RSM Malta

Mdina Road,
Zebbug ZBG 9015,
Malta.

T +356 2278 7000
F +356 2149 3318

www.rsm.com.mt

26th May 2020

The Mayor
Local Council Xewkija
28, Triq Santa Katerina
Ix-Xewkija XWK 2032
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 Xewkija 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 bookkeeping 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 12 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

Local Council Xewkija

Management Report for the year ended 31 December 2019

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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:

a. The fixed assets register was not provided;
b. Computer software was capitalised as property, plant and equipment rather than as an intangible asset;
c. Costs relating to a project which was abandoned were still capitalised as property, plant and equipment;
d. Items that were disposed off, or were obsolete, were not written off from the accounts;
e. Depreciation was not taken from the month when an asset was acquired or a project was finalised but was worked out on a yearly basis;
f. It was noted that furniture and fittings were not fully covered by the insurance policy; and
g. When checking the adoption of Directive 01/2017, we were provided with limited information to ensure that it has been correctly applied.

All the above weaknesses, other than point (c), still existed during the current year.

1.2 Receivables

In the prior year, the following issues were noted:

a. No confirmation was received from the accounts receivable chosen for testing;
b. The issue found in the reconciliation of the account of Water Services Corporation was not followed up;
c. It was noted that balances older than two years were not being provided for as instructed;
d. No audit evidence was obtained for balances included in accrued income account relating to various projects and activities, which have been brought forward from the previous years; and
e. Prepayments relating to rent and insurance were not recorded.

Weaknesses (b) and (d) were also noted this year.

1.3 Bank and Cash

When performing our tests on bank and cash accounts, last year we noted the following:

a. When checking the list of unpresented cheques, it was noted that a cancelled cheque was not reversed in the books of accounts; and
b. It was noted that there was a balance in account 5000 that had as a description 'Do not use' for which no explanation was provided.

Weakness (b) was found again during the current audit.

1.4 Payables

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

a. From the architect's letter it transpired that capital projects carried out for which no invoices were received, were not accrued for;
b. An invoice received from a contractor relating to the project under Measure 4.3, was not reflected in the accounts; and
c. Government grants relating to projects not yet carried out were still capitalised under property, plant and equipment rather than classified under deferred income.

No such issues were found this year.

1.5 Income

Last year, we noticed the following weakness:

a. Income from Wasteserv Limited and SportsMalta were shown as income from the Central Government.

This weakness was not found this year.

1.6 Expenditure and tenders

When performing our tests on the expenditure, last year we noted that:

a. Cases were encountered whereby the procurement procedures were not properly followed;
b. Purchase requests and purchases order were sometimes not prepared and sometimes they were prepared on the same document;
c. The Council was using an expired contract for street cleaning and street lighting services;
d. The actual costs in various categories exceeded the budgeted costs; and
e. The expenditure incurred in respect to 'Jum il-Lokalita' was not within the stipulated limits set in Memo 122/2010.

Weaknesses (b) and (d) were also noted this year.

1.7 Personal Emoluments

Last year, we noticed the following weaknesses:

a. A difference between the emoluments shown in the accounts and those shown in the FS7 was noted;
b. Variances were found between the figures declared in the FSs and those in the FS7; and
c. In the FS7, the number of FS3s issued for the year was missing.

Weaknesses (a) and (b) were found again this year.

2.0 PROPERTY, PLANT AND EQUIPMENT

2.1 No fixed assets register was provided to us during our audit and hence we could not perform any checks on the existence and completeness of the property, plant and equipment.

2.2 We recommend that a fixed assets register is built that would contain complete details of every item of property, plant and equipment of the Local Council. Fixed assets should be properly coded to facilitate the identification of the assets. Periodic inspections should be conducted to check the completeness and validity of the items in the fixed assets register, thereby increasing control over the assets and maintaining the integrity of the data in the fixed assets register. If the correct costs and accumulated depreciation could not be recorded in the fixed assets register due to the change in the accounting policy for the depreciation, 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 financial statements.

