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11<sup>th</sup> June 2020

The Mayor  
Local Council Ta' Kercem  
Pjazza Orvieto  
Kercem VCT 113  
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 Ta' Kercem 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 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.

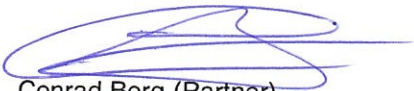
Our engagement obliges us to distribute copies of this report to (a) your Council; (b) the National Audit Office; and (c) the Local Councils Department. Consequently this report, in part or in full, may not be distributed, used or quoted except for the scope it is prepared, without our prior written consent.

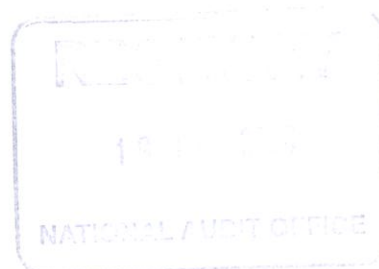
This report has been prepared on the basis of the limitations set out in the Responsibility Statement as presented on page 9 of this report.

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



**Local Council Ta' Kercem**

**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 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 provided during the audit was identical to that presented in the previous years that had several deficiencies.
- Within the fixed assets register there were assets with the narrative 'Adjustment' with no further indications as to what they are.
- Following Directive 01/2017 we noted that items of property plant and equipment whose useful life expired were not written off.
- Depreciation charge for the year was not calculated correctly.
- Certain additions for the year were capitalised under the wrong assets' categories
- The insurance policy in place was not adequate.

During this year's audit, except for the last two points, all the other weaknesses were encountered once again.

### 1.2 Receivables

When testing the samples of the accounts receivable, we noted a variance between the balance shown in the accounts and the statement received from a customer. No such instances were noted this year.

### 1.3 Cash and bank

When testing the cash and bank, we noted that the Local Council had undeposited cash of €8,623. The same situation was noted during the current year.

### 1.4 Payables

When testing the accounts payable balances, we were only provided with two statements from the samples selected. Furthermore, we found differences in the confirmations received when compared to the balances in the books of accounts. We faced a similar situation this year.

In the prior year, we have requested a report from the architect about the projects that were completed during the year. This report was however not received and hence we could not verify whether there were any projects not reflected in the accounts. During the current year, the same report has been requested and it has been received on time.

### 1.5 Income

During our testing on the income, we noticed that some income items were being accounted for in the wrong nominal account. Such issue was noted again during the current year.

While performing reasonability test for the rental income, we have noted a variance between the rental income as per books of accounts and the rental agreements. The same issue was noted this year.

1.6 Expenditure and Tenders

During our testing on the expenditure, last year we noticed that purchase requests and purchase orders were not being prepared. Also, several instances were encountered where the actual expenditure within specific categories exceeded the budget for the year. Both weaknesses were found again during the current year audit.

Instances were also noted where VAT fiscal receipts were not obtained for some of the expenditure tested and in other cases the procurement procedures were not properly followed. Only the first issue was encountered during the current audit.

1.7 Personal Emoluments

In the prior year, we have noted that 52 national insurance contributions were deducted for the employees instead of 53 as was applicable for 2018. Additionally, we also noted that for one employee who worked on reduced hours, the basic weekly salary shown in Section E of her FS3 was not correct.

No such issues were noted this year.

1.8 Liquidity

As at 31 December 2018, the current liabilities of the Local Council exceeded its current assets by €3,846. A similar situation existed as at 31 December 2019.

1.9 Financial Situation Indicator

The Financial Situation Indicator held by the Council at 31<sup>st</sup> December 2018 stood at negative 21.01% which fell below the 10% threshold required by the Financial Provisions to the Local Councils Act. The Financial Situation Indicator as at 31<sup>st</sup> December 2019 was still negative.

## 2.0 PROPERTY, PLANT AND EQUIPMENT

2.1 During our audit, we noted that the fixed assets register presented to us was identical to that presented during the previous year's audit. No updates whatsoever have been made to the fixed assets register. May we remind you that apart from the fact that the figures in the fixed assets register did not agree to the figures shown in the financial statements, there was also the issue described below with respect to the fixed assets register which have been recurring.

2.2 The fixed assets register contains a number of audit adjustments without a reference to any particular asset. The way the entries were made is defeating the whole objective of maintaining the fixed assets register in the first place. The fixed assets register should contain a detailed list of the assets held by the Council in line with the requirements of the Local Councils (Financial) Procedures, section P1.16 (b). The items noted were:

2.2.1	G028	"Adjustment ye March 07"	Euro 4,507
2.2.2	A003	"Adjustment"	Euro 16,306
2.2.3	W004	"Adjustments"	Euro 154,324
2.2.4	V008	"Adj up to March 07"	Euro 1,144
2.2.5	SP001	"Adjustments up to March 00"	Euro 1,165
2.2.6	SP002	"Adjustment up to March 08"	Euro 58,194

2.3 It seems that the Council does not know what assets these adjustments refer to. We continue to recommend that the Council acquires the information required to analyse the "adjustments" referred to above and adjusts the fixed assets register accordingly.

2.4 Following Directive 01/2017 issued by the Department for Local Government to Local Councils on the change in the accounting policies on depreciation, whereby the straight line method is to be applied instead of the reducing balance method and the accounting policy on government grants, whereby the capital approach is to be applied instead of the income approach, we noticed from the limited procedures that we could carry out that:

2.4.1 Items of property, plant and equipment whose useful life expired were not written off. We could not quantify the value of such assets as we were not provided with the dates of acquisition of all the items of property, plant and equipment.

