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www.rsm.com.mt29th October 2021The Mayor
Local Council Iz-Zebbug (Gozo)
Church Street,
Zebbug ZBB 1200,
Gozo

Dear Mayor,

RE: MANAGEMENT REPORT – FOR THE YEAR ENDED 31 DECEMBER 2020

We have completed our audit of the financial statements of the Local Council Iz-Zebbug (Gozo) for the year ended 31 December 2020. 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.

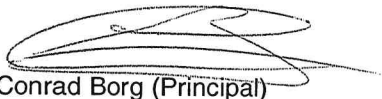
This report has been prepared on the basis of the limitations set out in the Responsibility Statement as presented on page 12 of this report.

During the course of our audit for the year ended 31 December 2020, 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 (Principal)
for and on behalf of
RSM Malta

Local Council Iz-Zebbug (Gozo)

Management Report for the year ended 31 December 2020

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1.0 FOLLOW-UP TO LAST YEAR'S REPORT

1.1 Property, Plant and Equipment

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

- The fixed assets register does not contain details of assets that have been fully depreciated.
- Additions of property, plant and equipment could not always be easily traced in the fixed assets register due to groupings, and different description and amounts registered in the fixed assets register compared to the accounts, despite the carrying value of the register still agreed somehow to that in the accounts.
- Invoices relating to a completed project were not accounted for and the grants received relating to this project were still being shown under the deferred income, whilst grants yet to be received were not accrued for.
- An asset that was completed during the year, was still being classified under the category assets under construction.
- Costs relating to restoration works, and the related grants, were capitalised under property, plant and equipment instead of accounted for through profit or loss.
- No explanations and supporting documentation were provided for some of the grants capitalised during the year, as well as for one of the additions of property, plant and equipment.
- Depreciation was calculated on a yearly basis and not on a monthly basis in accordance with the accounting policy.

During the year under review, the issues mentioned above, apart from the last one, still existed.

1.2 Cash and Bank

Last year we noted that on the savings account, tax at 15% was being withheld on the interest receivable. No action has been taken during the current year.

1.3 Payables

Last year, we noted the below weaknesses with respect to the payables:

- Opening accruals were reversed when the respective invoices were still not received.
- No supporting documentation was obtained for one of the accruals relating to a capital project.

The above issues were still encountered during the year under review.

1.4 Income

When testing the income, the following weaknesses were noted:

- Certain items of income were accounted for in the wrong income account.
- A variance resulted when a reasonability test was carried out on the income from the sale of the books.

Whilst the first weakness was not encountered again, the second weakness was noted again this year.

1.5 Expenditure and Tenders

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

- Purchase requests were not always drawn up.
- The actual expenditure exceeded the budgeted costs in several categories.
- The Council used services for the collection of bulky refuse under an expired contract.

The above issues, except for the last one, were noted again this year.

1.6 Payroll

Variances were noted between the figures reported in the FS7 and those reported in the FS5s. This weakness was also encountered this year.

We also noted a slight overpayment in the Mayor's honoraria. No such errors were noted during the current year.

1.7 Liquidity

As at 31 December 2019, the current liabilities exceeded the current assets by €104,586 indicating possible liquidity problems. As at the end of the financial year under review, the Local Council experienced the same situation.

1.8 Financial Situation Indicator

As at 31 December 2019, the financial situation indicator of the Local Council stood at negative 19.06% which fell below the 10% threshold required by the Financial Provisions to the Local Councils Act. As at 31 December 2020, the financial situation indicator was still negative.

1.9 Mid-Term Audit

During the year, the executive secretary terminated his employment with the Local Council and no mid-term audit was carried out. There was a similar situation during the current year.

1.10 Other Matters

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 made it impractical to trace the double entry of any entry posted in a nominal account. A similar situation was encountered during the current year.

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 fixed assets register. In the fixed assets register, it seems that certain assets were grouped together whilst other 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 We have requested a report from the architect about the projects that were completed during the year ended 31 December 2020 and the projects that were ongoing as of that date. This report was not received by the time we concluded our audit. Consequently, we could not confirm whether all the projects carried out by the Local Council during the year were properly reflected in the books of accounts.
- 2.4 The Local Council should ensure that this specific report is asked for during the closure of the accounts to make sure that all possible accruals are properly reflected in the accounts, and that the property, plant and equipment are correct. This report is to be made available to the auditors during their testing.
- 2.5 One of the projects completed during the year, was that of the public convenience. The costs capitalised with respect to this project were less than what was expected from the assessment made. From further investigation, it resulted that further costs relating to this project, amounting to €12,200, were written off to the profit and loss under the expense item materials and supplies. Audit adjustments were passed to capitalise these costs and to reflect the depreciation thereon amounting to €1,220.
- 2.6 The Council should be aware what every invoice being accounted for relates to and should ensure that it is posted in the correct account. Items relating to a capital project should be capitalised under property, plant and equipment and depreciation calculated thereon as from the date the project is completed and is available for use.
- 2.7 We were not provided with sufficient appropriate documentation and explanations on the Local Council's property, plant and equipment including the additions for the year, the depreciation charge for the year and the grants capitalised during the year. Amongst the issues we could notice, there were grants relating to projects not yet carried out amounting to €18,538 that were still capitalised during the year. The note in the financial statements on property, plant and

