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Our Ref: NAO 107/2015/56  
Your Ref:

**Ta' Sannat  
Local Council**

12 MAY 2017

11 May 2017

**Received**

The Mayor and Executive Secretary  
Sannat Local Council  
Sannat

Dear Sir/Madam,

**AUDIT REPORT and FINANCIAL STATEMENTS  
YEAR ENDING 31 DECEMBER 2016**

In terms of Section P2.06 (c.02) of the Local Councils (Audit) Procedures 2006, I am forwarding a copy of the Audit Report and Financial Statements, together with the Management Letter for the financial year ending 31 December 2016.

After seeking the Council's approval, you are kindly requested to submit your response to the Director (Local Government), the Local Government Auditor, and to this Office as stipulated in Section P2.06 (d) of the same Procedures, by not later than six weeks following receipt of this letter.

Yours faithfully,



**Tanya Mercieca**  
Asst. Auditor General

Encls.

25<sup>th</sup> April 2017The Mayor  
Local Council Sannat  
Sannat Road,  
Sannat,  
Gozo.

Dear Mayor,

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

We have completed our audit of the financial statements of the Local Council Sannat 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, 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 8 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 clerks for their assistance during the course of our audit.



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

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**Local Council Sannat**

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

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

### 1.1 Property, plant and equipment

Last year, several issues were noted with regards to property, plant and equipment including:-

- No fixed assets register was provided to us as it was not being updated;
- Errors were found in the calculation of the depreciation for the year;
- Variances were found in the opening balances;
- Property, plant and equipment were under insured; and
- Costs relating to a study about a project which was then not carried out were capitalised.

A new fixed assets register was built during 2016 and the other issues mentioned, apart from the one related to the under insured assets, were not encountered this year.

### 1.2 Receivables

The recommendation made by us last year, to accrue for income not yet received with respect to projects which are completed by the end of the year, was still not taken by the Council during the year under review.

### 1.3 Payables

A weakness we highlighted last year was on the amortisation of the deferred income with respect to grants relating to capital projects whereby several errors were found. Another error encountered with respect to deferred income was that funds received for one project were posted in the deferred income account of another project. No similar issues were encountered this year.

Other weaknesses encountered with respect to payables last year included, debit balances in the creditors' list not reclassified under receivables, accruals being reversed when the respective invoices were not accounted for and an accrual being accounted for based on an estimate without getting quantification from the architect. None of these weaknesses were found this year.

### 1.4 Income

Last year errors were found in the calculation of the amortisation of the deferred income for the year. An item of income was also found posted in the wrong nominal account and had to be reclassified. We did not encounter these issues during the current year.

### 1.5 Expenditure and Tenders

Last year, the Local Council did not draw up purchase requests in line with the Local Councils Financial Procedures. During the current year, the Local Council has been drawing up these purchase requests. The Council also exceeded the budgeted expenditure under various expenditure categories. This weakness was once again encountered during this year's audit. Furthermore, last year the Council was still using an expired contract for street lighting services. This matter was solved during the current year as the responsibility for street lighting is now of the Gozo Regional Committee.

### 1.6 Payroll

Last year, it was noted that the councillors' allowances were being shown as part-time emoluments in the FS5s, while they were being shown as full-time emoluments in the FS3s and the FS7. Also, when checking the tax deductions of the clerk we noted that it is being calculated incorrectly. These weaknesses were not encountered during this year's audit.

1.7 Liquidity

As at 31 December 2015, the current liabilities exceeded the current assets by Euro 118,269 indicating possible liquidity problems. As at the end of the financial year under review, the Local Council had the same situation.

1.8 Financial Situation Indicator

As at 31 December 2015, the financial situation indicator of the Local Council stood at negative 38.14% which fell below the 10% threshold required by the Financial Provisions to the Local Councils Act. As at 31 December 2016, the financial situation indicator was still negative.

