

Report by the *Auditor General*

Public Accounts 2014





Annual Audit Report

Public Accounts 2014

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List of Abbreviations

AAR	Annual Audit Report
AFM	Armed Forces of Malta
AG	Attorney General
ARR	Arrears of Revenue Return(s)
AVS	Attendance Verification System
BFID	Benefit Fraud and Investigation Department
BO	Budget Office
BOT	Board of Trustees
CapEx	Capital Expenditure
CBM	Central Bank of Malta
CCoF	Central Co-operative Fund
CD	Customs Department
CDRT	Centre for Development, Research and Training
CEO	Chief Executive Officer
CIO	Chief Information Officer
COJ	Courts of Justice
COLA	Cost of Living Adjustment
CPSU	Central Procurement and Supplies Unit
CVB	Conservatorio Vincenzo Bugeja
DAS	Departmental Accounting System
DC	Department of Contracts
DCS	Director Corporate Services
DES	Directorate for Educational Services
DFA	Directorate for Finance and Administration
DG ECFIN	Directorate General for Economic and Financial Affairs
DHPP	Department of Health, Policy and Planning
DMD	Debt Management Directorate
DO	Direct Order(s)
DPM	Deputy Prime Minister
DSS	Department of Social Security
EAMS	Euro Area Member States
ECB	European Central Bank
ECCD	Elderly and Community Care Department
EDA	Extra Duty Allowance
EFSF	European Financial Stability Facility
EGRD	EcoGozo Regional Development Directorate
EO	Executive Officer
EPD	Economic Policy Department
EPI	Economic Policy Institute
ESC	Eurovision Song Contest
ESM	European Stability Mechanism
ETC	Employment and Training Corporation
EU	European Union
FIC	Fortifications Interpretation Centre
FMS	Fleet Management System

FR	Financial Report
FS4	Payee Status Declaration Form
FSS	Final Settlement System
FSWS	Foundation for Social Welfare Services
GDP	Gross Domestic Product
GGH	Gozo General Hospital
GPD	Government Property Department
GPDMA	Government Borrowing and Public Debt Management Act
HR	Human Resources
IAID	Internal Audit and Investigations Department
IAS	International Accounting Standard
ICT	Information and Communications Technology
IPSAS	International Public Sector Accounting Standards
IPSL	Industrial Projects and Services Ltd
IRD	Inland Revenue Department
ISA	International Standards on Auditing
ISSAI	International Standards of Supreme Audit Institutions
IT	Information Technology
JESC	Junior Eurovision Song Contest
KOLS	<i>Koperattiva</i> Linen Service Ltd
LA	Letter of Acceptance
LPO	Local Purchase Order
MCA	Malta Communications Authority
MCAST	Malta College of Arts, Science and Technology
MCC	Mediterranean Conference Centre
MCCAA	Malta Competition and Consumer Affairs Authority
MCH	Mount Carmel Hospital
MCST	Malta Council for Science and Technology
MDH	Mater Dei Hospital
MEAIM	Ministry for the European Affairs and Implementation of the Electoral Manifesto
MECW	Ministry for Energy and the Conservation of Water
MEDE	Ministry for Education and Employment
MEH	Ministry for Energy and Health
MEIB	Ministry for the Economy, Investment and Small Business
MEPA	Malta Environment and Planning Authority
MESC	Malta Eurovision Song Contest
MFIN	Ministry for Finance
MFSA	Malta Financial Services Authority
MFSS	Ministry for the Family and Social Solidarity
MGA	Malta Gaming Authority
MGI	Malta Government Investments Ltd
MGOZ	Ministry for Gozo
MGS	Malta Government Stocks
MHAS	Ministry for Home Affairs and National Security
MIP	Malta Industrial Parks Ltd
MITA	Malta Information Technology Agency

MITTS	Malta Information Technology and Training Services Ltd
MPO	Malta Philharmonic Orchestra
MSDC	Ministry for Social Dialogue, Consumer Affairs and Civil Liberties
MSE	Malta Stock Exchange
MTI	Ministry for Transport and Infrastructure
MUMN	Malta Union of Midwives and Nurses
NAO	National Audit Office
NCF	National Celebrations Foundation
NMW	National Minimum Wage
NSO	National Statistics Office
OHS	Occupational Health and Safety
OJEC	Official Journal of the European Community
OMAS	Office of the Manager Airport Security
OPM	Office of the Prime Minister
OPS	Office of the Permanent Secretary
PAHRO	Public Administration Human Resources Office
PBS	Public Broadcasting Services Ltd
PC	Personal Computer
PDMAC	Public Debt Management Advisory Committee
PH	Public/National Holiday
PHC	Primary Health Care
PLR	Player Liability Report
PPP	Public-Private Partnership(s)
PPR	Public Procurement Regulations
PS	Permanent Secretary
PSMC	Public Service Management Code
PV	Payment Voucher
R&I	Research and Innovation
RD	Restoration Directorate
SA	Social Assistance
SABS	Social Assistance and Benefits System
SAMM	Structural Annualised Econometric Model for Malta
SPBH	Sir Paul Boffa Hospital
SSA	Social Security Act, 1987 (Cap. 318)
SSC	Social Security Contributions
SUP	Single Unmarried Parent
TM	Transport Malta
TOIL	Time Off <i>In Lieu</i>
TP	Taxpayer Profile
TVLU	Television Licensing Unit
UA	Unemployment Assistance
VAT	Value Added Tax
VL	Vacation Leave
WSC	Water Services Corporation

Guide to using this Report

This Report summarises the conclusions reached following our Financial and Compliance audits. For the first time, the Auditor General is presenting to the House of Representatives separate Audit Opinions, on the financial and compliance audits respectively.

We sought to spread our reviews across Government Ministries and Departments or across Government-wide activities in accordance with the NAO Annual Audit Programme drawn up from year to year. We have also attempted to make this Report as user friendly as possible and have tried to adopt common language, although this was not always possible due to the technicality of some of the issues raised.

This Report is presented by ministerial portfolios as featuring in the Government of Malta Financial Estimates 2014, each containing either the Ministry itself, or one or more Departments or Entities which were the subject of our review. Most audit reports under the ministerial portfolios have the following structure:

Background

Includes a brief description of the relevant activities, roles and operations of the respective Ministry, Department or Entity under review. Where applicable, it may also include new legislation governing such Entity.

Good Practice

Outlines areas where NAO expressed satisfaction on full compliance, solely in respect of specific areas subjected to audit review, and where this was applicable.

Key Issues

Highlight any material findings or outcomes of our audit and any major developments impacting on the respective Ministry, Department or Entity.

Control Issues

Outline any shortcomings that came to our attention relating to the Ministry's or Department's internal control and internal checking mechanisms. These controls are expected to be in place so as to serve as an effective safeguard of public assets and resources.

Compliance Issues

Summarise instances whereby the relative Ministry, Department or Entity lacked compliance with effective legislation, standing General Financial Regulations and/or Circulars issued from time to time.

Recommendations

Outline our suggestions to the respective Ministries and Departments, to encourage them to address any weaknesses that came to our attention, as well as to consolidate and improve upon the management and proper discharge of public funds. In general, our recommendations are aimed at improving the internal control systems, addressing areas where there is lack of compliance with pertinent rules and regulations, and promoting good practice in the best interest of the taxpayer.

Management Comments

Seek to include the Management's reaction to NAO's comments and action taken, or planned to be taken, so as to address in a timely manner the issues and any shortcomings identified.

Executive Summary

The **Financial Report** (page 17), incorporating Financial Statements and Accounts for the year 2014, was submitted by the Accountant General in terms of the Financial Administration and Audit Act, 1962. Following examination, in terms of the Auditor General and National Audit Office Act, 1997, it is emphasised that:

- Letters of Comfort and Bank Guarantees reached €1,403,270,738 (against €1,257,929,437 in 2013). These may translate into dues by Government should the companies call upon the former to make good for their debts;
- substantial excess of actual over budgeted figures of various items of Expenditure was once again reported, these being similar to those reported last year. The reasons for these reoccurrences are being noted accordingly;
- a detailed statement showing outstanding Advances made to various Government Departments, Agencies and Organisations is being provided, including the Ministry for Finance's plans to have such amounts settled. Pending advances totalling approximately €84.1 million will continue to be repaid out of an annual budgetary provision; and
- following the enactment of the Government Borrowing and Public Debt Management Act, a number of measures will be implemented by Treasury thereby introducing a risk management framework with supporting Information Technology systems, together with a code-of-conduct and conflict-of-interest rules for debt management officers. An overview of Government's strategy on public debt during 2014 is also outlined.

An audit of expenditure at the **Office of the Prime Minister**, revealed several instances of lack of adherence to the Public Procurement Regulations with respect to expenditure by the National Celebrations Foundation and other contractual services. Shortcomings were also identified in the areas of inventory, general-use vehicles and compliance with fiscal obligations. (page 77)

An analysis of the expenditure incurred by the **Ministry for European Affairs and Implementation of the Electoral Manifesto** divulged that repeated extensions for cleaning services were authorised following expiration of contract. Other shortcomings consisted of non-adherence to Procurement Regulations, as well as concerns of a compliance nature. (page 85)

Expenditure on the **Restoration of Forts, Fortifications and Historical Places**, included substantial variations to the original tender, some of which were approved retrospectively. Overpayments and lack of documentation were also encountered. (page 92)

A review of the revenue collection system in place at the **Mediterranean Conference Centre** revealed that the limited human resources within the Accounts Department had a negative impact on the effectiveness of internal controls. This included lack of segregation of duties, untimely bank deposits, and non-adherence with Inventory Control Regulations. (page 100)

The majority of procurement reviewed during an expenditure audit at the **Ministry for Education and Employment** was not made in line with standing regulations. Internal controls in various other areas were also considered to be weak. (page 112)

An audit at the **Malta Council for Science and Technology** revealed instances where payments to employees were either unauthorised, not properly supported by evidence or inaccurate. Other shortcomings, particularly but not limited to attendance records and inventory management, were also noted. Concerns with respect to the filing of documents led this Office to question the completeness of information made available during the audit. (page 121)

The main weaknesses identified during the audit of capital expenditure of **EcoGozo** related to the absence of independent verifications by the Directorate, on the quality of materials supplied for the various projects it undertook, the lack of segregation of duties, as well as non-compliance with tender requirements. Furthermore, most of the projects reviewed experienced delays. (page 132)

An audit at the **Malta Competition and Consumer Affairs Authority** revealed that by the end of the lease agreement in September 2021, the Authority will have incurred an aggregate rental expenditure of €4,421,630 on the main office premises over a 10-year period. Documentation supporting the decision to lease the offices was not available. A number of internal control weaknesses, such as the absence of a fixed asset register and shortcomings with respect to the completeness of revenue, were also encountered. (page 142)

An analysis of the capital expenditure incurred by the **Malta Information Technology Agency (MITA)** on four main projects; being ICT Core Services, PC Leasing, Digital Outreach and e-Government; revealed that all documentation relative to the audit was available from MITA upon request. This Office satisfactorily noted good practice in that authorisation for various items of expenditure and investment was duly obtained before the relative purchasing process was initiated, with procurement and contracting policies, procedures and existing regulations being correctly followed. (page 152)

An audit on Gaming Taxes collected by the **Malta Gaming Authority (MGA)**, on behalf of Government, revealed that Financial Statements presented by the gaming operators did not give sufficient detail of the composition of income for the purpose of tax calculations in line with MGA's definitions. As a result, the scope of this audit was limited since it was difficult to verify the tax calculations on the basis of the information provided by the operators. In addition, monthly reporting obligations with respect to player liabilities and taxes, were not always being followed by the gaming operators. Other shortcomings consisted of the lack of procedures within the Authority to address shortfalls in players' funds, and the acceptance of taxation payments in instalments rather than requiring taxation to be paid when it falls due. (page 155)

An audit on selected Non-Contributory Social Assistance Benefits paid by the **Social Security Department** revealed lack of sufficient verification during the application and evaluation processes from the Department's side, coupled with beneficiaries failing to report change in circumstances. Instances where transfers of property and number of vehicles owned were not considered for means testing, as well as where arrears were substantially paid in excess, were also noted. Differential treatment was also given to claimants with children listed as 'unknown father'. (page 162)

Shortcomings were noted following a review at **Aġenzija Sedqa**. During audit testing, NAO was on five instances provided with a fabricated or amended document. The audit also revealed weak internal controls in various areas relating to personal emoluments, leading to overpayment of overtime and unreliable leave records. Logbooks controlling the use of general-use vehicles were at times inadequately maintained. (page 171)

The lack of appropriate internal controls throughout the payroll process exposed the Office of the Permanent Secretary, within the **Ministry for Home Affairs and National Security**, to a number of deficiencies. These included, but were not limited to, remuneration paid to Board Members in excess of the approved amounts and various inaccuracies relating to salary payment. (page 181)

The main area of concern following an audit at the **Public Broadcasting Services Ltd** was the overall deficit, which has contributed further to liquidity problems. (page 195)

Information required by NAO for the performance of the Personal Emoluments audit was not always made available by the **Customs Department** within a reasonable timeframe, thus hindering the audit process. Furthermore, the information was often found to be insufficient and had to be resubmitted. Testing revealed incorrect amounts of basic salary, allowances and overtime paid to officers. Various shortcomings were also noted in the maintenance of attendance and leave records. (page 199)

A review of expenditure of the **Ministry for Energy and the Conservation of Water**, revealed several instances of lack of adherence to the Public Procurement Regulations with respect to legal and other contractual services. Testing also showed a significant increase in overtime hours worked during the last six months of 2014, as well as other weaknesses in relation to overtime approvals. (page 209)

Overtime at **Mount Carmel Hospital** was being resorted to consistently. Substantial amounts of allowances were also paid to employees, some of which were either unauthorised, inadequately supported by evidence, or incorrect. The audit also revealed several internal control deficiencies, amongst others comprising lack of attendance verification and inadequate practices leading to excessive time-off *in lieu* balances. (page 220)

The major cause of concern noted from an expenditure audit on contractual services at **Gozo General Hospital** related to the provision of meals in respect of both patients as well as staff, where significant weaknesses and discrepancies were noted in the ordering process and respective payments. Controls in place were lacking, which, coupled with inadequate verifications, resulted in substantial overcharging by the service provider. (page 233)

Koperattiva Linen Service Ltd is not in line with the provisions of the pertinent Circular issued by the Office of the Prime Minister relating to the set-up of co-operatives. A number of issues including lack of independent oversight and potential conflict of interest indicate weak governance. (page 245)

An analysis of **Government's Capital Programme**, from both the planning and financing aspects, is augmented with NAO's insights and proposals aimed at enhancing the current processes. Innovative financing mechanisms, to engage the private sector in infrastructure investment, are being proposed. Economic insights on local policy considerations, in respect of fiscal consolidation efforts and public investment, are also provided. (page 258)

Similar to previous years, a review of the **Arrears of Revenue** Return for 2014, submitted by Ministries/ Departments in terms of Treasury Circular No. 4/2015, revealed several issues in the collectability of outstanding balances. (page 276)

A clean audit opinion was issued following the financial audit on the Financial Statements of the **Co-operatives Board** for the year ended 31 December 2014. Few issues, of a compliance nature, were also noted. (page 320)





Financial Audit Opinion

Opinion on the Financial Audit to the House of Representatives

Audit Mandate

As stipulated by Article 108(5) of the Constitution of Malta and para. 7 of the First Schedule of the Auditor General and National Audit Office Act, 1997, I am hereby reporting on the presentation of the statements and accounts prepared by the Accountant General in fulfillment of the provisions of Article 67 of the Financial Administration and Audit Act, 1962, for the financial year under review.

I consider the primary users of the statements and accounts to be Parliament and the Public Accounts Committee.

Respective Responsibilities of the Accountant General and Accounting Officers

As determined by the Financial Administration and Audit Act, 1962, the onus for the proper discharge of financial administration and the preparation of statements and accounts rests with the Accountant General and the Accounting Officers. They are also responsible for institution and application of such internal controls as deemed necessary, to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and to ensure that the audited entities' operations are in accordance with the pertinent rules and regulations.

These officers are entrusted with the sound management of public funds. They are therefore to demonstrate transparency, accountability and integrity in their actions, and are to exercise good governance for the resources with which they are entrusted.

Auditor's Responsibilities

NAO's responsibility is to obtain reasonable, rather than absolute, assurance as to whether statements and accounts of Government Ministries and Departments, as well as of other entities that were subject to audit, are free from material misstatement. Thus it is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISA) will always detect material misstatements, arising from fraud or error.

Basis for Opinion

We conducted our financial audit in accordance with the relevant ISAs, the applicable public sector perspective provisions, and in line with NAO's auditing practices.

An audit of financial statements involves performing procedures to enhance the degree of confidence that intended users have in the financial statements and accounts under review. The procedures selected depend on the auditors' judgement, which entails the assessment of risk, evaluation of internal controls, consideration of sensitivity of particular areas and other qualitative factors, as well as the assessment of materiality in terms of value, nature or context in which it occurs.

I have complied with independence requirements in accordance with the International Standard of Supreme Audit Institutions (ISSAI) 30 Code of Ethics and NAO Code of Professional Conduct and have fulfilled my ethical responsibilities in accordance with such codes. I have also adhered to avoidance of conflict of interest regulations as stipulated by Article 108(3c) of the Constitution of Malta and fulfilled the independence requirement in accordance with Article 108(12) of the aforementioned Constitution.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion, which only draws on conclusions upon areas that have been examined.

Opinion

Clean Opinion

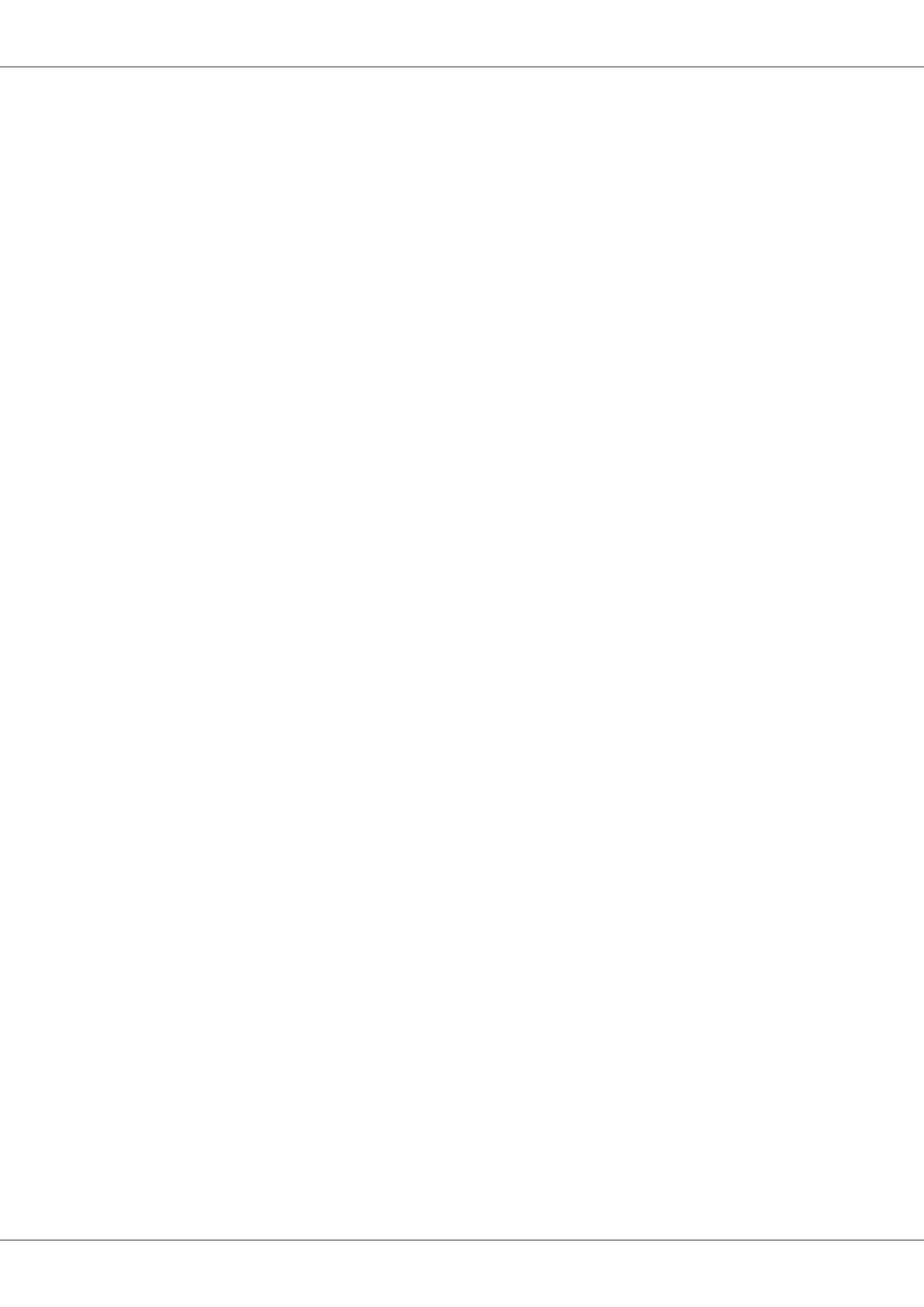
In my opinion, the statements and accounts subjected to our audit were fairly presented in accordance with the stated accounting policies applicable to the public sector by the Government of Malta.

In terms of para. 5(ii) of the First Schedule of the Act, I am to report that, subject to instances referred to in the 'Analysis of the Financial Report' Report, I received all the information and explanations required for the carrying out of my duties.

A separate audit opinion is being published, for the first time, dealing with the compliance aspect.



Anthony C. Mifsud
Auditor General
14th December 2015





Financial Report

Analysis of the Financial Report 2014

Introduction

Statements of the Consolidated Fund Account, showing the comparative positions in 2013 and 2014, and the receipts and payments of funds created by law, were laid on the Table of the House of Representatives during Sitting No. 256 on 1 April 2015, after being reconciled with Treasury Books by the Auditor General in accordance with Sub-para. 1(c) of the First Schedule of the Auditor General and National Audit Office (NAO) Act, 1997.

The Financial Report (FR) statements and accounts for year 2014 were submitted by the Accountant General in terms of Article 67 of the Financial Administration and Audit Act, 1962, and were examined in terms of Sub-para. 1(e) of the First Schedule of the Auditor General and National Audit Office Act, 1997. The Report was laid on the Table of the House of Representatives during Sitting No. 288 on 13 July 2015.

Further details of Government financial operations can be found by making reference to both the Annual Financial Statements and FR for 2014.

Consolidated Fund Statement – 2014

As detailed in Article 102(1) of the Constitution of Malta, the Consolidated Fund incorporates all moneys raised or received by the Government of Malta, not being revenues or other moneys payable into some other fund, being a fund established by or under any law, for the time being in force in Malta for a specific purpose. All disbursements out of the Consolidated Fund are authorised by means of Appropriation Acts of Parliament, which include the Supplementary Estimates.

The House of Representatives approved the year 2014 Budget (Estimates) for an expenditure of €4,013,960,000, as authorised by Warrant No. 1 of 2014 issued on 4 December 2013, and a further €258,545,000 approved by Supplementary Estimates Warrant No. 2 of 2014 dated 23 December 2014. Following the closure of the 2014 Accounts, actual expenditure amounted to €3,964,481,000, which resulted into an excess of revenue of €71,569,000, as detailed in *Table 1*, leading to an end-of-year consolidated negative balance of €23,536,000.

Table 1: Consolidated Fund 2014

	Estimated (Original & Supplementary)		Actual	
	€'000's	€'000's	€'000's	€'000's
Opening Consolidated Balance as on 1 January 2014				(95,106)
<i>Revenue</i>				
Ordinary (incl. Grants)	3,272,918		3,387,209	
Capital	650,002	3,922,920	648,841	4,036,050
<i>Expenditure</i>				
Recurrent	(2,922,688)		(2,857,050)	
Public Debt Servicing	(806,130)		(658,327)	
Capital	(543,687)	(4,272,505)	(449,104)	(3,964,481)
Net Cash Flow		(349,585)		71,569
Closing Consolidated Balance as on 31 December 2014				(23,536)

Figures in Statement may not add up due to rounding up.
(Source: FR 2014, page xvi)

Table 2 hereafter shows the same end-of-year consolidated negative balance of €23,536,000 as in the preceding Table, highlighting figures relating to the Recurrent Deficit for 2014, amounting to €121,306,000, as well as the financing of present Foreign and Local Loans, totalling €455,965,000. This led to a total Public Sector Borrowing Requirement of €577,272,000, which was financed with the issue of new Local Loans, amounting to €648,841,000.

Table 2: Consolidated Fund 2014

	2014	
	€'000's	€'000's
Total Recurrent Revenue		3,387,209
Total Recurrent Expenditure	(3,088,146)	
Capital Expenditure	(420,369)	
Overall Expenditure		(3,508,515)
Recurrent Deficit		(121,306)
Financing (excluding New Loans)		
Foreign	(6,465)	
Local	(449,500)	
Total Financing		(455,965)
Public Sector Borrowing Requirement		(577,272)
Opening Consolidated Balance as on 1 January 2014	(95,106)	
Local Loans Issuance	648,841	
		553,736
Closing Consolidated Balance as on 31 December 2014		(23,536)

Figures in Statement may not add up due to rounding up.
(Source: FR 2014, page xviii)

Revenue

Details of Revenue collected during 2014, classified by heads and subheads, as compared with the Estimates, are shown in FR pages xix to xxi. Explanatory comments regarding variations between actual and budgeted revenue, as forwarded by the Ministry for Finance (MFIN) follow these details.

