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[www.rsm.com.mt](http://www.rsm.com.mt)28<sup>th</sup> May 2020Local Council Xaghra  
Vjal it-Tmienja ta' Settembru  
Xaghra XRA9021  
Gozo

Dear Mayor,

**RE: MANAGEMENT REPORT – FOR THE YEAR ENDED 31 DECEMBER 2019**

We have completed our audit of the financial statements of the Local Council Xaghra for the year ended 31 December 2019. 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, in part or in full, may not be distributed, used or quoted 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 2019, 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 Council Staff for their assistance during the course of our audit.

Yours faithfully

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

**Local Council Xaghra**

**Management Report for the year ended 31 December 2019**

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## 1.0 **FOLLOW-UP TO LAST YEAR'S REPORT**

### 1.1 **Property, Plant and Equipment**

The management letter of previous year pointed out the following issues in relation to the Council's property, plant and equipment:

- No detailed fixed assets register was prepared following the adoption of Directive 01/2017.
- No information was provided as to the allocation of the grants to specific assets and the workings of the grossing up and accumulated amortisation of each grant allocated.
- Assets that were no longer in use were not written off.

The above weaknesses were encountered again in the current year under review.

### 1.2 **Receivables**

With respect to the receivables, last year the following weaknesses were found:

- Included in the prepaid expenditure, we found prepayments in relation to a project which has a high probability to not be carried out.
- Balances which have been outstanding for over two years have not been provided for.
- Included in the accrued income was an amount relating to a capital project for which no adequate audit evidence was obtained.
- The income not yet received relating to a project completed during the year, has not been accrued for.

The first two weaknesses listed above, were noted again this year.

### 1.3 **Cash and Bank**

When testing the cash and bank, the following weaknesses were noted:

- We noted that there is still a balance in one of the nominal accounts when the related bank account was already closed.
- Minor variances were found in the petty cash reconciliation.
- Stale cheques were noted in the list of unrepresented cheques as at year-end.

The same weaknesses were encountered during the current year's audit.

### 1.4 **Payables**

The below are the weaknesses found last year with respect to the payables:

- Variances were found between the balances in the books of accounts and the balances quoted in the confirmation letter or statements received from the suppliers.
- There was a balance in the suspense account resulting from a software error back in 2009, which remained unsolved.
- Debit balances in the creditors' list were not reallocated to under the debtors for presentation purposes.
- The non-current liabilities were not accounted for in accordance with IFRS 9.

- No documentation was made available for a grant received amounting to €41,250 relating to a capital project. We were told that this project was not completed but yet, it was capitalised under property, plant and equipment.
- Funds amounting to €155,000 for which no documentation was obtained, were allocated to under property, plant and equipment when we were told that the project was not carried out yet.
- We have not received the report requested from the architect showing which projects were completed and which projects were still ongoing.

The first four weaknesses were noted again during the current year.

#### 1.5 Income

During the income testing, we came across a collection in aid of the Malta Community Chest Fund which was accounted for as income of the Council instead of as a payable. The same issue was noted again this year.

#### 1.6 Expenditure and Tenders

Last year, we listed the following weaknesses in the management letter:

- Purchase requests and purchase orders were not always drawn up.
- The actual expenditure exceeded the budgeted costs in several categories.
- VAT fiscal receipt were not always available for the sample of expenditure item chosen.
- No contract between the Council and the architect was made available to us.
- Directive 02/2017 relating to the change in public procurement regulations was not abided with for all expenditure items tested.

Except for the fourth item listed above, all the above weaknesses were encountered again in this year's audit.

#### 1.7 Personal Emoluments

The weaknesses noticed on personal emoluments included:

- A difference was found between the personal emoluments' costs shown in the accounts and the figures reported in FS7.
- The basic weekly wages quoted in the FS3s were incorrect.

The above weaknesses were not encountered during this year.

#### 1.8 Financial Situation Indicator

As at 31<sup>st</sup> December 2018, the Financial Situation Indicator held by the Council at the Statement of Financial Position date stood at 6.77% which falls below the 10% threshold. As at 31<sup>st</sup> December 2019, the financial situation indicator was above the threshold.

