LOCAL COUNCIL PEMBROKE

Report to Management

for the financial year ended 31 December 2018

3a
MALTA

24th April 2019

The Mayor
LOCAL COUNCIL PEMBROKE
Triq Alamein
PEMBROKE PBK 1776

Dear Sir,

REPORT TO MANAGEMENT

As you are well aware, our firm has been appointed by the National Audit Office to carry out the annual audit of the financial statements of your Council. Our engagement includes the obligation on our part to prepare a report addressed to the Council, explaining weaknesses and recommendations that emanate from the review of your systems as part of our audit. You will understand that our examination cannot be expected to disclose every weakness and therefore the matters dealt with in this report are not necessarily the only shortcomings which exist. This report is intended as a source of guidance for the Council to refine its systems for better compliance, internal controls and governance. The controls will also be used by the National Audit Office to compile its own report on Local Councils.

For clarity purposes, this report is distributed to your Council, the National Audit Office and the Department of Local Councils. The contents of this report shall not be quoted in part or in full or used in any way other than for the above-mentioned scope, without our prior written consent.

During the course of our audit for the period ended 31 December 2018, we have examined the principal accounting records, systems and controls in use by the Council to enable it to ensure as far as possible, the accuracy and reliability of its records and to safeguard its assets. Additionally, we also examined the level of your Council's compliance with the Local Councils Act (1993), the Financial Procedures (1996), the various Legal Notices and Local Councils Department Memos and Circulars globally issued to Local Councils in the Maltese Islands.

We remain at the Council's disposal for any clarification required regarding this report. We shall be happy to render assistance should you decide to implement any of the recommendations.

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3A is a civil partnership duly registered as an audit firm under
the Accountancy Profession Act with warrant number AB/26/84/62

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Finally, we take this opportunity to thank the Executive Secretary, Mr Kevin Borg and his Council's administrative team for their valuable assistance and co-operation rendered to us at all times during the course of our audit.

Yours faithfully

Neville Cutajar
Partner

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The Council does not have direct control on this matter as it is dependent on third party reports and therefore it could not address this issue. In this respect, we draw your attention to paragraph 2.1 of our management report.

1.2. System of Council Income Receipting and Invoicing

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 2.2 of our management report.

1.3. Income not recorded in the appropriate accounting period

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 2.3 of our management report.

1.4. Income recognised as an increase in government grants

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 2.3 of our management report.

1.5. Classification of expenses

The Council has addressed the matter during the year under review.

1.6. Personal vehicle allowance

The Council has addressed the matter during the year under review.

1.7. Categorization of assets and depreciation thereof

The Council has addressed the matter during the year under review.

1.8. Insurance policy

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 3.2 of our management report.

1.9. The Upkeep of the Fixed Asset Register (FAR)

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 3.1 of our management report.

1.10. Reconciliation of the Fixed Asset Register (FAR) to the Financial Statements

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 3.3 of our management report.

1.11. Assets no longer used by the Council

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 3.4. of our management report.

1.12. Accounting for Intangible Assets

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1.13. Fixed Assets Labelling

The Council has addressed the matter during the year under review.

1.14. Capital Commitments

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1.15. Capital Expenditure vs Revenue Expenditure

The Council has addressed the matter during the year under

1.16. Collection of Local Enforcement fines outstanding

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 4.2 of our management report

1.17. Accounting for prepayments and accrued income

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 4.1 of our management report

1.18. Accruals

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 6.1 of our management report.

1.19. Supplier balances reconciliation

The Council has addressed the matter during the year under review.

1.20. Disclosures required in respect of certain IFRSs

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 7.1 of our management report.

1.21. Financial statements presentation

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 7.2 of our management report.

1.22. Comparison of Actuals with the Annual Budget

The Council has not addressed the matter during the year under review and we therefore draw your attention to paragraph 8.1 of our management report.

1.23. Council Minutes

The Council has addressed the matter during the year under review.

2. INCOME

2.1. Income arising from the Local Enforcement System

Observations

By the date of conclusion of our audit work, the Council had still not received the audited annual report of the Joint Committee for the period ended 31st December 2018. During the year under review, the Council has been correctly recording any cash receipts received by the Joint Committee, as well as making the distinction between LES pooling and pre-pooling receipts. Income received in relation to the former amounted to €288.97.

One also has to note that the Joint Committee function ended in August 2011 in view that from September 2011 the Local Enforcement System was delegated to Regional Committees, which delegation has now been passed to LESA as from October 2015.