For the financial year 2014, it transpired that the Grand Total Variation in Revenue amounted to a favourable variance of €113,130,000, as against the aggregate adverse variation of €61,243,000 in 2013.

Furthermore, this Office satisfactorily noted that the improvement registered in the previous financial year with respect to explanations given for variations in Revenue, was maintained for the financial year being reported upon. Some of the major recognised variances are listed in *Table 3*. This is followed with explanations for these variances, as provided by MFIN.

Table 3: Major Variances in Revenue for Financial Year 2014

Revenue	Budget Estimates	Actual	Variation
	€'000's	€'000's	€'000's
<i>Tax Revenue</i>			
Direct:			
Income Tax	984,000	1,068,089	84,089
Indirect:			
Excise Duties of which Petroleum	142,450	172,582	30,132
<i>Non Tax Revenue</i>			
Fees of Office:			
Investment Registration Scheme	-	31,798	31,798
<i>Grants</i>	241,169	176,803	(64,366)

(Source: FR 2014, pages xxii-xxiv)

Reasons for Variations

Direct Tax Revenue – Income Tax

The increase in Income Tax stems mainly from enhanced enforcement and in line with economic activity.

Indirect Tax Revenue – Excise duties (Petroleum)

There was an increase in receipts of accrued excise duty payments of petroleum from Enemalta p.l.c.

Non Tax Revenue – Fees of Office (Investment Registration Scheme)

No budget estimate was made in respect of the Investment Registration Scheme for the financial year 2014, and thus the revenue generated during this year out of this Scheme represented a favourable variance.

Grants

The adverse variance in Grants of €64,366,000 resulted from programmes financed by the European Union (EU), including those originally budgeted for in 2014, which will continue to be implemented in 2015. The Budget Office confirmed that “*At time of compilation of the Financial Estimates, an equivalent amount to the pre-financing (EU Funds) provided under the respective Capital Votes is simultaneously featured under Revenue, working on the assumption that the projected amounts should cater for reimbursements in respect of the previous year (in this case, 2013) and part of the current year (in this case, 2014). However the amount of reimbursements actually received by year-end will depend on the rate of progress registered on project implementation as well as the rate at which the amounts are certified, claims for reimbursement are made to the EU Commission, and reimbursed by the said Commission ... It is noted that any funds not received in the current year will be accrued for, hence leaving a neutral effect on the budget deficit target for the respective year.*”

Expenditure

The appropriations for expenditure during 2014, authorised by the issue of MFIN Warrant Nos. 1 and 2, were made under the following Statutes:

	€
a. Appropriation Act	2,504,485,692
b. In terms of Special Laws	1,764,765,000
c. In terms of the Constitution	3,254,308

Analysis of Appropriations

a. Appropriation Act

	€
Appropriated by Act XVI of 2013 (Original Budget)	2,277,897,692
Appropriated by Act XL of 2014 (Supplementary)	226,588,000

b. Special Laws

The following amounts (including Supplementary Estimates as detailed in Warrant No. 2 of 2014) were appropriated in terms of the various laws as indicated:

Table 4: Amounts Permanently Appropriated in terms of the various Laws

Description	2014	2013
	€	€
Expenses of the Electoral Commission – General Elections Act (Cap. 354)	350,000	450,000
Expenses of the Broadcasting Authority – Broadcasting Act, 1992 (Act XII of 1991 – Cap. 350)	620,000	620,000
Expenses under Re-letting of Urban Property Ordinance (Cap. 69) and Agriculture Leases (Re-letting) (Cap. 199)	81,000	71,000
Land Acquisition (Public Purposes) Ordinance (Cap. 88)	115,000	110,000
Social Security Act, 1987 (Act X of 1987 – Cap. 318)	859,560,000	815,318,000
Pensions Ordinance (Cap. 93)	88,400,000	87,500,000
Expenses of the Office of the Ombudsman (Cap. 385)	1,437,000	750,000
Expenses of the Permanent Commission Against Corruption (Act XXII of 1988 – Cap. 326)	40,000	55,000
Interest plus contribution to the Sinking Funds in respect of Local Government Stock – Registered Stock and Security Ordinance 1959 (Cap. 161)	790,514,663	599,646,460
Interest plus contribution to the Sinking Funds in respect of Foreign Loans (Cap. 213)	8,770,269	9,279,935
Malta Arbitration Centre (Act II of 1996 – Cap. 387)	67,000	67,000
Expenses of NAO (Act XVII of 1997 – Cap. 396)	2,600,000	2,265,000
Refunds under Value Added Tax/Customs & Excise Tax Acts	1,388,000	1,618,000
Widows' and Orphans' Pensions Act (Cap. 58)	525,000	500,000
Personal Injuries (Emergency Provisions) Ordinance (Cap. 111)	45,000	55,000
Members of Parliament (Retiring Allowances) (Act XVII of 1966), Members of Parliament Pensions Act (Act XXVI of 1979) as amended by Act XIII of 1981 and Act VII of 1989 (Cap. 280)	1,480,000	1,410,000
Short Term Borrowing – Treasury Bills Act (Cap. 133)	4,700,068	5,750,000
€56,378,732 Interest payable on ex Malta Drydocks/Malta Shipbuilding Co. Ltd Loans (Act XV of 2003)	2,247,000	2,247,000
Lease of Parliament Building – Budget Measures Implementation (Act V of 2012)	1,825,000	340,000
Totals	1,764,765,000	1,528,052,395

Following queries forwarded to the Budget Office, the following explanations were provided to explain major increases of actual expenditure over the previous year:

Social Security Act, 1987 (Act X of 1987 – Cap. 318)

The increase of €44,242,000 in 2014 over the previous year's budget was due to rises in the number of beneficiaries, as well as the cost of living element by which social security benefits are indexed.

Expenses of the Office of the Ombudsman (Cap. 385)

A higher budgetary allocation over the previous year, totalling €687,000, was provided to cover the works that were being carried out during such year.

Interest plus contribution to the Sinking Funds in respect of Local Government Stock – Registered Stock and Security Ordinance 1959 (Cap. 161)

The increase in budgetary allocation of €190,868,203 was necessary to cover the interest and sinking fund contributions related to the stocks which were up for renewal, as well as new issues occurring during year 2014, according to borrowing requirements.

Lease of Parliament Building – Budget Measures Implementation (Act V of 2012)

The amount permanently appropriated in year 2014 refers to a full year's rent, whereas during 2013 budget preparation time, only a *pro rata* rental payment was estimated as being required.

c. In terms of the Constitution

In terms of Article 107(2) of the Constitution, the following amounts were permanently appropriated in respect of:

	€
The President of Malta	75,001
The Attorney General	73,686
Judges and Magistrates	3,018,723
The Public Service Commission	<u>86,898</u>
	<u>3,254,308</u>

Budgetary Procedure for 2014

Following NAO query, Budget Office provided a detailed description of the 2014 budgetary process' main elements, as outlined below.

The top-down¹ approach for budgetary allocations has been adopted for the past years and continued being adopted in 2014, which process commenced through MFIN Circular No. 2/2013, '2014 Financial Plans'. By means of this Circular, all Ministries, Departments and Entities, were requested to submit their respective expected revenue, as well as recurrent and capital expenditure projections for the year 2014.

Given that Government policy remained one of ensuring a further reduction in the yearly fiscal deficit, Ministries were encouraged to strive towards expenditure containment and the enhancement of revenue generation.

Indications for additional funding, if any, were to be kept at an absolute minimum, limited only to those instances where non-provision of funds, above the parameters set through the Circular, would adversely impact the core workings of the respective Ministries, Departments and Entities.

Excess of Expenditure over Estimates

The Supplementary Estimates contributed in part to the overall fiscal outturn for 2014, with the other contributing element being revenue performance. *Table 5* portrays those votes whose expenditure exceeded budgeted figures, by well over €1 million.

¹ This means that MFIN sets the overall expenditure ceiling and sub-ceilings, and delegates detailed resource allocation decisions to line Ministries.

Table 5: Excess of Expenditure over Original Budget by Vote

Vote	Original Budget 2014	Actual 2014	Variation Actual 2014/Original Budget 2014
	€	€	€
Recurrent Expenditure			
Vote 5: Office of the Prime Minister	21,588,000	28,997,071	7,409,071
Vote 9: Electoral Office	5,195,000	7,427,777	2,232,777
Vote 10: Government Property Division	6,283,000	8,232,447	1,949,447
Vote 14: Ministry for Tourism	62,478,000	66,067,717	3,589,717
Vote 16: Ministry for Education and Employment	194,638,000	205,766,910	11,128,910
Vote 17: Education	184,947,000	194,887,669	9,940,669
Vote 18: Ministry for Sustainable Development, the Environment and Climate Change	44,598,000	47,213,970	2,615,970
Vote 19: Ministry for Transport and Infrastructure	70,061,000	90,603,898	20,542,898
Vote 25: Ministry for the Family and Social Solidarity	45,143,000	47,247,251	2,104,251
Vote 26: Social Policy	234,283,000	239,079,406	4,796,406
Vote 27: Social Security Benefits	828,560,000	852,908,279	24,348,279
Vote 29: Elderly and Community Care	65,747,000	76,994,220	11,247,220
Vote 30: Ministry for Home Affairs and National Security	20,644,000	26,709,010	6,065,010
Vote 32: Police	53,108,000	54,963,305	1,855,305
Vote 33: Correctional Services	8,874,000	10,131,609	1,257,609
Vote 46: Ministry for Energy and the Conservation of Water	42,199,000	46,309,432	4,110,432
Vote 47: Ministry for Health	383,151,000	414,577,687	31,426,687
Capital Expenditure			
Vote II: Office of the Prime Minister	11,206,000	12,411,892	1,205,892
Vote V: Ministry for Tourism	16,231,000	17,797,383	1,566,383
Vote VI: Ministry for Education and Employment	56,021,000	68,283,051	12,262,051
Vote XIV: Ministry for Finance	49,249,000	53,220,930	3,971,930
Vote XV: Ministry for Energy and the Conservation of Water	20,698,000	24,931,127	4,233,127
Totals	2,424,902,000	2,594,762,041	169,860,041

(Source: FR 2014 pages xi-xiv, 42-169)

Excess expenditure over original budgeted figures exceeding €1 million occurred in the Line Items shown in *Table 6*. The same line items experienced a similar excess of expenditure during 2013, as portrayed in the same Table.

Table 6: Excess of Expenditure over Original Budget/Revised Estimates by Item

Vote, Item	Original Budget 2014	Revised Estimates 2014²	Actual 2014	Variation Actual 2014/ Revised Estimates 2014	Variation Actual 2014/ Original Budget 2014	Variation Actual 2013/ Original Budget 2013
	€	€	€	€	€	€
Vote 9: Electoral Office						
Item 5219: Electoral Commission Activities	3,500,000	6,050,000	5,850,892	(199,108)	2,350,892	2,349,605
Vote 17: Education						
Item 12: Salaries and Wages	140,000,000	148,400,000	147,691,219	(708,781)	7,691,219	3,085,238
Vote 27: Social Security Benefits						
Item 5140: Invalidity Pensions	23,500,000	27,000,000	25,846,396	(1,153,604)	2,346,396	1,276,508
Item 5149: Social Assistance	71,000,000	79,900,000	79,647,591	(252,409)	8,647,591	5,317,345
Vote 29: Elderly and Community Care						
Item 16: Allowances	6,300,000	8,700,000	8,633,514	(66,486)	2,333,514	2,885,641
Item 30: Contractual Services	4,000,000	7,500,000	7,498,944	(1,056)	3,498,944	1,028,729

² Revised estimates are made up of the Original Budget 2014 and the Supplementary Estimates for the same Item.

Table 6: Excess of Expenditure over Original Budget/Revised Estimates by Item *cont./*

Vote, Item	Original Budget 2014	Revised Estimates 2014²	Actual 2014	Variation Actual 2014/ Revised Estimates 2014	Variation Actual 2014/ Original Budget 2014	Variation Actual 2013/ Original Budget 2013
	€	€	€	€	€	€
Vote 47: Ministry for Health						
Item 16: Allowances	52,000,000	62,000,000	61,756,375	(243,625)	9,756,375	7,891,773
Item 17: Overtime	4,200,000	7,600,000	7,065,238	(534,762)	2,865,238	1,302,574
Item 5400: Medicines and Surgical Materials	78,000,000	89,000,000	87,409,144	(1,590,856)	9,409,144	8,980,807
Capital Vote V: Ministry for Tourism						
Items 7801 & 7901 ³ : EU Structural Funds 2007 – 2013	11,488,000	18,488,000	14,659,293	(3,828,707)	3,171,293	2,753,280
Capital Vote VI: Ministry for Education and Employment						
Items 7801 & 7901 ³ : EU Structural Funds 2007 – 2013	35,831,000	55,981,000	50,559,937	(5,421,063)	14,728,937	16,801,864

³ In the previous year the EU Structural Funds 2007 – 2013 were reported under one Line Item 7211.

Table 6: Excess of Expenditure over Original Budget/Revised Estimates by Item *cont./*

Vote, Item	Original Budget 2014	Revised Estimates 2014²	Actual 2014	Variation Actual 2014/ Revised Estimates 2014	Variation Actual 2014/ Original Budget 2014	Variation Actual 2013/ Original Budget 2013
	€	€	€	€	€	€
Capital Vote VIII: Ministry for Transport and Infrastructure Item 7266: Grand Harbour Regeneration Corporation	2,630,000	5,630,000	3,942,847	(1,687,153)	1,312,847	6,000,000
Capital Vote XV: Ministry for Energy and the Conservation of Water Items 7801 & 7901 ³ : EU Structural Funds 2007 - 2013	19,913,000	21,813,000	23,076,864	1,263,864	3,163,864	11,574,298

The following reasons as published in the Supplementary Estimates of Expenditure 2014, were forwarded in respect of the repeated excess expenditure over original budgeted figures of the Line Items outlined in Table 6.

Vote 9: Electoral Office - Item 5219: Electoral Commission Activities

An additional amount of €2,550,000 was necessary in connection with the activities relating to the European Parliament elections.

Vote 17: Education - Item 12: Salaries and Wages

Supplementary funds of €8,400,000 were resorted to provide for emoluments in respect of staff in post, according to the respective Collective Agreements and in terms of recurrent requirements.

Vote 27: Social Security Benefits - Item 5140: Invalidity Pensions; and Item 5149: Social Assistance

Additional amounts of €3,500,000 and €8,900,000, for Invalidity Pensions and Social Assistance respectively, were required to cover a higher expenditure according to the actual number of beneficiaries in receipt of the respective assistance, and to include payments expected to be made by year-end. These amounts were permanently appropriated in terms of the Social Security Act, 1987.

Vote 29: Elderly and Community Care - Item 16: Allowances

Owing to Public Service Collective Agreements' requirements, it transpired that additional funds of €2,400,000 were required to cover payment of allowances to staff for the running of the sector.

Vote 29: Elderly and Community Care - Item 30: Contractual Services

An additional amount of €3,500,000 was provided to service the needs of elderly at St Vincent de Paule Residence and other Homes. The main reason behind this increase was the contracting out of the catering services for the Residence, due to the closure of its kitchen, which occurred during the year.

Vote 47: Ministry for Health - Item 16: Allowances; and Item 17: Overtime

Additional funds of €10 million and €3,400,000 have been provided for amounts requested up to year-end in terms of Collective and Sectorial Agreements, as well as recurrent requirements, based on expenditure trends and actual recruitment.

Vote 47: Ministry for Health - Item 5400: Medicines and Surgical Materials

Additional supplementary funds totalling to €11 million were made available for procurement of medicinal and surgical materials to meet ongoing commitments. As the year progressed, requests were made by the Health Authorities for the provision of further funds to cover various areas of the National Health Service, including the running of the State Hospitals and Outpatient Services. Cognisant with this need, the approved budgetary provisions were supplemented accordingly following an assessment of the requirements as presented, within the parameters of the financial resources available, in order to ensure the continued provision of this public service.

Capital Vote V: Ministry for Tourism; Capital Vote VI: Ministry for Education and Employment; and Capital Vote XV: Ministry for Energy and the Conservation of Water - Items 7801 and 7901: EU Structural Funds 2007 – 2013

Extra funds of €7 million were estimated to be required by the Ministry for Tourism to cover commitments on various projects which were co-financed by EU.

Estimated supplementary finances of €20,150,000 were required by the Ministry for Education and Employment to meet obligations on a range of assignments which were co-financed by EU.

Additional amounts of €1,900,000 were provided to the Ministry for Energy and the Conservation of Water to cover commitments on different projects.

At time of compilation of the Financial Estimates during the budget preparatory process, all Managing Authorities of EU funds were requested to make available their submissions on the budgetary allocations that were expected to be required to cover planned expenditure for the following year.

Utilisation of the funds provided depends on project management and implementation periods. In this case, projects advanced at a steadier pace than as was anticipated at budget preparation time, thus the need to provide supplementary funding arose. In such way, risk on eventual loss of EU funds during such year was minimised. Moreover, it is to be noted that expenditure incurred out of EU funded items is subsequently reimbursed by EU in response to claims made by the Certifying Authorities.

Capital Vote VIII: Ministry for Transport and Infrastructure - Item 7266: Grand Harbour Regeneration Corporation

An additional €3 million of funds have been provided to enable payment of Value Added Tax (VAT) due on the new Parliament Building.

Assets and Liabilities

Article 67(j) of the Financial Administration and Audit Act, 1962 states that the Accountant General shall prepare “... a statement of assets and liabilities of the Government at the end of the financial year ...”.

This Statement may be looked upon as a statement of end-of-year balances in the Treasury books, which result from cash transactions accounted for in the Public Account during the year. Given that Central Government accounts are still cash-based, not all Government’s assets and liabilities are included in this Statement as would be under an accruals-based accounting system.

Assets

Table 7 represents the Statement of Assets.

Table 7: Statement of Assets

	2014	2013
	€'000's	€'000's
Public Credit		
Shareholding	721,762	501,582
Other Investments	113,568	453,689
Loans	<u>108,145</u>	<u>108,145</u>
	<u>943,476</u>	<u>1,063,415</u>
Investments held on behalf of		
Sinking Funds (Local)	122,878	69,330
Sinking Funds (Foreign)	25,531	29,593
Trust Funds	<u>1,650</u>	<u>1,646</u>
	<u>150,060</u>	<u>100,569</u>
Advances		
Advances	<u>111,173</u>	<u>137,877</u>
Bank and Cash		
Banks ⁴	6,059	5,742
Central Bank of Malta – Public Account	<u>92,976</u>	<u>86,396</u>
	<u>99,035</u>	<u>92,138</u>
Total Assets	<u>1,303,743</u>	<u>1,393,998</u>

Figures in Statement may not add up due to rounding up.
(Source: FR 2014, page 188)

Public Credit – Shareholding

As at 31 December 2014, the value of direct investments, stood at €721,762,235 (€501,581,806 in 2013). This was made up of €471,616,865 unlisted shares valued at purchase cost, and €250,145,369 listed shares, which have been valued at market price as at year-end. The nominal value of shares denominated in British Pounds (£41,339) and United States Dollars (\$138,630,753) remained unchanged from 2013.

The following were the major changes in Treasury Clearance Fund/Consolidated Fund investments during the year:

New Investment

Enemalta p.l.c.

As *per* extraordinary general meeting of Enemalta p.l.c. held on 10 December 2014, a new and revised Memorandum and Articles of Association of the Company was unanimously approved. This was followed by an investment agreement entered into by the Government of Malta, Enemalta p.l.c., Shanghai Electric Power Company Limited and SEP (Malta) Holding Limited dated 12 December 2014.

⁴ Consists of bank accounts held by foreign Embassies/Commissions and the National Lottery Good Causes Fund bank account.

In the Statement of Other Investments published in FR 2013, the Government of Malta reported an investment in the then Enemalta Corporation amounting to €342,850,080. During 2014, this was absorbed by the new investment in Enemalta p.l.c. of €200 million Ordinary A shares of €1 each, fully paid up.

Increases in Investments

Air Malta p.l.c.

As part of the Restructuring Plan approved by the European Commission, approving the Government of Malta to take up €130 million shares in the company as restructuring aid, Government further subscribed to 52 million Ordinary Shares, being its *pro rata* share of the issue by the company of 53,088,957 shares of €1, offered to all shareholders of Air Malta p.l.c.

In accordance with the Subscription Agreement dated 6 October 2012 entered into between the Government and Air Malta p.l.c., by end-of-year 2014, the Government paid-in the cash sum of €30,004,000, equivalent to 57.7% of the nominal value.

Moreover, in connection with the 78 million shares allotted to Government in 2012 by virtue of the same Agreement, amounts due for 2014 in respect of the unpaid part of the aforementioned Ordinary Shares, led to an increase of €9 million in the paid-up share capital.

Government is expected to contribute the full 100% of the nominal value of Ordinary Shares by 15 January 2016. Government's shareholding in Air Malta p.l.c. as at 31 December 2014, reached 99.98%.

European Investment Bank

With reference to the decision of the Board of Governors of the European Investment Bank taken in 2012 to increase its capital by an aggregate paid-in amount of €10 billion, the share of the capital increase to be paid by Malta amounted to €4,235,500.

During 2014, a second instalment of €1,058,875 was paid, in aggregate representing 75% of the total share of the capital increase, thus bringing Government's total paid-in capital by the end of the year to €8,089,100. Moreover, as *per* confirmation dated 27 April 2015, the nominal value of Malta's share in the subscribed capital of the European Investment Bank as at end-of-year 2014 stood at €102,665,000.

European Stability Mechanism

As established in the European Stability Mechanism (ESM) Treaty and subsequent decisions, ESM Members were requested to provide the fifth instalment of the ESM paid-in capital during 2014.

To this effect, during the year under review, Malta effected a further tranche due to ESM, bearing the value of €11,696,000, as paid-in capital. As at year-end, the total paid-up share capital of €58,480,000 represented 11.4% of the 5,117 authorised share capital, of which, 584.8 are paid-in shares and the remaining 4,532.2 shares are callable.

Bank of Valletta p.l.c.

By means of Board resolution dated 19 December 2013, Bank of Valletta p.l.c. capitalised the amount of €30 million from the company's reserves for the purpose of a bonus issue of an equal amount of fully paid Ordinary Shares with a nominal value of €1 *per* share.

On the basis of the allocation ratio of one bonus share for every ten shares held, a total amount of 7,569,035 Ordinary Shares were allotted to Government. To this effect, the nominal value of Government's investment as at 31 December 2014 amounted to €83,259,386.

Meanwhile, as at year-end 2014 the investment in Bank of Valletta p.l.c. ended up with a lower market price than that quoted in previous year, resulting in an aggregate decrease in market value of €14,002,715.

Termination of Investment

Malta University Sports Complex Limited

Government's shareholding in Malta University Sports Complex Limited, valued at €22,828, did not feature in the Statement of Investments as at 31 December 2014, since the latter was struck-off on 19 March 2014. To this effect, Treasury confirmed that up to 2 September 2015, no funds have been transferred from the entity in question.

Movements in Values of Existing Investments

During 2014, the cost of investments in:

- a. Council of Europe Development Bank;
- b. International Bank for Reconstruction and Development;
- c. Malta Freeport Corporation Ltd;
- d. Mediterranean Offshore Bunkering Co. Ltd; and
- e. Multilateral Investment Guarantee Agency,

increased by €1,316,306 due to changes in United States Dollar (\$) exchange rate.

Public Credit – Other Investments

Investment in Industry

A Schedule of Investments submitted by MGI to the Accountant General showed that the total cost of investment in 44 companies amounted to €16,327,354 as at 31 December 2014.

MGI estimated that the net book value of these investments amounted to €14,074,396, after an accumulated provisional loss of €2,252,954. Further details are provided in *Table 8*.

The Schedule also indicated that eight of these companies were undergoing liquidation procedures and another two never commenced operations.

Table 8: Investments through Malta Government Investments Ltd

Investment Type	No. of Companies	Cost	Provisional Loss	Net Book Value
		€	€	€
Subsidiary Companies	26	14,870,477	1,146,502	13,723,975
Associated Companies	2	1,455,858	1,106,452	349,406
Other Companies of Minority Interest	16	1,019	-	1,019

At the end of 2014, the total of indirect investment in industry as reported by Treasury amounted to €16,349,729 as against €13,619,732 on 31 December 2013, an increase of €2,729,997 over the previous year. Such movement was due to an increase in shareholding in Gozo Ferries Company Ltd of €999,999 and new investments in subsidiary companies as shown in *Table 9*.

Table 9: New Investments in Subsidiary Companies

Details	Cost/Net Book Value
	€
Projects Malta Ltd	699,999
Petromal Company Ltd	24,999
Health Change Management Unit	4,999
Engineering Resources Ltd	1
Enemalta p.l.c.	1

It is to be noted that indirect investments, at year-end, as reported by Treasury, amounting to €16,349,729, do not tally with MGI aggregate balances reported, standing at €16,327,354. The difference of €22,375 between Treasury's and MGI's records warrants mostly of an investment of €22,362 in Topwear Ltd that is not reported on MGI records, this being an investment made from Government funds by the former Malta Development Corporation.

Movements in 'Other Investments'

As already reported under Public Credit – Shareholding, Government's holdings in the then Enemalta Corporation as reported in FR 2013, amounting to €342,850,080, were absorbed by the new investment in Enemalta p.l.c. of €200 million.

