

RSM Malta

Mdina Road,
Zebbug ZBG 9015,
Malta.

T+356 2278 7000

F+356 2149 3318

www.rsm.com.mt

13th September 2021

The Mayor
Local Council Sannat
Sannat Road,
Sannat,
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 Sannat 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 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 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 Executive Secretary and the clerks for their assistance during the course of our audit.



Conrad Borg (Principal)
for and on behalf of
RSM Malta

THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

Local Council Sannat

Management Report for the year ended 31 December 2020

Contents	Pages
Follow-up to last year's report	3
Property, Plant and Equipment	5
Payables	6
Income	6
Expenditure and Tenders	6
Liquidity	7
Financial Situation Indicator	7
Responsibility Statement	8

1.0 Follow-up to Last Year's Report

1.1 Property, Plant and Equipment

In the prior year, we noted that upon the application of Directive 01/2017, items of property, plant and equipment whose useful life expired, were not written off, depreciation for the year was applied on the carrying values as at 1 January 2018 at the applicable depreciation rates as if the assets' useful life started in 2018 rather than using the remaining useful lives, and the allocation of grants to the respective assets was not properly carried out. It was also noted that the fixed assets register does not contain details of the assets that have been fully depreciated. No action was taken on these issues during the current year.

When analysing the items classified under the category 'assets under construction', it had been noted that these related to a project that was originally going to be carried out by the Local Council but was then taken over by the Ministry for Gozo due to the high costs involved and the Council was refunded for the costs incurred. Other weaknesses encountered last year on property, plant and equipment included wrong depreciation rates used, wrong amounts of grants being capitalised and inadequate insurance coverage. Similar weaknesses were encountered again this year, except that items of property, plant and equipment are now properly insured.

1.2 Receivables

Last year, it was noted that within the accrued income, there was an amount receivable relating to a project that was completed back in 2013 and we were not provided with adequate evidence that such funds are still receivable. This issue was not noted in the current audit.

1.3 Income

During 2019, the Local Council collected money on behalf of the Malta Community Chest Fund which money was accounted for as income and expense of the Local Council which should have not been the case. No such instance was encountered during the current period.

Tax at source was being charged on the interest earned on bank accounts held by the Local Council despite the Council is not subject to tax. No action was taken during the year under review.

1.4 Personal Emoluments

When checking the honoraria of the Mayor, we noticed errors in the calculation of the honoraria for the months of April and December. No such issues were encountered this year.

1.5 Expenditure and Tenders

During the year ended 31 December 2019, the Council had exceeded the budgeted expenditure in several expenditure categories. There were instances where the Council did not abide in full, with the public procurement regulations. These weaknesses were once again encountered during this year's audit.

1.6 Liquidity

As at 31 December 2019, the current liabilities exceeded the current assets by Euro 105,221 indicating possible liquidity problems. As at the end of the financial year under review, the Local Council experienced a similar situation.

1.7 Financial Situation Indicator

As at 31 December 2019, the financial situation indicator of the Local Council stood at negative 27.37% 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.

2.0 PROPERTY, PLANT AND EQUIPMENT

- 2.1 Following Directive 01/2017 issued by the Department for Local Government to Local Councils on the change in the accounting policies on depreciation and on government grants, we noticed from the limited procedures that we could carry out that:
- 2.1.1 Depreciation has been applied on the carrying values as at 1 January 2018 at the applicable depreciation rates as if the assets' useful life started in 2018, rather than using the remaining useful lives.
 - 2.1.2 Grants received for specific projects, were allocated to several items of property, plant and equipment rather than to those specific projects, clearly indicating that the allocation of grants to the respective assets was not properly carried out. This affected the calculation of the depreciation on the items wrongly allocated, or not allocated, the grants which items were bought in different years.
- 2.2 We highly suggest that the exercise of applying the changes in the accounting policies is redone diligently and the necessary corrections made to the accounts through a prior year adjustment. Once the exercise is completed, the fixed assets register would need to be updated as well. When doing such an exercise, it is important to keep all the necessary workings to be able to reconcile the costs and accumulated depreciation as per updated fixed assets register to the figures shown in the note to the financial statements on property, plant and equipment.
- 2.3 The fixed assets register does not contain any details of the assets that have been fully depreciated 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.
- 2.4 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.
- 2.5 When analysing the items classified under the category 'assets under construction', we noticed professional fees amounting to €27,612 relating to the project of Sannat Square. This project was originally going to be carried out by the Local Council, but following the very high cost of the project, the Ministry for Gozo took over this project itself. The Ministry agreed to keep using the services of the architect of the Local Council since he did all the preparatory work, planning and design of the project and agreed to reimburse the Local Council for such services of the architect. The Council had already received the funds to cover these costs, which funds were still being shown as deferred income in the books of accounts. An audit adjustment was passed to match the costs with the refund received, as these costs are not costs of the Local Council.
- 2.6 The Local Council should continuously monitor the items under the category 'assets under construction' to follow the progress of the respective projects and if they are completed, the assets are to be transferred under the correct assets' category whilst if a project is abandoned as happened in this case, the costs are to be immediately written off and matched against any related reimbursement income if there is such, as in this case.
- 2.7 During the year, €216,928 were capitalised under the category assets under construction. These represented works already carried out, invoiced and paid, in relation to Triq Sannat project, which project was still ongoing as at the end of the year. These costs were covered through a funding agreement with the Ministry for Gozo and €400,000 were already received in the previous years. The portion of the grants received to cover these costs already incurred, has not been capitalised in line with the accounting policy. Therefore, an audit adjustment was passed to reclassify this amount from deferred income to property, plant and equipment.