Issues Arising

In view of the absence of an audited annual report for the Joint Committee as at 31st December 2018, we could not rely on third party financial information as provided by the Joint Committee to provide reasonable assurance on the amounts being recorded in the financial statements as income from the Local Enforcement System. We have qualified our audit report in this respect.

Recommendations

The Council should pressure the Joint Committee to provide audited financial statements for every financial year in order to have a basis on which to recognise all LES income due to the Council.

2.2. System of Council Income Receipting and Invoicing

Observations

We noted that the Council issues proper official receipts for the income received. However, the system used by the Council is manual based, and therefore the system does not provide a proper electronic audit trail.

Issues Arising

The current system used by the Council is working well because no major issues were identified, and all receipts issued were in sequential numerical order for ease of reference. However, it should be noted that this system could lead to errors in view of human intervention and requires more physical space to keep track and storage of the paper documents. Furthermore, more effort is needed to find information when required.

Recommendations

The Council may consider adopting an electronic based receipting system, such as ***Lornit***. Such system will help the Council to be more efficient in keeping its financial records and requires less storage space. Furthermore, this will prevent loss of data if backups of the system are done regularly.

2.3. Income recognition

Observations

It was noted that income of €100 relating to donations from various residents during the Christmas 2018 activities was dated 31 December 2018 however, it was recognised in 2019 rather than recorded within the accounts of 2018.

Issues Arising

The Council is obliged to ensure that all revenue is properly accounted for and recognised in line with the requirements of IAS 18-Revenue Recognition. Income relating to a particular year, even though it is not yet received at year end, should be estimated and accounted for as accrued income.

All such income should be accounted for appropriately in its financial statements, based on the requirements of the "accruals concept" of accounting and revenue recognition requirements arising from IAS 18-Revenue Recognition.

Recommendations

The Council should follow the provisions of IAS 18-Revenue Recognition and ensure that all income is properly recorded in the year in which it is generated as well as that all income is properly accounted for and properly categorised in the nominal ledger.

2.4. Grants recognised as other government income

Observations

In 2017, the Local Councils of the Northern region of Malta entered into a Memorandum of Understanding with the Northern Regional Committee, whereby funds were allocated to the various councils for the purposes of road works and resurfacing; to which Local Council Pembroke was allocated the sum of €4,660 and such refund was received during 2018.

The Council has recognised such income as Other Government income during the year under review.

Issues Arising

However, when reviewing the additions for the year, the Council has been undertaking road resurfacing in Triq il-Mediterran for the amount of € 10,002.59, which capital expenditure was capitalised during the year under review.

If these funds have been utilised for the said capital expenditure, then these funds should have been accounted for using the capital approach according to IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance in line with Directive No. 1/2017 issued by the Department for Local Government.

Recommendations

The Council should assess whether such funds have been utilised to finance capital expenditure and if this is the case, it should ensure that it allocates the grant received against the respective fixed asset in line with the requirements of the capital approach according to IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance.

3. PROPERTY, PLANT AND EQUIPMENT

3.1. The Upkeep of the Fixed Asset Register (FAR)

Observations

The Council has undertaken a revision of its Fixed Asset Register to bring it in line with the requirements of Directive 1 of 2017. Overall the Council has revised its FAR properly, duly revising the method of depreciation from reducing balance to straight line method as well as properly applying the capital approach in relation to assets covered by capital grants.

Having said that, some descriptions of assets still lack fundamental details about the asset being capitalised. In some cases, the description of the FAR card only includes a very generic description thus not providing relevant information about the asset and its location, example 'TREES048 – 290 Lantana; 'URBAN196 – Street Lighting Sit F; IRBAN306- Crash Barrier and 'URBAN347 – Cycling Gov Scheme U Bars.

Issues Arising

Proper asset description as well as its specified location is of particular importance to tighten controls on physical existence and eventual asset disposals. There may be cases where the assets, especially those located in the outer environment, may be exposed to theft, vandalism, arson or extreme nature elements and one would need to identify them to be able to correctly dispose of them.

Recommendations

The Council should undertake an exercise so that the description of the asset in the FAR card should contain the highest degree of detail possible. The detail should not be of a generic nature, such as 'road resurfacing' and 'general works'. Furthermore, the FAR card should contain the exact location of the asset so that in case when the asset is subject to theft, vandalism, fire or any other damage, these can be identified easily. This would be useful for insurance claims and asset disposal adjustments.