Euro Coins

During 2014, the Central Bank of Malta (CBM) made Euro Coin issues on behalf of Treasury totalling €5,118,000, bringing the total amount of Euro Coins in circulation as at 31 December 2014 to €60,397,000.

Dividend/Profit Received

Central Bank of Malta

During the year under review, a total of €50 million was received in six tranches from CBM, consisting of 2013 net profits paid to Government.

Malta Financial Services Authority – Capital Fund

Total surplus funds amounting to €6,750,000 were received in two tranches from the Malta Financial Services Authority during 2014, in terms of Section 26(3) of the Malta Financial Services Act (Cap. 330).

Inspection of Securities/Investments - Government Securities Board

The purpose of the Government Securities Board is to verify and certify the List of Securities held by the Government at year-end, with the relative Stock Certificates held by Treasury. Representatives from NAO attend the annual meeting in an observer capacity.

The Board is made up of three members, namely the Chairperson, this being MFIN Permanent Secretary, a Malta Investments Management Company Ltd representative and the Accountant General.

The Government Securities Board meeting was held on 28 October 2015, during which the Board verified the correctness of security details against documents including, where available, official Stock Certificates issued by the company concerned, Malta Stock Exchange (MSE) Statements, and other related documents maintained by Treasury.

Public Credit – Loans made by Government and Repayments thereof

Balances and other details of all loans issued by Government as on 31 December 2014 as reported in Appendix E of FR 2014, are summarised as follows:

	€
a. Loans under Act II of 1956	23,099
b. Other Loans	108,122,000

Other Loans at (b) consist of the following:

	€
Aids to Industries Scheme	3,718
Agriculture – Assistance to Co-Operatives	66,620
Water Services Corporation	4,967,885
Loan Facility Agreement with the Hellenic Republic	50,683,923
Loan Facility Agreement with Air Malta p.l.c.	52,000,000
Loan – Mariam Al Batool	399,854

(Source: FR 2014 page 170)

Existing Loan Agreements

Agriculture – Assistance to Co-Operatives

A total balance of €66,620 was still due as at year-end by four different Co-Operatives, for loans given to them during the period 1983 to 1985.

Water Services Corporation

The loan to the Water Services Corporation is interest free, and repayable either through a direct payment to Treasury in the event that no subvention is required by the Corporation or through a Transfer Voucher in the event that the Government's subvention is still required. The initial amount of the loan was of €10,482,180.

No loan repayments were effected in the years 2008 to 2014. Furthermore, previous repayments were, either charged from grants to the Water Services Corporation or set-off against the Corporation's bills,

mainly from the then Malta Drydocks.

Loan Facility Agreement with the Hellenic Republic

The loan to the Hellenic Republic originated from an €80 billion Loan Facility Agreement signed between the Euro Member States (the Lenders) except Greece, and the Hellenic Republic (the Borrower), dated 8 May 2010. The maximum amount that the lenders shall contribute under the Facility was established in this Agreement, which in Malta's case, stood at €74,543,026.

The balance of the loan facility agreement with the Hellenic Republic as at 31 December 2014 amounted to €50,683,923. The principal repayments are scheduled between 15 June 2020 and 15 September 2026.

Loan Facility Agreement with Air Malta p.l.c.

As already reported in the previous year's Annual Audit Report (AAR), on 15 November 2012, a 'commercial' loan of €52 million was granted to Air Malta p.l.c. as part of a restructuring plan, which was authorised by the European Commission. The first repayment of €40 million fell due in January 2015, whilst the remainder sum of €12 million is payable a year after.

In fact, on 9 January 2015, the Government and Air Malta p.l.c. entered into a Set-off and Payment Agreement, whereby the first repayment of €40 million was set-off in accordance with the Loan Agreement, against the acquisition by Government of additional Ordinary shares in Air Malta p.l.c., as earlier agreed. Further details of the Government's investment in Air Malta p.l.c., in accordance with the restructuring plan, may be found under 'Investments' on page 31 of this Analysis.

Loan – Mariam Al Batool

During 2011 and 2012, Government lent a total of €399,854 to the Mariam Al Batool School, due to the suspension of the financial subsidy which the School used to receive from Libya, as *per* agreements dated 28 April 2011 and 14 December 2011. The repayment dates are scheduled at a rate of €25,000 at end of each quarter for the period March 2014 to December 2017. However, up to the writing of this Report, the first six payments due, totalling €150,000, were not honoured by the borrower. NAO was informed that Treasury does not have formal documentation explaining why the School is not servicing the loan.

Investments held on behalf of Sinking Funds

The following is a breakdown of Investments held on behalf of Sinking Funds:

Table 10: Sinking Funds Investments

Investment	Sinking Funds - Local	Sinking Funds - Foreign
	€	€
Central Bank of Malta Deposit Accounts	55,299,020	25,531,453
Malta Government Stocks	67,579,199	-
Totals	122,878,219	25,531,453

(Source: FR 2014, page 184)

Advances

Accounting for Advances

Article 89 of the General Financial Regulations, 1966 stipulates that “... *it shall be the duty of the Accounting Officers to see that such accounts are repaid as early as possible in the manner specified in the warrant*”.

Appendix L of FR incorporates a detailed statement of balances remaining outstanding as on 31 December 2014, in respect of advances made to various Government Departments, Agencies and Organisations.

Pending advances were reported as amounting to €111,172,533 as on 31 December 2014, as against €137,876,589 outstanding by the end of the previous year.

Advances Repaid

Two advances in relation to Social Security Benefits and Malta Drydocks Corporation (1999) totalling €11,860,093 were fully repaid during the year.

Outstanding Advances

Outstanding advances as at 31 December 2014, apart from advances forwarded to the former Malta Drydocks Corporation and Malta Shipbuilding Co. Ltd, were the following:

Table 11: Outstanding Advances

Description	Amount
	€
Malta Development Corporation on 24 July, 1984 for the purchase of Verdala Hotel	1,724,785
Ministry of Finance to the Bank of Valletta Employees Foundation, for the purchase by the Foundation of 1,385,406 ordinary shares in Bank of Valletta Ltd in 1995	1,967,926
Commissioner of Inland Revenue, to meet loans in terms of Article 4 of the Monte Di Pieta' Act (No. XXXIX) of 1976	318,401
Ministry of Finance, for the purchase of shares held by Enemalta Corporation in Mediterranean Offshore Bunkering Co. Ltd	9,317,494
Treasury for the purchase of shares held by Sea Malta Co. Ltd in Mediterranean Offshore Bunkering Co. Ltd. The amount so advanced should be accounted for and repaid, in the first instance, out of proceeds forthcoming from the eventual privatisation of the same Company, immediately such proceeds become available to Government. In the second instance, in the event that such funds are not sufficiently available, out of funds made available from the Consolidated Fund upon the privatisation of the Company	1,109,173
Ministry of Finance and Commerce, to be utilised as a loan facility by the Maltacom Employees Foundation, to purchase ordinary shares in Maltacom p.l.c. in 1998	4,907,504
Ministry for Economic Services, for the purpose of settling during 1999 and further servicing costs of Malta Freeport loans	7,977,644
Ministry for Economic Services, to meet expenditure in connection with the privatisation process of the Malta Freeport operations	2,118,836
Ministry for Economic Services, for the purpose of settling Malta Freeport equipment claims	10,482,180
Treasury for the purchase of Medigrain shares from Mid-Med Bank p.l.c. in 1999	1,314,927
Ministry of Finance, advanced to Mid-Med Employees Foundation, for the purpose of investment, pursuant to the agreement dated 3 December 2002 and entered into between Malta Government and the Foundation in the interest of the members of the said Foundation	6,988,120
Ministry for Information Technology and Investment, to enable Gozo Channel Co. Ltd to settle urgent debts, including social security contributions and income tax (FSS) payments	291,172
Ministry of Finance, the Economy and Investment for the purpose of extending loan Facilities to Mariam Al Batoool School	399,854
Total	48,918,016

Remarks*Purchase of Verdala Hotel – €1,724,785*

This advance was made to Malta Development Corporation on 24 July 1984 for the purchase of Verdala Hotel, and is still showing in the books of Malta Enterprise as due to Government. This advance will continue to be pursued within the context of pending legal proceedings that were initiated against a local holding company. This company entered into a deed of sale in 1997. Legal proceedings covered

outstanding dues to Malta Enterprise and the unfulfilled obligations for the development and operation of a new hotel complex. MFIN stated that it communicated with Malta Enterprise on 24 March and 28 November 2014, however the latter was not yet in a position to confirm settlement of the matter.

Bank of Valletta Employees Foundation - €1,967,926

Treasury stated that Bank of Valletta Foundation benefitted twice from the tax at source withheld on its holding of shares in Bank of Valletta p.l.c. In the first case, the amount of tax at source was transferred on MFIN's request and credited against the loan account balance in terms of the 1995 Loan Agreement between the Government of Malta and the Foundation. The latter claimed the tax at source as credit in its income tax return through the self assessment system, which claim eventually resulted in a tax refund. As this double benefit had to be neutralised, the Bank of Valletta Foundation was asked to reimburse the amount of €1,071,686 so that the balance could be reinstated. To this effect, a net amount of €131,613 was repaid. The Ministry shall continue to pursue the repayment of the balance due on this advance.

Loans in terms of the Monte Di Pieta' Act, 1976 - €318,401

This advance is administered by the Capital Transfer Duty Department in terms of the Monte Di Pieta' Act, 1976. During 2014, repayments made in respect of this advance totalled €12,350.

Purchase of Mediterranean Offshore Bunkering Co. Ltd Shares from the then Enemalta Corporation and Sea Malta Co. Ltd - €9,317,494 and €1,109,173 respectively

As in previous years, MFIN confirmed that the amount advanced is planned to be repaid out of proceeds forthcoming from the eventual privatisation of the Mediterranean Offshore Bunkering Co. Ltd.

Loan to Maltacom Employees Foundation - €4,907,504

MFIN reinstated that it is continuing to pursue the repayment of this advance through annual installments due, together with possible renegotiation with the Foundation of the original terms under which the advance was granted.

Malta Freeport Loan Servicing - €7,977,644

According to MFIN, this advance will continue to be repaid out of the annual budgetary provision under Item 7189 (Contribution towards Treasury Clearance Fund) of MFIN Capital Vote, as is being done each year in the case of other past advances to the Malta Freeport Corporation. During 2014, a repayment out of public funds themselves, was made in respect of this advance, amounting to €3 million.

Malta Freeport Privatisation Process, Malta Freeport Equipment Claims and Purchase of Medigrain Shares from Mid-Med Bank p.l.c. - €2,118,836, €10,482,180 and €1,314,927, respectively

As confirmed by MFIN, these advances are planned to be repaid by public funds out of the annual budgetary provision under Item 7189 (Contribution towards Treasury Clearance Fund) of MFIN Capital Vote.

Mid-Med Bank Employees Foundation - €6,988,120

As stated by MFIN, the repayment of this loan is expected to commence in 2018, when the 15-year moratorium of the loan agreement expires.

Gozo Channel Company Ltd - €291,172

Originally, the Advance Warrant had to be repaid by 31 March 2005, as stipulated by the same Warrant. In July 2004, MFIN, in agreement with Gozo Channel Co. Ltd, compiled a new schedule of interest and capital repayments, for the Advance amount of €1,164,687, which was to be completely repaid by 2013.

During 2014, no payments were effected by Gozo Channel Co. Ltd to honour its dues. MFIN stated that further communication requesting settlement of the amounts due was sent to the company on 28 November 2014.

Loan Facilities to Mariam Al Batool School - €399,854

MFIN stated that the programme of Government is being kept in view when considering the outstanding amount due on this advance.

Other Outstanding Advances

Further pending advances to be repaid out of the 'Contribution towards Treasury Clearance Fund' are listed in *Table 12*.

Table 12: Pending Advances to the former Malta Shipbuilding Co. Ltd and Malta Drydocks Corporation

Description	Amount
	€
Construction of ships at Malta Shipbuilding Co. Ltd	21,643,890
Malta Drydocks Corporation – 2000	10,623,291
Malta Drydocks Corporation – 2001	29,987,336
Total	62,254,517

MFIN confirmed that the above advances will continue to be repaid out of an annual budgetary provision under Item 7189 – ‘Contribution towards Treasury Clearance Fund’ of MFIN Capital Vote. In fact, as indicated in the 2014 FR, an amount of €11 million has been repaid in settlement of the advance of Malta Drydocks Corporation – 2000. In addition to the €62.3 million, one is also to note advances in respect of Malta Freeport Loan Servicing, Malta Freeport Privatisation, Malta Freeport Equipment Claims and Purchase of Medigrain Shares from Mid-Med Bank p.l.c., for an aggregate amount of €21,893,587.

Central Bank of Malta Public Account

Treasury submitted to NAO outstanding monthly reconciliation statements for the Public Account for the period June 2013 to August 2014. Further statements for the Public Account will be submitted to NAO when the import module is completed. NAO noted €4.9 million classified as “*Other Adjustments*” in the August 2014 Reconciliation Statement. The explanation forwarded by Treasury referred to “... *fixes that are taken in the BRS system ...*”.

As reported in the last year’s AAR, on the Reconciliation for the period June 1992 to December 2001, Treasury once again confirmed no development in this respect, and its position remained the same as detailed in the 2013 AAR.⁵

Developments on the Bank Reconciliation Report and the Multiple Matching Facility

Since its introduction in October 2014, Treasury confirmed that the Multiple Matching Facility is working effectively and the Bank Reconciliation Report automatically reconciles any Departmental Accounting System (DAS) entry having multiple CBM transactions.

Boards of Survey

Boards of Survey at Treasury and at the Ministry for Gozo were appointed in terms of Section 98 of the General Financial Regulations, 1966, in order to take account of moneys, deposits and other values as at 31 December 2014.

This Office received the Report prepared by the Board of Survey at the Ministry for Gozo, on 15 October 2015. The Board had no adverse remarks to make.

On the other hand, up to the date of writing of this Report, the Board of Survey at Treasury has not been convened to certify the correctness of the relevant statements, since the Government Securities Board approved the 2014 List of Securities held at Treasury late in the year on 28 October 2015.

⁵ Treasury still maintains that the start-off date of the new reconciliation exercise should be January 2002. Treasury stated that during the indicated 10-year period, there had been various changes both in Government’s accounting system and in that of CBM, making it impossible to embark on any kind of reconciliation for the years in question. This decision is based on cost considerations and human resources requirements.

Ministerial/Departmental Bank Accounts

Treasury Circular No. 2/2015, 'End of Year (2014) Statements of Account Cash in hand and Bank Balances held at Local Commercial Banks and Central Bank of Malta' issued on 13 January 2015, requested Heads of Departments and other Accounting Officers to submit both soft and hard copies of the Return indicating the cash and bank balances as at 31 December 2014, including the position of each bank account held both at local commercial banks and CBM. In addition, officers were to submit a hard copy of these balances to Treasury, clearly indicating those bank accounts against which a liability exists, as well as identify bank accounts in respect of Trust Funds.

The respective balances were published accordingly in FR 2014 (pages i to vii refer). Whilst the credit balance as *per* Bank Statement consists of the 'Liability', 'Trust' and 'Resulting Balances', the 'Debit Balance' on the other hand, should portray only credit card accounts. An exception to this was reported in FR, in relation to the Education Department, which had overdrawn balances on two of its schools' accounts as at year-end, albeit lower than the previous year. Treasury stated that this has been highlighted to the said Department.

NAO noted that with respect to the Trade Services Department, the bank balance reported in FR 2014 was overstated by €17,490. Upon further enquiry, it transpired that a number of year-end transactions pertaining to one particular bank account were not taken into consideration by Treasury, thus resulting in an incorrect balance being reported in FR.

Moreover, NAO noted that a number of foreign bank account statements for the year ended 31 December 2014, in aggregate amounting to €4,271,959, pertaining to the Ministry for Foreign Affairs, were not made available to Treasury. Therefore, this Office was not in a position to vouch such statements with the Return.

During the year under review, Treasury confirmed that it held discussions with National Statistics Office (NSO) in relation to bank accounts as reported in FR 2014. It was established that NSO uses data relating to the "*major bank accounts*" as a basis for the compilation of their Financial Accounts in reporting to Eurostat. In fact, out of a total of €394 million reported in FR, NSO coverage approximates €325 million. Moreover, Treasury sought legal advice from the Attorney General regarding the nature (*i.e.* classification of an asset or liability) of some of the bank accounts reported in FR 2014.

Liabilities

Table 13 features the Statement of Liabilities.

Table 13: Statement of Liabilities

	2014	2013
	€'000's	€'000's
Public Debt	4,996,343	4,718,202
Euro Coins issued on behalf of Treasury	60,397	55,279
Treasury Bills	140,356	247,407
Deposits		
Court and Other Deposits	91,958	76,462
Other	23	23
	91,982	76,486
Funds		
Sinking Funds	148,410	98,923
Contingencies Fund	1,165	1,165
Trust Funds	1,891	1,708
	151,466	101,796
Total Liabilities	<u>5,440,543</u>	<u>5,199,169</u>
Excess of Total Liabilities over Total Assets	<u>(4,136,800)</u>	<u>(3,805,171)</u>
Accumulated Fund		
Consolidated Fund at year end	(23,536)	(95,106)
Net Public Debt/Public Credit	<u>(4,113,264)</u>	<u>(3,710,065)</u>
	<u>(4,136,800)</u>	<u>(3,805,171)</u>

Figures in Statement may not add up due to rounding up.
(Source: FR 2014, page 189)

Public Debt

Debt Composition

In general, Government's borrowing programme includes Malta Government Stocks (MGS) and Treasury Bills. The Government sets the long-term Public Debt management goal, and its preference as to the type of debt and the maturity profile helps provide the market with long-term confidence about the nature of Government's future borrowing consistent with an acceptable level of risk.

Debt Composition of the General Government Sector Debt as at end-of-year stood as follows (*Tables 14 and 15 refer*):

Table 14: Debt Composition – Domestic and External

2014		2013	
Domestic Debt	External Debt	Domestic Debt	External Debt
%	%	%	%
95.90	4.10 ⁶	95.74	4.26 ⁶

(Source: Refer to *Table 15* for percentage calculations)

Table 15: General Government Sector Debt

Type of Debt	2014		2013	
	Amount	Percentage of Total Debt	Amount	Percentage of Total Debt
	€'000's	%	€'000's	%
Malta Government Stocks (Consolidated)	4,828,017	89.07	4,565,563	87.11
European Financial Stability Facility (Rerouted Debt) ⁷	181,794	3.35	172,476	3.29
Treasury Bills	140,440	2.59	248,117	4.73
Extra Budgetary Units and Local Councils	114,043	2.10	92,509	1.77
Euro Coins	59,629	1.10	55,279	1.05
Other Local Loans	56,379	1.04	56,379	1.08
Foreign Loans	40,389	0.75	50,964	0.97
Total Debt	5,420,691	100	5,241,287	100

(Source: Budget Speech 2016; Government Finance Data January to December 2014 – National Statistics Office News Release No. 061/2015; Quarterly Accounts for General Government Q1/2015 – National Statistics Office News Release No. 128/2015)

⁶ Excludes MGS held by non-residents which in 2014 amounted to 4.8% (2013: 3.14%) and includes the European Financial Stability Facility (EFSF) (Debt Rerouting).

⁷ EFSF was established on 7 June 2010 for the purpose of providing stability support to Euro Area Member States (EAMS). EFSF finances such support by issuing or entering into bonds, notes, commercial paper or other financing arrangements. The operations are backed by guarantees of EAMS on the basis of an agreed 'Adjusted Contribution Key'. On 27 January 2011, Eurostat decided that the debt issued by EFSF for each support operation must be rerouted (sent by a different route) to the Public Accounts of EAMS providing guarantees, proportionately to their contribution key. Therefore, the recording of such flows will impact the Gross Government Debt (as defined in the Maastricht Treaty), but not the Net Debt.

Public Debt Percentages

Table 16 portrays debt as a percentage of Gross Domestic Product (GDP) as at 31 December.

Table 16: Debt as a Percentage of Gross Domestic Product

2014			2013		
Public Debt	Gross Domestic Product	Ratio of Public Debt to Gross Domestic Product	Public Debt	Gross Domestic Product	Ratio of Public Debt to Gross Domestic Product
€'000's	€'000's	%	€'000's	€'000's	%
5,420,691 ⁸	7,941,342 ⁹	68.26	5,241,287 ¹⁰	7,533,607 ⁹	69.57

As at end-of-year 2014, the percentage of Government's debt to the country's GDP amounted to 68.26%, resulting in a decrease of 1.31% over the previous year. This indicates that the economy grew faster than debt during 2014. Such result was in line with Government's core medium-term fiscal objective of restoring the trajectory of public finances to a sustainable path.

Local Loans

On 31 December 2014, the local Public Debt amounted to €5,380,302,000, representing an increase of €189,979,000 over the corresponding reported figure for 2013. In addition to MGS totalling €4,828,017,000, the closing Public Debt balance is inclusive of EFSF Rerouted Debt, Treasury Bills outstanding at year-end, debts of Extra Budgetary Units and Local Councils, Euro Coins, as well as Domestic Loans with Commercial Banks, amounting to €181,794,000, €140,440,000, €114,043,000, €59,629,000 and €56,379,000 respectively. (Details in Table 15)

Foreign Loans

As reported in last year's AAR, the authorisation and regulation of raising foreign loans is governed by the Development Loan Act (Cap. 229), which authorises the Government of Malta to enter into agreements with foreign governments, international organisations or other institutions, to obtain financing from abroad to support Malta's economic development.

Whereas all domestic borrowing by the Maltese Government is by way of public offer of securities, all foreign borrowing is in the form of bilateral non-marketable loans with foreign governments and international institutions.

The policy of borrowing from overseas through bilateral agreements with foreign governments/organisations lies within the remit of MFIN, and is usually sought to finance specific projects. All loan agreements are subject to the final approval of the Minister for Finance, after consulting CBM on the terms and conditions of each loan. The Debt Management Directorate (DMD) is ultimately responsible for the recording and servicing of such loans. The process of sourcing foreign loans falls exclusively under the responsibility of MFIN.

⁸ Source: Table 15 above

⁹ Source: Gross Domestic Product Q2/2015 – National Statistics Office News Release No. 163/2015

¹⁰ Source: Table 15 above. Public Debt balance as at 31 December 2013 has been updated from the balance reported in the previous year's AAR to provide a more accurate analysis as per detail included in Table 15.

A detailed analysis of existing foreign loans due, which as at end 2014 stood at €40,389,274, is provided in *Table 17*.

Table 17: Foreign Loans Analysis

Foreign Loan	Financing Purpose	Year of Issue	Amount Disbursed	Interest Rate	Date of Maturity	Balance due as at 31 December 2014
				%		€
Council of Europe Fund for Development 2003	Mater Dei Hospital	2003	€75.5 million	4.65	07/05/2018	30,200,000
Council of Europe Fund for Development 2002	Mater Dei Hospital	2002	€25.5 million	5.06	11/12/2017	7,650,000
European Union Loan C	Solid Waste Composting Project	1987	€3 million	1.00	15/09/2027	1,411,200
European Union Loan B	Improvements in the Grand Harbour	1979	€5 million	1.00	15/11/2018	757,000
U.S.A. Government	Tug boat, cranes and spare parts related to projects	1973	\$5 million	3.00	13/11/2015	202,191
Government of Canada	Telephone cables and equipment	1974	CAD 1 million	-	31/05/2024	168,883
Total						40,389,274

(Source: FR 2014, page 174; AAR 2013 page 41)

Debt Management

Background

DMD was established within the Treasury Department in December 2006 with responsibilities for debt and cash management for the central Government and for providing specified funding requirements as authorised by Parliament.

The principal objective of the Directorate in its debt and cash management activities is to raise funds, as well as to carry out other financial transactions in such a way as to ensure that:

- a. central Government borrowing programme (short and long-term) is financed at the lowest possible long-term servicing costs and subject to a prudent level of portfolio risk;
- b. liquidity of Government funds is adequate to meet Government's payment obligations as they arise and fall due; and
- c. domestic financial markets are given the necessary support.

Legal Framework for Borrowing

The statutory basis for central Government borrowing is set out under the following primary and subsidiary legislation:

- a. Malta Treasury Bills Act, Cap. 133
- b. Malta Treasury Bills (Dematerialisation) Regulations, 2007
- c. Local Loans (Registered Stock and Securities) Ordinance, Cap. 161
- d. Local Loans (Registered Stock) Regulations, S.L. 161.01
- e. Development Loan Act, Cap. 229 (in respect of bilateral loans raised outside Malta)
- f. Government Borrowing and Granting of Loans to the Hellenic Republic Act, 2010 (Act III of 2010)
- g. An annual budget law that authorises the Minister for Finance to raise loans on behalf of the Government for an established amount during the financial year by the issuing of securities, and also provides the main purposes for which Government can apply such borrowing (for year 2014, Act No XII of 2014 'The Budget Measures Implementation Act' refers).

Government Borrowing and Public Debt Management Act

During January 2014, DMD hosted a delegation from the Commonwealth Secretariat's Public Debt Management Advisory to identify areas of advisory support on Debt Management. The main objectives of the visit by the delegation were to:

- a. strengthen the existing Debt Management Framework through the identification of areas where improvement could be made;
- b. build capacity in Debt Management;
- c. provide advice on the formulation of a comprehensive medium-term Debt Management Strategy; and
- d. provide assistance with Debt Analysis.