#### 1.9 Other Matters

Opening balances in the nominal accounts relating to items pertaining to the statement of comprehensive income were noted in the prior year. This has been noted again during the current year's audit.

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

- 2.1 When testing the additions for the year, it was noted that the Local Council received invoices dated in 2017 and 2018 amounting to €30,898 and €33,871 respectively, that were not previously reflected in the accounts. These amounts were included in the books of the Local Council as additions to the property, plant and equipment during 2019. Furthermore, we noted that the invoice of 2018 was accounted for net of the retention money of €1,783 which amount was not reflected in the accounts. Given the materiality of these invoices, a prior year adjustment should have been passed and depreciation should have been calculated as from the completion date of these projects. Depreciation that would have been reflect in 2017 would amount to €772 and for 2018 would amount to €3,372.
- 2.2 The Local Council should be aware of any works of a capital nature that were carried out and completed during the year for which it would have not yet received the respective invoices till the end of the year, and should accrue for such works when closing off the accounts. Depreciation should be started as from the date when the projects are completed.
- 2.3 No proper fixed assets register was provided to us during our audit and hence we could not perform any checks on the existence and completeness of the property, plant and equipment. We were only provided with the schedules used for the working of the depreciation.
- 2.4 We recommend that a proper fixed assets register is built that would contain complete details of every item of property, plant and equipment of the Local Council. Fixed assets should be properly coded to facilitate the identification of the assets. Periodic inspections should be conducted to check the completeness and validity of the items in the fixed assets register, thereby increasing control over the assets and maintaining the integrity of the data in the fixed assets register. If the correct costs and accumulated depreciation could not be recorded in the fixed assets register due to the change in the accounting policy for the depreciation, then a separate register containing this information should be maintained that would then be used when reconciling the costs, accumulated depreciation and grants found in the fixed assets register with those found in the accounts and financial statements.
- 2.5 When checking the adoption of Directive 01/2017, we were provided with limited information to ensure that it has been correctly applied. No information was provided as to the allocation of the grants to specific assets and the workings of the grossing up and accumulated amortisation of each grant so allocated. Furthermore, we noticed that the depreciation was worked out again from the date of acquisition based on the cost of the assets less any grants allocated to them using the straight-line basis on a yearly basis. The difference between the new accumulated depreciation and the accumulated depreciation as previously stated as at 31 December 2017, was written off as an impairment. No remedial action was taken during the year under review on these issues.
- 2.6 It is important that the exercise relating to the adoption of Directive 01/2017 is properly documented showing step by step what was done including the grossing up of the grants, the working of the accumulated amortisation, the allocation of these grants against the specific asses they intended to cover, as well as the correct calculation of the depreciation in line with the Local Council's accounting policy.
- 2.7 During the previous years, while carrying out the physical inspection on a sample of property, plant and equipment, we noticed that in the fixed assets register there were more computers than we saw at the Local Council's premises. We were told that the computers dating back more than ten years for sure no longer exist. The Council had to take note of such assets and follow the

necessary procedures to write them off. However, when carrying out this year's audit we noted that no assets have been written off.

- 2.8 It is important that the Local Council carries out at least an annual exercise to check whether there are any assets no longer in use or any assets that have been impaired and take the necessary actions to write off their cost and accumulated depreciation from the accounts and the fixed assets register accordingly, after following the necessary procedures.

### 3.0 **RECEIVABLES**

- 3.1 Included within the prepaid expenditure, are €8,794 representing MEPA permits and architect's fees carried forward from the previous years. These relate to the project of the Civic Centre which has not been started given that it is a huge capital project. Other costs relating to the same project were written off last year, while the costs shown under prepaid expenditure have been left there despite the high probability that this project will not be carried out.
- 3.2 We suggest that if it is highly probable that this project will not be carried out in the near future, such costs are to be written off to the statement of comprehensive income.
- 3.3 While going through the receivables' aged list we noted that the Council has receivables older than two years amounting to €10,592 and have not been provided for as doubtful debts. It was agreed to pass an audit adjustment to provide for such long outstanding debts.
- 3.4 We recommend that the Council goes through the receivables' balances at the end of every financial year and makes a provision against any balances which it thinks will not be recovered. In any case, the Local Council should make a provision for doubtful debts for any balances older than two years as instructed by the Department.
- 3.5 From the sample of the accounts' receivable chosen for testing, we came across a variance in the largest receivable which was WasteServ Malta Limited between the balance in the accounts and the balance in the statement provided by the third party. Part of the variance came from the weakness mentioned in point 6.3 below which we had discovered during the audit. When considering the un-presented cheque and the invoice of December not yet accounted for by the third party, we remained with a variance of €553 for which we were not provided with an explanation.
- 3.6 We highly recommend that the Local Council should obtain statements from the major receivables at least, as at the end of the year, and should reconcile the balances as per statements with the balances as per accounts.