2.4.2 Depreciation for the year seems to have 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.

2.5 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, a proper 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.

- 2.6 When testing the depreciation of the property, plant and equipment, we have noted that purchases of property plant and equipment were not being depreciated from the month of purchase but the depreciation on the additions for each category of assets was started in the same month. .
- 2.7 We highly suggest that the Council maintains a proper depreciation schedule and that the depreciation is calculated on a monthly basis from the date each asset is available for use, that is, when the asset is in the location and capable of operating in the manner intended, in line with IAS 16: Property, Plant and Equipment.
- 2.8 When checking the grants capitalised during the year under property, plant and equipment, we noticed that for one of the resurfacing of roads project, the grants capitalised exceeded the costs they intended to cover by €2,589. An audit adjustment was passed to reverse such excess funds and present them under the liabilities.
- 2.9 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 be capitalised under the property, plant and equipment. 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.

### **3.0 CASH AND BANK**

- 3.1 When testing the cash and bank, we have noted that the Local Council had undeposited cash as of 31 December 2019 of €6,564.
- 3.2 We would like to point out that this practice opens the threat of a loss of cash while it is on the premises of the Local Council. We highly suggest that whenever the Local Council has a heavy cash inflow, deposits to the bank are made daily. This practice will greatly lessen the likelihood that that cash could be lost before it is deposited to the bank.

### **4.0 PAYABLES**

- 4.1 From the five samples chosen for the testing of the accounts payable, no confirmations were received by the time we concluded the audit. Therefore, we could not conclude on whether the accounts' payable are complete and correct.
- 4.2 The Local Council should regularly obtain statements from its suppliers and reconcile the balances shown therein with the balances shown in its own books of accounts. Any variances found should be investigated and the necessary actions taken to reconcile the balances. It is especially important that statements are obtained as at year-end and kept so that we can refer to them during our audit testing.

### **5.0 INCOME.**

- 5.1 When testing the income, we came across two items that should have been accounted for as deferred income rather than as income for the year. The first item related to a grant received of €4,345 relating to a project for an irrigation system which project has not yet been carried out. The second item was CIES income relating to 2020 amounting to €10,149 that was received in advance. Audit adjustments were passed to transfer these items to under deferred income.

- 5.2 Before accounting for any funds received, it is important that one checks the supporting documentation available and treat that income accordingly. If the income relates to future projects, then it should be deferred to be matched against the related costs that would be incurred in the future.
- 5.3 Whilst browsing through the nominal accounts relating to income, we came across an instance where the revenue of €955 generated from the sale of stamps, was posted under other income instead of in the account specifically opened for this income.
- 5.4 Every income received should be properly analysed and posted in the correct income account to ensure that it is properly classified and presented in the financial statements, as well as to ensure comparability from one year to the next.
- 5.5 While performing the test of reasonableness on the rental income, we have noted a variance of €424 between the rental income as per books of accounts that amounted to €4,924 and the rental income we arrived at based on the rental agreements in place, that amounted to €4,500. Given that the variance was not deemed material, no further checks were carried out.
- 5.6 The Local Council should carry out this quick check to confirm the correctness of the income being recognised in the accounts and to ensure that the accrued rental income being accounted for is not overstated.

## 6.0 **EXPENDITURE AND TENDERS**

- 6.1 As in previous years, we noticed that the Local Council does not draw up a purchase request or a purchase order in line with the Local Councils (Financial) Procedures. It is understood that at times the urgency of matters might require as little bureaucracy as possible, however we are still of the opinion that the necessary paperwork should have been compiled in line with the financial procedures.
- 6.2 We highly recommend that the Council should strictly adhere to all the Local Councils' Procedures applicable to all Local Councils in full.
- 6.3 The Local Council has exceeded the budgeted expenditure under the following headings:
- 6.3.1 Rent (Category 2400) by €94
  - 6.3.2 National and international memberships (Category 2500) by €354
  - 6.3.3 Transport (Category 2700) by €2,069
  - 6.3.4 Contractual services (Category 3000) by €6,859
  - 6.3.5 Hospitality and community (Category 3300) by €9,971
- 6.4 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.
- 6.5 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.
- 6.6 When testing a sample of the expenses, an instance was noted where the Local Council did not obtain the VAT fiscal receipt. This expense amounted to €1,680.

- 6.7 We recommend that the Council should chase suppliers for the VAT fiscal receipts and if they repetitively don't give the receipt, then the Council should withhold the payments until the VAT fiscal receipt for payments already affected is given.

## **7.0 PERSONAL EMOLUMENTS**

- 7.1 When checking the computation of the Mayor's honoraria and allowances, we noted that there was an overpayment of €400.
- 7.2 When computing the payroll, it is important that the Local Council follows the instructions issued by the Department through the Circulars from time to time. During the current year, Circular 14/2019 and Circular 20/2019 were issued with respect to the Mayor's honoraria and allowances, amongst other things. The effective dates of the changes should be abided with.

## **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 €18,645. This implies that the Council does not have enough current assets to support its current liabilities.
- 8.2 The current ratio is €0.98 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 €0.93 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 further capital expenditure 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 6.65% which falls 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 the 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, to avoid such a negative Financial Situation Indicator. Moreover, it is recommended that the Council obtains the necessary clearance from the Department for Local Councils if it anticipates a Financial Situation Indicator level which will fall below the 10% threshold in future years.



### **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.