After a review of DMD's legislative framework, policies, strategies and operations, priority was given to review and update the current legal framework relating to Government Debt Management legislation. To this effect, two further in-country missions from the Commonwealth Secretariat were held in June and November 2014. During the June visit, various meetings were organised with stakeholders, including

NAO, with a view to receive their input on the proposed review of current legislation. Following these consultations, an advanced and comprehensive draft of the new Government Borrowing and Public Debt Management Act (GPDMA) was compiled and subsequently discussed during the third visit by the Debt Management Advisory's officials, hosted in November 2014.

In the third quarter of 2015, the Legislative Review Team, made up of all the Public Debt Management Advisory Committee (PDMAC) members, as well as representatives from DMD and CBM, met twice to discuss and review the final draft of the new GPDMA. NAO is informed that Treasury shall be referring the final draft to the Attorney General for its legal drafting.

General Economic Factors

General economic factors are likely to have an influence on the nature and extent of Public Debt Management activities. During the year 2014, such factors included:

a. Lower Tax Rates

For the last three years, the top personal marginal income tax rate has been gradually reduced with the aim of boosting disposable income and consumption expenditure. This resulted in material increases in tax revenue, especially VAT revenue, which contributed to the reduction in the budget deficit and therefore borrowing needs.

b. Lower Interest Rates

The year 2014 was characterised by historically low interest rates, both in the money and capital markets. The weighted-average interest rate payable on total Treasury Bills issued during the same year amounted to 0.421%, compared to 0.663% in 2013. This had a positive effect on total interest cost incurred on short-term borrowing for the year, which amounted to €1.9 million, compared to an approved 2014 budget estimate of €4.7 million, and €2.6 million actual interest expenditure on short-term borrowing incurred in 2013.

The low interest rate environment was also reflected in the coupon rates offered on new MGS issues during 2014. DMD launched a new 10-year MGS bearing a 3.3% annual coupon. During the same year, the Directorate managed to continue extending the average maturity of MGS portfolio, and at the same time issue new long-term MGS progressively with lower coupons of 4.45% (maturing in 2032 – 18 years), 4.3% (maturing in 2033 – 19 years) and 4.1% (maturing in 2034 – 20 years). This development enabled Treasury to secure long-term funding at very low and predictable cost for relatively long periods of time.

c. Lower Euro Strength

The general economic performance of the Euro Zone during 2014, and the policy actions undertaken by the European Central Bank (ECB) which intended to stimulate credit, demand and economic growth, as well as to avoid a deflationary spiral, led to a substantial weakening of the Euro against all the major currencies.

d. Euro Zone/Greek Debt Crisis

Although the Euro Zone registered moderate growth in 2014, sovereign yields continued on their downward trend owing to weak inflation, primarily caused by lower energy prices, and to progress achieved in establishing a Banking Union aimed at strengthening financial stability in the Euro area. Yield spreads between yields on benchmark 10-year German Government Bonds and those issued by other Euro Zone Governments continued to fall further in 2014. The fall in yields and spreads

was particularly pronounced in the latter half of 2014 in anticipation of further monetary policy easing measures by ECB. The announcement by ECB of its expanded asset purchase program to include sovereign Euro area bonds in January 2015, led to a substantial rally in global bond prices, resulting in extremely low yields. These developments enabled the Maltese Treasury to issue MGS with historically low coupons and advantageous spreads.

After recording the first signs of economic recovery in mid-2014, Greece again reversed course and went against the general trend in the Euro Zone with widening yield spreads, starting towards the end of 2014, due to rising political uncertainty. Anxiety caused by the difficult nature of negotiations between Greece and its creditors caused fears of a default and Euro Zone break-up to resurface, leading to a consequent widening of spreads for the ‘peripheral’ Euro Zone countries (Portugal, Italy, Ireland and Spain) in the first half of 2015. These factors also led to material corrections to bond prices and yields.

Main Aspects of Debt Management

As already reported in the previous year’s AAR, the Advisors from the Commonwealth Secretariat explained the following as being the five main aspects of Debt Management that need to be audited every year, as part of International Best Practices:

- a. Policy
- b. Operations
- c. Risk Control Procedures
- d. Information Technology (IT) Systems
- e. Financial Aspect

Methodology for the Analysis of Public Debt

As part of this year’s analysis of Public Debt, NAO deemed it appropriate to forward to DMD a number of queries related to each of the five main aspects of Debt Management. These questions were based on the existing local Legal Framework and the latest Revised Guidelines for Public Debt Management dated 1 April 2014, as prepared by the World Bank and the International Monetary Fund. Moreover, in preparation for the adoption and implementation of the International Public Sector Accounting Standards (IPSAS) by the Maltese Government,¹¹ this Office featured a number of additional questions, based on a number of related International Standards of Supreme Audit Institutions (ISSAI).

The applied standards are outlined as follows:

- a. ISSAI 5410 – Guidance for Planning and Conducting an Audit of Internal Controls of Public Debt
- b. ISSAI 5421 – Guidance on Definition and Disclosure of Public Debt
- c. ISSAI 5440 – Guidance for Conducting a Public Debt Audit – The Use of Substantive Tests in Financial Audits

¹¹ The adoption and implementation of IPSAS by the Maltese Government will revolutionise the current system from a cash to an accruals-based public sector accounting system based on IPSAS.

In this regard, DMD provided a detailed description of the main elements comprising the 2014 Debt Management, as further outlined.

Malta Government Stocks – Strategy and Implementation

Government's 2014 borrowing strategy was broadly on the same lines to that of previous years. It continued to tap the domestic capital market, by issuing both fixed-rate and floating-rate-euro-denominated securities (zero currency risk) in the medium and long-term maturity horizons. The conventional fixed-rate MGS constitute Treasury's primary financial instrument by which central Government's borrowing requirements are funded.

The reliance on funding from local sources is driven by the strong demand for Government paper, both from the retail and wholesale sectors, and for its benefits that help lessen the impact from the volatility and uncertainty prevailing in the international capital markets. Following consultations held with institutional investors, Treasury targeted not only the demand coming from credit institutions, but also retail and insurance investors in search of attractive yields in today's low interest rate environment. The Treasury's overall objective is to meet demand, and at the same time provide the right balance between new issuances and existing ones consistent with an acceptable level of risk.

The strong demand from the retail investors in MGS (See Total Participation in *Table* below) has mitigated the risk of relying too much on few domestic players within the local capital market.

Table 18 summarises the issuance performance of MGS for the year 2014, including the level of overall participation by domestic investors.

Table 18: 2014 Malta Government Stocks Issuance Performance

Date	On offer (plus over-allotment)	Total participation
	€'million	€'million
March	100 + 60	232.7
April ¹²	35 + 20	122.4
June	100 + 80	322.6
August ¹³	100 + 80	193.5
October ¹²	40 + 35	205.1
Totals	375 + 275	1,076.3

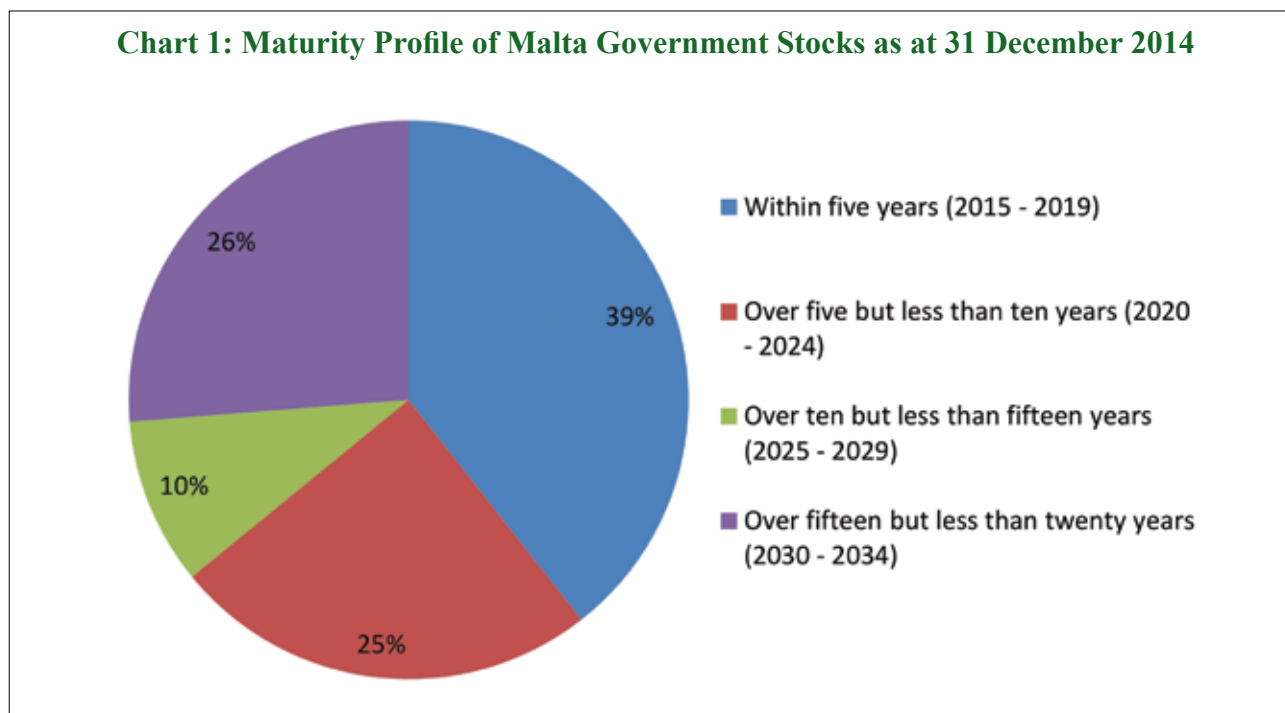
(Source: DMD 2014 Annual Report)

¹² Issues targeted for institutional investors only.

¹³ August issue was over-subscribed by retail investors.

Thirty-nine percent of the total existing MGS, as at 31 December 2014, are due for redemption by Government within five years. Moreover, a further 25% are due for redemption ranging between six and 10 years. Further analysis is illustrated in *Chart 1*.

This short-term maturity in the majority of the existing MGS increases potential risks in terms of rollover, concentration and duration. In this regard, throughout the past few years, DMD implemented a three-year MGS Switch Auction Programme (2011 – 2013) which contributed to the smoothening and lengthening of the maturity profile. Moreover, consultations were held with the main market players with a view to relaunch another bond switch transaction and by the end of 2014, the maturity profile was extended by another two years up to 2034, whilst the issuances were spread more evenly among the different maturity profiles.



(Source: FR 2014, pages 171-173)

Treasury Bills – Strategy and Implementation

Over the past few years, DMD's policy has been to change the composition of debt away from short-term instruments in the form of Treasury Bills and in favour of more medium-to-long term MGS. In fact, as at the end-of-year 2014 the Treasury Bills balance was reduced by €107.7 million, more than reversing the €94 million increase experienced in 2013. The outstanding balance by the end of 2014 stood at €140.4 million.

In year 2012, a standard operating manual was compiled by the Management Efficiency Unit¹⁴ following discussions held with DMD staff. The manual covers the operational procedures involved in the issuance of debt issuing, as well as compilation of reports. There were no changes in the Treasury Bills issuance process from 2012 to-date.

NAO officials attended a Treasury Bills Auction to better understand the procedures and controls in place. During such visit, this Office satisfactorily noted that written-down procedures, as well as a number of internal controls were in place, and these were adhered to by DMD during said auction.

Funding Programme

In 2014, funds were mainly raised to finance:

- a. the redemption of MGS amounting to €361.3 million;
- b. central Government Budget Deficit of €121.3 million; and
- c. €27 million equity acquisitions/injections with respect to ESM paid-in capital contribution and support for the domestic airline's restructuring programme.

Operational Planning

Gantt Charts and Timetables are compiled prior to every new issuance of MGS to minimise operational risks. These would include a series of actions that would need to be taken at different points in time, in preparation for, and during an MGS issue.

An event calendar is shared among responsible officers to indicate the dates where action is needed to be taken, including processing of interest payments, redemptions, rate announcements and stop trading instructions.

Risk Control Plan and Procedures

The main risks faced by DMD relate to market risk, amongst which interest rate and exchange rate risks, refinancing, liquidity, credit, settlement, operational and fraud risks. The risk exposures of a public debt portfolio are determined by the composition of such portfolio, including the share of the short-term *versus* the longer-term debt in the portfolio, the variable interest rate debt relative to fixed rate debt, and debt denominated in foreign currency.

¹⁴ The Management Efficiency Unit forms part of the Office of the Prime Minister.

a. Market Risk

Market risk refers to the possibility of increases in the cost of the debt arising from changes in market variables, such as interest rates and exchange rates. DMD's market risk mainly lies in that all MGS and Treasury Bills are being issued on the local market, and thus any change in market conditions can affect the demand for Government paper.¹⁵

A decrease in demand would require DMD to increase the coupon¹⁶ offered to make Government paper more attractive. To mitigate this risk, during 2014, DMD worked with the Debt Management Advisory Unit of the Commonwealth Secretariat and finalised the draft legislation governing the issue of new debt and Debt Management. If approved, the new GPDMA will bring about a mechanism whereby Government can resort to the international markets to raise funds if such need arises.

b. Interest Rate Risk

Interest Rate risk is defined as the risk of increases in the cost of debt arising from changes in interest rates. In this regard, DMD bases the coupon of new fixed rate stocks to be issued in the primary market on the yields prevailing in the secondary market. The final decision on the coupon is taken by PDMAC during meetings specifically conveyed to discuss new issues of MGS. This Committee's discussion also focuses on the current yields offered by other countries, how yields are expected to move, and how markets are reacting together.

For prudence purposes, and in order to mitigate the risk from an increase in interest, the Directorate keeps the level of Floating-Rate Debt below 10%. As at 31 December 2014, such ratio stood at 4.96%. It is to be noted that as a matter of policy, DMD does not enter in any interest swap agreements and its portfolio does not include any derivatives instruments. The Directorate shall continue monitoring the market conditions to identify the ideal time to intervene in the market, as well as decide on the type of instruments to be offered, so that a balance is struck between cost, associated risks and demand.

c. Exchange Rate Risk

Exchange Rate risk refers to the risk of increases in the cost of debt arising from changes in exchange rates. With regard to exchange rates, DMD's exposure for exchange rates is limited to a minor balance of foreign loans, totalling €371,074, representing only 0.01% of the total debt at year-end, rendering such risk immaterial.

d. Refinancing Risk

Refinancing risk is the danger that debt will have to be refinanced at an unusually high cost or cannot be refinanced at all. DMD has an internal policy that the outstanding balance of MGS shall not exceed a pre-established amount. Consequently, from time to time, DMD reviews MGS portfolio and when the outstanding balance in a particular year lies in a specific region, it recommends to PDMAC to evaluate the conduct of a bond switch transaction.

This auction is earmarked only for financial institutions holding a particular stock, which normally matures within a year, and exchange it with a stock of longer maturity. The aim of this type of issuance is to mitigate the refinancing risk, lengthen and smoothen the interest and redemption profile of the existing MGS debt portfolio, and to provide an opportunity for institutional investors to diversify the maturity of their bond portfolios.

¹⁵ 'Government paper' refers to debt securities that are issued or guaranteed by a sovereign Government.

¹⁶ A 'coupon' represents the interest rate stated on a bond when it is issued.

e. **Liquidity Risk**

Liquidity risk refers to a situation where the volume of liquid assets diminishes quickly as a result of unanticipated cash flow obligations and/or a possible difficulty in raising cash through borrowing in a short period of time. Every week the Treasury Bills' 'Take-up Projections' sheet is compiled to take into account all information in respect of expected receipts from main revenue generating departments, expenditure and redemptions.

DMD takes a broader time horizon of the cash flow projections based on information made available to the Directorate. These projections are fine-tuned every Tuesday before the Treasury Bills' take-up. When planning the monthly Treasury Bills' calendar, DMD officials take into consideration various factors, such as the expected stream of revenue and expenditure as well as financing items falling due in a particular week and the target balance of Treasury Bills at the end of the year.

This system is fundamental for DMD to project all funding needs and to meet other expenditure whether expected or not. DMD plans to improve this system by including other sources of revenue and expenditure, if made available, in order to get a better picture of all funding requirements.

f. **Credit Risk**

Credit risk is associated with non-performance by borrowers on loans or other financial assets, or by a counterparty on financial contracts. Since Treasury does not have any interest rate swap agreements or any other financial contracts directly related to the risk management of its debt portfolio, such risks pertinent to counterparties do not arise. Moreover, DMD stated that the risk management associated with Investments held by Government does not fall within its remit.

g. **Settlement Risk**

Settlement risk relates to the possibility that a counterparty does not deliver a security as agreed in a contract, after the Government has already made the payment according to the agreement. DMD encounters no such risk since Treasury does not have any interest rate swap agreements or any other financial contracts directly related to the risk management of its debt portfolio. DMD's exposure to the delivery of a security after the payment is made is limited to a small number of transactions related to Sinking Funds. The exposure arising from these transactions does not create any risk in view of the quality of the counter party with which such transactions are conducted. Moreover, in the case where investors who were successful at the auction and allotted Treasury Bills or MGS, fail to pay the amounts due, the Directorate will not register the investment in their name with MSE. Furthermore, the retail investors who subscribe for MGS are required to pay for the Stocks applied for with the application.

h. **Operational Risk**

Operational risk is the possibility of loss (financial/non-financial) resulting from inadequate or failed internal processes, people and systems, or from external events that impact Government's ability to operate its on-going business processes. In order to avoid operational risks, DMD keeps an operational logbook whereby the main events are logged in by all officers involved in Debt Management operations. The main events included in this logbook include the payments of interest; any reject or partial rejects/returns which are followed up and payment issued accordingly; re-setting of interest rates of floating-rate notes; redemptions; the due dates of interest and capital repayments on all foreign loans repayments; as well as mergers of fungibility issues. Additionally, an officer working within the Operations Section continuously updates such logbook with the latest information.

i. Fraud Risk

Fraud risk refers to the possibility of an intentional act or omission, which is committed to secure unfair or unlawful gain. In order to minimise such risk, DMD's systems and procedures include a number of functions inbound in all processes as a means of control, such as approvals and authorisations from senior staff prior to proceeding with a particular process. A number of random checks are performed throughout all processes in order to avoid as much as possible errors and other risks. Moreover, the outcome of DMD's debt issuance processes are immediately published on the Treasury's website, and are thus subject to scrutiny by external users.

When it comes to the external users, DMD performs a number of checks on the data received from third parties, including information received from Investment Services Providers. For example, when it comes to MGS issuance, the bank accounts listed on all the applications are checked for their validity. The data on all MGS applications is checked with the electronic batch forms (compiled by the selling agents) for its correctness and are further corroborated with MSE's data. Any discrepancies are highlighted and corrected.

The checking process of applications is a time consuming one, that is made worse by the time constraints within which such applications must be checked, in order to determine the amount left for subscription by institution investors through the auction process. The auction is held within three days after the closure of applications by the retail.

To this effect, all DMD human resources available are mobilised to check the applications. Most discrepancies are of an ordinary nature and are dealt with as well as corrected by the officer who identifies such a discrepancy. More complex discrepancies are discussed and resolved at higher level and instructions are given to the checkers as to how to deal with the correction.

A Senior Officer co-ordinates the authorisation of all checked applications (by the checkers) before they are sent to MSE for the build-up of the register. If discrepancies still remain after applications are sent to MSE, these are dealt with by the Senior Officer and if the need arises such discrepancies are discussed at a higher level and authorised accordingly.

Risk Management Framework

In last year's AAR, NAO recommended that an implicit risk management framework was to be created and regularly updated by DMD as necessary. This will provide the necessary evidence that the structured risk plan is actually carried out. In the same AAR, DMD commented that the draft GPDMA requires the Minister for Finance to prepare a medium-term Debt Management strategy. Such strategy will set forth Government's strategic priorities that guides its borrowing policies and Debt Management operations, and seeks to achieve the objectives of public Debt Management, by assessing the range of cost and risks to the debt portfolio. The strategy, covering a time horizon of a minimum of three years, is to be approved by the Minister for Finance and shall take into account:

- a. the future borrowing needs of Government;
- b. the current conditions and medium-term outlook on macro-economic and market conditions;
- c. macroeconomics and other shocks to which the economy is exposed; and
- d. any other factors which may be related to market development and the public debt management strategy.

Upon enquiry by this Office for an update on this matter, DMD stated that due to the fact that GPDMA has not yet been enacted, the medium-term Debt Management strategy was not yet formally compiled. However, DMD officials also highlighted the fact that Government's strategic priorities, borrowing policies and Debt Management operations were thoroughly discussed during PDMAC meetings. Various meetings were held during the year with CBM and MSE, to discuss risk management, the medium term macro-economic outlook, market conditions, including other factors which may be related to market development.

Additionally, in the beginning of each year, the Treasury publishes *via* a Press Release issued by the Department of Information, the indicative calendar which charts the borrowing/issuance plan for the year. By means of this calendar, DMD gives information on the mixture of Government securities planned to issue during that year.

Monitoring of Government Debt and the Debt Portfolio

The monitoring of the Government Debt and the Debt Portfolio provides valuable information for debt sustainability, to identify any vulnerabilities arising from interest rate and refinancing risk. DMD analyses the Government debt portfolio in order to identify years where maturities in the short-term (one or two years) are too high, leading to a recommendation to PDMAC to authorise the initiation of a bond switch, and thus reduce the amount of redemptions. DMD also monitors the movement in interest rates, and any sign of an increase in interest rates will again prompt a recommendation to PDMAC. DMD also monitors investors' behaviour, both in the primary and secondary markets, as these are deemed necessary to achieve successful issuance outcomes.

Coordination with Monetary, Fiscal and Financial Sector Policies

Debt Management should be secured in sound macroeconomic and financial sector policies to ensure that the level and rate of growth in public debt are sustainable. In this regard, DMD is involved in various meetings and committees where officials from the monetary, fiscal and financial sectors are also involved.

With regards to monetary authorities, DMD communicates regularly with CBM. Preceding every issue, PDMAC is convened where *inter alia* the funding requirements and maturity profiles are discussed. Closer to the issuance, bilateral discussions between CBM and DMD are held on the pricing of the new MGS to be issued to the retail sector. Such prices take into account the prices prevailing in the secondary market that would reflect secondary market conditions.

In addition, DMD is invited by CBM to attend and participate in the Financial Markets Committee meetings, which is a forum organised and chaired by the latter that gathers all credit institutions operating in Malta. DMD is neither an official member of this Committee nor an observer. It is invited by CBM to deliver *post mortem* presentations on issued debt and to communicate other initiatives that the Directorate will embark on during the year. DMD's attendance to these invitations provides an opportunity to the Directorate and the banking community to exchange views on matters of interest to both parties.

In respect of fiscal authorities, DMD compiles the data on Government Debt published in the Budget Estimates. The data includes a list of MGS balances as at end of the following year, together with the amount of stocks to be issued. These expected securities will be based on the budgetary projections published in the previous year, which includes a three-year budget projection, including the amount of MGS to be issued. DMD also prepares the budgetary interest expenditure for the following year, based on MGS balance and the projected new MGS to be issued as well as Treasury Bills' take-ups. Moreover, DMD updates the Budget Office on a monthly basis, with the interest expenditure for that particular month, together with information on the total interest expenditure *versus* the budgeted interest expense. The Budget Office is also kept updated with changes that will affect the budget plans, both in the current or forthcoming year.

In view of the financial sector policies, DMD also holds a number of meetings and discussions with MSE about developments in the local market. The latter also updates DMD with all communications issued to the market. Moreover, the Malta Financial Services Authority (MFSA) regularly updates DMD with developments in the financial sector that can have effect on sovereign debt.

Role in promoting efficient markets in Public Debt Instruments

The Revised Guidelines for Public Debt Management stipulate that in order to minimise cost and risk over the medium to long-term, debt managers should take adequate measures to develop an efficient government securities market. An efficient market for securities provides the Government with a mechanism to finance its expenditures in a way that does not rely on the Central Bank to finance budget deficits. Moreover, by promoting the development of a deep and liquid market for its securities, debt managers, in tandem with the Central Bank, supervisors, and regulators of financial institutions, as well as market participants, can achieve lower debt service costs.

Thus, all market participants, including DMD, CBM, MSE, MFSA and the other stakeholders must work together to promote an efficient market. Since DMD is by far the largest issuer in the local capital market, it therefore plays an important role. One of the core objectives of DMD is to support the development of the domestic financial markets. To this effect, the Directorate takes a number of market considerations before tapping the market. Due consideration is given to other corporate issuers so as to avoid flooding the market with excessive supply of bonds more than the market can absorb. This would not only mitigate the reputational risk of the Sovereign, but would also be beneficial to the capital market as a whole.

Moreover, DMD holds ongoing consultation with market players to better understand their investment needs. From the outcome of these consultations, the Directorate would offer those stocks which create an investment opportunity for investors and at the same time fit within the parameters of its risk management framework.

In this regard, in every issuance, DMD offers two stocks, one in the short-term earmarked for banks and one in the medium/long-term for the retail investors, insurance sector and the funds industry. In the event that institutional investors are crowded out in a particular issue, immediately afterwards, DMD launches specific issuance earmarked for wholesale institutions in order to give them the possibility to participate and acquire MGS to meet their investment needs.

The number of players in a market has to be viewed within the perspective of the size of the market, including the amount of stocks issued on a yearly basis and in terms of the liquidity of the market. The limitation of the number of market players is somewhat mitigated by the strong demand for Government paper from the retail investors. With regard to the liquidity of the market, DMD issues fungible stocks to deepen the securities market, avoid fragmentation and enhance liquidity.