### 4.0 **CASH AND BANK**

- 4.1 When we carried out the petty cash count during our audit visit and worked back the theoretical balance as at 31 December 2019, we remained with an unexplained difference of €76.
- 4.2 The Council should ensure that all transactions relating to petty cash are reflected in the books of accounts in a timely manner for the Council to carry out the necessary reconciliations between the cash till and the balance shown in the accounts. Regular cash counts should be carried out and any variances noted should be investigated immediately. This will help the Council to manage better the petty cash of the Council and to ensure that the petty cash regulations are being followed.

- 4.3 When checking the list of unrepresented cheques as at 31 December 2019, it was noted that cheques totalling to €6,779 were already considered as stale by the end of the year and hence should have been reversed.
- 4.4 At the end of each financial year, the Local Council should go through the list of unrepresented cheques and any cheques that would have become stale by that date should be investigated. It could be that another cheque was issued to replace a particular cheque and the old cheque would have not been reversed.
- 4.5 It was noted that the Local Council is being charged withholding tax on the interest received on the balances of some of its bank accounts, despite the Local Council is not subject to tax.
- 4.6 We suggest that the Local Council informs immediately the bank to stop charging withholding tax on the interest earned.
- 4.7 When checking the list of bank balances, we noted that for one of the bank accounts that have been closed, there is still a balance of €41 in the accounts.
- 4.8 The Local Council should investigate this remaining balance and should pass the necessary entries to clear this nominal account.

## **5.0 PAYABLES**

- 5.1 When testing the accounts payable, minor variances were found between the balances in the books of accounts and the balances quoted in the confirmation letters or statements received. Furthermore, only 4 confirmations were obtained from the twelve samples chosen for our testing of the accounts' payable. This means that the other accounts payable chosen, amounting to €250,477, could not be confirmed. There were no adequate alternative procedures that we could perform to confirm that correctness and completeness of the accounts' payable.
- 5.2 We strongly recommend that each statement received from the suppliers is immediately reconciled. In cases where the suppliers do not send statements, the Council should ask for one especially at the end of the year. Any variances resulting from this exercise should be investigated immediately and appropriate action taken. This would ensure that the Local Council has a more accurate picture of its liabilities at any point in time which would help it in monitoring better its cash flows and monitor its debts.
- 5.3 Included with the other payables is an amount of €1,304 representing the unresolved difference that arose in the trial balance of the year 2009, following a corruption in the accounting software. This balance has been carried in the books since then.
- 5.4 We continue to recommend that this amount found in the suspense account is carefully examined and the necessary adjustments passed to clear off such balance once and for all.
- 5.5 When checking the aged creditors' list, debit balances were noted amounting to €972. An adjustment had to be passed to reclassify these balances to under the receivables for presentation purposes.
- 5.6 We recommend that the Council investigates these debit balances as they could indicate an overpayment or a mistake in the recording of the payment or missing invoices. Any valid negative balances should then be presented under the receivables in the financial statements.

- 5.7 Part of the payables amounting to €73,545 have been classified as non-current liabilities. These balances have not been accounted for at the amortized cost using the effective interest method in accordance with IFRS 9: Financial Instruments.
- 5.8 The Local Council should ensure that all the applicable standards are properly applied in the preparation of the accounts, including IFRS 9 with respect to the accounting of non-current liabilities.

