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02 May 2023

Il-Munxar Local Council
Profs. Guze Aquilina Street,
Munxar VCT 114
Gozo

Dear Mayor

RE: MANAGEMENT REPORT FOR THE YEAR ENDED 31 DECEMBER 2022

We have completed our audit of the financial statements of the Il-Munxar Local Council for the year ended 31 December 2022. 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 2022, 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 clerk for their assistance during the course of our audit.

Signed

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

REGISTRY
-5 MAY 2023
NATIONAL AUDIT OFFICE

Munxar Local Council

Management Report for the year ended 31 December 2022

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1.0 FOLLOW-UP TO LAST YEAR'S REPORT

1.1 Property, plant and equipment

Last year we noted that Directive 01/2017 was not properly applied, and the following weaknesses were pointed out:

- Items of property, plant and equipment whose useful life expired were not written off.
- Depreciation for the year has been applied on the carrying values as at 1 January 2018 at the applicable depreciation rates as if the assets' useful lives started in 2018.
- The cost column in the fixed asset register reflects the total cost of property, plant and equipment less the grants and no date of acquisition was recorded in the same register.

This year the situation remained the same.

Furthermore, the following weaknesses were noted in relation to ongoing projects:

- The amount of grants capitalised and released from the deferred income with regards to two capital projects were understated due to the Council not having yet received all the funds.
- For another project, grants were not being capitalised in line with the amount of costs capitalised within the property, plant and equipment.

Similar instances were noted during the current year.

1.2 Payables

In the prior year, we noted that an accrual relating to the rent of the basement from the Housing Authority was increasing year on year due to their being no lease agreement signed by the parties and no invoices being issued. During the year under review, there was no update in this regard.

It was also noted that an accrual was being taken in relation to lease agreements that expired and for which no new agreements had been entered into. This is still applicable for the current year.

1.3 Income

During last year's audit, we noted that the Local Council recognised a lower income with respect to a lease agreement with HSBC Bank Malta p.l.c as a result of transactions being recorded in the incorrect account. No such instance was noted this year.

1.4 Expenditure and Tenders

Last year, it was pointed out that the Council has exceeded the budgeted expenditure in certain categories. During the current year, some expenditure still exceeded the budget.

It was also noted that the Local Council had lease agreements which met the criteria of IFRS 16 and in relation to which no assessment had been carried out. No such instance was noted during the current year.

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, 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:

2.1.1 Items of property, plant and equipment whose useful lives 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.

2.1.2 Depreciation has been applied on the carrying values as at 1 January 2018 at the applicable depreciation rates as if the assets' useful lives started in 2018.

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 if material. 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 items of property, plant and equipment found in the fixed assets register provided to us, do not have the date of acquisition recorded. This means that we could not identify which assets should have been fully depreciated as at the end of the financial year. Furthermore, we noted that the cost column reflects the total cost of property, plant and equipment less the grants. This means that if an asset has been fully covered by grants received, there is no track of such an asset in the register. If the asset is disposed of one day, it would be difficult to trace the information about its cost and the grants received to remove them from the accounts.

2.4 We highly suggest that the Council should register the acquisition date of every asset in the fixed assets register. The Council should also adopt a system through which information about those assets for which grants have been received is maintained, unless it can use the fixed assets register itself to keep such information.

2.5 During the year under review, we noted that the funding for the GAG3 projects – 'Enhancing the Localities Environmental, Cultural and Artistic Value', covered both capital projects to be undertaken by the Local Council alone. as well as events that were to be sponsored in full or in part by third parties. Accordingly, an exercise was conducted to identify which costs pertain to the capital project and to determine the grants to be capitalised in its respect. This resulted in the following adjustments being passed based on certifications issued by the architect in relation to the capital project, which amounts were not accounted for in the books:

2.5.1 Assets under construction and the related grants were capitalised amounting to €66,920 and €65,582 respectively; and

2.5.2 Accrued income and deferred income were adjusted since both were overstated by €10,297 and €11,635 respectively.

2.6 We also noted that in the case of the GAGF project – 'Valorising Gozo's Potential and the Quality of Life for Young Persons and Young Families', the total amount of grants capitalised and released from the deferred income was understated due to the Council not having yet received all the funds. Consequently, the amount €13,212 was accrued for whilst €12,132 was released from deferred income as it represented the portion of the cost covered by grants received.

2.7 Moreover, we noted that with respect to one of the expenditure incurred in relation to the GAGF project, the Council has netted off the cost incurred with the respective grant. Consequently, an adjustment was passed to capitalise these amounts separately within the property, plant and equipment of the Council. The total costs and grants capitalised amounted to €18,192.

