

16<sup>th</sup> April 2018

The Mayor  
Local Council Sannat  
Sannat Road,  
Sannat,  
Gozo.

RSM Malta  
Meina Road  
Zebbug ZB9 9015  
Malta  
T+356 2278 7000  
F+356 2149 3318  
[www.rsm.com](http://www.rsm.com)

Dear Mayor,

**RE: MANAGEMENT REPORT FOR THE YEAR ENDED 31 DECEMBER 2017**

We have completed our audit of the financial statements of the Local Council Sannat for the year ended 31 December 2017. 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 7 of this report.

During the course of our audit for the year ended 31 December 2017, 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

**THE POWER OF BEING UNDERSTOOD**  
AUDIT | TAX | CONSULTING

## **Local Council Sannat**

### **Management Report for the year ended 31 December 2017**

<b>Contents</b>	<b>Page</b>
Follow-up to last year's report	3
Property, Plant and Equipment	4
Payables	4
Expenditure and Tenders	5
Payroll	5
Liquidity	5
Financial Situation Indicator	5
Responsibility Statement	7

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

### 1.1 Property, plant and equipment

Last year we noted that the interest relating to loans taken for the acquisition of property, plant and equipment, were not taken into consideration when the new fixed assets register was built up. This year, we noted variances between the fixed assets register and the financial statements.

The furniture and fittings were under insured when we compared the insurance coverage with the net book value as per financial statements. The situation was still the same in 2017.

### 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 implemented by the Council during the year under review.

### 1.3 Payables

When testing the payables, we noticed that accruals relating to street lighting were not accounted for last year. This year we did not find such accruals not accounted for although we found invoices and credit notes not accounted for.

### 1.4 Income

The income was understated due to the effect of the accrued income not accounted for mentioned above. No such instances were encountered this year.

### 1.5 Expenditure and Tenders

The Council exceeded the budgeted expenditure under various expenditure categories. This weakness was once again encountered during this year's audit.

### 1.6 Payroll

The bonuses were not being accounted for in the relevant nominal account. Same thing was found this year.

### 1.7 Liquidity

As at 31 December 2016, the current liabilities exceeded the current assets by Euro 126,446 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 2016, the financial situation indicator of the Local Council stood at negative 33.21% which fell below the 10% threshold required by the Financial Provisions to the Local Councils Act. As at 31 December 2017, the financial situation indicator was still negative.

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

2.1 The fixed assets register's figures did not agree with those shown in the nominal ledger and in the financial statements prior to any audit adjustments, as follows:

- 2.1.1 The total cost as per fixed assets register amounted to Euro 1,705,929 while the cost as per the financial statements amounted to Euro 1,714,032.
- 2.1.2 The total accumulated depreciation as per fixed asset register amounted to Euro 689,526 while the total depreciation plus grants as per the financial statements amounted to Euro 851,237.
- 2.1.3 The net book value as per fixed assets register amounted to Euro 1,016,403 while the net book value as per financial statements amounted to Euro 862,795.

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 It was also noted that the Council's calculations of the depreciation charge for the year were incorrect. The depreciation was calculated again by us and an audit adjustment was passed to reduce the depreciation charge for the year of special programmes by Euro 7,815, of Urban Improvements by Euro 2,070 and of Construction by Euro 11,091.

2.4 When calculating the depreciation charge for the year, it should be ensured that the calculations are properly carried out in line with the Local Council's accounting policy on depreciation.

2.5 During our testing, we noted that an amount of Euro 2,076 was capitalised when this should have been expensed, as it related to initial studies relating to planned road resurfacing works for which the Council is still in the application phase.

2.6 Any costs incurred prior to even having a project approved and permits obtained, should be expensed, as at that stage it is uncertain as to whether that expenditure will give future economic benefit to the Local Council.

2.7 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 6,062 since the insurance covers the amount of Euro 9,400 while their net book value amounts to Euro 15,462.

2.8 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 PAYABLES**

3.1 It was noted that a credit note relating to works carried out in Triq Il-Falkun, was not posted during the year. The credit note amounted to Euro 1,845. Furthermore, during our cut-off tests, we noticed that there were invoices from a supplier relating to works on various pavements that have not been accounted for. These invoices amounted to Euro 5,683.

3.2 It is important that all invoices and credit notes received are posted immediately in the books of accounts of the Local Council. Not recording invoices received would mean that the liabilities as well as the expenditure would be understated.

#### **4.0 EXPENDITURE AND TENDERS**

4.1 The Council has exceeded the budgeted expenditure under the following categories:

Repairs and maintenance (category 2300) – by Euro 7,161  
Transport (category 2700) – by Euro 1,308  
Travelling (category 2800) – by Euro 450  
Professional fees (category 3100) – by Euro 3,762  
Hospitality costs (category 3300) – by Euro 4,289

4.2 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.

4.3 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.

#### **5.0 PAYROLL**

5.1 During our review of the payroll accounts, we noticed that the 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.

5.2 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.

#### **6.0 LIQUIDITY**

6.1 The Statement of Financial Position on page 5 of the financial statements indicates that the current liabilities, after excluding the current deferred income, exceed the current assets by Euro 64,474. This implies that the Council does not have enough current assets to support its current liabilities.

6.2 The current ratio is Euro 0.44 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 0.09 of cash and cash equivalents for every Euro 1.00 of current liabilities.

6.3 We recommend that the Council curtails its current expenditure and does not enter into capital projects until the cash deficit situation is remedied.

#### **7.0 FINANCIAL SITUATION INDICATOR**

7.1 The Financial Situation Indicator held by the Council at the Statement of Financial Position date stood at negative 54.06% 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.

- 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 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.