2.3 During our testing on the depreciation charge for the year, it was noted that depreciation was not taken from the month when the project was completed and available for use or from when an asset is acquired, but was worked out on an annual basis based on the total costs of the assets in every category.

2.4 Kindly note that this goes against the accounting policy applicable to the Local Council as disclosed in the financial statements, which states that depreciation is to be calculated on a monthly basis. Once the fixed assets register mentioned above is completed, the depreciation could be calculated automatically through the register.

2.5 It was noted that the furniture and fittings of the Local Council having a carrying value as at 31 December 2019 of €25,036 are underinsured. The insurance policy covers up to €8,868.

2.6 In case of fire, theft or another other accident, the Local Council will not be able to recover the losses incurred. We therefore suggest that the insurance policy is revised to ensure that all the assets are properly covered.

2.7 Whilst testing a sample of the additions for the year of the property, plant and equipment, we found that for two of the additions no VAT fiscal receipt was available. These additions amounted to €1,288 and €3,469, respectively.

2.8 The above issue goes against the Local Councils Financial Procedures that the Council should abide with. It is important that in the future these procedures are followed in every respect.

2.9 Last year when checking the adoption of Directive 01/2017, we were provided with limited information to ensure that it has been correctly applied. No information was provided as to the allocation of the grants to specific assets and the workings of the grossing up and accumulated amortisation of each grant so allocated. Furthermore, we noticed that the depreciation was worked out again from the date of acquisition based on the cost of the assets less any grants allocated to them using the straight-line basis on a yearly basis. The difference between the new accumulated depreciation and the accumulated depreciation as previously stated as at 31 December 2017, was written off as an impairment. No action was taken this year on this matter.

2.10 It is important that the exercise relating to the adoption of Directive 01/2017 is properly documented showing step by step what was done including the grossing up of the grants, the working of the accumulated amortisation, the allocation of these grants against the specific asses they intended to cover, as well as the correct calculation of the depreciation in line with the Local Council's accounting policy.

2.11 When checking the grants capitalised under the property, plant and equipment during 2019, we found grants pertaining to the project of Resurfacing St. Elizabeth Street amounting to €206,230, to the project under Measure 4.4 amounting €72,422 and to the Library Scheme amounting to €2,890, which projects have not been carried out during 2019. Grants relating to projects not yet done should not be capitalised but should be presented as deferred income under the liabilities. We also noted that grants capitalised relating to the project carried out under Measure 4.3 exceeded the costs incurred by €6,384. These funds should have also been classified under the liabilities as any excess funds should be returned to the funding authority. Audit adjustments have been passed to correct these misstatements.

2.12 The Council should properly apply IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance. Any grants received should be classified under the liabilities as deferred income until the related project is carried out at which point, the grant is to either be capitalised under the property, plant and equipment if it relates to a capital project or it is transferred to under income in the statement of comprehensive income if it relates to operating expenditure. Furthermore, the amount so transferred should be in line with the conditions of the funding agreement, which in most cases, limits the funding to either a percentage of the eligible costs or mostly to the full amount of the eligible costs.

2.13 From the architect's letter that we received during the audit it transpired that resurfacing works carried out in Church Street were completed by July 2019. The final certification of this project was not yet issued by the end of the year and no invoice was received either. The estimated cost of this project was €253,775. No accrual for this project was reflected in these financial statements. On the other hand, we noted that funds received in 2017 for this project, amounting to €83,592, were capitalized to under property, plant and equipment upon the adoption of Directive 01/2017 as noted in our report on the financial statements for the year ended 31st December 2018. This means that the accruals, the property, plant and equipment, the accrued income and the depreciation charge for the year, are understated.

2.14 The Local Council should chase the architect to issue the certification for completed projects in a timely manner so that projects are reflected in the financial statements in the year in which they are carried out. Furthermore, the grants are to be transferred from under deferred income to under property, plant and equipment in the same period the related costs they intend to cover are capitalised to abide with the matching concept.

