciation charge for the period, it was noted that the depreciation on the assets category Construction was not calculated correctly. Depreciation for this category as per accounts amounted to Euro 690 when it should have been Euro 6,625. An audit adjustment with the difference of Euro 5,935 has been passed to rectify this error.
- 2.4 Care should be taken when calculating the depreciation charge for the period to ensure that the correct opening net book values are taken, that all the additions for the year are taken into account as from the correct date and that the correct depreciation rates are applied. Once the fixed assets register is updated, depreciation should be calculated on an item by item basis through the register.
- 2.5 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 office equipment with a value up to Euro 192,832; while the net book value as per the financial statements amount to Euro 1,138,147. This means that an amount of Euro 945,315 is not covered by the insurance policy.
- 2.6 The 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 so that in the case of an accident, the Local Council would be in a position to recover the losses incurred.
- 2.7 Upon review of the letter received from the architect about the projects undertaken by the Local Council during the period, it was noted that works relating to the project Belvedere Colle Umberto were 49% completed by the end of the period, but no invoices were yet received from the supplier and these works completed have not been accrued for. In this respect an adjustment of €51,833 has been passed to reflect the asset under construction.
- 2.8 It is important that the Local Council is fully aware of projects still in progress as at the end of period and any works completed but not yet invoiced are properly accrued for. This would ensure that the assets under construction, as well as the corresponding liabilities arising, are reflected in the accounts.

### **3.0 BANK AND CASH**

- 3.1 When testing the petty cash balance as at the end of the period, we noted that the petty cash account was showing a negative balance of €18. Upon investigating this matter, it was noted that this was due to expenses incurred after the end of the period which were accounted for during the period. An audit adjustment amounting to €23.72 was passed to reverse these transactions.
- 3.2 At the end of every reporting period, the Local Council should carry out a petty cash count and ensure that the actual petty cash balance agrees with that shown in the book of accounts of the Local Council. Any variances arising should be investigated immediately and corrective action taken.
- 3.3 We also noted that one particular expense paid from the petty cash exceeded the limit set by the regulations governing Local Councils of Euro 23.29. This was the purchase of books amounting to Euro 23.92.
- 3.4 For any expense in excess of Euro 23.29, the Council should issue a cheque and should not affect payment through the petty cash.
- 3.5 When checking the bank reconciliations, we noticed that in two bank accounts there was a variance of Euro 1,088. It transpired that the variance was coming from a transfer between these two accounts that has not been reflected in the accounts. An audit adjustment was passed to reflect this transaction.
- 3.6 The Local Council should ensure that at the end of every financial period, the bank reconciliations are properly carried out and checked for their correctness.

### **4.0 PAYABLES**

- 4.1 While performing tests on the period-end creditors' balances, a discrepancy was found between the balance shown on the supplier's period-end statement and the amount payable as per the Council's records. Upon enquiry, it was found that this variance relates to works on water culverts carried out in 2012. An amount of Euro 31,350 was accrued for in 2012 out of which Euro 20,000 were paid during 2013 leaving a balance of Euro 11,350 in the accruals at the end of 2013. In 2014, this balance was reclassified to creditors. It seems that no official invoice was issued by the supplier to date for this amount, which means that this amount should be still shown as an accrual.
- 4.2 During our audit visit, it was agreed with the Local Council that this matter is further investigated to conclude whether this balance is actually payable to the supplier or not. If it is, an invoice should be requested from the supplier to close the matter. If it is not due, meaning that the works carried out were less than the tendered for amount, then the accrual should be reversed and the respective depreciation adjusted.

### **5.0 EXPENDITURE AND TENDERS**

- 5.1 The 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 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 Council should adhere to the procedures applicable to Local Councils. Moreover the



proper use of purchase orders would also help the Council to identify all liabilities at period-end.

- 5.2 When browsing the nominal accounts for the period ended 3<sup>rd</sup> October 2016, it was noted that the Council gave donations to the local school and for a concert held in the locality.
- 5.3 Whilst the kindness of the 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.
- 5.4 It was also noted that the Council has exceeded the budgeted expenditure for several categories, namely:
- 5.4.1 Utilities (Category 2100) by Euro 281
  - 5.4.2 Materials and Supplies (Category 2200) by Euro 575
  - 5.4.3 Repairs and upkeep (Category 2300) by Euro 1,221
  - 5.4.4 Rent (Category 2400) by Euro 312
  - 5.4.5 Office services (Category 2600) by Euro 1,769
  - 5.4.6 Transport (Category 2700) by Euro 62
  - 5.4.7 Travel (Category 2800) by Euro 635
  - 5.4.8 Information services Services (Category 2900) by Euro 440
  - 5.4.9 Contractual services (Category 3000) by Euro 4,033
  - 5.4.10 Professional fees (Category 3100) by Euro 3,846
  - 5.4.11 Community and Hospitality (Category 3300) by Euro 2,280
  - 5.4.12 Incidental expenses (Category 3400) by Euro 15
- 5.5 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.
- 5.6 We recommend that the Council makes use of the reporting tools in hand to take corrective measures in the budget every quarter.
- 5.7 Whilst browsing through the expenditure accounts, we noticed that in the insurance coverage nominal account there was an accrual for the lease of equipment posted in it amounting to Euro 819. Furthermore, we noticed that a refund of part of the insurance premium paid, was posted in an income account instead of the insurance coverage account. The refund was of Euro 169. Two audit adjustments were passed to rectify these errors.
- 5.8 Care should be taken when posting transactions in the books of accounts to ensure that the proper nominal accounts are chosen. This would ensure correct and consistent presentation.

## **6.0 PAYROLL**

- 6.1 When performing tests on payroll, a discrepancy was noted between the FS5s and the accounts. The gross wages as per FS5s amounted to Euro 35,677 whilst the gross wages as per accounts amounted to Euro 33,118.
- 8.4 It is highly recommended that particular care is taken when preparing the FSS forms and when NI payments are being affected. When compiling the FSS forms it is important to ensure that these are properly filled in. Furthermore, it is important to carry out reconciliation between the various FSS forms and also between these forms and the books of account.

## **9.0     LIQUIDITY**

- 9.1     The Statement of Financial Position on page 5 of the Financial Statements indicates that the current liabilities exceed the current assets by Euro 95,368. This implies that the Council does not have enough current assets to support its current liabilities. It is important to mention that Euro 82,097 within the current liabilities represent the non-current deferred income.
- 9.2     The current ratio, is Euro 0.90 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 0.68 of cash and cash equivalents for every Euro 1.00 of current liabilities. These ratios have been computed after excluding the non-current deferred income.
- 9.3     The Council is also projecting further capital expenditure for the period 2016 as disclosed in the capital commitments note 16 to the Financial Statements. The said note indicates that there is Euro 53,163 worth of commitments which have been approved and contracted for.
- 9.4     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.