

28th April 2018

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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 Nadur 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 9 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.

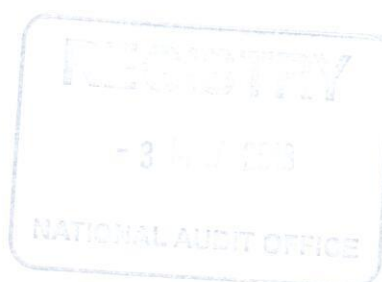
The objective of this letter is to bring to your attention those divergences in the system that were noticed during our audit work and suggest ways of how these can be remedied.

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

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Local Council Nadur

Management Report for the year ended 31 December 2017

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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;
- Errors were found in the computation of the depreciation charge for the year.

The above weaknesses were still present during the current year.

1.2 Receivables

Last year we pointed out that the receivables included a balance outstanding for more than two years and was not provided for as doubtful debts as per instructions given.

This issue was not resolved during the current year.

1.3 Bank and Cash

Whilst testing the petty cash, last year we came across one expense paid from the petty cash the value of which exceeded the limit set by the regulations governing the Local Councils of Euro 23.29.

No such instances were found this year.

1.4 Payables

Last year the only issue relating to the payables of the Local Council related mainly to an over accrual for open skips.

The above weakness was not present in the current year, although we found other errors in the accruals.

1.5 Income

When testing income, last year we noted that the Government income for carnival sponsorship was posted in sponsorships account rather than other government income account. 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.

During this year's audit, a reclassification error was found again.

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.

1.7 Personal Emoluments

Last year differences were noted between the figures included in the FS7 and those shown in the financial statements. There was also the performance bonus, unutilised leave and the handyman allowance which had not been accrued for. In addition, there was a transaction relating to overtime payments and allowances which mistakenly accounted for in the bonuses account.

During this year, the above issues were not present.

1.8 Financial Situation Indicator

The Financial Situation Indicator of the Local Council as at 31st December 2016 stood at a negative 59.53% which fell well below the 10% threshold required by the Financial Provisions to the Local Councils Act. As at 31st December 2017, the financial situation indicator was still negative.

1.9 Liquidity

As at 31st December 2016, the current liabilities exceeded the current assets by Euro 311,243 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, other than the cost figure, 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 assets register amounting to Euro 2,009,187 was not agreeing with the total depreciation plus grants in the nominal ledger which amounted to Euro 1,952,919, a variance of Euro 56,268.
 - 2.1.2 The net book value disclosed in the financial statements was Euro 1,460.745 whilst that shown in the fixed assets register was Euro 1,404,477, a variance of Euro 56,268.
- 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 939 was passed in relation to depreciation on property which was understated, an audit adjustment of Euro 1,949 was passed in relation to the depreciation on urban improvements which was overstated while with regards to the construction we had to pass an adjustment of Euro 11,151 since the depreciation thereon 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 receivables' list, we noticed that balances amounting to Euro 4,970 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 Euro 1,293. This means that the provision for doubtful debts is understated by Euro 3,677.
- 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 This year we came across two cheques which at the end of the year had been considered to have become stale and should have thus been reversed from the list of unrepresented cheques. Even though the amounts totalled to just Euro176, it has been agreed that these are adjusted for.
- 4.2 The Council should regularly review the list of unrepresented 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.
- 4.3 When carrying out the cut-off tests, we noted that the Local Council has received a cheque dated 21st December 2017 that has not been accounted for. The cheque received from the Ministry for Gozo amounted to Euro 143,407 and related to a resurfacing of roads project that is to be carried out in 2018. An audit adjustment was passed to reflect these funds not accounted for, against the deferred income.

- 4.4 It is important that transactions are accounted for on the date on which they occur and not when the Local Council deposits the money in the bank. The Local Council should have been aware of this cheque since it was then deposited on 5th January 2018 prior to closing off the accounts.

