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Our Ref: NAO 107/2015/43

Your Ref:

8 May 2017

The Mayor and Executive Secretary  
Nadur Local Council  
Nadur

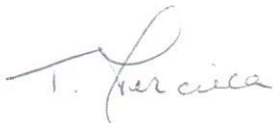
Dear Sir/Madam,

**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.

26<sup>th</sup> April 2017

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



**Local Council Nadur**

**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

With regards to property, plant and equipment, last year we had pointed out the following issues:

- The fixed assets register did not agree with the accounts;
- The insurance policy did not cover all items of property, plant and equipment;
- Certain items of property, plant and equipment were capitalised under the wrong category;
- Errors were found in the computation of the depreciation charge for the year; and
- Incorrect analysis between expenditure of a capital and that of a revenue nature.

Most of these issues have been resolved this year. The only weaknesses which were encountered again this year relates to fixed asset register not agreeing to the accounts and mistakes in the depreciation.

### 1.2 Receivables

Last year we pointed out that receivables included a balance outstanding for more than two years and not provided for and that the accounts receivable included negative balances not being reclassified.

Whilst the first issue remained this year, the second issue was resolved.

### 1.3 Bank and Cash

Last year we come across two cheques which were considered stale but which were still in the list of unpresented cheques as at the end of the year. We also come across two expenses paid from the petty cash even though their values exceeded the limit set by the regulations governing Local Councils of Euro 23.29. The first instance was not present this year however, the petty cash payments issue was present again this year.

### 1.4 Payables

Last year we had mentioned various issues relating to the payables of the Local Council, mainly:

- Expenses not being accrued for;
- No regular reconciliations being carried out between suppliers' ledgers in the accounts and the suppliers' statements received; and
- Incorrect calculation and treatment of the release of deferred income.

The above weaknesses were not present in the current year, although we found an over accrual.

### 1.5 Income

When testing income, last year we noted that actual Central Government allocation received differed from the Central Government allocation recorded in the accounts due to the deductions which were not grossed up. It was also noted that the income from the LES administrative fees as shown in the accounts varied from the theoretical revenue computed on the LES report. In addition, it was noted that funds received in relation to a capital expenditure was accounted for as income for the year rather than deferred and amortised.

During this year, only the issue with regards to the administrative fees relating to the LES was encountered.

1.6 Expenditure and Tenders

With regards to expenditure and tenders, last year we noted that the budgeted expenditure was exceeded in various categories. This issue was encountered again this year.

We also noticed that the Council was using an expired contract for street lighting. This issue was resolved since now street lighting is under the responsibility of the Gozo Regional Committee.

1.7 Personal Emoluments

Last year differences were noted between the figures included in the FS7 and those shown in the FS5s. There was also a discrepancy between the amounts declared in the FS7 and those shown in the financial statements. Whilst this year no discrepancies were found between the different FSS forms, a variance was noticed between the amounts as per FS7 and the payroll costs in the accounts.

1.8 Financial Situation Indicator

The Financial Situation Indicator of the Local Council as at 31<sup>st</sup> December 2015 stood at a negative 69.38% which fell well below the 10% threshold required by the Financial Provisions to the Local Councils Act. As at 31<sup>st</sup> December 2016, the financial situation indicator was still negative.

1.9 Liquidity

As at 31<sup>st</sup> December 2015, the current liabilities exceeded the current assets by Euro 351,108 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 The fixed assets register's figures do not agree with those shown in the nominal ledger and financial statements prior to any audit adjustments, as follows:
- 2.1.1 The total accumulated depreciation as per fixed asset register amounting to Euro 1,857,205 was not agreeing with the total depreciation plus grants in the nominal ledger which amounted to Euro 1,811,239, a variance of Euro 45,966.
- 2.1.2 The net book value disclosed in the financial statements was more than that shown in the fixed assets register by Euro 45,966.
- 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 When checking the depreciation charge for the year several errors were found. An audit adjustment of Euro 948 was passed in relation to depreciation on property being understated, an audit adjustment of Euro 1,667 was passed in relation to the depreciation on urban improvements being overstated while with regards to the construction we had to pass an adjustment of Euro 9,583 since the depreciation was overstated.
- 2.4 It is to be ensured that the depreciation is correctly calculated by applying the correct depreciation rates and taking the correct opening net book values and additions for the year.

## **3.0 RECEIVABLES**

- 3.1 When going through the aged debtors' list, we noticed that balances amounting to Euro 3,386 were older than 2 years by the end of the financial periods and the provision for doubtful debts amounted to only Euro 1,293. This means that the provision is understated by Euro 2,093.
- 3.2 We recommend that at least 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 testing the petty cash payments, we found one case whereby the payment exceeded slightly the limit set by the regulations governing Local Councils which is that of Euro 23.29. this payment related to the purchase of stamps for the amount of Euro 23.40.
- 4.2 For any expense in excess of Euro 23.29, the Council should issue a cheque and should not affect the payment through the petty cash.

