

RSM MaltaMdina Road,
Haż-Żebbug, Malta
ZBG 9015

T: +356 2278 7000

www.rsm.com.mt

24 May 2024

Local Council Ghajnsielem
J.F Chambray,
Ghajnsielem GSM 1501,
Gozo

Dear Mayor,

RE: MANAGEMENT REPORT – FOR YEAR ENDED 31 DECEMBER 2023

We have completed our audit of the financial statements of the Local Council Ghajnsielem for the year ended 31 December 2023. 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 13 of this report.

During the course of our audit for the year ended 31 December 2023, 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.

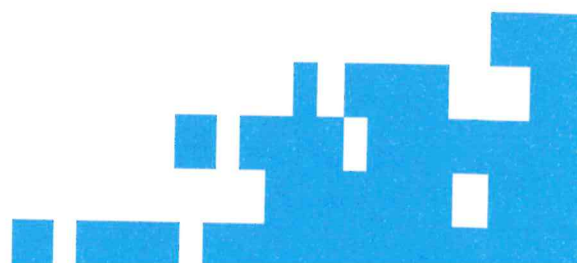
We would like to take this opportunity to thank the Executive Secretary and the Council Staff for their assistance during the course of our audit.

Yours faithfully

Conrad Borg (Principal)
for and on behalf of
RSM Malta**THE POWER OF BEING UNDERSTOOD**
ASSURANCE | TAX | CONSULTING

Management Report for the year ended 31 December 2023

| Contents | Page |
|--|------|
| Follow-up to last year's Management Report | 3 |
| Property, plant and equipment | 5 |
| Receivables | 8 |
| Cash and cash equivalents | 8 |
| Payables | 9 |
| Expenditure and Tenders | 10 |
| Financial situation indicator | 11 |
| Other Matters | 12 |
| Responsibility Statement | 13 |



1.0 Follow-up to Last Year's Report

1.1 Property, plant and equipment

During the previous audit, several weaknesses relating to the property, plant and equipment had been identified namely:

- During the exercises carried out by the Local Council on the fixed assets register in 2012 and in 2017, variances were found that were simply written off without the necessary justifications. The method used for the building up of the new fixed assets registers was not reliable.
- The fixed assets register lacked certain important details and excluded assets fully written off.
- The adoption of Directive 01/02017 was not properly carried out.
- The net book value of the fixed asset register was not reconciling to the amount shown in the financial statements.
- Grants not yet received relating to a completed project were not accrued for whilst in another case, the grants accrued for exceeded the amount the Council was eligible for.
- No accrual was made to reflect the costs related to an ongoing project.
- For one of the completed projects during the year, revised and additional invoices were issued after the end of the year, and these were not reflected in the accounts.

During the year being reviewed, the issues mentioned above still existed except for the last two points.

1.2 Receivables

The below issues were noted last year with respect to the receivables:

- A variance was noted between the balance shown in the accounts and the balance confirmed for the account receivable tested resulting from the fact that the Council sent the invoices late.
- The provision for doubtful debts was understated.
- Accounted within the prepayments, was a bank guarantee that had to be reclassified.

The above issues were not encountered during the current year.

1.3 Payables

During the previous audit, several weaknesses relating to the payables had been identified namely:

- From the eleven samples chosen to test the accounts payable, no statements or confirmations were received by the time that the audit was concluded, despite the regular chasing made.
- All deferred income was being shown under current liabilities when some should have been presented under non-current liabilities.
- In the list of accounts payable we noted a negative balance, representing a payment in advance to a foreign supplier, that was not reclassified to under the receivables.
- Invoices were noted within the expenses accounts which related to previous years but for which no accruals were made in their respect in the previous years.
- Accruals as at the end of the year were understated.

During the year under reviewed, the issues mentioned above still existed with the exception of the first two points.

1.4 Income

In the prior year, an amount pertaining to the adjustment fund from the financial allocation was accounted for under supplementary government income.

No such issue was noted in the current year.

1.5 Expenditure

During the previous audit, the following weaknesses have been highlighted:

- Actual expenditure in certain categories exceeded the budgeted expenditure.
- Purchase requests and purchase orders were not prepared regularly.
- For the majority of the samples chosen to test expenditure, evidence was not provided to confirm whether the procurement procedures were properly followed.

