

RSM Malta

Mdina Road,  
Zebbug ZBG 9015,  
Malta.

T+356 2278 7000

F+356 2149 3318

[www.rsm.com.mt](http://www.rsm.com.mt)

28<sup>th</sup> May 2020

The Mayor  
Local Council Iz-Zebbug (Gozo)  
Church Street,  
Zebbug ZBB 1200,  
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 Iz-Zebbug (Gozo) 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



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

**Local Council Iz-Zebbug (Gozo)**

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

<b>Contents</b>	<b>Page</b>
<b>Follow-up to last year's report</b>	<b>3</b>
<b>Property, plant and equipment</b>	<b>4</b>
<b>Cash and bank</b>	<b>5</b>
<b>Payables</b>	<b>5</b>
<b>Income</b>	<b>6</b>
<b>Payroll</b>	<b>6</b>
<b>Expenditure and Tenders</b>	<b>7</b>
<b>Liquidity</b>	<b>7</b>
<b>Financial Situation Indicator</b>	<b>8</b>
<b>Mid-Term Audit</b>	<b>8</b>
<b>Other Matters</b>	<b>8</b>
<b>Responsibility Statement</b>	<b>9</b>

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

### 1.1 Property, Plant & Equipment

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

- Differences were noted between the figures shown in the fixed assets register and those in the financial statements; and
- According to the letter received from the architect, some of the assets classified under the category 'assets under construction' were completed by the end of the year.

During the year, other matters were noted with respect to the property, plant and equipment and the fixed assets register.

### 1.2 Cash and Bank

It was noted that the Local Council was being charged withholding tax on the bank interest received despite the Local Council is not subject to tax. No action has been taken in this regard during the current year.

### 1.3 Payables

Fees for legal services provided during the year were not accrued for and supporting documents for some of the accrued expenses were not provided by the Local Council. The latter issue was encountered again this year.

When the comparative figures were restated following the application of Directive 01/2017, an error was noted in the amount that should have remained under deferred income. This matter has been resolved during 2018, when the work was carried out.

### 1.4 Payroll

Variances were noted between the figures declared in the FS7 and in the FS5s. This weakness was encountered again during the current year.

### 1.5 Expenditure and Tenders

Amongst the issues encountered in this area were the facts that in certain cases, purchase requests were not being prepared, the Council had exceeded the budgeted expenditure in several expenditure categories and the maximum amount allowed to be spent on 'Jum il-Lokalita' was exceeded. Similar issues, other than the last one, were encountered during the current audit.

### 1.6 Liquidity

As at 31 December 2018, the current liabilities exceeded the current assets by €135,165 indicating possible liquidity problems. As at the end of the financial year under review, the Local Council experienced the same situation.

### 1.7 Financial situation indicator

As at 31 December 2018, the financial situation indicator of the Local Council stood at negative 25.99% which fell below the 10% threshold required by the Financial Provisions to the Local Councils Act. As at 31 December 2019, the financial situation indicator was still negative.



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

- 2.1 The fixed assets register being kept by the Local Council does not contain any details of the assets that have been fully depreciated other than the description and hence, one cannot obtain the breakdown of the costs, accumulated depreciation and grants of all the property, plant and equipment shown in the notes to the financial statements. Furthermore, we noticed that the additions of property, plant and equipment during the year, as shown in the accounts, are not easily traceable to the additions in the fixed assets register. In the fixed assets register, it seems that certain assets were grouped together whilst others have different amounts and description from what is found in the accounts. The fact that the carrying value of the fixed assets register agreed with the figures shown in the unaudited financial statements, does not necessarily mean that the fixed assets register is correct.
- 2.2 Whilst we understand that the carrying amount of these assets is nil, if there are any disposals one would not be able to trace the costs, accumulated depreciation and potential grants received with respect to those assets, to remove them from the accounts. Also, it is important that assets are not grouped in the fixed assets register unless they relate to the same project. It is important to record items separately and make sure that any groupings are well documented so that one can check the correctness of the fixed assets register on an individual item basis when compared to the accounts.
- 2.3 In the report received from the architect, it was noted that the project under Measure 4.3 relating to the resurfacing of Triq Wied L-Abjad and Triq Wied L-Infern was fully completed during the year. When checking the costs in the accounts relating to this project, a huge difference was found. Upon investigation, it was found that several invoices received from the contractor, amounting to €186,971 were not accounted for. An audit adjustment was passed to reflect these missing invoices. Relating to this project there were grants that were still being shown under the deferred income amounting to €92,121 and other funds that have not yet been received amounting to €62,439 and which were not accrued for. These have been adjusted for during our audit. Finally, in view of these adjustments, the depreciation charge for the year for this category of assets had to be increased by €1,038.
- 2.4 It is of utmost importance that the Local Council accounts for all the invoices received. The Council should be fully aware of all the projects completed during the year and therefore should realise that costs are missing from the accounts. The letter is to be requested from the architect prior to closing off the accounts as the information provided therein would assist the Council to notice such omissions.
- 2.5 During our testing on the property, plant and equipment, we noted that an asset amounting to €51,570 was still classified as an asset under construction despite that the project was fully completed by the end of the year. The project related to Xwejni Quay. A reclassification adjustment was passed during the audit. Depreciation of €5,157 also had to be accounted for in relation to this asset.
- 2.6 The Local Council should have the detailed breakdown of the costs classified under the category assets under construction and should be aware of which projects have been completed and which are still in progress. Any assets completed should be immediately reclassified under the appropriate assets' category and depreciation commenced as from the date of completion and available for use.
- 2.7 When checking the workings of the depreciation charge for the year, we noted that depreciation is being worked out on a yearly basis and not on a monthly basis in accordance with the accounting policy for depreciation as applicable to the Local Council and as disclosed in the financial statements.
- 2.8 It is important that the Local Council follows the accounting policy for depreciation that is applicable to it and starts working the depreciation on a monthly basis.