Additionally, in the year 2014, in order to enhance the liquidity and the efficiency of the secondary market, DMD established a Sinking Fund for the purpose of the repurchase of loans raised under the Local Loans (Registered Stocks & Securities) Ordinance.

Consultation is another important factor to promote the efficiency in the market. In this regard, DMD stated that it holds regular consultations and asks for market participants' feedback prior to implementing any changes. In fact, in 2014, the Directorate launched a consultation exercise with stakeholders prior to implementing the T+2¹⁷ settlement cycle in the primary market for Treasury Bills. Following this consultation exercise, in March 2015, DMD announced to the market the move from T+3 to T+2 settlement cycle in the primary market for Treasury Bills as from 1 October 2015.

¹⁷ The 'T' stands for transaction date, which is the day the transaction takes place. The number following the 'plus sign', in this case '2', denotes how many days after the transaction date, the settlement/transfer of money and security ownership shall take place.

Transparency is another factor when it comes to the promotion of efficient markets. In this regard, during the first week of January, DMD publishes the indicative calendar for the year. Moreover, if it may be necessary for DMD to divert from the published indicative calendar due to changes in the market conditions, the Directorate would publish a revised indicative calendar.

Relations with Stakeholders and Sovereign Credit Rating Institutions

DMD has a feedback and consultation policy in place to obtain stakeholders' views before implementing any changes that in some way or another could affect them. Such an exercise gives the opportunity to stakeholders to express their concerns and provide suggestions which would be factored in by DMD before any changes are implemented. This was evidenced during the consultation exercise with stakeholders regarding the move to T+2 settlement cycle in the primary market for Treasury Bills. DMD's plan is to further involve all stakeholders before taking any important decision that can have an effect on the market and their operations.

In 2014, DMD participated in various meetings with Credit Rating Agencies, the Directorate General for Economic and Financial Affairs (DG ECFIN), as well as International Monetary Fund missions. In all meetings, except for that held with DG ECFIN, DMD prepared an information document. The reports included a review of the results achieved in the previous year and the outlook for the year 2014, including details on the issuance strategy for such year. Meetings held with DG ECFIN focused on how the Government was going to meet the debt targets, interest rates expenditure, as well as development in the local sovereign debt market.

Responsibilities and Accountabilities

The operational responsibility for debt management activities of DMD is separated into Front, Middle and Back Offices with distinct functions and accountabilities, and separate reporting lines. This is in line with best International Practices. The Front Office executes Government's debt policy regarding the issuance of securities, the Middle Office undertakes market research and analysis, while the Back Office deals with the registration, administration and settlements of central Government debt.

International Guidelines recommend that staff involved in debt management should be subject to a code-of-conduct and conflict-of-interest rules regarding the management of their personal financial affairs. In this regard, DMD explained that even though GPDMA has not yet been enacted by Parliament, the Directorate has completed the first draft of the code-of-conduct and conflict-of-interest rules for debt management officers. DMD is planning to discuss this draft internally by end-of-year 2015 so that they can conclude it by the time that the legislation is enacted in Parliament.

Moreover, DMD pointed out that all MGS are subject to the scrutiny of all the members of PDMAC. The final decision on which stock and coupon is to be issued on the primary market is discussed and approved by PDMAC. In this regard, DMD provided to NAO a copy of the minutes of PDMAC meetings and related correspondence.

Control Environment and Activities

A number of approvals are required from Senior Management in all DMD's processes. When a new process or application form is introduced, DMD tries to identify what would be the problems and risks associated with that particular process, and plans in advance to mitigate the risks by introducing a number of control procedures associated with that process. Although there are no official control checklists, DMD stated that as a result of the training provided over the years and their experience, its staff are well aware of the risks associated with each process. Thus, they immediately alert Senior Management, both when they identify problems/risks prior to the introduction of new processes, as well as in executing the day-to-day operational tasks.

Internal Audit Function

Similar to what was reported in last year's AAR, DMD stated that even though it does not have an Internal Auditor, there are a number of functions inbound in all processes as a means of control, including, authorisations from senior staff prior to proceeding with a particular process, and random checks of the work performed. Moreover, DMD stated that from time to time Senior Management reviews and monitors the internal controls and updates them where necessary, without introducing unnecessary bureaucratic procedures which may hinder the efficiency of the day-to-day operations of the Directorate.

Additionally, as with all Departments, DMD is subject to any internal audits that the Internal Audit and Investigations Department may wish to undertake, apart from external ones conducted by NAO.

Information Technology, Accounting and Communication Systems in place

DMD keeps all data in respect of MGS issuance, Treasury Bills and interest payable, on spreadsheets, which were specifically compiled to accommodate the Directorate's requirements. Furthermore, DMD has online access (viewing facility) to MGS Register maintained by MSE, and to the Public Account held at CBM.

As already recommended in the previous year's AAR, the debt management activities should be supported by a reliable, accurate and comprehensive IT management system with proper safeguards, which produces accurate debt data and ensures timely payment of debt service. The IT management system is to capture all relevant cash flows, be fully integrated with the Government's accounting system, as well as enable the management of the medium-term strategy, cash management and contingent liabilities. As a result of the increase in demand from retail investors for MGS over the past years, coupled with the extraordinary demand from retail investors in the February 2015 issuance, Treasury initiated the process to start looking for an IT system in order to replace the current manual system.

All transactions in connection with MGS and Treasury Bills are recorded on DAS. As a means of control, a small number of officers within DMD have access to DAS, whilst there is one Senior Officer within the Directorate responsible for inputting all debt transactions in DAS.

DMD maintains clear and transparent communication with the market. The Treasury announces and publishes all the data/information in connection with MGS and Treasury Bills on its website, and disseminates information to MSE and the Investment Service Providers.

Business Recovery Procedures

A back up of all data and information held on the aforementioned spreadsheets is kept by the Malta Information Technology Agency (MITA) in accordance with Government policy. Operational transactions related to the management of the Government Debt Portfolio are held and backed up on MITA servers, whilst the maintenance of the Government Securities' Register is under the responsibility of MSE.

In addition, DMD holds a hard copy of all the applications received in respect of all stocks issued for seven years after the maturity date of the security. This represents one year more than the Government's discharge of liability on the stock as prescribed by the law.

Financial Aspect

Table 19 portrays the servicing cost of the central Government Debt.

Table 19: Central Government Debt Interest Expense

Description	2014	2013	Variance
	€	€	€
Local Loans:			
Treasury Bills	1,877,535	2,576,605	(699,070)
Malta Government Stock	224,666,766	220,278,947	4,387,819
Ex-Malta Drydocks/Malta Shipbuilding Co. Ltd Loan	2,246,458	2,246,458	-
Sub-Totals (Local)	228,790,759	225,102,010	3,688,749
Foreign Loans	2,305,483	2,802,836	(497,353)
Totals	231,096,242	227,904,846	3,191,396

(Source: FR 2014, pages 136-139)

During year 2014, the overall servicing cost of Government's debt totalled €231.1 million, resulting in an increase of €3.2 million over the previous year. Notwithstanding the fact that the servicing cost on local short-term debt decreased by €0.7 million, the overall servicing cost of Government's domestic debt totalled €228.8 million, resulting in an increase of €3.7 million over the prior year.

The cost of MGS registered an increase of about €4.4 million over year 2013, partly reflecting Government's allotment policy which was systematically biased towards the long-term end of the curve, and on the back of the higher outstanding levels of MGS at the end-of-year 2014. The strategy to issue MGS in the long end of the curve was intended to take advantage of the low interest rate environment and lock in at low rates for long dated Stocks, as well as satisfy the strong demand from the retail sector. This strategy has had a positive impact on the weighted average maturity of the central Government's debt portfolio.

Finally, the servicing cost of foreign loans marked a decrease of €0.5 million over 2013, as a result of the decrease in foreign loans balances as at end-of-year 2014, including the maturity of one of the loans (Republic of Italy 1991) on 9 December 2014.

Contingent Liabilities

As already reported in the previous year's AAR, risk assessment needs to be carried out by DMD prior to a Guarantee being granted in favour of the entity. Moreover, where contingent liabilities exist, information on their cost and risk aspects should be disclosed in the Public Accounts. Since it was stated in the same Report that Government Guarantees were not being managed by DMD, but resided within MFIN, this Office expressed its opinion that there should be a link between Treasury and MFIN with regards to Government Guarantees. Moreover, this Office had recommended that DMD should be properly equipped to be able to assess the risks associated with a particular guarantee before it is actually granted.

In addition, NAO also recommended that Government should monitor the risk exposures that it is entering into through its explicit contingent liabilities, and ensure that it is well informed of the associated risks of such liabilities. In such cases, DMD should not only be informed of the explicit contingent liabilities that the Government intends to undertake, but also be conscious of the conditions that could trigger such liabilities.

Upon enquiry, during this year's analysis, DMD confirmed that up to the date of writing of this Report, there were no updates in this regard since the new legal framework has not yet been enacted. However, DMD officials also stated that once the law is enacted, they will start planning on how DMD shall report and monitor all Government Guarantees, including those issued prior to the enactment of GPDMA.

Cash Management

Strategy and Implementation

The latest Revised International Guidelines stipulate that there should be cost-effective cash management policies in place to enable the authorities to meet their financial and budgetary obligations as they fall due. The need for cost-effective cash management recognises that the window of opportunity to issue new securities does not necessarily match the timing of expenditures. A liquidity buffer consisting of cash, liquid financial assets, and contingent credit lines can provide flexibility in debt and cash management operations, in the event of temporary financial market disturbances.

In seeking to ensure that sufficient funds are always available to meet any net daily Government cash shortfall, DMD collaborates with the Cash and Banking Units of the Treasury to obtain timely forecasts of central Government cash flows and end-of-day account balances. The efficiency and effectiveness with which cash management operations are conducted, very much depends on having accurate, detailed and timely cash forecasts, which are communicated to DMD.

In formulating these forecasts, Treasury relies heavily on the information provided by Ministries and Departments. For this purpose, all Ministries and Departments are required to send on the first week of January, a statement of Cash Flow Projections, split on a month-by-month basis, covering a financial year (*i.e.* till 31 December). To streamline and secure a more reliable forecast of cash flows, major revenue earning and heavy spending Departments are required to submit their Statement every month, with revisions submitted on a weekly basis in advance.

Moreover, DMD seeks to maintain an adequate minimum balance at CBM. In this context, DMD issues Treasury Bills on a weekly basis to fine-tune any fluctuations to the cash balance at CBM. In this way, it offsets the impact on CBM's cash balance, which arises from the mismatch between the timing of receipts and payments, and at the same time ensures that adequate cash is available to meet Government's daily expenditure.

DMD has also developed a spreadsheet model which forecasts Government's financing needs for the three months ahead. Such forecasts are derived using a hybrid approach, by basing forecasts on previous years' trend of actual revenue and expenditure. This will take into account foreseeable expenditure, which would be 'accurately known' well in advance, such as wages, social security benefits, interest payments and redemptions.

Close co-ordination between Cash and Banking Units of the Treasury and DMD is vital for the latter to take debt issuance decisions, in the context of achieving its objective, to meet Government's daily obligation in the most cost-effective manner.

Liquidity Buffer

In the unlikely event that emergency funds would be required after the Treasury Bills' auction is held, and cannot be met, either in full, or partly from CBM account, DMD can resort to transfer funds temporarily from:

- a. the Sinking Funds to CBM account, and redeposited again in the former together with the interest due; and
- b. other Department bank accounts held with CBM, after consultation is held with that particular Department.

Correction of the Excessive Deficit

(Source: Malta: Update of Stability Programme 2015 – 2018)

In 2012, Malta recorded a general Government deficit of 3.6% of GDP, well above the reference value of 3%. Consequently, the European Council established that an excessive deficit situation existed in Malta and recommended the Government to correct its excessive deficit by 2014.

In this regard, Government took effective action to bring down the deficit below the 3% threshold by the end of 2013, a year prior to the deadline set by the European Commission, but in line with the projections of Malta's 2013 Update of the Stability Programme. In fact, the Deficit-to-GDP ratio for 2013 improved by 1.0 percentage points to 2.6% of GDP.

The Government continued on the path of fiscal consolidation and further reduced the deficit to 2.1% of GDP in 2014, which is well below the target recommended by the Council.

Fiscal Outlook and the Medium-Term Fiscal Strategy

(Source: Malta: Update of Stability Programme 2015 – 2018)

The medium-term fiscal strategy is consistent with the newly enacted Fiscal Responsibility Act and also the calendar of convergence established by the Commission for Malta. After having reduced the deficit below the 3% mark in 2013 and reached the target of 2.1% of GDP in 2014, Government's Programme targets a further reduction in the deficit to 1.6% of GDP in 2015. The Debt-to-GDP ratio has declined to 68.26% of GDP in 2014. An improvement in the primary surplus projected over the medium-term, together with positive growth prospects, sustained investor confidence, as well as an efficient and effective Debt Management strategy should ensure further improvements in the underlying debt dynamics. In this respect, the Debt-to-GDP ratio is expected to exhibit a downward trajectory and to approach the 60% target by the end of year 2018.

Furthermore, consistent with the requirements of the national fiscal rules, the Government is targeting an average structural effort of 0.65% points of GDP *per annum* which foresees the attainment of the Medium-Term Budgetary Objective in 2019.

Fiscal Responsibility Act

During the year under review, Government has introduced a set of major reforms in the fiscal framework, aimed at aligning Malta's fiscal law with the legal obligations in the Fiscal Compact and the relevant EU Regulations and Directives on economic governance. In fact, fiscal responsibility was enforced through Act XXVII of 2014 on 8 August of the same year. In this context, the Fiscal Responsibility Act establishes the Medium-Term Budgetary Objective as defined in Council Regulation (EC) No. 1466/97, Article 2.

In summary, the Fiscal Responsibility Act provides for the following:

a. Fiscal Responsibility and Objectives of Fiscal and Budgetary Policy

Government shall define and carry out its fiscal and budgetary policies according to the principles of transparency, stability, fiscal responsibility, equity, efficiency, effective management of personnel spending, as well as effective financial and asset management.

Moreover, Government should pursue its fiscal and budgetary policy objectives, in addition to formulating and executing its annual fiscal strategy, in accordance with the fiscal rules specified in the same Act.

b. Fiscal Rules

Government is to secure that both budgetary rule requirements imposed by Articles 8 and 9 of this Act, which derive from Articles 3 and 4 of the Treaty on Stability, Coordination and Governance, are complied with.

c. Monitoring of Fiscal Rules and Endorsement of Official Forecasts

There shall be an independent body to be recognised as the Fiscal Advisory Council to perform the functions conferred or imposed on it by the Fiscal Responsibility Act. The Council is to monitor and at least once a year provide an assessment on whether obligations related to the requirements of the above-mentioned Treaty, are being adhered to. Moreover, MFIN must also publish the official forecasts to be used in the context of the national medium-term fiscal plan, in addition to the draft budget.

d. Budgetary Process

Each Ministry, Department, Public Sector Authority, Entity and Agency, as well as Local Council that is in receipt of a Government subvention, shall prepare a three-year rolling Business and Financial Plan, as prescribed, from time to time, by the Minister for Finance.

Letters of Comfort and Bank Guarantees

When a Government entity applies for a loan or overdraft facility, the banks usually request a Letter of Guarantee or Comfort as a security on such banking facilities. As a result, when MFIN receives such a request from an entity, through its respective Ministry, it takes into account Government (Guaranteed) Debt in the context of the Maastricht criteria and State Aid Regulations. With respect to the latter, such request has to be referred to the State Aid Monitoring Board for their comments and recommendations.

Prior to its approval, MFIN also takes into account aspects as to whether:

- a. the purpose of the related loan involves the financing of capital programmes required to improve the operations of the entity concerned and to enhance its assets;
- b. Government will be eventually financing the interest, or the interest and capital, of the loan;
- c. such loan is being taken to replace another already existing loan, and whether the interest rate of the new loan will be the same, or less than the interest rate of the loan being replaced;
- d. a Government bank guarantee is required in the national interest; and
- e. a clear and specific loan repayment schedule is available for the purpose of eventual monitoring of such schedule, especially when, and if, a subsequent request for guarantee extension is made. Such schedule is requested by MFIN in those cases where the entity fails to provide it when submitting its request for a guarantee in the first instance.

In the light of the above guidelines, after having assessed each request, MFIN must also consider whether any specific reason exists behind the request for a Government bank guarantee.

Furthermore, the Ministry has a Manual of Procedures, which is used for the issue, extension, cancellation and compilation of data on Letters of Guarantee/Comfort. NAO however did not carry out detailed tests to ascertain that this Manual is being fully adhered to.

The position of Contingent Liabilities as at 31 December 2014, as reported upon in Part I of the FR 2014 and comparative figures for 2013 are reproduced in *Table 20*, a breakdown of which can be found in *Table 21*.

Table 20: Contingent Liabilities

	2014	2013
	€	€
Government Guarantees:		
Local	889,028,146	591,631,859
Foreign	<u>488,980,624</u>	<u>586,393,032</u>
	1,378,008,770	1,178,024,891
Letters of Comfort	<u>25,261,968</u>	<u>79,904,546</u>
Totals	1,403,270,738	1,257,929,437

Table 21: Actual Guarantees made by Government

Beneficiary	31 Dec 2014	31 Dec 2013	Remarks
	€	€	
Enemalta p.l.c.	-	75,000,000	This loan was taken up by Enemalta Corporation to repay all its existing government secured facilities with local banks and foreign financial institutions. This was cancelled during the year.
	-	21,250,000	This Guarantee secures loan taken on 13 December 2007 to finance part of its capital expenditure programme for the period 2007 to 2013. This was cancelled during the year.
	9,114,599	9,538,514	A Letter of Guarantee was issued for an amount of €10,000,000 on 5 January 2009, to secure overdraft facility.
	20,000,000	20,000,000	A Letter of Guarantee was issued for this amount, on 27 November 2008, to secure temporary short-term overdraft facility.
	-	16,000,000	A Letter of Guarantee was issued on 9 July 2009, for this amount to cover general Banking Facility and the issuance of a stand-by Letter of Credit. This was cancelled during the year.
	20,921,097	22,754,238	This Letter of Guarantee, originally issued on 9 July 2009 and amounting to €27,000,000, was issued to cover loan facility.
	149,655,249	150,000,000	This Guarantee secures loan taken on 22 September 2008 to part-finance the Corporation's investments in the national electricity supply system and distribution network.
	47,058,800	50,000,000	A Letter of Guarantee was issued for this amount, on 9 December 2010, to secure loan facility in connection with the construction of interconnector between Malta and Sicily.
	46,488,095	24,305,556	This Letter of Guarantee, originally issued on 14 December 2010 and amounting to €50,000,000, was issued to secure loan facility in connection with the construction of the interconnector between Malta and Sicily.

Table 21: Actual Guarantees made by Government cont./

Beneficiary	31 Dec 2014	31 Dec 2013	Remarks
	€	€	
Enemalta p.l.c.	100,000,000	100,000,000	This Guarantee secures loan for €100,000,000, taken on 20 December 2010, to part-finance the construction of the interconnector between Malta and Sicily.
	37,413,821	-	On 25 March 2014 a Letter of Guarantee was issued to secure loan facility of €50,000,000 in connection with the Interconnector project.
	17,650,000	-	On 28 July 2014 a Letter of Guarantee was issued to secure a loan facility of €18,900,000.
	75,000,000	-	On 28 July 2014 a Letter of Guarantee was issued to secure loan facility of €75,000,000.
	523,301,661	488,848,308	
Malta Enterprise Corporation (ex Malta Development Corporation)	1,276,792	1,444,467	The Letters of Comfort issued to cover the Loan Guarantee Scheme taken over from the Institute for the Promotion of Small Enterprises (IPSE Ltd), and the New Enterprise Loan Guarantee Scheme, were replaced by Letters of Guarantee for €2,911,717, dated 19 May 2009, and by a Letter of Guarantee dated 3 March 2010.
	1,503,639	1,454,517	Letter of Guarantee issued on 6 July 2001 to secure loan/credit facilities made available to the Corporation.
	1,956,741	2,112,571	A Letter of Guarantee issued on 21 October 1991 for the amount of €5,823,433 was reduced to €2,500,000 in 2012.
	4,737,172	5,011,555	
Water Services Corporation	54,724,980	62,194,946	Three Letters of Guarantee issued on 30 April 2007 in connection with Loan 1 and Loan 2 facility for €31,912,416, and to secure general banking facility for €4,658,747. Another Letter of Guarantee was issued on 1 October 2008, originally for €37,269,974, to cover general banking facility.

Table 21: Actual Guarantees made by Government cont./

Beneficiary	31 Dec 2014	31 Dec 2013	Remarks
	€	€	
Water Services Corporation	38,570,537	39,388,194	On 30 November 2007, Water Services Corporation entered into a guarantee agreement with a foreign bank for €40,000,000 to undertake a project concerning investments in the sector of water supply and wastewater collection and treatment.
	93,295,517	101,583,140	
Malta Freeport Corporation Ltd	3,285	60,503	Letter of Guarantee was issued in substitution of the Letter of Guarantee covering the balance on the loans of €18,052,644.
	200,754,838	200,754,838	On 20 January 2004, Malta Freeport Corporation Ltd entered into a Currency SWAP agreement with a private company over the 2028 bonds (original denomination \$250 million). This SWAP agreement is guaranteed by the Government of Malta, but does not increase the overall exposure of the Government of Malta. As a result, the currency denomination has been changed to Euro.
	25,977,394	-	On 6 March 2014 a Letter of Guarantee was issued to secure overdraft facility of US \$65,000,000.
	226,735,517	200,815,341	
Malta Industrial Parks Ltd	-	14,723,849	On 3 December 2008, Letter of Guarantee was issued to secure loan facility in replacement of Letter of Comfort for €25,623,107 dated 28 April 2005. This Letter of Comfort was amended to €18,000,000 in 2012. This was cancelled during the year under review.
	-	6,988,120	Letter of Comfort issued on 5 March 2007 in connection with the expropriation of land at Ricasoli. This was cancelled during the year.

Table 21: Actual Guarantees made by Government *cont./*

Beneficiary	31 Dec 2014	31 Dec 2013	Remarks
	€	€	
Malta Industrial Parks Ltd	18,178,474	20,451,478	Letter of Comfort issued on 31 January 2007 in connection with the development of a specialised facility at Luqa Airport leased land. This Letter of Comfort was replaced by a new one dated 10 March 2011 for €27,000,000, and again superseded on 10 July 2012.
	2,613,641	3,321,656	Letter of Comfort dated 10 March 2011 for €6,000,000 replaced a former Letter of Comfort issued on 4 February 2008 to secure loan facility in connection with capital projects. This Letter of Comfort was amended to €4,500,000 during 2012.
	10,441,598	10,941,698	A Letter of Guarantee, originally amounting to €13,000,000, was issued to secure loan facility. This was superseded by Letter of Guarantee dated 10 July 2012 for €11,650,000.
	1,005,560	1,997,496	A Letter of Guarantee, originally amounting to €7,500,000, was issued with a commercial bank in connection with the Medavia Project, to replace a guarantee dated 4 March 2010 in favour of Malta Enterprise. This was superseded by a Letter of Guarantee dated 10 July 2012.
	-	25,000,000	Letter of Guarantee was issued for this amount, on 5 October 2012, to secure loan facility to finance the acquisition of property from Air Malta p.l.c. This Letter of Guarantee was cancelled during the year.
	6,368,471	4,903,963	On 9 August 2012, Letter of Guarantee was issued to secure loan facility of €12,000,000.

Table 21: Actual Guarantees made by Government cont./

Beneficiary	31 Dec 2014	31 Dec 2013	Remarks
	€	€	
Malta Industrial Parks Ltd	595,000	595,000	Letter of Guarantee issued on 10 July 2012 with a local bank to supersede the one issued on 12 June 2009 to cover a Bank Guarantee facility.
	1,427,307	1,503,008	Letter of Guarantee issued on 3 January 2013 with a local bank to secure loan facility of €3,000,000.
	29,600,000	-	On 5 December 2014 a Letter of Guarantee was issued for €29,600,000 to secure loan facility.
	47,018,126	-	On 24 September 2014 a Letter of Guarantee was issued to secure a loan facility of €50,000,000.
	117,248,177	90,426,268	
Malta Government Technology and Investment	386,336	499,491	A Letter of Comfort was issued for €1,000,000 on 12 February 2009 to secure loan facility. This was replaced by a Letter of Guarantee dated 12 March 2009 for the same amount.
Malta Government Investments Ltd	-	6,565,952	Two Letters of Guarantee were issued on 23 December 2005 to cover working capital and other financing requirements. The limit of one guarantee was reduced to €6,700,000 on 24 August 2012. This was cancelled during the year.
	8,000,000	-	On 23 April 2014, a Letter of Guarantee was issued to secure loan facility of €15,000,000.
	8,000,000	6,565,952	
Foundation for Tomorrow's Schools	71,796,459	66,216,520	A Letter of Guarantee issued on 29 August 2013 to secure loan facilities for €123,200,000 in replacement of Letter of Guarantee dated 19 September 2011.
Property Management Services Ltd	-	5,012,644	This Letter of Guarantee, originally amounting to €9,000,000, was issued to secure loan facility. This was reduced to €6,000,000 in 2012. This was cancelled during the year.