3.2. Insurance Policy

Observations

The Council is not properly insured in certain categories of property, plant and equipment held by the Council. In fact, the Council has an insurance policy covering the Council's furniture and fittings for the amount of €74,610, "property in the open" for the amount of €182,172, plant and machinery for €6,300 and Council's buildings for the amount of € 74,100.

The Council's total cost of fixed assets, excluding special programmes, as disclosed in its financial statements, amount to €1,376,266, of which €24,745 relate to furniture and fittings, €55,309 relate to office and computer equipment, €6,300 relate to plant and machinery, €11,787 relate to street signs, €17,307 relate to trees, and €638,369 and €622,449 relate to urban improvements and construction works respectively.

Issues Arising

The Council is exposed to a risk of being underinsured in the case of theft and fire or damage for assets held by the Council that are not properly covered. This is mainly evident with respect to office and computer equipment and to a certain extent urban improvements/construction works.

The Council's insurance policy in respect of its assets insured needs to be reviewed on an annual basis to avoid having over and under insurance in different categories of property, plant and equipment.

Recommendations

The Council should ensure that the actual value of all insurable and material non-current assets held and maintained by the Council are provided to the insurance company for an adequate cover.

The Council should review the insurance policy on an ongoing basis to avoid unnecessary over and under insurance cover for each respective applicable asset categories and to ensure that the Council is properly insured.

It would be appropriate that the insurance policy details better those assets to be covered under each asset category. In this manner, it will be easier to carry out a claim in case of damage to any particular asset.

3.3. Reconciliation of the Fixed Asset Register (FAR) to the Financial Statements

Observations

We noted that the accumulated depreciation as per FAR for certain fixed asset categories is not in agreement to the accumulated depreciation in the financial statements. The below variances were identified:

Category of assets	**Depreciation as per FAR**	**Depreciation as per FS**	**Variance**
	€	€	€
Construction	603,918.59	604,332	(413.41)
Office equipment	48,700.33	48,692	8.33
Furniture and fittings	18,338.18	18,511	(172.82)
Urban improvements	470,931.17	473,941	(3,009.83)

The monthly depreciation charges are being passed automatically on Sage Evolution, and the differences noted above could have been the result of reconciling differences when updating the FAR during the accounting exercise undertaken in line of Directive 1/2017; Accounting for Government Grants from revenue approach to capital approach.

Issues Arising

The upkeep of a proper Fixed Asset Register is of utmost importance to the Council. A Fixed Asset Register is deemed as one of the principal accounting ledgers of a Council, which enables the Council to maintain its control of its capital expenditure by recording the value, depreciation as well as the location of the particular asset being recorded.

Recommendations

The Council should ensure that any such variances in the depreciation provision of these asset categories within the FAR is duly reconciled and adjusted so that they fully agree with the amounts as per nominal ledger and financial statements.

3.4. Assets no longer used by the Council

Observations

We noted that certain fixed assets such as 'COMP012 -Scanner and Zip Drive' purchased in 1998 at a cost price of €743.07 and 'COMP023 – New Computer/Tel /Fax Network' purchased in 2000 at a cost price of €391.33 are still included in the Fixed Asset Register albeit they are fully depreciated. The Executive Secretary stated that these assets were disposed when replaced some years ago.

Issues Arising

IAS 16 - Property, Plant and Equipment and IAS 36 - Impairment of Assets require that assets are assessed for impairment on an annual basis and any asset which is no longer in use should be duly disposed of accordingly in the accounts of the Council and such disposal should duly be reflected in its FAR.

Recommendations

The Council should undertake an exercise whereby all Council's assets are reviewed to confirm whether to remove these asset's cost and depreciation from its nominal ledger as well as consequently remove its related FAR card.

3.5. Accounting for Intangible Assets

Observations

The Council has purchased computer software in the previous years to be able to operate its IT systems, including a new accounting software, Sage Evolution Pro which was purchased in the previous financial year. However, the Council has not recognised any such expenditure within its financial statements as Intangible Assets.

Issues Arising

Computer software falls under the definition of "Intangible assets" and has to be accounted for in line with the requirements of IAS 38 - Intangible Assets. This class of assets needs to be disclosed separately in the financial statements.

Recommendation

The Council should ensure that the requirements of IAS 38 are properly applied with respect to any computer software purchased by the Council.

4. RECEIVABLES

4.1. Accounting for Prepayments and Accrued Income

Observations

We noted that a prepayment with respect to rental fees (St. Patrick site) for the period January to June 2019 was understated by €455.19.