2.15 During our audit, we noticed that there were items related to completed projects that were still being classified as assets under construction at the end of the year. These costs amounted to €21,633. Furthermore, we noticed that within the additions for the year under this assets' category, there were €450 that represented expenditure of a maintenance nature. Adjustments were passed to correct this error and to reclassify the other items relating to completed projects.

2.16 The Local Council should be aware of the items being classified under the category assets under construction and once a project is completed, all the items related to that project should immediately be reclassified under the appropriate assets' category and depreciation thereon started in the same month as that of the other costs relating to the same project. Furthermore, the Local Council should ensure that no expenditure items of a maintenance nature are capitalised. These costs should be written off immediately to the statement of comprehensive income as they are incurred.

2.17 When analysing the projects completed during the year, we noticed that architect's fees relating to these projects were expensed rather than capitalised as part of the project costs. It has been agreed to pass an audit adjustment to capitalise these costs that amounted to €4,258.

2.18 When posting invoices received, the Local Council should properly analyse them after having verified their correctness, to see to which project or activity they relate to. Any costs relating to projects of a capital nature, should be capitalised under property, plant and equipment.

2.19 Following the above-mentioned adjustments to the costs and grants relating to property, plant and equipment, adjustments had to be passed to correct the depreciation charge for the year. We also had to pass an adjustment to correct the depreciation charge for the year of the assets' category construction as there was an error in the computation. The depreciation for the year was increased in total by €26,286.

2.20 Given that the depreciation is currently being calculated manually, the Council should take extra care to ensure that the computations are correctly carried out and that the correct depreciation rate is used.

2.21 Last year we noted that computer software with a cost of €1,280 was classified as computer equipment when this should be shown separately as an intangible asset.

2.22 We once again recommend that the necessary reclassifications are made to present such an asset under the correct category of intangible assets.

3.0 RECEIVABLES

3.1 As part of our testing on the accounts receivable, confirmations were requested from a sample of the receivables. Variances were noted in two of the samples for which no explanations were provided. The variances noted amounted to €1,670 and €134, respectively. We also noted that the balance shown as receivable from the Water Services Corporation of €2,512 remained unchanged from the previous years. In the previous years, the corporation confirmed that the amount due by it was only €93. This discrepancy was not investigated during the year under review.

3.2 We suggest that when closing the accounts, confirmations are sought for at least the major receivable balances. Where there are disagreements, the detailed transactions history is to be requested so that the necessary reconciliations are carried out. The confirmations received should be made available to the auditors whilst carrying out their audit. We also suggest to the Local Council to discuss the discrepancy noted above with the Water Services Corporation and if it concluded that the balance shown in the books of the Local Council is not valid, it is removed once and for all from the accounts.

3.3 During the year, the Local Council carried out an exercise to analyse the opening accrued income to try and verify its recoverability in view that no supporting documentation was available and the audit report for the year ended 31 December 2018 was qualified on this matter. Any accrued income for which no supporting document and no explanation could be obtained, was written off against the opening retained earnings through a prior year adjustment. In doing so, we noticed that €750, stated to be relating to permits, was also reversed in this exercise. However, there was no such item in the opening accrued income. Therefore, it was decided to pass an audit adjustment to correct this mistake. Furthermore, it was noted that part of the opening accrued income that was reversed against the opening retained earnings, was a government grant relating to a capital project carried out in the previous years. Hence, the reversal should have been posted against the grants capitalised under the property, plant and equipment and a depreciation adjustment should have been passed.

3.4 The Local Council should maintain appropriate documentation to support every item of the accrued income. It should also be aware of what the accrued income at any point in time is made up of. Furthermore, it should continuously chase for the pending balances and any such correspondence should be made available to the auditors during their audit.

3.5 When analysing the prepayments, it was noted that the prepayment relating to the insurance was overstated. An adjustment of €421 was passed to reflect the correct prepaid amount.

3.6 Care should be taken to ensure that the prepayments are correctly calculated and reflected in the books of accounts so that the respective expenses are recognised in the statement of comprehensive income in the year to which they relate.

4.0 BANK AND CASH

4.1 When checking the list of unrepresented cheques as at 31 December 2019, it was noted that cheques totalling to €1,258 were already considered as stale by the end of the year and hence should have been reversed.