- 2.8 The Local Council should be fully aware of the government grants it is entitled to and apply the capital approach in accordance with IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance for all capital expenditure already incurred.
- 2.9 When checking the government grants that have been capitalised during the year under property, plant and equipment, several errors were noted. Grants amounting to €10,982 relating to the Sqaq Dun Nazju project, were capitalised when the project has not yet been carried out. These grants received in the previous year, should have remained under deferred income. The amount of grants capitalised with respect to Measure 4.4 – First call projects, was overstated by €2,205. When checking the grants capitalised, it was also noted that in the previous year, an amount of €15,120 was capitalised relating to Measure 4.3 project, when those funds were not related to that project as the correct funds were received in 2020. These errors were all adjusted during the audit. Adjustments were also passed to adjust the depreciation charge for the year, following these corrections. The depreciation charge for the year for the category special programmes, was increased by €4,343.
- 2.10 It is important that before capitalising any grants relating to completed projects, the respective funding agreements are analysed to check the correct amount of funds that relate to the specific project, whether any funds are still receivable and the percentage of the costs to be covered including the capping of the funds. Such analysis including the details of the costs of the project should be made available to the auditors during the audit. The Local Council should also keep proper records showing to which projects, the grants shown under deferred income, relate to.

3.0 PAYABLES

- 3.1 During our testing on the payables, it was noted that an amount of €7,500 received by the Local Council in 2018 in relation to the Urban Green Project, being the part of the grant received for the ongoing maintenance of the plants and trees, is still being recorded as deferred income as at 31 December 2020. The plants and trees were installed during 2018 and since then, the watering and maintenance thereof commenced and is being carried out regularly. Therefore, parts of this grant should have already been written off to the statement of comprehensive income.
- 3.2 The Local Council should keep track of the costs being incurred regularly on the installed plants and trees and on an annual basis, an amount of the grant equivalent to such costs is to be written off to the statement of comprehensive income to be matched with the costs it is intended to cover.

4.0 INCOME

- 4.1 When testing the bank interest received by the Local Council, we noticed that for two of the bank accounts held with Bank of Valletta p.l.c., final withholding tax at 15% was being deducted from the interest received. Since the Council is not subject to income tax, the bank should be advised to not withhold any tax on the interest.

5.0 EXPENDITURE AND TENDERS

- 5.1 The Council has exceeded the budgeted expenditure under the following headings:
- 5.1.1 Utilities (category 2100) – by €2,125
 - 5.1.2 Contractual services (category 3000) – by €30,412
 - 5.1.3 Professional & management services (category 3100) – by €4,400
 - 5.1.4 Law enforcement expenses (category 3600) – by €331

- 5.2 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 help the Council revise the budgets in line with actual expenditure.
- 5.3 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 such discrepancies would not materialise.
- 5.4 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 relating to street lighting from the same supplier through direct orders. The amounts invoiced for 2020 totalled to €10,858. From the samples tested, there were two instances whereby only one quotation was obtained. The value of these services amounted to €5,107. In another three instances, no quotations were obtained. and the services were acquired through a direct order. The value of these services amounted to €5,248.
- 5.5 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.

6.0 LIQUIDITY

- 6.1 The Statement of Financial Position on page 5 of the financial statements indicates that the current liabilities exceeded the current assets by €64,000 as at 31 December 2020. This implies that the Council does not have enough current assets to support its current liabilities.
- 6.2 The current ratio is €0.82 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 €0.73 of cash and cash equivalents for every €1.00 of current liabilities.
- 6.3 We recommend that the Council curtails its current expenditure and does not enter into capital projects until the cash deficit situation is remedied.

7.0 FINANCIAL SITUATION INDICATOR

- 7.1 The Financial Situation Indicator held by the Council at the Statement of Financial Position date stood at negative 22.10% 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.
- 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, 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.

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.