Issues Arising

In order for the Council to comply with the requirements of International Financial Reporting Standards, it needs to account for prepayments and accrued income correctly and completely, adequately covering the financial period to which such transactions relate to.

Recommendations

The Council should ensure that it makes a proper assessment of its prepaid expenses and accrued income at the end of every financial reporting period. Further to our recommendations, the necessary adjustments were included, and the financial statements were rectified by the Council accordingly.

4.2. Local Enforcement System Debtors Balance

Observations

The Council has recognised in its financial statements (and nominal ledger) LES debtors amounting to €96,636 in respect of Pre-Regional LES contraventions issued till 31 August 2011. This amount agrees to the LES report 622 issued for the specified parameters as of 31st December 2018. The Council maintains an equivalent provision in lieu that such amount is deemed not recoverable.

Whilst the above is fully in line with the expected accounting treatment for such balances, it is pertinent to note that such LES Debtors and equivalent provision were recognised within the financial statements as follows in the last five financial years:

2014 - €101,437
2015 - €8,629
2016 - €8,583
2017 - €8,583
2018 - €96,636

Issues Arising

While we appreciate the fact that the Council does not have control over the amounts depicted within such LES reports and that the year-end effect on the Financial Statements is Nil, it is pertinent to note that such fluctuations in this balance gives rise to inconsistent disclosures from one financial year to another.

Recommendations

The Council should always ensure that the balances recognised in the financial statements are properly supported and reconciled with the appropriate reports from the LES system. In view of the inconsistent amounts being reported from one financial year to another, the Council should obtain the necessary support from the entity handling the LES/LESA system so that such inconsistencies are eliminated going forward.

5. CASH AND BANK

5.1. Stale Cheques

Observations

The Council had some cheque payments recorded in its current account which have exceeded six months from date of issue and are thus null and void. The amounts in question amount to €358.67.

Issues Arising

The period by which these cheques should be presented at the bank have exceeded six months and therefore legally they have become stale.

Recommendations

The Council should ensure that it verifies such cheque payments and transactions on a regular basis and adjusts its records accordingly when such cheque payments become stale.

6. PAYABLES

6.1. Accounting for Accruals

Observations

We reviewed the accruals recognised in the financial statements and the following has been noted:

- WasteServ Tipping Fees December 2018 - €1,500. As per the supporting documentation provided, the amount accrued should have amounted to €1,280.52, leaving an over accrual of €219.48

Issues Arising

In line with the concept of accrual accounting, accruals should be estimated and accounted for correctly and completely. This also entail that payables are properly recognised in the financial period in which they arise.

Recommendations

The Council should prepare accounts in compliance with the "accruals concept" of accounting in line with the generally accepted accounting principles and International Financial Reporting Standards. Invoices received and dated after year end should be checked carefully to determine if any amounts should be accrued for and included in the correct accounting period. Further to our recommendations, the necessary adjustments were included and the financial statements were rectified by the Council accordingly.

7. OTHER DISCLOSURES IN THE FINANCIAL STATEMENTS

7.1. Disclosures required in respect of certain IFRS

Observations

The Local Council (Financial) Procedures, 1996, require that the financial statements should be prepared in accordance with International Financial Reporting Standards. These financial statements are not compliant in all respects with the requirements of these standards and in fact disclosures emanating from certain accounting standards are missing or not in line with the relevant accounting standard.

Disclosure of related parties and related party transactions in note 20 is not complete in view that the requirements of articles 18, 25 and 26 of the said standard have not been complied with.

In page 12 of the financial statements, the Council has disclosed a note in relation to a change in accounting policy in view to the change in accounting method of depreciation from reducing balance method to straight line method, disclosing this change as a change in accounting policy when it should have only been disclosed as a change in accounting method.

Other presentation and disclosure deficiencies have been duly noted in other areas of this management report.

Issues Arising

The financial statements should be prepared in a consistent manner, whereby all disclosures need to be undertaken in line with the requirements of International Financial Reporting Standards. These disclosures are not simply quantitative but also descriptive and we noted that the latter have sometimes been omitted as noted above. In this respect, we have qualified our audit report.

Recommendations

The financial statements should be prepared in accordance with International Financial Reporting Standards and that all necessary disclosures are undertaken as required.

7.2. Financial Statements presentation

Observations

During our review of the financial statements we noted a number of areas in the presentation of the financial statements which were not properly presented or disclosed.