5.0 PAYABLES

- 5.1 Whilst going through the documents supporting the accruals accounted for in the accounts, it was noted that several invoices were dated in 2017. These amounts should have been technically accounted for as accounts payable rather than accruals. Therefore, the amount of Euro 14,832 was reclassified from the accruals to the accounts payable.
- 5.2 The Council should always base its accruals on either the invoices received and dated after the end of the year, or on purchase orders placed before the end of the year for which no invoices would have yet been received despite the services would have been provided before the end of the year. Services provided and invoiced before the end of the year should be accounted for as accounts payable.
- 5.3 From the cut off tests on the payables, it was noted that the Local Council under accrued for expenses relating to 2017. The under accrued amount of Euro 428 was not adjusted for due to the amount not being material.
- 5.4 The Local Council should ensure that all the invoices issued after the end of the year that relate to services provided during the current year, are properly accrued for.
- 5.5 Upon testing the deferred income, it was noted that funds received with respect of planters which were capitalised as property, plant and equipment, amounting to Euro 5,700, were not included as part of the deferred income but were instead treated as income for the year. An adjustment was passed to record this amount as deferred income and also to account for the amortisation for the year of such funds amounting to Euro 414.
- 5.6 It is important that any government grants received for capital projects, are accounted for in accordance with International Accounting Standard 20 – Accounting for Government Grants and Disclosure of Government Assistance.

6.0 INCOME

- 6.1 The income received from the distributions made by the Law Enforcement System Agency (LESA) from the pooling system, was not being shown under the category income from the law enforcement system in the financial statements provided to us for audit. Instead it was shown under the general income category. The necessary reclassification for presentation purposes was made in the financial statements following our recommendation during the audit.
- 6.2 It is important that every item of income is properly classified to ensure correct and consistent presentation thereof in the financial statements, both in the statement of comprehensive income and in the notes.

7.0 EXPENDITURE AND TENDERS

- 7.1 The Council has exceeded the budgeted expenditure under the following categories:
- 7.1.1 Materials & Supplies (Category 2200) by Euro 124;
 - 7.1.2 Repairs & Upkeep (Category 2300) by Euro 6,982;
 - 7.1.3 Transport (Category 2700) by Euro 2,268;
 - 7.1.4 Professional Services (Category 3100) by Euro 2,363;

- 7.1.5 Training (Category 3200) by Euro 24;
- 7.1.6 Hospitality (Category 3300) by Euro 4,145;
- 7.1.7 Incidental Expenses (Category 3400) by Euro 128;

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.

7.4 Upon testing the expenditure, it was noted that the Big Friends Guggen Musik Malta band was invited to perform during the Carnival 2017 activities in Nadur. Since the amount exceeded the threshold of Euro 1,165 but was less than Euro 4,659, the Local Council should have obtained three quotations. No quotations were obtained since the Local Council wanted the services of that particular band.

7.5 We also noticed that there were cases where the Local Council had to issue addendums to extend the contracts over the period allowed in the original agreements because new contracts were not entered into on time. These cases included:

7.5.1 The contract for the public convenience of Gnien il-Kunsill whereby the previous supplier ended the contract in 2016 and the new contract was signed in June 2017. The amount invoiced until the new contract was signed amounted to Euro 1,055.

7.5.2 The contract for the collection of mixed refuse which contract expired in June 2017 and the new contract was signed in September 2017. The amount invoiced since the expiration of the old contract until the new one was signed amounted to Euro 9,201.

7.5.3 The contract for the bulky refuse expired in July 2017 and the new contract was signed in November 2017. The amounts invoiced during that period amounted to Euro 3,734.

7.6 The above issues go against the Local Councils Financial Procedures that the Council should abide with. The Council should monitor the contracts that it has entered into and should be aware of those coming to an end, so that a new call for tenders is issued on time to ensure that a new contract is entered into before the old one expires.

8.0 PAYROLL

8.1 During our testing on payroll, we noticed that the FS7 and the FS5s were not agreeing since the non-taxable fringe benefits of Euro 386 were included in the FS5s when they should have not been included.

8.2 We also noted that in the FS7, the fringe benefits were by mistake inputted in the wrong box. They were included in box C3a as share options fringe benefits when they should have been included in box C3 under fringe benefits excluding share options.

8.3 Care should be taken when preparing the FSS forms to ensure that the information given therein is correct, that the figures are inputted in the correct boxes and that all the FSS forms tally with each other.

8.4 When we enquired about the fringe benefit, totalling to Euro 770, we were told that this is being paid as disturbance allowance to one of the Local Council's employees since he is using his personal van to carry out work for the Local Council. We were told that a verbal

approval was obtained from the Department and hence there was no correspondence that could be shown to us during our audit.

- 8.5 We suggest that the Local Council obtains such approval in writing from the Department so that such correspondence can then be referred to during the audit or if any enquiry arises.

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 34.72% 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, after excluding the current deferred income, exceeded the current assets by Euro 13,873. This implies that the Council does not have enough current assets to support its current liabilities.
- 10.2 The current ratio is Euro 0.76 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 0.69 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.