equipment is showing additions under the category assets under construction of €15,348 which amount was already part of the opening balance of €274,168, which total amount bought forward was reclassified to under construction and special programmes during the year. The costs relating to the public convenience were partly presented under the category urban improvements and partly under the category construction and special programmes. Due to the weaknesses mentioned in point 2.1, we could not confirm the correctness of the calculation of the depreciation for the year. The total cost of the project Triq Ghajn Mhelhel amounted to €320,582. Grants were received to cover the total costs of this project but yet the total grants capitalised during the year under the category construction and special programmes, according to note 12 in the financial statements, that includes the €18,538 mentioned earlier, amounted to only €275,599. Due to these issues, we could not conclude whether the carrying value of the property, plant and equipment shown in the statement of financial position is correct.

- 2.8 We recommend that the Council prepares a proper fixed assets register which is reconciled to the nominal ledger. The register should include among other details, the detailed description of the assets, their identification codes, their locations and the category of the assets according to their nature. It is important that in the process of building the register, the Council confirms that all the assets are properly categorised, and that any errors noted in the capitalisation of costs and grants relating to projects, are immediately corrected. If the correct costs, accumulated depreciation and grants in the fixed assets register could not be recorded in the fixed assets register due to the change in the accounting policies in line with Directive 01/2017, 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 the financial statements.

3.0 RECEIVABLES

- 3.1 When checking the balance receivable from WasteServ Malta Limited as per accounts with the statement received, a difference of €3,572 was noted. When carrying out the reconciliation, it transpired that the November and December 2019 invoices amounting to €3,572 were not included in the receivables' account. These invoices were accrued for last year and then this year they were reversed without the Council accounting for the actual invoices subsequently issued. An adjustment was recorded to account for these issued invoices.
- 3.2 We suggest that when the Council is in the process of closing the accounts at the end of the year, the Council should ask for statements of account, or confirmations of the receivables, to reconcile the balance in the books and any variances noted should be investigated immediately and the appropriate action taken.
- 3.3 When analysing the aged accounts' receivable list, we noticed an account with a negative balance of €15,321. It has been agreed that for presentation purposes, a reclassification adjustment is passed to reflect this balance under the liabilities.
- 3.4 Kindly note that any overpayments within the accounts' receivable are to be presented in the financial statements under the liabilities and accordingly, these are to be reclassified at the end of the year to ensure proper presentation.
- 3.5 While going through the receivables' aged list we noted that the Council had receivables older than two years amounting to €1,857 as at 31 December 2020, but the provision for doubtful debts in the accounts amounted only to €214. The provision was therefore understated by €1,643.

- 3.6 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.

4.0 CASH AND BANK

- 4.1 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.
- 4.2 Since the Local Council is not subject to income tax, the bank should be notified not to withhold any tax on the interest receivable.
- 4.3 When testing the nominal account representing funds yet to be deposited as at the end of the year, we noticed an amount of €53,113 which was received from WasteServ Malta Limited. Upon enquiry, we noticed that this amount was higher than the balance due by WasteServ Malta Limited to the Local Council. After further investigation, it transpired that WasteServ Malta Limited has issued a payment to the Local Council when that payment should have been issued to Haz-Zebbug Malta Local Council. The amount received was to be refunded and therefore it was agreed that the receipt accounted for in the accounts' receivable is to be reversed.
- 4.4 When accounting for any receipt, the Local Council should obtain details of the invoices being settled so that it is allocated against the correct invoices. If this was done, then it would have been realised immediately that the payment did not pertain to the Local Council and would have not been accounted for in the accounts' receivable.

5.0 PAYABLES

- 5.1 When testing the accruals, we noted that one of the opening accruals relating to project of a capital nature, was reversed against the property, plant and equipment when the respective invoices were still not yet received. This item that was reversed to under the assets' category assets under construction, amounted to €15,348. An audit adjustment was passed to correct this error.
- 5.2 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.
- 5.3 Included in the accruals, is an amount of €15,350 with respect to resurfacing works carried out in Triq Il-Ponta. No adequate audit evidence was made available to support this accrual. 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.
- 5.4 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.
- 5.5 From the samples chosen for the testing of the accounts' payable, we did not receive a confirmation from the main contractor for road resurfacing whose balance as at the end of the

year as per accounts amounted to €84,585. This balance represented 78% of the total accounts' payable as at the end of the year. We could not carry out satisfactory alternative audit procedures to confirm the completeness and correctness of such a balance.

- 5.6 We 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.
- 5.7 As at the end of the year, the Local Council had savings from the Triq Is-Saghtrija and Triq Ghajn Mhelhel projects amounting to €45,737. These excess funds were still shown as deferred income rather than as other payables given that they would need to be refunded. When we enquired about this, we were told that these funds will now be utilised for other projects. However, when we requested documentation supporting this agreement with the respective Ministry, we were not provided with any anything.
- 5.8 It is highly recommended that the Local Council should have the agreements supporting all the grants received and when it is agreed with the respective party, that funds may be utilised for a different project, a new agreement should be entered into and made available to the auditors.