All these weaknesses were encountered again this year.

1.6 Personal Emoluments

When testing the personal emoluments, a difference was noted between social security contributions per the FS7 and the social security contributions as recorded in the books.

No such instance was identified in the current year.

1.7 Other Matters

In the prior year, it was noted that no legal reply was received from the Council's lawyer up until the end of the audit. This was also the case in the current year.

2.0 PROPERTY, PLANT AND EQUIPMENT

- 2.1 During 2012, the Local Council outsourced the exercise of building the fixed assets register from scratch. One of the problems encountered in this exercise was the fact that the Council had no Sage backups of the accounts prior to the year 2008 since there was a change in the Council's accountant and apparently, he had the backups on his personal computer which were never given to the Local Council. We were given to understand that the procedure adopted was that the Council staff went around the Council premises and the urban areas within the locality to take note of the assets and then gathered all the relevant documents that could be found about the items of property, plant and equipment of the Council. As for the road resurfacing, the executive secretary contacted the architect who was responsible for the roads which were resurfaced by the Council from 1994 onwards and the costs connected to such works were taken from the final architect certification obtained. As for the Council premises, the Council listed all the assets present in the new civic centre and agreed them to the nominal ledger.
- 2.2 The method used by the Council created discrepancies in relation to the 2011 audited financial statements and the difference between the register and the nominal ledger has been accounted for as an impairment through a prior year adjustment. The following were the variances noted:
- 2.2.1 The closing cost of property, plant and equipment as per the audited financial statements for the year ended 31st December 2011 amounted to €1,046,654 whilst the new opening cost as at 1st January 2012 amounted to €889,317. This means a difference of €157,337 out of which €1,108 represented a reclassification to under intangible assets.
 - 2.2.2 The accumulated depreciation as per the audited financial statements for the year ended 31st December 2011 amounted to €484,800 whilst the new opening accumulated depreciation as at 1st January 2012 amounted to €361,049. This means a difference of €103,751 out of which €330 represented a reclassification to under intangible assets.
 - 2.2.3 The resulting net figure after removing the reclassified amounts was €52,808. This amount has been passed as a prior year adjustment without an indication as to which assets the amounts written off related to.
- 2.3 Moreover, the new fixed assets register still lacked important details with respect to the new civic centre. A one-line item under the buildings category showed the total balance of all the construction works, electrical works and other expenditure incurred in the building of the new civic centre. It is understood that the Council grouped all the assets together as one asset since the civic centre was capitalised wholly. During our audit visit, we were then provided with an itemised list on MS Excel.
- 2.4 The method used for the building of the new fixed assets register as described above, creates several problems. There is no assurance that the costs taken for the individual items of property, plant and equipment are all correct. It is very possible that items have been left out from the register even though they are still in existence and in good condition. There is no assurance that the new calculation of the depreciation of the assets was carried out correctly by commencing the depreciation calculation from the correct date. The new register still lacks sufficient details to ease the traceability of the different assets.

- 2.5 Furthermore, since the above exercise was carried out, the fixed assets register was not being regularly updated. During 2017, another exercise to update the fixed assets register was carried out. Again, variances arose in both costs and depreciation that were written off without there being a real justification. The most material write offs related to the assets under construction as at 31 December 2016 amounting to €30,488 and the accumulated depreciation of the 'Special Programmes' category of €32,919. No justification was obtained for the former adjustment other than because no details were available about what the assets under construction were.
- 2.6 Due to the materiality of the amounts involved and the number of uncertainties in the new valuations of the Local Councils' property, plant and equipment, we had to qualify our audit report.
- 2.7 The current fixed assets register furthermore does not contain details of the costs, accumulated depreciation and grants of the assets fully written off. It only contains a description of some of these assets. Should the Local Council dispose of, or would need to write off, any of these fully depreciated assets, the information would not be available to pass the necessary adjustments in the accounts.
- 2.8 It is recommended that an exercise is carried out to identify the variances that arose between the accounts and the register during the two exercises that were carried out in 2012 and 2017, which variances were simply written off from the accounts. 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. Assistance might be sought from the previous and current auditors of the Local Council, for any possible information that they might have which for some reason is not available at the Local Council. If the correct costs, accumulated depreciation and grants 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.
- 2.9 Furthermore, we highly recommend that the Council obtains copies of the accounts' backups for the periods before the year 2008. Kindly note that the Council is obliged to have such backups available at its offices.
- 2.10 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:
- 2.10.1 Items of property, plant and equipment whose useful life expired were not written off upon the adoption of the new depreciation accounting policy.
- 2.10.2 The depreciation is not being worked out on the remaining useful life of the assets.
- 2.10.3 Grants received for specific projects, were allocated to several items of property, plant and equipment rather than those specific projects, clearly indicating that the allocation of grants to the respective assets was not properly carried out.