Table 21: Actual Guarantees made by Government *cont./*

Beneficiary	31 Dec 2014	31 Dec 2013	Remarks
	€	€	
Authority for Transport in Malta	5,171,774	6,895,873	A Letter of Guarantee was issued for €11,086,270 on 11 August 2011 to replace the former Letter of Guarantee, amounting to €13,976,240, which was issued on 29 March 2010.
	-	45,085,039	A Letter of Comfort was issued on 9 February 2011 for €56,000,000 to secure loan facility, to finance its capital expenditure and to pay for the licences and buses from present bus owners. This was cancelled during the year.
	5,000,000	-	On 31 January 2014, a Letter of Guarantee was issued to secure loan facility of €5,000,000 to replace letter of Comfort of €56,000,000 dated 9 February 2011.
	10,171,774	51,980,912	
Grand Harbour Regeneration Corporation	998,192	328,056	A Letter of Comfort issued on 31 October 2012, to secure overdraft facility and finance services/works associated with the City Gate project.
Housing Authority	1,437,709	320,341	A Letter of Guarantee was issued with a local bank for €4,658,747 to secure overdraft facilities.
Malta Air Traffic Services	-	436	A Letter of Guarantee was issued on 11 August 2011 for €14,631,000 to secure loan facility, to finance shortfall in liquidity and capital expenditure to upgrade the air traffic management system and surveillance capacity. This was cancelled during the year.
Gozo Ferries	-	1,256,683	Letter of Guarantee issued for €1,360,000 on 18 December 2012 to secure loan facility. This was cancelled during the year.
Public Broadcasting Services	3,471,661	3,730,197	Letter of Comfort issued on 26 September 2012 to secure loan facility up to €6,800,000, to finance investment in equipment upgrade and the development of the company's properties.

Table 21: Actual Guarantees made by Government cont./

Beneficiary	31 Dec 2014	31 Dec 2013	Remarks
	€	€	
Vault Finance Ltd	224,687,075	235,333,594	Letter of Guarantee issued on 31 December 2012 to secure loan facility for €318,500,000 and replace existing Enemalta Guarantees.
Electrogas Ltd	30,749,739	-	On 19 December 2014 a Letter of Guarantee was issued to secure 80% of the €110,000,000 bridge loan facility granted to Electrogas Ltd.
Malta Investment Management Co. Ltd	1,253,749	-	On 30 April 2014 a Letter of Guarantee was issued to secure loan facility of €10,000,000.
Petromal Co. Ltd	85,000,000	-	On 27 August 2014 a Letter of Guarantee was issued to secure a loan facility of €85,000,000 to finance the takeover of Enemalta's Petroleum Division.
Totals	<u>1,403,270,738</u>	<u>1,257,929,437</u>	

The above Letters of Comfort and Bank Guarantees may translate into dues up to €1,403,270,738 by Government, should the companies call upon the Government to make good for their debts.

Enemalta p.l.c. Guarantees

The current shareholding of the Government of Malta in Enemalta p.l.c. is 66.67%, whilst the remaining 33.3% was taken up by Shanghai Electric Power (Malta) Holding Ltd. Since 12 December 2014, when the Agreement with the latter was signed, Enemalta p.l.c. has not asked for any guarantees in favour of third party lenders in respect of any loans and/or credit facilities.

Clause 1.2.4 of the same Agreement further stipulates that “*Enemalta shall procure from the Government of Malta the necessary guarantees in favour of third party lenders, in respect of any bank loans and credit facilities, for the benefit of Enemalta solely in proportion to the Government of Malta's shareholding in Enemalta ...*”.

In view of the fact that part of the funds invested in the company have been agreed to be used to pay off loans, in order to improve the gearing of the company, MFIN noted that the amount of Government guarantees has decreased from 2014, since a number of loans which were guaranteed by the Government were settled in full during 2015.

Creditors' Analysis

Fifty-five Ministries and Departments submitted to Treasury an 'Analysis of Creditors' as at 31 December 2014, in the required accruals' template. Total creditors reported in this analysis amounted to €164,602,726 as at year-end. The opening balance as at 1 January 2014 was made up of balances submitted by 56 Ministries and Departments, with an aggregate amount of €198,213,704.

At the end of the year under review, 12 Ministries and Departments reported a 'Nil' creditors balance in their Return. Moreover, €266,777 of total creditors (equal to 0.16%) related to contested amounts. *Table 22* shows an ageing analysis of the remaining creditors' balances as at 31 December 2014:

Table 22: Ageing of Remaining Creditors

Days Overdue	2014		2013	
	Amount Due	Percentage	Amount Due	Percentage
	€	%	€	%
01 - 30	21,249,372	12.93	71,314,791	36.04
31 - 60	43,033,292	26.19	14,427,771	7.29
61 - 90	14,269,124	8.68	14,671,414	7.41
91 - 180	15,360,761	9.35	25,510,645	12.89
181 - 360	14,097,711	8.58	16,571,322	8.38
Over 360	56,325,689	34.27	55,370,757	27.99
Totals	164,335,949	100	197,866,700	100

Credit balances overdue by over 360 days related mainly to the Government Property Division, Mater Dei Hospital, Ministry for Sustainable Development, the Environment and Climate Change, Ministry for Health and Ministry for Education and Employment, with aggregate amounts of €47,057,069, €3,225,698, €2,479,805, €1,323,750 and €1,137,479 respectively.

School Council Fund

The opening balance in the 2014 Statement of Revenue and Expenditure pertaining to the School Council Fund of the Ministry for Education and Employment, as reported in Part I of FR, stood at €958,069. This figure does not agree with the closing balance reported in the previous year of €958,824, by €755, resulting from an update in the opening balance of one of the schools.

Moreover, NAO noted a number of changes in the 'Total Revenue' and 'Total Payments' reported in FR 2014 as against the balances earlier reported for the same schools in the Financial Statements. As a result, this Office requested the Ministry for Education and Employment to provide an explanation for these differences, and to state whether each school reported figures as *per* their respective cash book, rather than as *per* bank statements.

In these regards, Education stated that “... *the discrepancies were the result of a typo in the compilation of the first report which were subsequently corrected in the Financial Report 2014. It is confirmed that Council Fund Statement for 2014 (as per the Financial Report) include figures computed from the balances as per bank statements.*”

Good Practice

NAO is satisfied that requested documentation was available. Moreover, once again, Treasury and MFIN staff were cooperative at all times during the conduct of the audit. More importantly, NAO satisfactorily noted that most recommendations were acted upon, with corrective action being taken immediately, wherever possible.

Management Comments

Both Treasury and the Budget Affairs Division agreed with the contents of this Analysis and their comments were taken in consideration.



Compliance Audit Opinion

Opinion on the Compliance Audits to the House of Representatives

Audit Mandate

As stipulated by Article 108(5) of the Constitution of Malta and para. 7 of the First Schedule of the Auditor General and National Audit Office Act, 1997, I am reporting on whether the audited entities, subjected to review, are in compliance with identified criteria, namely, the applicable rules and regulations, as well as the principles of sound financial management, among others.

I consider the primary users of the Annual Audit Report to be Parliament and the Public Accounts Committee.

Respective Responsibilities of the Accountant General and Accounting Officers

As determined by the Financial Administration and Audit Act, 1962, the onus for the proper discharge of financial administration rests with the Accountant General and the Accounting Officers. They are also responsible for the institution and application of such internal controls as deemed necessary, to enable the processing and recording of financial transactions to be free from material misstatement, whether due to fraud or error, and to ensure that the audited entities' operations are in accordance with the pertinent rules and regulations.

These officers are entrusted with the sound management of public funds. They are therefore to demonstrate transparency, accountability and integrity in their actions, and are to exercise good governance for the resources with which they are entrusted.

Auditor's Responsibilities

NAO's responsibility is to obtain reasonable, rather than absolute assurance as to whether statements and accounts of Government Ministries and Departments, as well as of other entities that were subject to audit, are free from material irregularity. Thus it is not a guarantee that an audit conducted in accordance with International Standards on Auditing (ISA) will always detect non-compliance and material misstatements, arising from fraud or error.

Basis for Opinion

We conducted our compliance audits in accordance with the relevant ISAs, the applicable public sector perspective provisions, and in line with NAO's auditing practices. Regularity audits involve audit procedures to test compliance with standing rules and regulations, as well as with the principles of sound financial management.

The procedures selected depend on the auditors' judgement, which entails the assessment of risk, evaluation of internal controls, consideration of sensitivity of particular areas and other qualitative factors, as well as the assessment of materiality in terms of value, nature or context in which it occurs.

I have complied with independence requirements in accordance with the International Standard of Supreme Audit Institutions (ISSAI) 30 Code of Ethics and NAO Code of Professional Conduct and have fulfilled my ethical responsibilities in accordance with such codes. I have also adhered to avoidance of conflict of interest regulations as stipulated by Article 108(3c) of the Constitution of Malta and fulfilled the independence requirement in accordance with Article 108(12) of the aforementioned Constitution.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for our opinion, which only draws on conclusions upon areas that have been examined.

Opinion

Adverse Opinion

Based on the audit work performed, I am of the opinion that the activities of a number of the audited entities under review were not, in all material respects, in compliance with the pertinent rules and regulations, and compliance deviations were pervasive.

In terms of para. 5(ii) of the First Schedule of the Act, I am to report that, except for instances reported upon, I received all the information and explanations required for the carrying out of my duties.

A separate audit opinion is being published, for the first time, dealing with the financial aspect.



Anthony C. Mifsud
Auditor General
14th December 2015





Office of the Prime Minister

Office of the Prime Minister

Expenditure Audit

Background

The Office of the Prime Minister's (OPM) initial approved budget allocation for 2014, in respect of the eight¹ cost centres, relating to Operational and Maintenance Expenses and National Celebrations Foundation (NCF), was €3,759,500. This allocation was made up of €2,559,500 for Operational and Maintenance Expenses and €1,200,000 for the Programmes and Initiatives pertaining to NCF.

This allocation was increased to a revised aggregate budget of €5,246,144. Payments effected throughout 2014 amounted to €5,114,887. For the majority of accounts, the allocated funds were fully utilised.

Audit Scope and Methodology

The scope of the audit was to determine the level of existing internal controls over expenditure incurred by OPM, and to ensure efficient administration of public funds, in line with standing laws, regulations, policies and procedures.

An introductory meeting, followed by additional queries, was held with OPM officials to discuss the scope of the audit, as well as relevant issues pertaining to the present procurement procedures applied by same. Detailed substantive testing was carried out to confirm the existence and the correct application of procedures and controls.

Audit work performed covered a sample of transactions charged to a number of accounts falling under Operational and Maintenance Expenses and NCF. A total of 44 transactions, in aggregate amounting to €1,192,009, representing 23% of total payments, were reviewed. Particular consideration was given to the materiality of amounts and nature of expense when selecting the audit sample. A number of departmental files were also reviewed in order to assess the procurement process. Out of these, 13 transactions totalling €709,394 related to NCF.

Selected payments were traced to Local Purchase Orders (LPOs)/Letters of Acceptance (LA), invoices and fiscal receipts, in order to determine whether authorisation was duly obtained before the purchase, that the amount due was correctly computed, and that payments issued to suppliers were invariably followed by a fiscal receipt, where applicable. Reference was also made to contract agreements, quotations or tender documentation, supporting the procurement procedures being followed.

Throughout the audit, reference was made to the Public Procurement Regulations (PPR) as set out in Legal Notice 296 of 2010, and the Public Service Management Code (PSMC), as duly updated. Adherence to applicable standing Finance Circulars was also verified.

¹ Excluding 'Notary to the Government'.

Inventory

Two locations were selected to ascertain the correctness of inventory held by OPM, namely the Directorate for Finance and Administration (DFA) area and *Villa Francia*. A sample of 66 inventory items, randomly selected from OPM – DFA’s inventory database, were checked to ensure that they were recorded in conformity with MF Circular No. 14/99 – ‘Government Accrual Accounting: Revised Inventory Control Regulations’. The National Audit Office (NAO) performed a physical inspection of the selected inventory items held at DFA on 28 January 2015.

Fuel Consumption and Logbooks

Testing was carried out on the fuel consumption of two fully-expensed vehicles assigned to senior officers, as well as on the maintenance of logbooks of three general-use vehicles. Each of the latter was randomly examined, to verify compliance with relative sections of PSMC.

In the case of the fully-expensed cars, relevant extracts from the Fleet Management System were obtained to ensure that monthly fuel consumption limits, as set by MFC Circular No. 5/98 – ‘Purchase and Use of Official Cars’, were not exceeded.

Limitations on Scope of Audit

Due to reasons beyond its control, NAO could not carry out testing of the inventory items located at *Villa Francia*. Thus, only DFA area was reviewed.

Key Issues

Non-compliance with Public Procurement Regulations with respect to Expenditure by National Celebrations Foundation

Background

In June 2013, the Government set up NCF, with the aim of organising national festivities marking four historical anniversaries which incidentally all occurred during 2014. These marked the 50th

anniversary of Malta’s Independence, the 40th years since Malta became a Republic, the 35th anniversary of Freedom Day and 10 years since Malta’s accession to the European Union.

Services procured by Direct Order

Testing revealed that in six instances out of the sample reviewed, NCF resorted directly to the Ministry for Finance (MFIN) for a Direct Order (DO) approval. Payments made during 2014 to three different suppliers totalled €432,374.

In three out of these six cases, amounting to €225,874, NCF obtained two quotations from the open market. These were followed by a DO approval obtained from DOs Office within MFIN in respect of the cheapest of the two quotes. On the other hand, an Expression of Interest was published for the remaining three instances, totalling €206,500, all of which were awarded to the same service provider, being the only bidder in two out of the three Expressions of Interest. Each publication was preceded and followed by an approval from MFIN for a DO, approval of which was granted just a few days before the events in question.

Even though DO approval was granted by MFIN, it is evident that, given the costs involved, a public call for tenders or quotations ought to have been published in line with PPR.

Contribution paid supported by a Verbal Agreement

It transpired that a financial contribution of €8,500 to a local band club was issued towards the exclusivity release of a musical band to perform at the Music and Steel Festival held on 30 March 2014. This contribution² was paid in addition to the fee paid to the musical band for their performance in the same concert. Approval was sought and obtained.

Following NAO enquiry, the band club confirmed to NCF that “... *no written agreement was ever signed between ...*” the Manager of the musical band and this particular band club. It resulted that only a verbal agreement has been in place for eight years as detailed through an exchange of correspondence.

² NAO was forwarded with an undated signed agreement between NCF and the band club.

No binding Contract Agreement

NCF did not provide a signed copy of a formal binding contract agreement between the Foundation and the three suppliers who were selected to offer their service for events related to the national celebrations. Total payments in this regard collectively amounted to €603,474.

Non-submission of Bank Guarantees

NAO testing further revealed that a particular service provider failed to submit a total of seven Performance and Pre-financing Bank Guarantees upon signature of the related contracts. These Guarantees were required in line with the conditions specified in the respective tender or Expression of Interest. In aggregate, such missing Guarantees amounted to €265,205 and related to four different projects.

Furthermore, since no contract agreement was presented for verification for three other services that were procured directly from the open market for an aggregate amount of €225,874, NAO could not ascertain whether any Guarantees were applicable.

Retrospective Direct Orders to settle Outstanding Payments

Services related to the ‘*Gvern li Jisma*’ Campaign

A Payment Voucher (PV) amounting to €23,222 in respect of services rendered by a particular supplier, was covered by a DO approval dated 18 June 2014. These services related to the ‘*Gvern li Jisma*’ campaign. Even though DO approval was obtained before date of invoice (*i.e.* 19 June 2014), the details as *per* invoice indicate that the campaign was held during March 2014, thus implying that DO approval was retrospective.

According to OPM, no quotations were obtained because of short time frames available and prices quoted by the selected service provider were fair and reasonable.

Payment related to Research Services

Similarly, another PV of €16,352 in respect of research services rendered by a particular supplier,

was covered by a DO approval dated 9 May 2014. This DO of £10,000 (Value Added Tax (VAT) excl.), was obtained retrospectively, since the relative invoice was dated 30 April 2014, thus implying that services had already been carried out.

Moreover, only one quotation from the same above-mentioned service provider was attached to the relative PV.

Services procured by Direct Order

Audit testing revealed that a payment in relation to quantitative and qualitative research by a marketing agency, amounting to €9,440, was procured through a DO covered by MFIN approval.

However, the respective PV was only supported by one quotation, submitted by the same service provider. The justification provided by OPM in its DO request consisted of the provider’s experience in the sector.

Control Issues

Invoices preceding Local Purchase Orders or Letters of Acceptance

In the case of nine transactions tested, representing 20% of the sampled transactions, and amounting to €315,172, the respective LPO or LA was raised following receipt of invoice.

Shortcomings in relation to Vehicles

Three general-use and two fully-expensed vehicles were chosen in the audit sample. Whilst reviewing whether the logbooks pertaining to the three general-use cars selected were adequately kept in accordance with PSMC requirements, the following shortcomings were noted:

- a. Three logbooks were not inspected on a monthly basis by a responsible officer, to monitor fuel consumption and to ensure that any irregular use of cars is duly reported.
- b. The logbook pertaining to one of these vehicles lacked certain important information when refuelling. Even though the words ‘petrol’ or ‘fuel’ were sometimes

written down, no details as regards requisition number and amount of litres taken were indicated. Furthermore, the logbooks pertaining to the other two selected general-use vehicles completely lacked any type of information related to refuelling.

Overcharging in respect of Photocopying Service

During 2011, OPM entered into an agreement with a supplier for the purchase of a Heavy Duty Multi-Function system, consisting of a colour photocopier, scanner, printer and binder. This was followed with the signing of a Full Service and Maintenance Agreement, including copy charges at €0.0099 for each black and white copy, and €0.0701 for every coloured copy.

Audit testing focused on consumption during March 2014 coloured copies. It was noted that the actual rate included in the supplier's invoice was that of €0.0708 and thus differed from the rate as *per* agreement. In the case of the March invoice, this resulted in OPM being overcharged approximately €18 for the coloured copies. NAO acknowledges the fact that the difference is negligible for one coloured copy, and may even be considered so for the number of coloured copies *per* month, but one has to consider the fact that the wrong rate was paid for by OPM.

Management explained that the difference was due to the programming function in the supplier's billing system. Exchange of correspondence during February 2015 indicated that the supplier "... *will be issuing a credit note covering overcharging of past invoices and will also be issuing a credit note with each future invoice*".

Hours claimed in respect of Cleaning Services not indicated on Timesheet

Testing on cleaning services provided at the Centre for Development, Research and Training by a service provider was carried out for July 2014, at a total cost of €1,342, covering 184 hours at €6.18 (VAT excl.). A close inspection of the relative timesheet revealed that the hours worked on 31 July 2014 were neither recorded, nor did any cleaner sign in on that day. Although no approval by the officer in charge was recorded to endorse the eight hours worked on 31 July, the said officer still certified the time sheet as correct.

Compliance Issues

Shortcomings related to Inventory

With regards to the physical review of selected items from the inventory database and Room Inventory Lists of DFA area, the following weaknesses were encountered:

Inventory Database not updated

The inventory database forwarded to NAO for audit purposes was dated June 2013, thus indicating that such database had not been updated since.

During the course of this audit, OPM commenced a thorough exercise in order to update its inventory, starting with a meeting held on 3 December 2014 with the officers in charge of inventory within all departments falling under OPM.

Discrepancies during Physical Verification

Testing revealed a number of inconsistencies during the physical verification of 23 items found on site, *vis-à-vis* information recorded in Room Inventory Lists. Such differences consisted of different asset identification number, items not traced to Room Inventory List, and in one case, the relative asset identification number was not affixed.

NAO could still not ascertain whether the laptop selected for testing but not physically traced is the same one referred to in OPM's Board of Survey Report dated 6 September 2005. This is because Information Technology items were not reported according to their unique serial number, but rather by a departmental inventory number.

Assets lacking important Detail

Whilst checking the Room Inventory Lists, it was noted that important details, such as brand name and serial number, were sometimes lacking as part of the asset description. The absence of essential information makes it difficult to identify the relative assets from others of a similar nature.

Non-compliance with Fiscal Obligations

Non-submission of VAT Quarterly Returns

OPM confirmed that VAT defaulters' lists are not submitted to the VAT Department on a quarterly basis, as required by MFIN Circular No. 2/2012. In fact, the only defaulters' list presented for verification was for the period January to September 2013. Moreover, it was also confirmed that a return covering the period up to end December 2014, was being raised at time of audit.

Fiscal Receipts not readily available

NAO requested fiscal receipts related to seven payments, totalling €117,541, pertaining to three service providers. This Office was informed that these three service providers did not have a VAT receipt book and had to order one from the VAT Department, on the grounds that *"All 3 did not previously issue VAT receipts given that they normally delivered their services in the business to business sector."* Although NAO is in a position to confirm that all three suppliers were VAT registered, this Office contends that the invoices issued cannot be considered as 'tax invoices'.

The respective fiscal receipts were made available after the pertinent suppliers were directly contacted by OPM in order to provide the relevant VAT receipts, following NAO's request thereof. Evidence in hand confirms that all three suppliers forwarded a request, for the first time, for a VAT receipt book during the period December 2014 – February 2015. It is pertinent to remark that VAT receipts forwarded, following the audit, were numbered between 1 and 7.

Recommendations

Key Issues

Non-compliance with Public Procurement Regulations with respect to Expenditure by National Celebrations Foundation

Adherence to procurement regulations, where applicable, are to be followed in order to ensure transparency, as well as promote fair competition.

Moreover, wherever possible, planning is to be made well in advance so as to publish public calls on time.

Approvals from MFIN for DOs are to be requested only in exceptional cases, as clearly spelled out in MFIN Circular No. 3/2013 – 'Public Procurement Regulations – Direct Orders'.

Additionally, all engagements are to be formally supported with a binding agreement, signed by the parties involved, indicating the applicable terms and conditions. Alternatively, the service provider has to officially accept the conditions stipulated in the tender or other method of procurement as specified by PPR, following receipt of LA.

Management is also to ensure that suppliers honour the respective terms and conditions including the issue of a Bank Guarantee. Failure to do so should automatically lead to the bidder in question being rejected.

Retrospective Direct Orders to settle Outstanding Payments

The PPR are meant to ensure that the basic principles of transparency and accountability are adhered to. As emphasised in MFIN Circular No. 3/2013, DOs should be limited to the barest minimum. Moreover, commitments should not be entered into directly with the service provider before requesting the necessary approval from the DOs Office, which instances are to be resorted to in exceptional circumstances, only and upon proper justification.

Services procured by Direct Order

As previously reported DOs are only to be resorted to in exceptional circumstances, in order to ensure accountability and that the most competitive prices for goods and services are obtained.

Furthermore, it is highly recommended that expenditure is timely planned so that the appropriate procurement procedure is followed.

Control Issues

Invoices preceding Local Purchase Orders or Letters of Acceptance

OPM is to ensure that officers observe the standard purchasing procedure, which is to issue an LPO or LA, as applicable, before placing an order for goods or services. This will ensure that proper authorisation for the purchase is obtained and adequate funds are committed to cover the expense.

Shortcomings in relation to Vehicles

Reference is to be made to the PSMC, in particular Section 8.2.5, which requires each logbook to be certified by the officer in charge of transport at the end of each month, in order to ensure that the trips recorded in the logbook were made on official duty and that fuel consumption is reasonable. Moreover, full details regarding fuel intake are to be clearly recorded on every logbook as per Appendix 8.I of the PSMC, as a means to verify each vehicle's fuel consumption.

OPM is further recommended to ascertain the current applicability of the above PSMC requirements in view of information available on the Fleet Management System.

Overcharging in respect of Photocopying Service

In order to mitigate the risk of overpayments, all invoices, including others supporting documentation on which payments are based, are to be vetted for correctness and properly certified, before being processed for payment, with particular attention to the charge agreed upon.

Hours claimed in respect of Cleaning Services not indicated on Timesheet

OPM is to make sure that timesheets submitted and hours invoiced are tallied prior to effecting payment, and that such payments are withheld until any discrepancies are investigated.

Compliance Issues

Shortcomings related to Inventory

All assets are to be recorded accurately in the inventory database. These are to be adequately identifiable and traceable to the respective location. Room Inventory Lists are also to be updated to reflect the latest movements.

As stated in MF Circular No. 14/99, "*Each item shall be physically marked with a consecutive identification number*". This procedure is expected to be adhered to, and items are to be physically marked with a permanent identification number, as far as it is practicable.

Periodic physical verification of inventory items is also recommended, to ensure that inventory records truly reflect the description, quantity and location of items.

Non-compliance with Fiscal Obligations

Every effort is to be made to enforce the principle that VAT receipts are invariably obtained from suppliers for every purchase of goods and/or services. Furthermore, all VAT receipts are to be adequately kept, in order to ensure that they are always readily available in a timely manner, and to enable verification by third parties.

Additionally, defaulting suppliers are to be reported in the quarterly VAT defaulters' lists, required to be submitted to the VAT Department as per MFIN Circular No. 2/2012, for appropriate action to be taken. Pertinent fiscal regulations are to be adhered to.

Management Comments

In its reply, Management took note of the observations and recommendations put forward by NAO. OPM pointed out that it has already implemented a number of measures to ensure transparency and good governance within its internal systems and procedures. OPM also

highlighted the fact that, during 2014, it took up a central role as regards the implementation of a number of projects and initiatives on a national level which automatically entailed a significant financial input in order to achieve the intended objectives within the stipulated timeframes.

Management also submitted the following additional comments:

Non-compliance with Public Procurement Regulations with respect to Expenditure by National Celebrations Foundation

NCF decided to pay the contribution of €8,500 requested by the band club in view of the fact that the band would not have been allowed to perform at the concert. NCF thus felt that the concert would not have been the success it was had the band not performed given that it plays a “... *unique genre of music which was ideal for this event*”.

