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12th June 2026

Il-Munxar Local Council
Profs. Guze Aquilina Street,
Munxar MXR 1012
Gozo

Dear Mayor

RE: <u>MANAGEMENT REPORT FOR THE YEAR ENDED 31 DECEMBER 2025</u>

We have completed our audit of the financial statements of the Il-Munxar Local Council for the year ended 31 December 2025. 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 9 of this report.

During the course of our audit for the year ended 31 December 2025, 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.

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

Munxar Local Council

Management Report for the year ended 31 December 2025

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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.

No action was taken on the above matter.

The below weaknesses were also noted with respect to property, plant and equipment:

- The cost column in the fixed assets register reflects the total cost of property, plant and equipment less the grants meaning that fully funded assets are not reflected.
- The fixed assets register does not show the acquisition dates of all the items of property, plant and equipment.
- The fixed assets register did not tally to the figures shown in the unaudited financial statements.
- Various grants relating to activities, were incorrectly capitalised within property, plant and equipment, and were adjusted during the audit.
- There were items of property, plant and equipment, as well as grants, that were classified under the wrong assets' categories.
- Prior year audit adjustment pertaining to a project that affected only the statement of financial position were not passed in the accounts during the year in relation to grants leading to incorrect balance.
- No explanation provided to us for an adjustment made relating to the property, plant and equipment.

The above weaknesses, other than the last three, were encountered again during this year.

1.2 Receivables

During our audit, we noted that the prepayments as at the end of the year were accounted for twice. As a result, we have passed an adjustment to reverse the double entry made.

The above matter was not encountered during this year.

1.3 Cash

The below weaknesses were noted with respect to cash:

- When checking the bank reconciliation of the HSBC bank account, we noted that the book balance shown in the bank reconciliation report did not match the balance in the books of accounts.
- When going through the list of unpresented cheques listed in the bank reconciliation report, we noted an unpresented cheque that had become stale and should have been reversed.
- When reviewing the nominal ledger relating to the petty cash, we noted two instances where the Council has made cash payments which were higher than the limit of €50.

The above matter was not encountered during this year, except for the last one.

1.4 Payables

In the prior year, we noted that an accrual relating to the rent of the basement under the Council's office from the Housing Authority, was increasing every year since 2008 as there is no lease agreement in place and no invoices are being issued to the Council.

We have also noted another accrual relating to rent whereby the related two lease agreements expired and they were never renewed.

The above matters are still unresolved during the current year.

1.5 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 in certain instances, the procurement procedures and policies in place were not followed. Similar instances were encountered this year.

1.6 Payroll

We had noted discrepancies between the gross emoluments reported in the FS5s and those reported in the FS7.

When browsing the accounts relating to payroll costs, we noted that the salary of the executive secretary was accounted for in the employees' salaries account rather than in the nominal account specifically available for the executive secretary's salary. A reclassification adjustment was passed to reflect the executive secretary's salary in the appropriate nominal account.

The last weakness was identified again during the current audit.

1.7 Other matters

Not all the audit adjustments passed during the previous year's audit were reflected in the accounts of the Local Council, particularly those affecting only the statement of financial position. This was encountered during the current year.

The financial statements provided to us for the audit, did not reflect 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. This year, such amendments were reflected.

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:

- 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.

- 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 While reviewing the fixed assets register, it was noted that the figures in the fixed assets register did not tally to the figures shown in the unaudited financial statements. The following variances, before passing any audit adjustments, have been noted:

- The total cost as per the fixed assets register amounted to €871,860 whilst the total cost as per financial statements, excluding the assets under construction, amounted to €4,546,438.

- The total accumulated depreciation, including grants, as per the fixed assets register amounted to €218,928 whilst the depreciation and grants as per financial statements amounted to € 4,416,919.

- The net book value as per the fixed assets register amounted to €128,556 whilst the net book value as per financial statements, excluding the assets under construction, amounted to €129,519.

One can notice that when the accumulated depreciation is deducted from the total cost in the fixed assets register, the resulting net book value should be €652,931 whilst the shown net book value is €128,556. This resulted since for some of the items, the cost was included and then the accumulated depreciation was left as nil, and the net book value was also somehow marked as nil. If these assets were fully depreciated, then the accumulated depreciation should be equal to the cost.

2.6 We recommend that a proper fixed assets register is built that would contain complete details of every item of property, plant and equipment of the Local Council, including the grants allocated to certain assets. 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.

2.7 We also noted that capitalised grants relating to different categories of assets were accounted for in an account named grants relating to ANYC. Consequently, we passed adjustments to reclassify such grants and show them under separate nominal accounts depending on the assets category. These reclassifications amounted to €73,298 in relation to opening balances and €261,251 in relation to new grants during the year.