2.8 It was also noted that in the case of Torri Xlendi not enough grants were capitalised to cover the amount of costs accounted for within property, plant and equipment due to such funds not yet having been received. As a result, the amount of €10,288 was accrued for.

2.9 Several projects were classified as completed without the work being certified by the architect. As a result, a reclassification adjustment amounting to €243,043 was passed to retain all such projects under assets not yet completed until they are certified.

2.10 It was also noted that grants pertaining to assets not yet completed were classified under the incorrect grant accounts and as such a reclassification adjustment amounting to €547,182 was passed to reflect such amount under the correct assets category.

2.11 We recommend that the Council performs a thorough review of all the status of its projects and ascertain that the respective grants are recognised in line with each respective grant agreement, if applicable, as the project costs are capitalised, in accordance with IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance. The Council should also be aware of costs incurred with respect to capital projects for which no invoices would have yet been received and the necessary accruals should be reflected in the books of accounts.

2.12 We have requested a report from the architect about the projects that were completed during the year ended 31 December 2022 and the projects that were ongoing as of that date. This report was not received by the time of issuing this report. Consequently, we could not confirm whether there should have been any accruals as at 31 December 2022 relating to such projects that have not been reflected in these financial statements, which would result in an understatement of the accruals and of the property, plant and equipment.

2.13 We recommend that when closing the books of accounts, the Council asks for the architect's letter to be able to determine whether any further accruals are to be reflected with respect to ongoing projects as at the end of the year and to also ensure that projects are properly categorised between those completed and those still ongoing.

3.0 PAYABLES

3.1 When testing the accruals, we noted that the Council has an accrual relating to the rent of the basement under the Council's offices from the Housing Authority that has been increasing from one year to the other. When we enquired why this accrual is always increasing and never invoiced, we were told that this is since there is no agreement in place between the Local Council and the Housing Authority. The annual rent being accrued for is €2,446.

3.2 We recommend that the Local Council should approach the Housing Authority and ensure that an agreement is signed between the two parties for the rent of the basement under the Local Council's office, clearly specifying the applicable terms and conditions.

3.3 We also noted that accruals are being accounted for in respect of two lease agreements which covered a period of 3 years, and which were automatically renewable for a further 3 years unless either party wished to suspend the arrangement. Both renewable periods have expired and no update to the lease agreement has been made.

3.4 We recommend that the Local Council approaches the lessors and ensures that the agreements are brought up to date or a document referring to the renewal of such agreements be drafted and signed.

3.5 We noted that all deferred income was being shown under current liabilities. After our review of the projects to which such deferred income pertains to, it was agreed with the Executive Secretary that an amount of €205,250 be reclassified as non-current given that the projects to which they relate, were either still in the tender stage or yet to start the process and the projects not planned to be done during 2023.

3.6 We recommend that at the end of the year, an analysis of the timing of each project be performed to ascertain whether the deferred income relating to the project, is correctly classified in the financial statements.

4.0 INCOME

4.1 During the year under review, we noted that the amount of €6,283 pertaining to the adjustment fund from the financial allocation has been accounted for under supplementary government income. The amount was reclassified together with the remaining amount allocated in terms of Article 55 of the Local Councils Act for presentation purposes.

4.2 Care should be taken when posting the transactions in the books of accounts to ensure that each transaction is posted in the correct nominal ledger, that will consequently lead to correct presentation in the financial statements.

5.0 EXPENDITURE AND TENDERS

5.1 The Council has exceeded the budgeted expenditure under the following headings:

- 5.1.1 Public & Office Utilities (Category 2100) by €921
- 5.1.2 Repairs & Upkeep (Category 2300) by €19,875
- 5.1.3 Rent (Category 2400) by €834
- 5.1.4 Memberships (Category 2500) by €90
- 5.1.5 Office Services (Category 2600) by
- 5.1.6 Professional services (Category 3100) by €1,380
- 5.1.7 Hospitality (Category 3300) by €85,822

5.2 The Financial Procedures applicable for Local Councils require Councils to draw up twelve (12) months budgets, three (3) year 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 During the year under review, it was also noted that in the case of the procurement of five different services, the procurement policies in place were not followed as no approval from the Department for Local Government was obtained before giving direct orders to the suppliers.

5.5 It is understood that at times, the urgency of matters might 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.

6.0 PAYROLL

6.1 During the year under review, we have noted discrepancies between the FS5s and the FS3 of €718 in the gross emoluments and of €118 in the fringe benefits.

6.2 We suggest that on an annual basis, a reconciliation is performed between all the FSS forms to ensure that they all tally with the accounting records and between themselves before submitting them to the Commissioner for Revenue.

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.