In its comments, OPM also stated that administrative backup was lacking due to shortage of human resources within NCF.

Services procured by Direct Order

In order to ensure value for money and transparency, OPM stated that at least three quotations are being sought, prior to submitting requests for DO approval to MFIN.

It was also stated that:

- no payments were made prior to confirmation that the services invoiced were duly delivered to the indicated and agreed standard;
- a number of the services in question were subject to expression of interest procedures, which expression of interests formed the basis of the contractual obligations assumed by the service providers; and
- NCF remained in control and was in a position to apply retentions and/or withhold payments for part-payments for non-delivery of goods or services as originally agreed with suppliers.

Shortcomings in relation to Vehicles

OPM acknowledges the fact that vehicle logbooks were not being rigorously checked on a monthly basis mainly due to lack of resources within the Transport Section. OPM stated that logbooks will continue to be reconciled with the Fleet Management System as per current procedure, thus retaining a two-tier checking process.

Overcharging in respect of Photocopying Service

The difference between the invoice and the agreement was brought about by a missing field in the supplier’s billing system as regards to charges for coloured copies. The supplier has, in the meantime, been contacted and the error rectified.

Hours claimed in respect of Cleaning Services not indicated on Timesheet

This mistake was a one-off incident brought about by a human error.

Shortcomings related to Inventory

OPM commissioned an inventory audit by an independent external audit firm. This exercise is being carried out after OPM ascertained that the Inventory Database had not been updated in 2012. Once concluded, OPM would be in a position to discuss its findings.

It was also pointed out that the number of events and activities being organised at *Villa Francia* dictated that the physical verification could only be carried out during the weekend. Notwithstanding, this could not materialise even though NAO confirmed its availability to conduct the inventory testing during the weekend.

OPM also informed that Room Inventory Templates have been updated accordingly. It also noted that further details, such as brand name and serial number, will be included in the asset description, when missing, in order to further identify assets that are similar in nature.

Non-compliance with Fiscal Obligations

OPM stated that the process is a continuous one and is systematically carried out on a routine basis.

**Ministry for European Affairs
and Implementation of the
Electoral Manifesto**

Ministry for European Affairs and Implementation of the Electoral Manifesto

Expenditure Audit

Background

During the year 2014, the Ministry for European Affairs and Implementation of the Electoral Manifesto (MEAIM) was allocated a Recurrent Expenditure budget allocation of €9,944,000. This allocation was made up of €7,802,000 for Personal Emoluments, €1,541,000 for Operational and Maintenance Expenses, €576,000 for Programmes and Initiatives and €25,000 for Contributions to Government Entities. Furthermore, this Ministry was allocated a total estimate of €27,528,000 for Capital Expenditure.

Audit Scope and Methodology

The main scope of the audit was to determine the level of existing internal controls over the procurement and payment of selected line items, under Operational and Maintenance Expenses and Capital Expenditure incurred by MEAIM, during the year under review. This exercise also aimed to ascertain the efficient administration of public funds in line with existing regulations, policies and procedures, including the prudent use of public resources.

Targeted accounts consisted mostly of Utilities, Office Services, Transport, Information and Contractual Services, Improvement to Property, Equipment, as well as Capital. A sample of 35

transactions, valued at €283,410, was selected, based on materiality and frequency of expenditure.

Audit testing was performed to assess whether standing procedures were followed when procuring goods and services, with reference made to the Public Procurement Regulations (PPR) as set out in Legal Notice 296 of 2010 and the Public Service Management Code (PSMC), as duly updated. Adherence to standing Finance Circulars was also verified.

A random amount of inventory items were checked to ensure that they were recorded in conformity with MF Circular No. 14/99 – ‘Government Accrual Accounting: Revised Inventory Control Regulations’. The National Audit Office (NAO) performed a physical inspection of these items.

Five visits abroad on official business, were selected randomly in order to ascertain compliance with PSMC and Ministry for Finance (MFIN) relative Circulars’ requirements.

Testing was carried out on the maintenance of logbooks of three general-use vehicles. One month usage for each car was selected and verified with relative sections of PSMC. NAO also selected at random three fully expensed vehicles, assigned to senior officers, and tested compliance against MF Circular No. 5/98 – ‘Purchase and Use of Official Cars’.

Good Practice

During the course of this audit, NAO satisfactorily noted that:

- all fiscal receipts in relation to the sample selected were available at the Ministry;
- quarterly Returns, reporting fiscal receipts defaulters were submitted to the Value Added Tax (VAT) Department in accordance with MFEI Circular No. 2/2012; and
- fuel consumption of the selected fully expensed cars was in conformity with relevant regulations.

Key Issues

Repeated Extensions for Cleaning Services following Expiration of Contract

- a. Following a call for quotations, MEAIM entered into a contract for cleaning services with a company for a three-month period, effective till 15 September 2013. Such contract provided for further extension periods of two months, unless notice of termination was given by either party two weeks prior to the expiry date.

It transpired that the Ministry extended this contract until a new tender was issued. In fact, according to the Departmental Accounting System (DAS), payments to this service provider continued to be effected till October 2014. This resulted in an aggregate payment of €21,207 following the expiration of the said contract in September 2013.

Furthermore, such extension was granted by the respective authority on 9 September 2013, on the premise that the limit specified in Article 20(c) of PPR was not to be exceeded. NAO opines that the basis used for such approval is deemed inappropriate, since the relative article is only applicable for store items and cannot be extended to the purchase of equipment, works or services.

- b. During 2014, MEAIM utilised an existing contract for cleaning services, awarded by the Office of the Prime Minister (OPM) to another company on 16 November 2012.

The contract was valid for a period of one year, ending on 18 November 2013.

Correspondence between OPM and MEAIM indicated that these cleaning services were extended by OPM up till 13 June 2014, seven months beyond the validity of the contract. This was achieved by means of monthly extensions which were approved by the relative authority at OPM.

Control Issues

Payments not as per prevailing Lease Agreement

On 15 December 2011, two entities within OPM, namely, the Planning and Priorities Co-ordination and the Funds and Programme Division, entered into a property lease agreement with Malta Industrial Parks Ltd (MIP), in respect of premises located at *Mrieħel* with effect from 1 January 2012 to 31 December 2016. According to the contract, annual rent payable from the commencement of the lease till the end of 2014 was €32,596 (VAT excl.). For the remaining two-year period up till December 2016, the annual rate was to increase to €34,225 (VAT excl.). The agreement also provided for an annual service charge of €2,020 (VAT excl.), which was to increase by €100 (VAT excl.) till 31 December 2016.

NAO noted that the amount charged by MIP both for the annual rent and the service charge for the last quarter of 2014 did not agree to the amounts stipulated in the signed contract. Infact, the amount charged for rent was €5,174, instead of the quarterly amount of €8,149 (VAT excl.). Likewise, the contracted service charge stood at €505, whilst in this case, only €133 was claimed and eventually paid.

Procurement from the Open Market without Appropriate Approval

During testing it was noted that a service in connection with transportation of furniture was procured directly from the open market, without a public call for tenders or quotations, and lacking the necessary approval from MFIN. In this regard, internal correspondence confirmed that due to short notice given to MEAIM regarding the relocation of the European Union Secretariat, it was decided

to make use of the same movers which at the time were relocating another Ministry to OPM. DAS entries show that total payments made to this supplier from MEAIM's Vote throughout 2014, amounted to €7,645.

Local Purchase Orders dated after Suppliers' Invoice

In six payments tested, representing 17% of the sampled transactions, and amounting to €8,920, the respective Local Purchase Order was only issued just before the payment was effected, and following the receipt of the invoice.

Compliance Issues

Rent of Official Car not in line with Standing Regulations

The Ministry rented an official car for the period January to July 2014, without obtaining the prior approval from MFIN, through the Government Transport Policy Unit. It transpired that during 2014, related rental payments totalled €8,330. Documents showed that the cheapest service provider was selected following the request of three quotations from different suppliers, for which no publication in the Government Gazette was traced, indicating that the procurement of this service was not in line with Article 20(1)(d) of PPR.

Insufficient Controls over Logbooks of General-use Vehicles

The signature of the officer making the journey was not evident on the three logbooks reviewed, as required by PSMC Section 8.2.4.1. Instead the driver signed for the respective journeys. This was confirmed through a Ministry correspondence dated 24 February 2015.

All three logbooks did not contain any evidence confirming that these were being inspected periodically by a responsible officer, as required by PSMC Section 8.2.5, to monitor fuel consumption, and to ensure that any irregular use of cars is duly reported.

Issues of petrol were not recorded in the logbooks of the three cars, while details in relation to purpose of journey pertaining to two of these, as required by PSMC Appendix 8.I, were at times lacking.

The first entry in the respective logbook of one vehicle was dated 1 December 2014, although as confirmed by the Ministry, this vehicle had been in use since March 2014.

Lack of Compliance with Standing Travel Regulations

The sampled five trips on official duty tested, made by MEAIM officers, totalled €4,195. In two of these cases, Section B of the GA27 was not duly signed by an authorised officer, certifying that the expenses incurred as attached in the Statement of Expenses conformed with regulations.

The Ministry did not draw up the Post Travel Submission Form as required by Section 8.10.1.6 of PSMC (Appendix 8.XI) for the five visits reviewed. MEAIM confirmed that such form will start to be compiled for travel in 2015.

Shortcomings related to Inventory

All sampled inventory items pertaining to the European Union Funds Programming Unit, were not tagged with a consecutive identification number. Moreover, an item listed in another room was not physically traced.

Recommendations

Key Issues

Repeated Extensions for Cleaning Services following Expiration of Contract

Management is to ensure that actions taken and commitments made are to be in line with relevant rules and regulations. Moreover, contracts should clearly specify a definite period to ensure rigorous compliance with applicable procurement regulations.

It is imperative that appropriate action is taken prior to the expiry of existing contracts, in order to limit any possible extensions. This practice will ensure that Government obtains the most economic prices and encourages competition.

Control Issues

Payments not as per prevailing Lease Agreement

Management is to ensure that prior to payment, invoices are properly certified against any contracts/agreements in place.

Procurement from the Open Market without Appropriate Approval

Procurement is to be made as regulated by PPR. In exceptional cases, in order to ensure accountability, MEAIM is to obtain the necessary approval from MFIN prior to procure directly from the open market.

Local Purchase Orders dated after Suppliers' Invoice

MEAIM is to ensure that officers observe the standard purchasing procedure, which is to issue a Local Purchase Order or Letter of Acceptance, as applicable, before placing an order for goods or services. This will ensure that proper authorisation for the purchase is obtained and adequate funds are committed to cover the expense.

Compliance Issues

Rent of Official Car not in line with Standing Regulations

MEAIM is to invariably adhere to the requirements of PPR, to ensure a fair, transparent and equitable opportunity to all interested parties in the provision of goods and services paid from public funds.

Moreover, it is recommended that the Ministry follows the provisions of MF Circular No. 6/2013 – ‘Guidelines regarding the Provision of Official Cars’, and abides by the directions given with respect to authorisation by MFIN for the provision of vehicles, including official cars.

Insufficient Controls over Logbooks of General-use Vehicles

The Ministry is expected to properly maintain and regularly monitor logbooks of its general-use vehicles, in line with PSMC, to ensure that such vehicles are used for official duty and that fuel consumption is reasonable.

Lack of Compliance with Standing Travel Regulations

Officers entrusted with the governance of official visits, are expected to conform to the pertinent regulations, in order to ascertain full accountability of the expenditure incurred. Thus, all travel advances are to be reconciled, and any refunds due are to be effected, within a reasonable time limit.

Shortcomings related to Inventory

As stated in MF Circular No. 14/99, “*Each item shall be physically marked with a consecutive identification number.*” This procedure is expected to be adhered to, and items are to be physically marked with a permanent identification number, as far as it is practicable. Also, in order to maintain control over all assets, these are to be recorded accurately and Room Inventory Lists are also to be periodically updated to reflect any movements.

Management Comments

In its reply, Management took note of the observations and recommendations put forward by NAO and forwarded the following additional comments:

Repeated Extensions for Cleaning Services following Expiration of Contract

The Ministry maintained that extensions were carried out since at the time the tendering process was still not finalised. However, due to changes in the regulations for the provision for cleaning services, the tendering process had to be restarted. Management stated that the contract in question has since been terminated, thus rectifying the situation. The Ministry added that the use of Article 20(c) was clarified and shall not be misapplied any further. Additionally, it was also claimed that ongoing internal monitoring is taking place.

Payments not as per prevailing Lease Agreement

MEAIM stated that this issue is in discussion with MIP in order to amend the contract in question.

Procurement from the Open Market without Appropriate Approval

The Ministry claimed that obtaining quotations prior to procuring transportation services is being prioritised. It was also pointed out that the decision to make use of the same service provider engaged by OPM was made due to logistical and operational issues.

Lack of Compliance with Standing Travel Regulations

MEAIM stated that monitoring of such travel procedures is being increased in order to eliminate further occurrences. Moreover, it was also stated that as from January 2015, MEAIM complied in submitting the Post Travel Submission Form as required by standing regulations.



Ministry for Tourism

Restoration of Forts, Fortifications and Historical Places

Expenditure

Background

The Restoration Directorate (RD) is the main Government entity responsible for the implementation of restoration works on public property and rehabilitation initiatives within the local historical urban context. The Directorate has a staff complement of over 160 personnel, including professional, administrative, technical and industrial employees with specific expertise in restoration works. RD operates from its offices and workshops at *L'Ospizio* Complex in Floriana. It also manages the Fortifications Interpretation Centre (FIC) in Valletta.

The Financial Estimates for Line Item 7048 – ‘Restoration of forts, fortifications and historical places’, under Capital Vote V, show that the estimate for 2014 was €1.88 million, whereas actual expenditure, as per the Departmental Accounting System, amounted to €1.39 million.

Audit Scope and Methodology

The objectives of the audit were to verify that expenditure incurred during financial year 2014, as well as the adopted procurement procedures, have been duly authorised and properly accounted for, and are accurate, complete and free of material misstatements.

A sample of 132 transactions for a total value of €1.26 million, *i.e.* 90.6% of the actual capital expenditure, was selected for testing, mainly covering Contractual Services. The sample selected was analysed to ensure that payments were supported by the necessary documentation, as well as confirming that the Public Procurement Regulations (PPR) S.L. 174.04 and other relevant circulars were adhered to. In addition, analysed the latest inventory databases provided, namely that of RD and FIC, and any shortcomings noted were reported accordingly.

Key Issue

Substantial Variations

A contract for the restoration of Castille Curtain and St. Christopher Bastion (Phase 2) in Valletta, amounting to €362,662, was signed during March 2011. As per letter dated 31 January 2013, the Directorate requested the Department of Contracts (DC) to approve variations and extra works, amounting to an aggregate of €431,172, representing approximately 120% over and above the contract value, claiming that the tasks in question were not foreseeable prior to the setting up of the scaffolding. RD confirmed that an element of the highlighted works was already completed.

Since the foregoing request was rejected by DC, on the basis that the additional works are to be procured under a separate public procurement procedure, another attempt was made. Approval was in fact sought and obtained retrospectively from the said Department. This covered net variations and extra works amounting to €167,744. Subsequently, an addendum was signed to this effect, stating that the provisions of the original contract entered into in March 2011 were to apply.

Given that further additional works were again deemed necessary, amounting to another €261,772, they required approval for a direct order. This was obtained from the Ministry for Finance (MFIN) and comprised a number of works, some of which were already carried out.

Notwithstanding the substantial amounts involved, the direct order approval did not specify that the terms and conditions of the original contract were still applicable. Moreover, the Directorate did not consider that another addendum was necessary. In the circumstances, specific conditions such as the respective period of performance and retention money could not be imposed.

Control Issues

Shortcomings related to the Provision of Cleaning Services

Contracted Timetable not followed

The tender for cleaning services at FIC was designed and issued prior to the opening of the said Centre, at which time it was considered best to have all cleaning operations completed prior to opening hours. However, since operations logistics dictated otherwise, Management worked on an *ad hoc* arrangement with the winning company, whereby the established schedules in the signed contract were not followed. However, no documentation was provided to support such change.

Overcharging

The number of cleaning hours recorded on the attendance sheets did not always tally with the amounts invoiced. Subsequent to audit queries, it was confirmed that in agreement with the contractor, the required 78 hours per week were being charged at a constant amount of 15.60 hours per day to facilitate the invoicing process. However, this still resulted in an overall unrecorded attendance of 143.15 hours, equivalent to an overcharge of €845 over the 15-month¹ period in question. Moreover, the respective 16 invoices were yet certified correct by the officer in charge and endorsed by the Director RD.

Furthermore, as from 18 June 2014 up to 9 October 2014, 50 cleaning hours per week were procured from the same service provider who submitted the cheapest quote. Again, the contractor kept invoicing at a fixed rate irrespective of not always adhering to the established schedule and falling short of the required aggregate weekly hours. This resulted in an overcharge of €207 over the said 16-week period. Notwithstanding this, five of the related six invoices were certified correct by the foregoing officer, whilst the remaining invoice was not even certified correct and still processed for payment. In addition, all invoices were endorsed by the said Director.

Hours performed without a rest break

As per S.L. 452.87 – ‘Organisation of Working Time’, “*Every worker shall be entitled to a rest break where the working day is longer than six hours*”. As per attendance sheets covering the 15-month period, in the majority of the cases, cleaners recorded more than six hours; at times up to nine consecutive hours. However, these were paid accordingly, in contravention to the said legislation.

¹ The 15-month duration is as from commencement date in 18 March 2013 up to date of completion in 17 June 2014, including the three months extension.

Paid Invoices not substantiated or not endorsed

Proper verification was not performed prior to processing bills for payment, since instances were encountered where the basis on which amounts were certified as correct, was not known. Furthermore, an invoice in the audit sample was not even endorsed. The following shortcomings relate:

- a. Documentation substantiating an invoice for the hire of machinery, totalling €6,000, was not provided. Furthermore, neither the quote submitted nor the respective stores requisition form were traced in the relevant file.
- b. Three invoices for the supply of water to Mdina and Birgu ditches, in aggregate amounting to €5,177, were endorsed and processed for payment. However, the delivery notes confirming the amount of trips and volume of water supplied were not provided.
- c. Delivery chits supporting two invoices of €410 each, covering the provision of sand, have been misplaced. In another instance, the delivery chits provided amounted only to 24 cubic metres of sand, rather than 30 cubic meters as invoiced. Notwithstanding the foregoing, the relative payments were still made, irrespective of the missing or contradictory documentation.
- d. A period contract clause for the hire of backhoe loaders clearly stated that no payments are to be made to the contractor unless the latter provides a 'signed delivery of service' chit. However, an invoice amounting to €432 was still paid, even though it was not backed up with the required documentation.
- e. An invoice for the amount of €6,683, covering the hire of excavator, was not endorsed by the officer in charge although processed for payment.

Double Payments

Weak internal controls that resulted in double payment, were also revealed while checking the sampled transactions as indicated below:

- a. A telegraphic transfer covering the cost of abseiling kits was authorised by the Ministry for Tourism on 12 March 2014. The disbursement included an amount of €1,016 which was previously settled on 28 June 2013 by the then Ministry for Resources and Rural Affairs. This double payment was brought to the attention of the Directorate.
- b. Part of the invoice for transport, covering 24,340 kilos of excavated material to dump site on 10 July 2013, was paid twice. The respective delivery chit was accounted for in two invoices, resulting in a double payment of 24,340 kilos at the rate of €2.33 per tonne.

Retrospective Approvals for Variations

The necessary approvals for variations were very often not sought before the commitment for additional works. This resulted in a number of unauthorised tasks, as well as undue pressure to approve changes when works were already carried out. The Auditors came across the following instances:

- a. The original cost of a tender for the design, supply and installation of a Closed Circuit Television at Mdina ditch amounted to €139,444. The final bill of quantities totalled €137,299, due to savings of €36,942 as a result of lesser quantities purchased than initially required, and adverse variations of €34,797, which were not originally envisaged. However, authorisation of the variations was only obtained from the Permanent Secretary (PS) after the actual completion of works.

- b. A departmental tender was awarded for landscaping works at Mdina ditch, at a contract value of €128,208. However, the quantity of soil supplied was substantially higher than the amount estimated by the contracting authority, exceeding the letter of acceptance by €23,368. RD confirmed that the relevant approval for a variation of 18.2% was only sought subsequent to works carried out.
- c. A departmental tender for the restoration of a curtain wall in Mdina ditch was awarded at a cost of €66,713. The works were completed during the first week of March 2013, with final expenditure totalling €76,171, inclusive of variations amounting to €12,024. Since savings of €2,566 were made on the original cost, the variations were netted to €9,458. PS approval in respect of the net variations was requested retrospectively on 15 March 2013.
- d. A contract amounting to €134,886 was awarded for the restoration of the parapet walls and surroundings in Mdina ditch. Though savings of €5,814 were made on the original cost, adverse variations amounting to €6,026, were included in the final expenditure of €135,098. PS approval in respect of the variations was again sought after completion of works.
- e. Director RD approved that the Occupational Health and Safety (OHS) services, with regard to the restoration works on five statues in Qrendi, were to be carried out for the amount of €2,583 over a 20-week period. The established timeframe was exceeded and further funds, totalling €1,650 exclusive of Value Added Tax (VAT), were required to complete the project. However, the Directorate confirmed that some inspections had already been carried out by the service provider prior to obtaining the relevant approval.
- f. As per request for quotations, OHS consultancy in respect of restoration works at a church in Tarxien was to last for about 44 weeks, *i.e.* 10 months. Subsequently, the submitted quote of €180 monthly (VAT excl.) was approved by PS for the total

amount of €1,800 (VAT excl.). However, although both the approved period and the respective amount were exceeded, a request to extend the value of the contract by an additional €680 (VAT excl.) was only made after OHS inspections were carried out.

Required Retention Money not held

From the sample of audit testing it was noted that the established amount of retention was not always withheld, rendering RD vulnerable to risks inherent from the performance of the contractor, whereby the latter cannot be held liable in case of default. The following cases refer:

- a. The tender awarded in March 2011 for various restoration works in Valletta specified that the sum of money retained from the interim payments was only to be released 12 months from the completion of the project. Notwithstanding this, the cumulative retention of €24,196, held up on all previously certified work, was released with the final certificate for payment.
- b. The tender for site-specific counting surveys of visitors and/or tourists to fortifications, stipulated that a cumulative retention equal to 5% of the total present value of the services rendered, is to be held for a 12-month period. However, it was confirmed that such retention was never withheld on payments effected up to the date of audit testing, totalling €20,461.
- c. Total certified works with respect to the restoration of the parapet at Mdina ditch totalled €135,098, thus the amount of €6,755, equivalent to 5%, was to be retained. However, due to a computational error, the retention money amounted to €1,591, which was €5,164 less than the actual amount that had to be withheld.

Funds disbursed unnecessarily

A contract awarded by the then Ministry for Resources and Rural Affairs, to design and build a lightweight structure in Mdina ditch, was budgeted to cost €159,409. However, the final expenditure amounted to €170,173, including a net variation of

€10,764. This comprised savings of €6,445 made following a reduction in the scope of works and a claim for additional costs of €17,209 submitted by the contractor due to suffering delays. However, it is debatable whether the claim for the extra charge was justified. Furthermore, the basis of the computation could not be established since a detailed breakdown of the amount in question was not available.

Performance Guarantees expired or overlooked

In the following instances, a valid performance guarantee was not available and therefore RD would not have been able to cover its claims, if the contractors failed to meet their contractual obligations:

- a. As per letter of intent, the performance guarantee submitted by the service provider, for cleaning tasks at FIC, was to be valid for 12 months. However, the only guarantee provided, dated 12 March 2013, merely covered up till 31 March 2013, thus, it was only valid for 19 days.
- b. A letter of intent stipulated that the performance guarantee to be submitted for the restoration of the parapet wall and surroundings in Mdina ditch was to be valid for 12 months. However, the two performance guarantees provided, in aggregate, only covered a five-month period from 15 October 2012 until 15 March 2013.
- c. The foregoing service provider was also awarded a tender to replace the concrete roof of a church in Santa Venera. However, the requirement for a performance guarantee was inadvertently omitted from the contract, thus such guarantee was not provided.

Compliance Issues

Awarded Tenders and Variations not published

PPR Article 20(2) stipulates that lists of departmental contracts awarded and cases involving variations of more than 5% are to be published in the Government Gazette every six

months. As per MFEI Circular No. 11/2011 – ‘Departmental Tenders issued under Part II of LN 296/2010’, this list is to include those tenders procured by direct order. However, four departmental contracts, three variations and one direct order, amounting to an aggregate value of €606,283, were not published accordingly.

Misallocation of Expenditure

Twenty cases tested in the audit sample, that amounted to €39,441, were recorded under account 30607048 – ‘Contractual Services’, even when items and/or services were not obtained by the Government under contract with third parties. Furthermore, similar goods and/or services, in the majority acquired from the same supplier and/or service provider, were inconsistently posted in the accounting system.

Deferred Payments

A total of 22 transactions amounting to €125,984, were expended in 2014, when in actual fact the respective invoices were raised prior to December 2013, some of which were paid more than a year later. This total does not include invoices, dated in December 2013 and also paid the following year.