- 2.9 Within the additions for the year of the property, plant and equipment, under the category urban improvements, there are €9,322 relating to restoration works carried out on a monument in the locality for which €8,390 government grants are to be received. Restoration works are of a maintenance nature and should have therefore been expensed through the statement of comprehensive income.
- 2.10 Care should be taken when accounting for expenditure to ensure that any expenditure of a maintenance nature is reflected in the statement of comprehensive income, as should also be done with the grants received/receivable to cover such costs.
- 2.11 We have not obtained any explanation and supporting documentation with respect to grants capitalized under property, plant and equipment in the category construction and special programmes amounting to €166,067. Furthermore, within the additions for the year of property, plant and equipment, we found an item with a value of €79,941 that had as a description 'year-end adjustment'. No information was obtained about this capitalized item. In view of the said lack of information and supporting documentation, we could not perform satisfactory audit procedures to obtain reasonable assurance on the correctness of the carrying amount of the property, plant and equipment shown in the financial statements. We could not even reconcile the movements in the note to the financial statements under the category construction and special programmes with the movements in the accounts.
- 2.12 We highly suggest that the Local Council looks into this matter and provides a reconciliation between the movement in the accounts and the figures presented in the notes to the financial statements. The Council should also obtain the supporting documentation for the above-mentioned figures so that their correctness or otherwise could be confirmed. Finally, posting journals with the description 'year-end adjustments' should be avoided. This matter is mentioned further in section 11 of this letter.

### **3.0 CASH AND BANK**

- 3.1 Whilst carrying out tests on the bank accounts held by the Local Council, we noted that on the savings account, tax at 15% is being withheld on the interest receivable.
- 3.2 Since the Local Council is not subject to income tax, the bank should be notified not to withhold any tax on the interest receivable.

### **4.0 PAYABLES**

- 4.1 When testing the accruals, we noted that two of the opening accruals relating to projects of a capital nature, were reversed against the property, plant and equipment when the respective invoices were still not yet received. These two items that were reversed to under the assets' category assets under construction, amounted to €16,598. An audit adjustment was passed to correct this error.
- 4.2 Before reversing any of the opening accruals, the Local Council should ensure that the respective invoices covering those accrued expenditure items have been received and accounted for. To be able to do this, the Local Council should have the details of what the opening accruals is made up from.
- 4.3 Included in the accruals, is an amount of Euro 15,350 with respect to resurfacing works carried out in Triq Il-Ponta. No adequate audit evidence was made available to support this accrual and this project was not even mentioned in the report that we obtained from the architect of the Local Council about the projects undertaken by the Local Council. Therefore, we could not satisfy

ourselves as to the correctness of this accrual and the respective asset being shown under property, plant and equipment in the category assets under construction.

- 4.4 The Local Council should ensure that every item that is accrued for is adequately supported by documentation which in the case of projects of a capital nature, should be the report from the architect of the projects undertaken by the Local Council including both those completed and those still ongoing.