6.0 INCOME

- 6.1 When checking the income relating to administrative fees receivable from LESA for contraventions paid at the Local Council, we noticed that for the month of May, there was another invoice accounted for amounting to €54 which was not correct. Given the amount was not material, no adjustment has been made.
- 6.2 We recommend that the Council should take care when recording the transactions in the books of accounts to ensure that the information recorded is correct, not accounted for double and that it agrees with the supporting documentation.
- 6.3 When we carried out a reasonability test on the income arising from the sale of books, we ended with a variance of €360 on the proceeds. During the year, the quantity of books in the inventories went down by 22. Given that the selling price is €35 and the cost per book is €8.17, one would expect revenue of €770, cost of books sold of €180 and a profit from the sale of books of €590. However, the income from the sale of books amounted only to €410 in the accounts. When we asked for an explanation, we were told that some of the books were 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. We also noted that the cost of books sold of €180 was posted in account 2610 being printing expenses which is not correct.
- 6.4 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. The cost of books sold should also be accounted for in the same account where the proceeds are accounted for so that the account would represent the profit earned from the sale of books.

7.0 EXPENDITURES AND TENDERS

- 7.1 We noticed that the Council does not draw up purchase requests in line with the Local Councils Financial Procedures. With regards to the purchase orders, these are prepared for most of the purchases but there are still cases where these are not prepared. There appears to be no specific reason behind these practices. 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.
- 7.2 Kindly note that the above issue is against the Local Councils Financial Procedures that the Council must 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 several categories as follows:
- 7.3.1 Utilities (Category 2100) by €327
 - 7.3.2 Materials and supplies (Category 2200) by €13,249
 - 7.3.3 Transport (Category 2700) by €1,993
 - 7.3.4 Contractual services (Category 3000) by €52,775
 - 7.3.5 Professional services (Category 3100) by €464
 - 7.3.6 Local enforcement services (Category 3700) by €53
- 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 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 from the samples tested, where the Council did not abide with the new regulations. The Local Council is acquiring services and goods through direct orders without obtaining the necessary quotations. The value of these goods and services amounted to €8,072. We also came across one instance where no VAT fiscal receipt was obtained by the Local Council. This expense amounted to €2,000.
- 7.7 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.
- 7.8 When browsing the nominal accounts relating to expenditure, we noted reclassification adjustments from the sundry materials and supplies account and the operating materials and supplies account to the roads and pavements account. When we looked at the items being transferred through such a reclassification adjustment, none of them related to roads and pavements. When we enquired about the reclassification, no valid reasons could be provided, and it was agreed that the adjustment should be reversed. Therefore, the sundry materials and supplies account was increased back by €12,415, the operating materials and supplies account was increased back by €14,013 and the roads and pavements account was decreased by €26,428. We also noted that in the sundry materials and supplies account there was an amount of €2,200 that related to an activity held by the Local Council and that should have therefore been

accounted for in cultural events account. A reclassification adjustment was passed during our audit.

- 7.9 All reclassification adjustments passed should be properly documented to identify which batch of transactions are being reclassified and the reasons thereof. Reclassifications should not be made for no valid reason. Furthermore, care should be taken to ensure that each item of expenditure is accounted for in the correct nominal account to ensure consistency and comparability from one year to another.

8.0 PAYROLL

- 8.1 When reconciling the FSS forms, we noticed that there was a variance of €5 between the gross emoluments reported in the FS7 which amounted to €126,751 and the gross emoluments reported in the FS5s which amounted to €126,746. Another variance of €266 was found between the social security contributions reported in the FS7 which amounted to €17,953 and the social security contributions reported in the FS5s which amounted to €17,687.

- 8.2 Care should be taken in 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.

9.0 LIQUIDITY

- 9.1 The Statement of Financial Position on page 5 of the financial statements indicates that the current liabilities exceeded the current assets by €72,040. This implies that the Council does not have enough current assets to support its current liabilities.

- 9.2 The current ratio is €0.68 of current assets for every €1.00 of current liabilities indicating that the Council may be in situation of 'overtrading'. The acid test ratio is €0.45 of cash and cash equivalents for every €1.00 of current liabilities.

- 9.3 We recommend that the Council curtails its current expenditure and does not enter into further capital expenditure until the cash deficit situation is remedied.

10.0 FINANCIAL SITUATION INDICATOR

- 10.1 The Financial Situation Indicator held by the Council at the Statement of Financial Position date stood at negative 10.11% 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.

- 10.2 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)

- 10.3 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.

11.0 MID-TERM AUDIT

- 11.1 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.
- 11.2 The Local Council should abide with the requirements of the Local Councils (Procedures) Regulations in all aspects.

12.0 OTHER MATTERS

- 12.1 Whilst browsing through the nominal ledger, we noted lengthy journal entries with the descriptions 'Year End Adjustment' and 'Reclassification' passed to reflect the end of year adjustments and reclassifications. 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.
- 12.2 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 a comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.