## **5.0 PAYABLES**

- 5.1 Whilst going through the accruals list, it was noted that the Local Council over accrued for open skips. The over accrued amount of Euro 3,920 was adjusted for by way of an audit adjustment.
- 5.2 The Council should always base its accruals on either invoices received after the end of the year, or on purchase orders placed, or on amounts agreed upon in contracts entered into with the various suppliers.

## **6.0 INCOME**

- 6.1 We noted that the income from LES administrative fees as shown in the accounts varied by Euro 617 when compared to the 10% computed on the total amount of contraventions paid during the year at the Local Council as per the report generated from the LES system.
- 6.2 Even though the income from administrative fees is immaterial, we do recommend that monthly reconciliations are carried out to ensure that all potential income is invoiced.
- 6.3 During our review of the income accounts, it was noted that an amount of Euro 5,000 received from the Government for the carnival activities, was posted in the sponsorships account rather than in the other government income account. A reclassification adjustment was passed to reflect this income in the correct account.
- 6.4 Given that Government income is disclosed separately in the financial statements from other income, it is important that any funds received from the Government are separately accounted for. This would ensure correct presentation in the notes to the financial statements.

## **7.0 EXPENDITURE AND TENDERS**

- 7.1 The Council has exceeded the budgeted expenditure under the following categories:
- 7.1.1 Material and supplies (Category 2200) by Euro 1,582;
  - 7.1.2 International memberships (Category 2500) by Euro 47;
  - 7.1.3 Office services (Category 2600) by Euro 3,452;
  - 7.1.4 Travel (Category 2800) by Euro 3,567;
  - 7.1.5 Contractual services (Category 3000) by Euro 28,451;
  - 7.1.6 Local enforcement expenses (Category 3600) by Euro 152.
- 7.2 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.
- 7.3 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.

## **8.0 PERSONAL EMOLUMENTS**

- 8.1 Whilst performing the reconciliation of the personal emoluments costs, we noted that there is an unexplained variance between the emoluments declared in the FS7 and the amounts shown in the financial statements. A difference of Euro 117 was noticed in the gross emoluments and another difference of Euro 130 was noticed in the employer's share of national insurance contributions.
- 8.2 It is highly recommended that particular care is taken when preparing the FSS forms and when affecting payments. When compiling the FSS forms it is important to ensure that these are properly filled in and that all the required information is disclosed correctly. Furthermore, it is important to regularly reconcile the FSS forms with the books of account, and to ensure that the payroll workings records agree with the actual payments affected.
- 8.3 During our testing, we noticed that the performance bonus for the year has not been accrued for as at year-end. An audit adjustment has been passed in this respect to reflect the 2016 performance bonuses amounting to Euro 3,130. Furthermore, an amount of Euro 797 has been granted to the Local Council's handyman as an allowance for making use of his personal motor vehicle for Local Council's works during 2016. This amount was not yet paid by the end of the year and it has not been accrued for. Therefore, an adjustment was passed

during our audit. In addition, at the expiration of the employment contract of the Local Council's clerk, she was not paid for the unutilised leave and for the overtime. The value of these amounted to Euro 1,463 and this amount was payable by the Local Council to the clerk by the end of the year. Again, no accrual has been made for this amount and therefore an audit adjustment was passed during the audit.

- 8.4 It is of utmost importance, that the Local Council is fully aware of the amounts still due by it with respect to personal emoluments at the end of each financial year and that it accrues for all these amounts still due to reflect the correct personal emoluments costs and liabilities.
- 8.5 In the bonuses account, we found some transactions amounting to Euro 667 relating to overtime payments and allowances. These were reclassified to their proper nominal accounts.
- 8.6 Care should be taken when posting the payments relating to personal emoluments to ensure that the correct nominal accounts are used. This would ensure comparability from one year to the other as well as ensure that the presentation in the notes to the financial statements is correct as well.

#### **9.0 FINANCIAL SITUATION INDICATOR**

- 9.1 The Financial Situation Indicator of the Local Council at the Statement of Financial Position date stood at a negative 59.53% 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 Councils if it anticipates a Financial Situation Indicator level which will fall below the 10% threshold in future years.

#### **10.0 LIQUIDITY**

- 10.1 The Statement of Financial Position on page 4 of the Financial Statements indicates that the current liabilities exceeded the current assets by Euro 311,243. This implies that the Council does not have enough current assets to support its current liabilities.
- 10.2 The current ratio is Euro 0.15 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 0.11 of cash and cash equivalents for every Euro 1.00 of current liabilities.
- 10.3 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.