- 2.10.4 As at 31 December 2017, the Local Council had deferred income amounting to €101,363 relating to three different projects that were not yet carried out as of that date. Yet, we noticed that when the comparative figures were restated following the change in the accounting policy on government grants, these grants were still allocated against property, plant and equipment rather than left under deferred income. The projects were then completed in subsequent years.
- 2.11 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. It is also to be ensured that grants are allocated to the correct projects given that some grants were capitalised before the projects were carried out and hence were allocated to projects which they did not intend to cover.
- 2.12 We noted that the net book value, additions and depreciation charge for the year disclosed in the fixed assets register, consisting of both the property, plant & equipment and the intangible assets, do not reconcile to the same corresponding figures disclosed in the financial statements by €82,940, €34,652 and €15,782 respectively.
- 2.13 We recommend that the fixed assets register is updated with all the correct and complete information about the fixed assets to reconcile with the amounts disclosed in the books and those presented in the financial statements, as this might subsequently impact the depreciation charge that is being calculated and accounted for.
- 2.14 When testing the additions of property, plant and equipment, and the related capitalised grants, we noted the below:
- 2.14.1 The Council accrued for costs as at the end of the year with respect to the Pjazza Tolfa Project of €79,578 for which it had no support. Therefore, it was agreed to reverse the accrual. The grants relating to the Pjazza Tolfa Project were also over accrued for by €35,955. Therefore, the accrued income and the capitalised grants were adjusted accordingly.
- 2.14.2 The reversal of an opening accrual amounting to €5,841 relating to Measure 4.4 Rubble Walls was incorrectly posted in the account related to Xatt l-Ahmar. A reclassification adjustment was passed to correct this error.
- 2.14.3 Within the grants capitalised in relation to the assets under construction, the Council incorrectly accounted for an addition of €6,525 which related to other assets. Therefore, we reclassified €5,487 under grants relating to urban improvements and €1,038 under grants relating to special programmes, to match with the expenditure they intended to cover.
- 2.15 We recommend that before posting transactions relating to property, plant and equipment, one should understand exactly to what the invoice or grant relates to, to ensure that each item is posted in the correct amount. This would ensure that the information about the Council's property, plant and equipment is properly presented in the notes to the financial statements. Furthermore, any amounts accrued for should be supported with adequate documentation.

- 2.16 When checking the capitalised grants relating to the Learning Garden project which was fully completed during the year, we noted that the amount of income accrued for was more than the amount covered by the various agreements relating to this project. Therefore, an adjustment of €45,156 was passed to reflect the correct accrued income and the correct amount of grants to be capitalised.
- 2.17 Where grants are concerned, the principles of IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance, are to be correctly applied using the capital approach in line with the accounting policy adopted by Local Councils. The Council should be aware of what costs have been capitalised for which the Council has received, or will receive, grants in accordance with agreements made, and should immediately reflect the correct related grants under the property, plant and equipment after considering the applicable terms and conditions as per agreement.