2.8 It is important that separate nominal accounts are maintained for the capitalised grants to keep them separate in line with the different categories of assets. This would ensure better monitoring of the grants relating to each class of assets and facilitates the preparation of the note disclosed in the financial statements relating to property, plant and equipment.

2.9 When testing the capitalised grants, the below errors were noted:

- A prior year audit adjustment relating to the grant amounting to €944 for Skemi Regjonali Librerijí fil-lokalita was not passed in the books. As such, we passed again such adjustment to conform with the prior year balances.
- A grant amounting to €30,801 relating to The Restoration and Conservation of Xlendi Tower, which was already completed in 2022, was received during the year. Such grant was not accrued in the prior year as the Council had no idea that they will receive the same.

2.10 We highly recommend that the Local Council takes more care when accounting for grants received and should distinguish between those grants that are related to capital projects that are to be capitalised if the project is done and those related to activities and therefore should be accounted for in the statement of comprehensive income to match them with the expenditure incurred they intend to cover. It is to be ensured that the Council abides with the requirements of IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance. Furthermore, the Council should always monitor the grants that should be reimbursed so that all accrued income will be accounted for in the books.

3.0 RECEIVABLES

3.1 For one accrued income sample relating to the Extra Summer Cleaning programme in Xlendi, no written grant agreement was provided to support the accrual. The Local Council explained that the arrangement was based solely on a verbal agreement. The absence of a written agreement weakens the recognition of accrued income and increases the risk that the income recognised is not enforceable or recoverable. This may result in misstatement of accrued income balances and exposes the Council to potential legal and financial disputes in the event of disagreement over funding terms or amounts.

3.2 The Local Council should ensure that all grant-related income is supported by a formally approved and signed written agreement before income is accrued. Where activities are ongoing without a written agreement, they should obtain retrospective written confirmation of the agreed terms and conditions from the granting authority and ensure that future arrangements are formalised in advance.

4.0 CASH

4.1 When reviewing the nominal ledger relating to the petty cash, we noted an instance where the Council has made cash payments which were higher than the limit of €50.

4.2 The Local Council should abide with the Local Councils (Financial) Regulations which stipulate that payments for expenditure affected from the petty cash should not exceed the value of €50.

5.0 PAYABLES

5.1 When testing the accruals, we noted that the Local 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 and the total accrual as at the end of the year amounted to €50,823. Due to the lack of a lease agreement, we could not assess whether International Financial Reporting Standard 16: Leases is applicable to such lease.

5.2 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.

5.3 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. The total accrual as at the end of the year amounted to €9,744.

5.4 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.

5.5 We have noted that an accrual relative to street lighting includes 2022 and 2023. As per the Local Council, no invoices were received from the supplier.

5.6 We recommend that the Local Council should follow up the invoices from supplier in order to account for the final actual balances in the books and not on estimate.

6.0 EXPENDITURE AND TENDERS

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

- Public Materials & Supplies (Category 2200) by €3,020
- Rent (Category 2400) by €1,532
- Office services (Category 2600) by €2,443
- Transport (Category 2700) by €705
- Hospitality (Category 3300) by €887
- Local Enforcement Expenses (Category 3600) by €2,555
- Mayor's Allowance (Category 1100) by €3,400
- Employees' Salaries & Wages (Category 1200) by €32,058
- Social Security Contributions (Category 1500) by €739

6.2 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.

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 in order for the discrepancies would not materialise.

6.4 From the sample of expenditure items tested during the audit, we noted that several sample suppliers were issued purchase orders and are supported by invoices rather than quotations or direct orders.

6.4 We recommend that the Local Council should always adhere to the standard procurement process.

6.5 When testing the expenses, we have noted that income and costs relative to waste depot were offset in the nominal accounts 3041 Refuse Collection and 3045 Tipping fees which were not related to those accounts. We have then reclassified the income amount to general income relative to Smart Waste Depot of €87,393 and the cost amount to Contractual Services under Waste Depot of €87,206.

6.6 We recommend that the Local Council should always account for the income and costs, on a gross basis, of each project so the users of the financial statements be informed of the financial performance of the Local Council and to avoid a misleading report.

7.0 PAYROLL

7.1 When reviewing the accounts relating to payroll costs, we noted that the salaries of the Mayor and the Executive Secretary were accounted for in the employees' salaries account rather than in their nominal accounts. A reclassification adjustment of €14,903 and €40,828, respectively, was passed to reflect their salaries in their appropriate nominal accounts.

7.2 It is to be ensured that the payroll costs are accounted for in the various specific nominal accounts available that would then make it easier to prepare the note to the financial statements relating to personal emoluments.

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.