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2nd June 2020

The Mayor
Local Council Nadur
North Street,
Nadur NDR 1222,
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 Nadur 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 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.

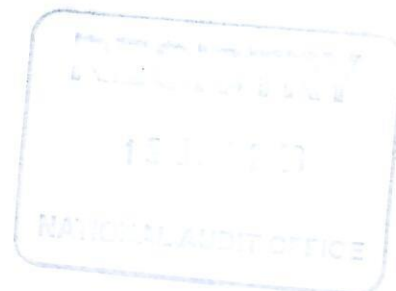
During the course of our audit for the year ended 31 December 2019, we examined the principal documents, systems and controls used by the Council, to help it ensure, as far as possible, the accuracy of these documents and to assess how much can one rely on these documents to safeguard the assets of the 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 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 Nadur

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 capital expenditure relating to a completed project for which no invoice was received by the end of the year, was not reflected in the financial statements through the accruals. Errors were also found in the depreciation charge for the year. Whilst testing the additions, we noticed that the acquisition of air-conditioners was classified as computer equipment. Variances were noted between the figures reported in the updated fixed assets register and the figures shown in the financial statements after excluding the assets under construction.

The above weaknesses, other than the first one, were not present during the current year.

1.2 Receivables

Last year we pointed out that the receivables that have been outstanding for more than two years, were not provided for as doubtful debts as per instructions given. We also encountered an amount relating to co-financing funds which upon checking the relevant documentation, it transpired that this represented the co-financing funds that were transferred from the current bank account to the new Central Bank account of the Local Council, and hence was not really a receivable balance.

Only the first issue was not resolved during the current year.

1.3 Bank and Cash

Whilst going through the list of unpresented cheques, two cheques were noted to have become stale and should have been reversed. A new bank account was not accounted for during the year. Also, when we were doing the cut off tests on the bank accounts, we noticed several cheques that were dated in 2019 but have been accounted for in 2018.

The first issue was still present during the current year, while the other issues were not encountered again.

1.4 Payables

Last year we found two invoices that were received from a supplier relating to road resurfacing works, that were not accounted for. Grants relating to projects not yet carried out were still allocated against property, plant and equipment rather than left under deferred income. The deferred income was wrongly classified as non-current in the statement of financial position.

The above weaknesses, except for the last one, were not present in the current year.

1.5 Expenditure and Tenders

With regards to expenditure, last year we noted that the budgeted expenditure was exceeded in various categories. During our testing on the expenditure, we came across an instance where quotations were not obtained. It was also noticed that the Local Council does not always draw up a purchase request.

From the above issues, only the first one was encountered again this year.

1.6 Financial Situation Indicator

The Financial Situation Indicator of the Local Council as at 31st December 2018 stood at a negative 27.06% which fell well below the 10% threshold required by the Financial Provisions to the Local Councils Act.

As at 31st December 2019, the financial situation indicator was still negative.

1.7 Liquidity

As at 31st December 2018, the current liabilities exceeded the current assets by €127,698 after properly classifying the deferred income, indicating possible liquidity problems.

As at the end of the financial year under review, the Local Council had a similar situation.

2.0 PROPERTY, PLANT AND EQUIPMENT

- 2.1 When testing the additions for the year of the property, plant and equipment, we noted that furniture and fittings with a value of €1,064 were classified under the category urban improvements and depreciated at the rate of 10%. The depreciation charge for the year on this asset amounted to €80. Reclassification adjustments were passed to correct this error. The depreciation charge for the year was not adjusted as the variance was trivial.
- 2.2 The Local Council should ensure that every addition of property, plant and equipment is properly classified in the accounts and the correct depreciation rate is applied. This would ensure proper presentation of the assets in the respective property, plant and equipment note in the financial statements.
- 2.3 Within the additions of the urban improvements, there were litter bins with a value of €675, which assets are being depreciated at the rate of 10% per annum, when the accounting policy of the Local Council states that litter bins are to be treated on a replacement basis.
- 2.4 The Local Council should abide with all the accounting policies applicable to it as disclosed in the financial statements. Any items bought that are to be treated on a replacement basis, are to be accounted for directly in the statement of comprehensive income in the year of purchase.
- 2.5 Upon enquiring with the accountant and the architect, it was noted that the project 'Resurfacing of Rural Roads in Nadur for Better Accessibility' was completed by the end of 2019. However, till the end of the year, only the works carried out in accordance with the tender were certified and invoiced by the contractor. The Local Council's architect stated that there were variations concerning this project due to unforeseen findings whilst carrying out such works, which variations are estimated to be around €100,000. No certification has been issued for such variations and consequently no invoices were issued by the contractor. The Council did not accrue for such unbilled completed works given that no correct estimates were available. We were also informed that the Local Council is discussing with the Ministry for Gozo to try to obtain funding, in full or in part, for these variations.
- 2.6 The Local Council should be aware of such instances and when the work is complete, it should ask the architect to certify all the work completed within a reasonable timeframe and at the same time. The Local Council should then accrue for any work completed during the year for which no invoices would have been received by the end of the year.
- 2.7 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. The fixed assets register provided included one line item with the net book value of all the assets up to 1 January 2018 when there was the adoption of Directive 01/2017 and then included the details of the items of property, plant and equipment that were acquired from 2018 onwards.
- 2.8 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.