3.0 RECEIVABLES

- 3.1 During our testing on the accrued income, the below matters were noted:
- 3.1.1 During the year, the Council received funds in relation to the Corallo Project amounting to €37,233. As at the end of the year, the Council accrued for funds that were yet to be received with respect to the project. However, we noted that the amount accrued for was higher than both the amount agreed in the funding agreement and the expenditure incurred with respect to this project. Therefore, the excess amount of €47,703 was reversed.
- 3.1.2 The Local Council carried out additional works relating to the Qighan Project, which works were also covered by the funding agreement but were not yet received by the Council and have not been accrued for as at the end of the year. Hence, the amount of €54,254 yet to be received was recorded in the accrued income and capitalised in the grants account.
- 3.2 We recommend that the Local Council maintains a list of all projects undertaken together with the relevant details of their status, invoices issued, payments made and details of the respective grant agreements, including amounts of grants received. Reference should then be made to this list when calculating the funds yet to be received and that must be accrued for as at the end of the financial year.

4.0 CASH AND CASH EQUIVALENTS

- 4.1 It was noted that towards the end of the year, the available petty cash was fully utilised and there were no available funds in the petty cash box. To meet the day-to-day petty cash acquisitions, the Executive Secretary started paying for any expenses which were needed at the time from her own money. Since only the petty cash payments were being recorded in the accounts, the petty cash account as at the end of the year ended with a negative balance of €99. It was agreed to reclassify this balance to under amounts payable to the Executive Secretary, under the liabilities.
- 4.2 It is recommended that the petty cash is regularly monitored and when the petty cash balance starts nearing its end, a cheque is issued in a timely manner to top up the petty cash balance accordingly.

5.0 PAYABLES

- 5.1 For two of the samples chosen for the testing of the accounts payable, the amounts as per the accounts payable's list and the balances shown in the supplier statement or confirmation received, were not agreeing. For one of these instances, the difference was traced. It resulted from the double posting of an invoice amounting to €54,432. This error was adjusted for during the audit. In the other instance, a difference of €68,570 was noted. No reconciliation or explanation was provided by the time we concluded our audit and since the difference was material, we had to qualify our audit opinion in this respect.
- 5.2 We recommend that the Local Council should ask its suppliers to provide it with statements at least at the end of the financial year, as we were given to understand that most of the suppliers do not send any statements. Statements received are to be reconciled with the balances shown in the books of accounts. These statements are to be made available to the auditors during their audit. It is also important that care is taken when posting entries in the accounting system to avoid any double postings. The Council should have a system that easily identifies that an invoice has already been posted.
- 5.3 When analysing the list of the accounts payable, we noted a negative balance of €1,790, which according to the Executive Secretary represented a payment in advance to a foreign supplier. It was noted that this negative balance was already there at the end of the previous financial year. A reclassification adjustment was passed to reflect such balance under the other receivables.
- 5.4 It is important that any negative balances within the payables, are properly reclassified for presentation purposes to be shown under the correct category in the financial statements.
- 5.5 During our testing on the accruals, we noted three amounts that were omitted from the accruals. These were €1,180 relating to a social event, €1,032 relating to water and electricity and €505 relating to another social event. An adjustment was passed to reflect these accruals.
- 5.6 Expenses should be accounted for in the year to which they relate. The Local Council should be aware of the services and products acquired for which no invoice would have been received by the end of the year, and an accrual is to be accounted for until the actual invoice is received.
- 5.7 When browsing the accounts, we noted invoices dated in 2022, amounting to €4,499, which were accounted for in the current year.
- 5.8 The Local Council should ensure that all invoices are recorded in the financial year in which the invoices are issued to ensure that the liabilities are not understated, together with the respective expenditure.
- 5.9 During our testing, it was noted that an amount of €453,066, representing 50% payment received in advance relating to the Project Green, was capitalised under property, plant and equipment when the project was not yet started. From discussions held with the Executive Secretary, it transpired that this project will be done in 2025. For this reason, it was agreed to transfer this amount from capitalised grants to non-current deferred income.
- 5.10 We recommend that the Council properly checks to what the funds received relate to and any advance payments received relating to projects which are not yet done, are accounted for under deferred income until such time that the projects are done.