4.2 At the end of each financial year, the Local Council should go through the list of unpresented cheques and any cheques that would have become stale by that date should be investigated. It could be that another cheque was issued to replace a cheque and the old cheque would have not been reversed.

4.3 When carrying out cut-off tests on the cash and cash equivalents, it came to our attention that a receipt recorded in January 2020,amounting to €1,448, related to tickets for the Christmas event for the elderly that took place in 2019. Such income has not been accrued for. No adjustment was passed due to the immateriality of the amount.

4.4 The Local Council should record income when it is received and not when it is deposited in the bank account. Any amounts not yet deposited, should be shown as cash in hand.

4.5 When checking the nominal accounts relating to the bank accounts, we noted that the description of account 5000 was 'Do not use' and in it there was a credit balance of €594. No explanation was given to us as to what this balance is. In the financial statements, this account was presented with the cash and cash equivalents.

4.6 The Local Council should investigate this balance and pass the necessary adjustments in the books of accounts. All nominal accounts should be properly named to know what they represent.

5.0 PAYABLES

5.1 During our audit, we noticed that the payables' aged list provided, that had a total of €63,574, did not tally with the balance of €63,618 shown in the payables' control account. No explanation was given to us for this discrepancy.

5.2 The Local Council should investigate this variance which should have arose through a transaction posted directly in the control account rather than through the payables' ledgers and once the transaction is identified, the entry should be reversed to ensure that the aged list and the control account tally.

5.3 When testing the accounts' payable, variances were noted in two of the samples tested between the balances shown in the suppliers' statements and the balances shown in the books of accounts. The unexplained variances amounted to €333 and €726 respectively. It was agreed that the latter variance is to be adjusted for, as from checks carried out it resulted that the variance was coming from previous years, when there should be no old balances due according to the Local Council and the statement of the supplier.

5.4 We strongly 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.

5.5 Whilst testing the accruals, it was noted that the opening accrued expense relating to a Christmas dinner and amounting to €1,160, was not reversed. An audit adjustment was passed to reverse such accrual. We also noted a difference of €133 in the amount accrued for transport service when compared with the supporting documentation which was showing a higher amount. Finally, no accrual was reflected in the accounts for the services provided by WasteServ Malta Limited during the month of December 2019, which services amounted to €1,690 and were invoiced in January 2020. An adjustment was passed during the audit to reflect this accrual.

5.6 The Local Council should base its accruals on invoices received after the end of the financial year or on the purchase requests made if the invoices are not yet received by the time of closing the accounts. The Local Council should be aware of all the services provided for which no invoices would have been received by the end of the year and accruals should be accounted for to reflect such costs. Furthermore, the Local Council should ensure that all opening accruals for which an invoice would have been received, are immediately reversed against the nominal account where the invoice would have been posted.

5.7 When reconciling the balance payable to WasteServ Malta Limited with the statement received, it was noted that €1,828 paid by the Department for Local Government to WasteServ Malta Limited on behalf of the Local Council, was not reflected in the accounts. This amount should have been deducted from the suppliers' account and reflected as income from the Department.

5.8 If reconciliations with suppliers' statements are carried out regularly, such an omission would have been noticed. Furthermore, the Local Council should have received a receipt from the supplier that would indicate that such a payment was affected on its behalf.

6.0 INCOME

6.1 Whilst testing the other government income, it was noticed that included therein were the co-financing funds received of €16,440 relating to the project carried out under Measure 4.3, which is of a capital nature. These funds should have been capitalised under property, plant and equipment in the category construction, where the Measure 4.3 project costs were capitalised. An adjustment was passed to correct this error during our audit.

6.2 The Local Council should properly analyse every grant received that is being accounted for and if the grant relates to a capital project, it should be capitalised under property, plant and equipment if it relates to a completed project or under deferred income if the project is not yet done.

6.3 When browsing through the income accounts, we noticed that in the organic waste collection income account there was a reversal of the opening accrued income of €3,814 when the invoices found in this income account all related to the services rendered during the year 2019. It seems that the invoice for the services for which an accrual was passed last year were still not yet issued. Hence, an adjustment was passed to reverse back this transaction.