3.0 RECEIVABLES

- 3.1 When going through the aged receivables' list as at 31 December 2019, we noticed that balances amounting to €5,063 were older than two years by the end of the financial year and the provision for doubtful debts reflected in the accounts amounted to only €1,293. This means that the provision for doubtful debts is understated by €3,770.
- 3.2 We recommend that at the end of each financial year, the Local Council goes through the list of receivables and checks whether there are any balances which are deemed doubtful to collect. If such balances are found, then a provision for doubtful debts should be accounted for immediately. Any balances older than two years should be considered as doubtful as per instructions received from the Department for Local Government.

4.0 BANK AND CASH

- 4.1 When checking the list of unpresented cheques in the bank reconciliation, we came across five cheques which at the end of the year were considered to have become stale and should have thus been reversed. Even though the amounts totalled to just €462, it has been agreed that these are adjusted for. Cheques were reversed against the respective expenditure account despite only one of them was confirmed to have been cancelled whilst the other ones seem to have been issued but not presented.
- 4.2 The Council should regularly review the list of unpresented cheques and any cheques which result to have become stale, are investigated. These cheques should be reversed and if necessary, replaced with new ones unless they would have already been replaced and the previous cheque not reversed.

5.0 PAYABLES

- 5.1 Upon testing the accounts payable, the audit team obtained statements for a sample chosen from the payables' aged list. For one of the suppliers, we noted that there were invoices relating to, and dated in, 2019 amounting to €3,508, that were recorded as accruals rather than in the supplier's ledger.
- 5.2 The Council should obtain statements from its suppliers, at least at the end of each financial year, in order to be able to reconcile its ledger balances with the balances shown in the suppliers' statements and should also ensure that all invoices are posted in the year they are issued.
- 5.3 The deferred income as at 31 December 2019 amounting to €352,333, has been classified as non-current in the statement of financial position. From the information we have obtained during our audit, the related projects are to be completed in the following year and thus this deferred income should have been classified as current liabilities.
- 5.4 It is important to ensure that all liabilities are properly categorised as either current or non-current in accordance with IAS1 – Presentation of Financial Statements.
- 5.5 When checking the aged creditors' list, debit balances were noted amounting to €17,569. 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.

6.0 EXPENDITURE AND TENDERS

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

- 6.1.1 Utilities (Category 2100) by €5,341
- 6.1.2 Materials & Supplies (Category 2200) by €1,393
- 6.1.3 Repairs & Upkeep (Category 2300) by €7,332
- 6.1.4 Rent (Category 2400) by €1,842
- 6.1.5 National & International memberships (Category 2500) by €376
- 6.1.6 Office services (Category 2600) by €879
- 6.1.7 Travel (Category 2800) by €6,408
- 6.1.8 Information services (Category 2900) by €1,110
- 6.1.9 Contractual Services (Category 3000) by €28,287
- 6.1.10 Training (Category 3200) by €15
- 6.1.11 Hospitality & Community (Category 3300) by €6,592

6.2 The Financial Procedures applicable for Local Councils require Councils to draw up twelve (12) months budgets, three (3) year 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 help the Council revise the budgets in line with actual expenditure.

6.3 We recommend that the Council makes use of these reporting tools in hand to take corrective measures in the budget every quarter such that by the end of the accounting period such discrepancies would not materialise.

6.4 While testing a sample of the expenditure, we came across an instance where a VAT fiscal receipt was not received by the Local Council. This expenditure amounted to €2,313.

6.5 Kindly note that the above issue is 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. For any type of expenditure incurred by the Local Council, the Local Councils Financial Procedures should always be applied without any exceptions.

7.0 FINANCIAL SITUATION INDICATOR

7.1 The Financial Situation Indicator of the Local Council at the Statement of Financial Position date stood at a negative 20.62% which is below the 10% threshold required by the Financial Provisions to the Local Councils Act.

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 Councils if it anticipates a Financial Situation Indicator level which will fall below the 10% threshold in future years.

8.0 LIQUIDITY

8.1 The Statement of Financial Position on page 4 of the Financial Statements is showing a net current assets position. However, if one removes the restricted cash and cash equivalents of €352,333, the current liabilities will exceed the current assets by €102,508. This implies that the Council does not have enough current assets to support its current liabilities.

- 8.2 Based on the above adjustment, the current ratio will be €0.84 of current assets for every €1.00 of current liabilities, indicating that the Council may be in a situation of 'overtrading'. The acid test ratio will be in fact only €0.67 of cash and cash equivalents for every €1.00 of current liabilities.
- 8.3 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.