6.0 EXPENDITURE AND TENDERS

- 6.1 It was noted that the Council has exceeded the budgeted expenditure for several categories, namely:
- 6.1.1 Public & Office Utilities (Category 2100) by €2,090
 - 6.1.2 Materials and supplies (Category 2200) by €28,037
 - 6.1.3 Rent (Category 2400) by €6,386
 - 6.1.4 Office services (Category 2600) by €7,692
 - 6.1.5 Transport (Category 2700) by €3,046
 - 6.1.6 Travel (Category 2800) by €2,869
 - 6.1.7 Information Services (Category 2900) by €2,093
 - 6.1.8 Contract & Project Management (Category 3100) by €23,816
 - 6.1.9 Training (Category 3200) by €1,263
 - 6.1.10 Hospitality (Category 3300) by €38,149
 - 6.1.11 Provisions (Category 3900) by €9,732
- 6.2 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.
- 6.3 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/year such discrepancies would not materialise.
- 6.4 During our testing on the expenditure, we encountered two instances where we were not provided with a tax invoice, but rather a letter was provided to support the amount paid. The value of these payments amounted to €4,950.
- 6.5 We recommend that the Local Council always asks for a tax invoice from its suppliers and does not affect any payments until a tax invoice is received and checked for its correctness.
- 6.6 When browsing the expenses accounts, it was noted that an opening accrual amounting to €3,000 was reversed as the invoice was issued during the year, however, was posted in the social events account rather than in the refuse collection account.
- 6.7 It is being recommended that when reversing prior year accruals, the invoice that would have been received covering that accrual, is properly traced in the expenditure accounts to ensure that the reversal of the accrual is posted in the same nominal account to set off the two amounts.
- 6.8 The Local Council rents a garage to be used for storage. The Council did not carry out the assessment under IFRS 16 – Leases, to quantify the value of the right of use asset and the corresponding lease liability. It just accounted for the rent paid as an expense for the year. From an analysis that we carried out, it transpired that the computed amounts fall under the materiality level.
- 6.9 It is recommended that whenever the Local Council enters into a rental agreement, it should carry out the necessary analysis to check whether the agreement falls under the scope of IFRS 16 – Leases. If it does, the value of the right of use asset and of the lease liability are to be computed and the agreement is to be accounted for accordingly.

- 6.10 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 this practice.
- 6.11 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.
- 6.12 From the samples chosen for the testing of the expenditure, the following deviations were noted from the requirements of the Local Councils Financial Procedures.
- 6.12.1 Only one quotation was obtained for the provision of goods relating to the playing field project mainly for stainless steel works by Edwin Gantar and the supply of plants and landscaping by IO Projects Ltd.
 - 6.12.2 Goods and services were acquired from Perit Godwin Sultana, Aurelio Bugeja and Rapa Stores through direct orders.
 - 6.12.3 Services were rendered to the Local Council by Ghaqda Piroteknika 10 ta' Dicembru through direct orders. According to the Executive Secretary, this was the only available supplier for the specific services which were needed.
 - 6.12.4 We also noted that, when direct orders were issued by the Executive Secretary no documentation was retained to justify the reason as to why direct orders were used rather than quotes being obtained.
- 6.13 Not following the procurement procedures, goes against the Local Councils Financial Procedures that the Council should abide with. Therefore, we strongly recommend that the Council should maintain evidence that the procurement procedures have been followed and if there were instances where these were not followed, it should take immediate action to ensure that such occurrences are not repeated in the future.

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 7% which falls below the 10% threshold required by the Financial Provisions to the Local Councils Act. Kindly note that a Financial Situation Indicator which falls below the 10% margin implies that the Council is 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) after providing for cash and cash equivalents that are restricted to specific projects not yet carried out.
- 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.

8.0 OTHER MATTERS

- 8.1 No legal reply was received from the Council's lawyer up until the end of the audit. Due to this, we could not assess whether there were any potential contingent liabilities to be disclosed within the financial statements, other than the case mentioned in the respective note.
- 8.2 We recommend that the Local Council should inform its lawyer that such a request will be made by its auditors on an annual basis and explain that a response is required as part of the audit process
- 8.3 When we were provided with the financial statements for the audit, we noted that the amendments to International Accounting Standard 1 – Presentation of Financial Statements, relating to the disclosures of the accounting policies, effective for annual periods beginning on or after 1 January 2023, were completely ignored.
- 8.4 The Local Council should be knowledgeable of the new and amended International Financial Reporting Standards as adopted by the European Union and should ensure that where applicable, any new requirements and amendments are implemented as from the effective date.

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.