6.4 Before reversing any accrued income, the Local Council should ensure that an invoice has been issued for that income. Furthermore, the Local Council should ensure that the invoices are issued and accounted for on a timely manner.

7.0 EXPENDITURE AND TENDERS

7.1 The actual expenditure of the Council has exceeded the budgeted expenditure under the following categories:

- 7.1.1 Utilities (Category 2100) by €2,092
- 7.1.2 Repairs and upkeep (Category 2300) by €27,858
- 7.1.3 Office services (Category 2600) by €4,406
- 7.1.4 Contractual services (Category 3000) by €20,824
- 7.1.5 Community and hospitality (Category 3300) by €56,409

7.2 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 note which areas in the budget need revising.

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 When testing a sample of the expenses, it was noted that in one case the Local Council did not have a VAT fiscal receipt in hand. This expenditure that related to an activity that was held in the locality amounted of €1,795.

7.5 The above issue goes against the Local Councils Financial Procedures that the Council should abide with. It is important that in the future these procedures are followed in every respect.

7.6 It was also noted that in some cases the purchase requests and the purchase orders were not drawn up. This does not go in line with the Local Council Financial Procedures.

7.7 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.

8.0 <u>PERSONAL EMOLUMENTS</u>

8.1 Whilst performing the reconciliation of the personal emoluments' costs, we noted that there is a variance of €2,649 between the personal emoluments' costs shown in the financial statements and the amounts shown in the FS7. From our enquiries, it transpired that €2,415 resulted from the fact that the payment of tax and social security costs for December 2018 was made in January 2019 and there was no accrual for it last year. The remaining variance of €234 remained unexplained.

8.2 Moreover, variances were found between the amounts shown in the FS7 and the amounts shown in the FS5s. The gross emoluments in the FS7 amounted to €72,886 while in the FS5s they amounted to €72,636 resulting in a difference of €250. The tax deductions in the FS7 amounted to €11,369 while in the FS5s they amounted to €11,359 resulting in a difference of €10.

8.3 It is important that the Local Council ensures that all the information declared in the various FSS forms agree with the personal emoluments' costs in the accounts and that the various FSS forms agree between themselves. An annual reconciliation between the accounts and the FSS forms should be prepared and any variances investigated.

8.4 When analysing the various payroll accounts, we found an invoice of €2,124 issued by the Community Workers Scheme Enterprise Foundation for the performance bonuses of the community workers who were servicing the Local Council. Such workers are not of the Local Council and hence their costs should not have been included under the personal emoluments' costs of the Local Council. Accordingly, these costs had to be reallocated to under other support services account.

8.5 The Local Council should carefully analyse the invoices being posted and should ensure that they are reflected in the appropriate nominal account. If the Council carries out the payroll reconciliation as stated above, such errors would have been noted.

8.6 When checking the Mayor's honoraria, it was noted that there was an overpayment of €48 during the year.

8.7 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.

8.8 When going through the different payroll costs' accounts, we noted that the Mayor's allowances amounting to €1,997 were not posted in the allowances account. A reclassification adjustment was passed to ensure that the allowances are properly presented in the financial statements.

8.9 Care should be taken when posting payments relating to payroll costs to ensure that they are posted in the correct nominal account. This would ensure that the personal emoluments are properly and consistently presented in the respective note to the financial statements.

9.0 OTHER MATTERS

9.1 When reconciling the opening balances, we noted that there were opening balances even in the accounts relating to items pertaining to the statement of comprehensive income when these accounts should not contain any opening balances. It is to be noted that the opening retained fund was still agreeing with the previous year's financial statements. No explanation was provided to us about these opening balances. Possibly, invoices dated in the previous year were posted in the current year's accounts.

9.2 Following the completion of the audit, and the presentation of the list of audit adjustments and extended trial balance to the Local Council, it is important that immediately the audit adjustments are reflected in the books of accounts after which a reconciliation of the opening balances is to be carried out.

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.