Issues Arising

- In Note 11 to the financial statements:
  - 2017 Comparatives – Total Depreciation as at 1 January 2017 should read €774,852, rather than €774,851.
  - 2017 Comparatives – Total Depreciation as at 31 December 2017 should read €723,744, rather than €723,743.
  - 2017 Comparatives – Net Book Value as at 31 December 2017 should read €316,601, rather than €316,602. This figure should also tally to the Statement of Financial Position balance.

- In note 2 to the financial statements, at the end of the "*Property, Plant and Equipment*" note in page 11, the following explanatory note should be included to explain the effect of Directive 1/2017:.
  - *" Up to the year ended 31 December 2017, depreciation was accounted for using the reducing balance method according to IAS 16 – Property, Plant and Equipment. On 1 January 2018, the straight-line method, according to IAS 16 has been adopted, in line with the Directive No. 1/2017 issued by the Department for Local Government. This is a change in accounting estimate, which according to IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors, has been accounted for prospectively."*

- In note 2 to the financial statements, the paragraph titled *"Government Grants"* on page 12 should instead read as follows:
  - *" Government Grants relating to operating expenditure are recognised in the Statement of Comprehensive Income in the same period that the related expenditure is incurred.*
  - *Government Grants relating to the purchase of property, plant and equipment are accounted for using the capital approach, and are thus deducted from the carrying amount of the relative non-current asset.*
  - *Up to the year ended 31 December 2017, government grants were accounted for using the income approach according to IAS 20 – Accounting for Government Grants and Disclosure of Government Assistance. On 1 January 2018, the capital approach, according to IAS 20, has been adopted, in line with Directive No. 1/2017 issued by the Department for Local Government. This is a change in accounting policy, and according to IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors, has been accounted for retrospectively."*

- A new note titled "Effect of Change in Accounting Policy" should be included after the trade payables note in page 21 to the financial statements, whereby the below disclosure note should be included and a further note showing the arithmetic implications of the change in policy, similar in nature to a Prior Year Adjustment Note (2017 as originally reported, Adjustments, 2017 As restated):
  - *"On 1 January 2018, the capital approach, according to IAS 20, has been adopted, in line with Directive No. 1/2017 issued by the Department for Local Government.*

This is a change in accounting policy, and according to IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors, has been accounted for retrospectively.

- *The effect of the restatement on these financial statements is summarised below:"*

- With respect to the Statement of Financial Position in page 5 to the financial statements, the current 2017 comparative column should be renamed to "31 Dec 2017 As Restated", and an additional column to be included showing the original position as per the audited position as at 31 December 2017, to clearly show the effect of the change in the accounting policy in line with the changes required in the application of Directive 1/2017.

Recommendations

The Council should ensure compliance with *International Financial Reporting Standards, respective Memos and Local Councils Procedures (2006 Audit)* in the preparation of the Financial Statements. Further to our recommendations, the Council has addressed the above matters within the financial statements.

8. GENERAL

8.1. Comparison of Actuals with the Annual Budget*Observations*

During our review of the 2018 annual budget, it was noted that certain items of expenditure exceeded the 10% allowable threshold when compared to budget, as follows:

		As per Budget 2018 €	As per FS 2018 €	Variance €
Expenditure	Rent	1,456.00	2,910.90	1454.90
	Street Lightning	8,000.00	12,522.65	4,552.65
	Refuse Collection	26,400.00	37,175.60	10,775.60
	Tipping Fees	13,200.00	28,991.29	15,791.29
	Other Contractual Services	17,055.00	19,273.69	2,218.69
	Professional Services	17,816.00	20,034.65	2,218.65
		442,001.00	507,320.00	15%

Issues Arising

We bring to the attention of the Council the fact that the Council is regulated by paragraph P1.07 (b.05) of the Local Councils Procedures (1996-Finance) KLP 1/96, which states that it should not spend more than its budgeted expenditure (usually based on the liquidity position and funds available).

Furthermore, it is envisaged that if any expenditure category requires materially more funds than budgeted, an adjustment is undertaken to the said budget and is duly approved by the Council.

The Council should compile the annual budget with due care and diligence to use it as a guideline to control its expenditure during the year. Any projected variances should be adjusted at least on a quarterly basis to ensure that the Council would either have sufficient funds available to justify the increase in expenditure, or else reallocate excess funds where there are decreases in expenditure or increase in income received.

Recommendations

In compiling a budget, each item of income or expenditure should be scrutinised to determine whether there is some form of agreement which gives certainty of the projection being presented. In the absence of a contract or an agreement, the item should be extrapolated over historic data to approximate the desired projections for the entire consolidation of the official final draft of the budget.