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

- 2.1 During 2016, the Local Council carried out the exercise suggested by us in the previous years' management letters and built a new fixed assets register. The resulting variances were passed as a prior year adjustment. Whilst carrying out this exercise, the Local Council capitalised the bank loan interest relating to the loan taken for the construction of the Local Council's premises, which were previously not capitalised. However, we noticed that the Council did not only capitalised the interest up to the date when the construction was finalised and the property was available for use, which was in May 2012, but it capitalised all the loan interest incurred, including that incurred during the year under review. Consequently, we had to pass an audit adjustment to reverse the interest incurred between June 2012 and December 2015 which amounted to Euro 19,474 and was passed as a prior year adjustment.. We also passed an audit adjustment to reverse the interest wrongly capitalised, being that incurred during 2016 and which amounted to Euro 4,708.
- 2.2 Kindly note that International Accounting Standard 23 – Borrowing costs states that capitalisation should commence when the expenditures are being incurred, borrowing costs are being incurred and the activities necessary to prepare the asset for its intended use are in progress. Capitalisation should then cease when substantially all of the activities necessary to prepare the asset for its intended use are complete.
- 2.3 During our testing on the adequacy of the insurance coverage of the property, plant and equipment, we found that the office furniture and fittings are under insured by Euro 7,316 since the insurance covers the amount of Euro 9,400 while their net book value amounts to Euro 16,716.
- 2.4 If assets are under insured, 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.

## **3.0 RECEIVABLES**

- 3.1 When an activity is held or eligible expenditure is incurred on a particular project, and there are government grants attributable to that activity or project which are still wholly or partly to be received, the accrued income with respect to that grant or part thereof should be accounted for. During the audit, we had to adjust the grant still due to the Local Council for the Twinning Project by Euro 5,305, in line with the eligible expenditure incurred during the year on this project and the agreement entered into.
- 3.2 The concept of recording accrued income in the period as it accrues should be respected. The Council should know what income is receivable and still not received by the time of drawing up the financial statements and as such should be able to accrue for that income. We strongly recommend that the accruals concept is embraced by the Council.

## **4.0 PAYABLES**

- 4.1 It was noted that works provided to the Local Council during the year with respect to street lights amounting to approximately €1,139, and which were not yet invoiced, were not accrued for at the end of the year.
- 4.2 The concept of recording liabilities and costs in the year as they accrue should be respected. The Council should know what orders for works and services were made and still not invoiced by the time of drawing up the financial statements and as such should be able to either accrue for the cost or request a copy of the invoice or statement from the respective suppliers. We strongly recommend that the accruals concept is embraced by the Council. Furthermore, the Local Council should ensure that all invoices received are immediately accounted for irrespective of from which funds they are going to be paid.

## **5.0 INCOME**

- 5.1 During our review of the income accounts, we noticed that income was understated by Euro 5,305 since the Local Council failed to adjust for the grant still due to it with respect to the Twinning Project.
- 5.2 It is important that the Local Council is fully aware of the funds it has been entitled to through the agreements entered into and any income not yet received with respect to projects already done is accrued for at the end of the financial year. This would ensure that the income is matched to the respective costs it is intended to cover.

## **6.0 EXPENDITURE AND TENDERS**

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

Utilities (category 2100) – by Euro 2,294  
Materials and supplies (category 2200) – by Euro 716  
Repairs and maintenance (category 2300) – by Euro 2,382  
Rent (category 2400) – by Euro 974  
Membership fees (category 2500) – by Euro 420  
Office costs (category 2600) – by Euro 788  
Transport (category 2700) – by Euro 161  
Travelling (category 2800) – by Euro 684  
Professional fees (category 3100) – by Euro 5,175

- 6.2 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.
- 6.3 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 year such discrepancies would not materialise. We also recommend that the Council starts using purchase requests in line with the Local Councils Financial Procedures.

## **7.0 PAYROLL**

- 7.1 During our review of the payroll accounts, we noticed that bonuses were being posted together with the employees' and executive secretary's salaries instead of in the specific nominal account for bonuses. A reclassification adjustment of Euro 1,025 was passed in order to reflect the bonuses in the correct nominal account.
- 7.2 It is important that the different elements of the personal emoluments costs are accounted for in the respective specific nominal accounts available to ensure correct presentation in the financial statements as well as ensure comparability from one year to the other.

## **8.0 LIQUIDITY**

- 8.1 The Statement of Financial Position on page 5 of the financial statements indicates that the current liabilities exceed the current assets by Euro 126,446. This implies that the Council does not have enough current assets to support its current liabilities.
- 8.2 The current ratio is Euro 0.36 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 0.23 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 capital projects until the cash deficit situation is remedied.

**9.0 FINANCIAL SITUATION INDICATOR**

- 9.1 The Financial Situation Indicator held by the Council at the Statement of Financial Position date stood at negative 33.21% 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 Government 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 comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.