## 5.0 **INCOME**

- 5.1 When we carried out a reasonability test on the income arising from the sale of books, we ended with a variance of €1,891. During the year, the quantity of books in the inventories went down by 152. Given that the selling price is €35 and the cost per book is €8.17, one would expect a profit from the sale of books of €4,078. The profit from the sale of books as per accounts amounted to €2,187. When we asked for an explanation, we were told that some of the books are sold at discounted prices whilst there were cases where books were donated. The Council does not maintain a detailed record of the movements in the inventory of books and hence we could not verify the explanation given.
- 5.2 We highly suggest that the Local Council starts maintaining a record of all the movements in the inventories, recording enough information to be able to reconcile figures including what was sold and what was donated. May we bring to your attention that the Local Council should not give donations neither in cash nor in kind.
- 5.3 We noticed that €158 presented as other government income, is not income coming from the central government but is income related to cultural activities. Given the amount is not material, it was decided to not pass a reclassification adjustment.
- 5.4 Care should be taken while accounting for transactions relating to income to ensure that the appropriate nominal account is used so that there is proper presentation of income in the financial statements whilst ensuring comparability from one year to another.

## 6.0 **PAYROLL**

- 6.1 When reconciling the FSS forms, we noticed that there was a variance of €21 between the gross emoluments reported in the FS7 which amounted to €101,211 and the gross emoluments reported in the FS5s which amounted to €101,232.
- 6.2 Care should be taken when preparing the FSS forms to ensure that the information disclosed therein agree between the different forms. A reconciliation should be carried out between the different forms when preparing the annual FS7 and FS3s and if variances are noted, the necessary action should be taken by filing an adjusting FS5 form.
- 6.3 When checking the Mayor's honoraria, it was noted that there was an overpayment of €42 during the year.
- 6.4 Kindly note that the Mayor's honoraria should be calculated as stipulated in the Local Councils Regulations and the circulars issued from time to time by the Department.



## **7.0 EXPENDITURE AND TENDERS**

- 7.1 We noticed that the Council does not draw up purchase requests in line with the Local Councils Financial Procedures. There appears to be no specific reason behind this practice. It is appreciable that at times the urgency of matters which may arise require the reduction of bureaucracy as much as possible, however we are still of the opinion that the necessary paperwork should have been done in line with the financial procedures.
- 7.2 Kindly note that the above issue is against the Local Councils Financial Procedures that the Council has to abide with. Therefore, we strongly recommend that the Council takes immediate action to regularize itself on these matters 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.
- 7.3 The total actual expenditure exceeded the budgeted costs in the following categories:
- 7.3.1 Materials & supplies (category 2200) – by €1,634
  - 7.3.2 Repairs & upkeep (category 2300) = by €47,189
  - 7.3.3 National & international memberships (category 2500) – by €1,482
  - 7.3.4 Transport (category 2700) – by €3,661
  - 7.3.5 Information services (category 2900) – by €1,446
  - 7.3.6 Training (category 3200) – by €40
  - 7.3.7 Hospitality & community (category 3300) – €17,533
  - 7.3.8 Local enforcement system (category 3600) – €1,500
- 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 It was noted that the Council used services for the collection of bulky refuse under an expired contract. The contract expired in 2018 and the total amount of the invoices for such services during 2019 amounted to €14,562.
- 7.7 The Council should be aware of the contracts that are about to expire and timely action should be taken to issue a new tender so that a new contract is in place before the old one expires.

## **8.0 LIQUIDITY**

- 8.1 The Statement of Financial Position on page 5 of the financial statements indicates that the current liabilities exceeded the current assets by €104,586. This implies that the Council does not have enough current assets to support its current liabilities.
- 8.2 The current ratio is €0.86 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 is in fact only €0.74 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 capital projects until the cash deficit situation is remedied.

## **9.0 FINANCIAL SITUATION INDICATOR**

- 9.1 The Financial Situation Indicator held by the Council at the Statement of Financial Position date stood at negative 19.06% 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.
- 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 Government if it anticipates a Financial Situation Indicator level which will fall below the 10% threshold in future years.

## **10.0 MID-TERM AUDIT**

- 10.1 During the year under review, the executive secretary terminated his employment with the Local Council. No mid-term audit was carried out in accordance with the regulations.
- 10.2 The Local Council should abide with the requirements of the Local Councils Procedures Regulations in all respects.

## **11.0 OTHER MATTERS**

- 11.1 Whilst browsing through the nominal ledger, we noted that a single lengthy journal entry with the description 'Year End Adjustment' was passed with all the end of year adjustments. This created an issue since there was no detailed description in the transactions posted in the different nominal accounts and it was impractical to trace the double entry of any entry posted in a nominal account. When asked for information of some of these entries, the Local Council was unable to provide us with the necessary explanations including some of the entries posted in the accounts relating to the property, plant and equipment as mentioned earlier on in the letter.
- 11.2 The Local Council should avoid passing such lengthy journal entries with no proper description of what they represent. Each adjustment should be passed separately with adequate description included therein. Every double entry should be easily traced so that the correctness thereof can be ascertained. The Local Council should be in a position to explain every entry passed in its books of accounts and provide supporting documentation for the journal entry passed.



### **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.