## **6.0 INCOME**

- 6.1 Included in the community and cultural services income account, we found €617 pertaining to a collection made in aid of the Malta Community Chest Fund (MCCF) and is therefore not income of the Council.
- 6.2 When the Local Council collects money on behalf of third parties, the ultimate intention is to eventually transfer the collections to the intended third party. Therefore, this collection should be classified as a liability and not as income of the Council. When the payment to the organisation is affected, that payment should then be netted off against the liability created, rather than being shown separately as an expense of the Local Council.
- 6.3 When analysing the income accounts, we noted that in the nominal account 0004 relating to income for the organic waste collections, there was an invoice for the month of April that was posted with the wrong amount. The Local Council passed a sales credit note to reverse this wrong amount and posted the correct sales invoice amount. Later during the year, another sales credit note was posted to reverse the same mistake. An audit adjustment of €2,390 was passed to reverse one of the double posting.
- 6.4 The Local Council should be cautious when posting entries in the nominal ledger and should ensure that the appropriate checks are made before posting any transaction. If the Local Council reconciles the debtors' balances as at the end of the year, such errors would be noticed.

## **7.0 EXPENDITURE AND TENDERS**

- 7.1 For several expenditures, we noticed that the Council does not draw up a purchase request or purchase order in line with the Local Councils Financial Procedures. There appears to be no specific reason behind this practice.
- 7.2 It is understood that at times the urgency of matters might require that bureaucracy is reduced to the minimum possible, however we are still of the opinion that the necessary paperwork should have been done in line with the financial procedures.
- 7.3 The total actual expenditure exceeded the budgeted costs in several categories as follows:
- 7.3.1 Materials and Supplies (Category 2200) by €210
  - 7.3.2 Repair and upkeep (Category 2300) by €26,287
  - 7.3.3 Rent (Category 2400) by €900
  - 7.3.4 Transport (Category 2700) by €3,752
  - 7.3.5 Information services (Category 2900) by €8
  - 7.3.6 Contractual Services (Category 3000) by €4,163
  - 7.3.7 Professional and Management Services (Category 3100) by Euro 17,158



- 7.4 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.
- 7.5 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 period/year such discrepancies would not materialise.
- 7.6 When checking a sample of expenditure items, we noted that a VAT fiscal receipt was not always available. From the samples tested, the expenditure for which no VAT fiscal receipt was available amounted to €6,985.
- 7.7 The above issue goes 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 this matter and to ensure that such occurrences are not repeated in the future.
- 7.8 Following Directive 03/2017 issued by the Department for Local Government to Local Councils on the change in the public procurement regulations, we noticed instances where the Council did not abide with the new regulations. The Local Council is acquiring cleaning services from the same supplier through direct orders. The amounts invoiced for 2019 totalled to €8,400.
- 7.9 We understand that the bureaucratic requirements of the public procurement regulations may be cumbersome, however we highly suggest that the Council adopts these regulations to full effect.
- 7.10 The contract for the collection of organic waste expired in June 2019. No new tender was issued during the year and the Local Council continued using the services of the expired contract. The amount invoiced to the Local Council as from July 2019 till the end of the year, amounted to €18,696.
- 7.11 The Local Council should be aware of all the contracts that are about to expire and should take timely action to issue a new tender to ensure that a new contract is entered into before the current one expires.

## **8.0 PERSONAL EMOLUMENTS**

- 8.1 When we recomputed the Mayor's honoraria following the changes that occurred during the year under review, we noted that the previous Mayor was paid €71 more than the amount we arrived at. On the other hand, the new Mayor was paid €400 less in allowances.
- 8.2 When computing the payroll, it is important that the Local Council follows the instructions issued by the Department through the Circulars from time to time. During the current year, Circular 14/2019 and Circular 20/2019 were issued with respect to the Mayor's honoraria and allowances, amongst other things.

## **9.0 OTHER MATTERS**

- 9.1 When reconciling the opening balances, we noted that there were opening balances even in the accounts relating to items pertaining to the statement of comprehensive income when these accounts should not contain any opening balances. It is to be noted that the opening retained fund was still agreeing with the previous year's financial statements. No explanation was provided

to us about these opening balances. Possibly, invoices dated in the previous year were posted in the current year's accounts.

- 9.2 Following the completion of the audit, and the presentation of the list of audit adjustments and extended trial balance to the Local Council, it is important that immediately the audit adjustments are reflected in the books of accounts after which a reconciliation of the opening balances is to be carried out.

### **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.