VAT Receipts not readily available or not provided

Whilst carrying out the necessary verifications on the payments included within the audit sample, the following VAT-related issues were noted:

- a. In the majority of the cases, VAT receipts were not attached to the relative original payment voucher for ease of reference, as required by MF Circular No. 5/2002 – ‘Submission of Fiscal Receipts to Government Departments’. It also cannot be excluded that 36 of the VAT receipts, amounting to €62,387, were requested and obtained from the respective service providers and/or suppliers subsequent to audit queries, and well following payments.
- b. Four service providers and/or suppliers failed to supply RD with VAT receipts amounting to €148,992, against payments made to them.

- c. In accordance with VAT regulations, when the service provider and/or supplier is exempt, he is to provide either a VAT receipt marked 'exempt', or a declaration that he is exempt from registering for VAT, or an invoice quoting the exemption number denoted by 'EX', as applicable. However, an individual providing consultancy services, amounting to €2,250, did not submit any of the said documents to confirm his exemption.

List of Defaulters not compiled

On 30 March 2015, the National Audit Office (NAO) requested copies of quarterly returns with details of defaulters covering the year under review, including also Nil returns. Notwithstanding the above-mentioned observations, quarterly returns highlighting the respective defaulters, as required by MFEI Circular No. 2/2012, were not provided.

VAT Element not indicated

The awarded quote of €2.33 per tonne, for transport of excavated material, did not indicate whether the rate is inclusive or exclusive of VAT. Although this should imply that the quotes are inclusive of VAT, RD stated that at the time of the assessment of the three quotes submitted, the service provider confirmed that the rate is exclusive of VAT. However, no documentation was available to this effect.

Returns not submitted to the Auditor General

MF Circular No. 14/99 – 'Government Accrual Accounting: Revised Inventory Control Regulations', outlines the information pertaining to inventory that is to be submitted to the Auditor General. However it was established that, at least for the year under review, a list of items added to the inventory and a copy of the inventory database were not forwarded to NAO.

On 20 February 2015, this Office requested a copy of the inventory database as at 31 December 2014. Two months later, copies of FIC and RD were provided. However, the latter copy was not updated. RD stated that this was due to lack of human resources.

Analysis of the Inventory Databases

From an analysis of the inventory databases provided, a number of shortcomings were noted, indicating non-compliance with MF Circular No. 14/99, for instances:

- a. a number of items were assigned the same 'Asset Identification Number', rather than uniquely allocated;
- b. certain required details were left blank; and
- c. a number of items not meeting the criteria of fixed assets, due to their immaterial cost, were included in the database.

Recommendations

Key Issue

Substantial Variations

It is important to give due attention to the planning phase prior to the issuance of tenders, so as to decrease the possibility of potential extra costs and the distortion of planned projects. In addition, considering especially the nature of works involved, a reasonable contingency is to be included in the tender estimates, to cover items, conditions or events, for which the state, occurrence, or effect is uncertain and that experience shows will likely to result in additional costs. As far as possible, requests for variation orders are to be made to DC or MFIN as applicable, prior to carrying out the respective works. Similarly, in line with MFEI Circular Nos. 3/2012 – 'Public Procurement by Direct Order' and 3/2013 – 'Public Procurement Regulations – Direct Orders', the necessary MFIN approval for direct order is to be sought before any commitment is entered into. In future similar instances, an addendum is to be drawn up in order to include terms and conditions to safeguard RD interests.

Control Issues

Shortcomings related to the Provision of Cleaning Services

Any changes to the agreed hours of service are to be formally authorised and documented. This will enable Management to confirm invoices to the

attendance sheets prior to payment, also ensuring that the number of hours claimed has been performed. Furthermore, any overpayments are to be recouped without undue delay. In addition, Management is to ascertain that all contractors abide with employment regulations.

Paid Invoices not substantiated or not endorsed

Before effecting payments, the responsible officer is invariably expected to ensure that the respective invoices were duly checked and endorsed accordingly. Furthermore, officers entrusted with the authorisation of such payments are to be held accountable in case they fail to carry out their duties properly. Each payment is to be adequately substantiated with source documentation, which is to be properly filed for future reference and audit purposes.

Double Payments

Internal controls are to be strengthened to ensure that double payments are prevented. Moreover, the Directorate is to do its utmost to recoup the amounts in question.

Retrospective Approvals for Variations

Where possible, works are not to be carried out unless appropriate authorisations are obtained.

Required Retention Money not held

The required retention is to be held in order to protect the contracting authority from any loss resulting from the contractor's failure to fully perform his contractual obligations.

Funds disbursed unnecessarily

Although NAO acknowledges the fact that planning projects may be challenging, the initial stage is of fundamental importance and needs to be carried out diligently in order to prevent unnecessary delays. Furthermore, in future similar instances, claims are to be substantiated with detailed documentation.

Performance Guarantees expired or overlooked

It is to be ensured that contractors submit the required performance guarantee, valid for the entire period of the respective contracts.

Compliance Issues

Awarded Tenders and Variations not published

Officers in charge are to be fully aware of the relevant regulations, to ensure that the required publications in the Government Gazette are made accordingly and in a timely manner.

Misallocation of Expenditure

Payments are to be appropriately posted in the respective accounts, ensuring consistency, as also required in terms of the regulations.

Deferred Payments

Deferred payments are to be kept at the absolute minimum, limited to that which is unavoidable.

VAT Receipts not readily available or not provided

Effort is to be made to enforce the principle that VAT receipts are invariably obtained for every purchase of goods and/or services in line with VAT regulations. Otherwise, as per MF Circular No. 5/2002, the Directorate is to consider discontinuing purchasing from such defaulters until this situation is rectified. Furthermore, all receipts are to be kept in the relevant file to support the respective payments.

List of Defaulters not compiled

Quarterly returns with details of defaulters are to be submitted to the Audit and Assurance Section of the VAT Department on a quarterly basis, as required by the respective circular.

VAT Element not indicated

Whilst acknowledging that the quote selected remained the cheapest, in future similar instances it is to be ensured that the quotes submitted, clearly indicate the VAT element in order to avoid any possible misinterpretations, also ascertaining compliance with applicable regulations.

Returns not submitted to the Auditor General

Both inventory databases are to be updated without undue delay. Furthermore, statutory information is to be forwarded to NAO as required by MF Circular No. 14/99, in order to ensure compliance with the established provisions and enable control over inventory items.

Analysis of the Inventory Databases

Shortcomings in the inventory records are to be rectified in order for the databases to be complete, reliable and in compliance with the requirements of the circular.

Management Comments

Management concurred with all recommendations put forward by NAO and action has already been taken to address certain areas. In addition, the following comments were submitted:

- The restoration of Castille Curtain and St. Christopher Bastion (Phase 2) in Valletta was a particular project since the site in question was very difficult to assess at tender preparation stage. Furthermore, the processes for requesting approvals of variations and direct orders were delayed due to a change in administration.
- The double payment of €1,016 for abseiling kits was recovered. Management has also taken the necessary action to recoup the other three overpayments.

- Every effort is being made to ensure that approvals for extras and variations are sought in a timely manner, even though the nature of works contracts often necessitates that works on site are not hindered by undue stoppages.
- The Directorate is keeping an updated database of tenders, variations and direct orders awarded, in order to be in a position to publish them in time.
- Action will be taken to ensure that the inventory is kept correctly and updated regularly.
- The set-up of the Accounts Section was strengthened since the beginning of 2015, through the addition of two officers and the replacement of another. In fact, action is being taken on a daily basis by the Accounts Section to ensure that:
 - no payments are being affected unless certification by the officer responsible for procurement and supporting documentation, where applicable, are in place;
 - double payments are prevented;
 - performance guarantees are presented when requested prior to the signature of a contract and extended where and as necessary;
 - proper postings are made;
 - pending payments are settled within the year and in the shortest time possible;
 - VAT receipts are attached to the copy of the payment voucher, and that suppliers and/or contractors are submitting said receipts in a reasonable time; and
 - all quoted prices are inclusive of VAT.

Mediterranean Conference Centre

Revenue, Stores and Inventory

Background

The Mediterranean Conference Centre (MCC) is a Government entity falling under the remit of the Ministry for Tourism, thus considered as an Extra Budgetary Unit. Its functions are vested by the Minister, upon a Board of Management which is composed of a Chairperson, five Members and a Secretary. In addition to conferences, MCC offers one of the finest venues in the Mediterranean for a range of events, including product launches, exhibitions, conventions, banquets and theatrical performances.

For the last nine years, MCC was not provided with a Government subvention, but its main source of income was the revenue generated from conferences, leisure and banqueting facilities, as well as rents receivable from leasing part of its premises. For the financial year 2014, the entity managed to overturn the forecasted loss of €19,537, into a net profit of €2,029.

As reported in the audited Financial Statements¹, the entity's financial position improved considerably by year-end 2014, when compared to the preceding year, whereby it had registered a net loss of €95,122.

Audit Scope and Methodology

The main objectives of the audit were to ensure that:

- a. an adequate system of internal controls on revenue collection was in place, to assess their effectiveness over a number of income streams, and to provide recommendations to enhance governance, the efficacy of control practices, as well as to reduce risks associated with revenue management; and
- b. MCC is in compliance with the Inventory Control Regulations as set out in MF Circular No. 14/99, as well as to verify that adequate controls exist over inventory items and identify any risks arising from the current procedures.

Audit fieldwork carried out by the National Audit Office (NAO) included various meetings, as well as correspondence with the main executive officers of the organisation, in order to obtain an understanding of the relevant policies and procedures adopted. The focus and extent of audit work was based on an assessment of materiality and related risk. This was achieved mainly

¹ The audited Financial Statements were not yet signed by Management by the conclusion of this audit.

through a walk-through of the system in place, as well as reviews of the applicable lease and/or events agreements, invoices raised, payments effected and relevant bank statements.

Key Issues

Lack of Segregation of Duties

The workforce at MCC throughout 2014 amounted to an average of 30 employees, of whom only three officers, namely the Financial Controller and two Executives manned the Accounts Department.

During the same year, the Financial Controller was also assigned the role of a Deputy Chief Executive Officer. Moreover, one of the employees in the Accounts Department works on a reduced timetable, whilst the other availed herself of vacation leave pursued by maternity leave and parental leave as from 1 December 2014.

In view of the limited human resources at the foregoing Department, the Financial Controller is resorting to perform those duties which in the normal course of business are assigned to staff in the executive grade. This is resulting in lack of segregation of duties, whilst limiting the incumbent's role as Financial Controller and which will also have a negative impact on the effectiveness of internal controls.

Weak Control on Store Items

Lack of control on the store items² falling under the responsibility of MCC was noted during the course of the audit. An adequate stock control system, as laid down in Treasury Circular No. 6/2004, was not in place and such stock was not properly safeguarded against theft, misuse and deterioration. This was evidenced by the number of shortcomings and discrepancies that were detected by the examiners during the audit inspection carried out on a specific publication.

- a. The stock of publications, together with brochures, compact discs, pens, theatre tickets etc, were held in MCC's store which is not the ideal storage place, since it is

humid and not clean. These factors caused irreversible damage to the stored items.

- b. A computerised system was not in place for the recording of stock items. All records were being maintained manually, lacking necessary details such as receipts and issues, as well as the value of stock in hand, thus cannot be considered as complete and reliable.
- c. Re-order levels, re-order quantities, consumption rates, as well as maximum and minimum stock levels did not exist.
- d. Bin cards had not been updated since 2008.
- e. Material discrepancies were noted between the stock in hand as recorded in the bin cards, the manual stock register, and the actual quantities found during a physical stock-take³ carried out on a particular day, by the officer who is currently manning the stores.
- f. The mandatory annual physical stock-taking exercise was not being performed. This hinders the possibility of identifying slow-moving and obsolete items, as well as discrepancies arising during the year.
- g. Through verbal communication with the officer who was assuming stores responsibility during the audit, it transpired that during 2015, a number of stock items, including returned old items by staff, as well as goods of a perishable nature, were disposed-off. However, no records showing details and/or values were maintained in this respect. Furthermore, no authorisation was sought to dispose of the respective goods. It was also confirmed that a Board of Survey was not appointed to inspect the items that were claimed as damaged.

Untimely Bank Deposits

From audit testing it transpired that MCC took long intervals to deposit at bank, the cash and cheques received at the booking office located within its

² As per audited Financial Statements as at 31 December 2014, this amounted to €26,628.

³ The stock-take was not carried out in the presence of NAO.

premises. Such income is collected on behalf of third parties from the sale of tickets related to the organisation of theatrical performance, as well as from its clients for the hire of premises and/or organisation of events.

By way of example, income received from sale of tickets during the period covering 4 August to 22 September 2014, which in cash alone accumulated to more than €15,000, was only deposited on 1 October 2014.

Another case in point is the receipts from customers aggregating to €95,726, received between 11 November and 19 December 2014, that were only deposited on 24 December 2014.

The amounts mentioned above go far beyond the limit of liability⁴ specified in the money insurance policy held by the entity, thus rendering the same coverage as inadequate. Consequently, any requests for amounts that can be claimed over the insured amount will not be met.

Control Issues

A conclusive Fixed Asset Register not in place

During 2012, MCC engaged a consultant to compile a Fixed Asset Register; however, up to mid-2015 this assignment was not yet concluded. Furthermore, the fact that some of the areas within the premises, which are outsourced on long-term lease, contain a mix of asset ownership, hindered the compilation of a precise report.

Notwithstanding this, disclosed in the audited Financial Statements for the year ended 2014, is Property, Plant and Equipment with a net book value of €1,152,320. Irrespective that the aforementioned balance was not substantiated by a Fixed Asset Register, a clean audit opinion was still issued.

Fixed Asset Register not in line with Pertinent Regulations

A review of the inventory database compiled revealed that the information disclosed therein is limited only to asset description, quantity,

location, condition of asset, and whether it is of a fixed or movable nature. This implies that certain specific details outlined in MF Circular No. 14/99 were completely omitted from these records.

Assets not marked with an Asset Identification Number

From the audit verifications carried out, it was noted that practically none of the inventory items were physically marked with an Asset Identification Number, as required in terms of MF Circular No. 14/99.

Room Inventory Lists not evident

Despite that the inventory regulations require that a list of items of inventory, in respect of each room, is to be hung on the wall in the room containing the items, this was not evident.

Lack of Effective Control on Inventory

It is evident that no monitoring and/or effective control is exerted over the tangible assets falling under the entity's responsibility, partly due to the fact that, MCC failed to nominate a specific person as officer in charge of inventory in line with standing regulations. Consequently, in the event that assets are transferred from one location to another, such movements were not being documented.

Heritage Asset Catalogue not compiled

Being one of the national monuments with a historical character, MCC has in its possession a number of assets, which are expected to be preserved in trust for future generations. Notwithstanding this, MCC failed to compile a Heritage Asset Catalogue in line with the terms laid down in MF Circular No. 14/99.

Entity not in possession of a Copy of the Insurance Policy maintained by the Tenant

One of the main sources of income generated by MCC is through long-term leasing of parts of the premises to third parties. During 2014, the entity housed a private company who provides an audio-

⁴ The limit of liability, in direct transit amounted to €23,000 and in the custody of the insured totalled €15,000.

visual show, the Cultural Heritage, as well as the offices of Identity Malta.

In all three instances, the related lease agreements bound the tenant with the responsibility to safeguard the entity's property and interest, by having a proper insurance cover in place at its own expense. However, MCC failed to request a copy of the respective insurance policies, thus failing to ascertain that it is covered for potential loss or damage.

MCC only requested the documentation in question following NAO's queries.

Provision and Management of Catering Services

Background

By virtue of an agreement dated 1 July 2012, MCC Board granted a private company the exclusivity of providing and managing catering services at and during all functions, productions, conferences and activities held within its premises. Apart from the rental charge, the latter is to pay the former a percentage rate of commission on the annual turnover generated from such events.

Commission received not validated

On a monthly basis, the company in question provides MCC with a breakdown of the income generated from its sales on the latter's premises, as well as the respective commission payable. Subsequently, MCC invoices the company accordingly.

- a. The catering company did not provide MCC with any source documentation, reflecting the sales figures from the open bar services in connection with events held at MCC. Only a monthly return was being forwarded together with the payment. Hence, the latter could not ascertain whether the 11% commission paid was correct. For the year under review, the auditee received the amount of €3,306 excluding Value Added Tax (VAT) with respect to €30,052 declared as sales from the open bars.

- b. This Office could not ascertain whether the commission of €1,436 paid to MCC by the service provider with respect to two events was correct, since the latter failed to attach a supporting invoice that should amount to €13,847 (VAT excl.) and a credit note for €788 (VAT excl.), with the respective monthly returns. This shortcoming implies that MCC is not carrying out the necessary verifications, which ultimately is at its own interest.

Clauses stipulated in the Lease Agreement not adhered to by the Lessor

Clause 1.17.2 of the agreement entered into with the catering company provides that, in addition to the consideration of the exclusive provision of catering services at and during all functions, and separate from any commissions due, the service provider is also to pay MCC a rental charge of €30,000 *per annum* (VAT excl.), payable one month in arrears. Notwithstanding the agreed terms, by year-end, MCC had not yet invoiced the company for the monthly rental charge of November, while rent for the month of December 2014 was only invoiced on 15 February 2015.

Furthermore, in line with clause 1.17.4 of the respective agreement, the lessee is also responsible to pay water and electricity on a monthly basis, as per metered usage of areas designated for its sole use. Though MCC's electrician was appropriately taking meter readings every month, the Accounts Section was only raising the respective invoices on a four-monthly basis.

Malta Philharmonic Orchestra

Shortcomings noted in the Electricity Consumption charged to Client

As per agreement terms for 2014, the Malta Philharmonic Orchestra (MPO) was to be charged for stage lighting at the rate of €0.45 per metered unit, which readings were to be taken jointly by both parties. The following shortcomings relate:

- a. For the theatrical performance titled 'MPO plays Queen', MCC charged for 880 units for stage lighting. This Office could not

ascertain whether the invoiced units were correct, due to the reasons hereafter:

- The hand-written note indicating the meter readings, which was traced in the respective registry file MCC/84/13, was only endorsed by MCC's electrician, notwithstanding that the related agreement specifies that the readings are to be taken in the presence of both parties.
- The foregoing note indicates two dates, namely 29 March on top of the page, left-hand side and 8 May 2014 at the bottom, close to the respective signature. However, NAO could not establish to what the bottom date relates. MPO made use of the Republic Hall on 26 and 27 March 2014 for preparations and rehearsals, whilst the actual performance was held on 29 March 2014.
- It also transpired that the second meter reading jotted down by the electrician was revised downwards by 300 units. Thus, whilst the original reading showed a total consumption of 1,180 units, the amended reading reflected 880 units. This amendment was neither endorsed nor dated.

- b. With respect to the theatrical performance titled 'From Russia with Love', MCC charged MPO for 1,200 units of electricity consumption. Source documentation related to these readings could not be traced in the respective registry file, thus accuracy of the amount in question could not be verified.

Deposit not paid prior to the holding of the Performances

Clause 2(1) of the theatrical performance agreements stipulates that no reservations are confirmed unless covered by a non-refundable deposit of €1,750 per performance. However, it transpired that the agreements in place for the two productions, held by MPO during 2014, were drawn up and duly signed by both parties, without any deposit paid on account.

Identity Malta

Background

By means of a lease agreement dated 4 December 2013, MCC accepted to hire out part of its premises to Identity Malta, for a three-year period commencing from 1 January 2014. For a total consideration of €110,000, the leased premises included areas known as the Marketing and Sales Office, as well as the Operations and Finance Office together with two adjacent rooms, the *Cotoner* Hall, and four ground floor rooms. With respect to the latter four rooms, the lessee was also to be charged for electricity based on consumption of 2,090 units per month, calculated at cost.

A number of amendments to this original contract came into effect through an addendum agreement dated 3 January 2014, whereby it was decided that one of the ground floor rooms was to be substituted by two rooms. In addition, the lessee was also assigned two car spaces.

Lease Agreement not signed by the Lessee

Whilst going through the Board minutes, an unsigned agreement dated 1 November 2014 was traced, whereby particular reference was made to the term of lease, as well as the possibility of vacation of certain rooms prior to the lapse of the lease agreement.

Eventually, before 31 December 2014, Identity Malta vacated some rooms, and the ground floor rooms were substituted for the new administrative offices and additional new spaces, namely *Perellos* Suite.

Notwithstanding that the revised agreement came into effect as from 1 January 2015, at least by the beginning of June 2015 when the audit was finalised, this was not yet signed by Identity Malta. The latter was awaiting a reinstatement value of the premises in use in order to place an adequate insurance cover.

Other Matters

Cash Receipts from the Booking Office not verified on a daily basis

During the sampled period, *i.e.* 22 August till 22 September 2014, the booking office operated on a total of 20 days.

Whilst reconciling the respective computerised sale of tickets reports and the manually filled-in daily cash and cheques reports against the amounts deposited at bank, various shortcomings as highlighted hereunder were noted:

- a. On 15 out of 20 instances⁵, no proof could be traced, indicating that MCC's accounts officers were reconciling the ticket sales against the monies passed on by the booking clerks. It was also observed that only on 10 occurrences⁶, the daily cash and cheques reports were endorsed as checked by a Manoel Theatre employee; the remaining five reports⁷ were not countersigned by anyone.
- b. When the cash and cheques daily reports were verified, the respective certification was not being carried out on a daily basis. A time lag of approximately one week was noted between the collection of monies and the respective checking.
- c. Although not material, a discrepancy was noted between the ticket sales report and the daily cash report prepared on 28 August 2014, notwithstanding that the latter was endorsed as checked by the employee from the Manoel Theatre. Amount deposited at bank reconciled with that of the ticket sales report.

Inadequate Insurance Coverage

Whilst going through the insurance coverage maintained by MCC, the following shortcomings were encountered:

- a. The amount of €388,736, insured with respect to salaries payable to directors, managerial and other staff, was short by €115,914, when compared to the actual gross emoluments of €504,650⁸, paid during the year under review.
- b. The physical contents held by the entity are insured at the sum of €1,868,687, of which €121,295 represents the agreed value for antique items in line with the valuations submitted by the latter to the insurers. According to the Financial Controller, these amounts are substantiated by a list drawn up following an exercise carried out years ago. However, this list was never reviewed again. Moreover, this substantiating documentation was not provided for audit purposes.

Electricity Consumption Readings not endorsed by the Auditee

Through a lease agreement dated 1 April 2005, MCC granted a local company the right to install a telecommunications service system facility on its roof, against an annual consideration. Seven years later, this agreement was renewed under the same terms and conditions, except for a revision in the annual rental charge, which during the year under review amounted to €4,000 (VAT excl.).

In view that the lessee did not install a separate electricity meter, through the aforementioned agreement it was bound to reimburse the lessor for the related utility charges on a quarterly basis.

⁵ With respect to sale of tickets between 22 August and 16 September 2014.

⁶ With respect to sale of tickets between 22 and 31 August 2014.

⁷ With respect to sale of tickets between 4 and 16 September 2014.

⁸ Out of this figure, the amount of €38,798 was paid in respect of overtime charges.

The following shortcomings relate:

- a. Sub-meter readings were taken every four months rather than on a quarterly basis.
- b. Notwithstanding that recharges were based on the amounts disclosed in the 'Electricity Meter Reading Form' drawn up by the lessee, such document was not endorsed by MCC. This implies that the respective readings were not taken in the presence of a representative of MCC.
- c. The sole substantiating documentation traced with respect to the reimbursable amount receivable was the remittance advice raised by the lessee, as no invoices were raised by MCC in this respect.

Invoices not raised in Sequential Order

Whilst going through the three invoices raised with respect to a workshop held by a foreign organisation between 15 and 17 September 2014, it was noted that invoice 8842, dated 28 October 2014, was raised more than one month after the issue of invoice 8843, dated 16 September 2014.

Theatrical Performance Agreements lacking detailed provisions

The theatrical performance agreements, signed with third parties for the use of the Republic Hall, provide the hourly charges for stagehands, lights operator, usherettes, as well as the booking office clerk. However, certain variable expenditure, including the overtime costs of the relative staff, such as the duty manager, cleaners, cloakroom attendants, as well as the extra security officers, were fully borne by MCC, since the respective agreements fail to refer to such services and the related costs. In the circumstances, this Office could not ascertain whether MCC or its clients were responsible for such expenses which, for the performances held by a non-profit organisation and MPO, both falling within the audit sample, in 2014 amounted to at least €4,742.

Compliance Issue

Statutory Returns not submitted to NAO

In breach of MF Circular No. 14/99, no statutory returns in respect of assets under MCC's responsibility, as well as additions to fixed assets, were ever forwarded to the Auditor General.

Recommendations

Key Issues

Lack of Segregation of Duties

The strengthening of the Accounts Department will enable the Financial Controller to improve the internal control set up, as well as assist in reducing inherent risks, whilst providing a vital step in the growth of the entity.

Weak Control on Store Items

Stock control procedures, as stipulated in Treasury Circular No. 6/2004 are to be adopted. The recording process is expected to be through a computerised stock management system. This will enable a proper audit trail for each transaction while mitigating related problems.

In addition, a physical check of all stock items is to be carried out on a regular basis, in line with the requirements of the General Financial Regulations. Any discrepancies between the physical stock count and the stock records are to be scrutinised.

Untimely Bank Deposits

In line with best practice, for the safeguarding of funds as well as to minimise the negative impact on the entity's cash flow, cash and cheques are to be deposited on a regular basis, whilst ensuring that the amount of money in hand is adequately covered by the insurance policy.

Control Issues

A conclusive Fixed Asset Register not in place

All assets falling under MCC's remit are to be identified. Management is to ensure that the assignment to comply a proper Fixed Asset Register is finalised without further delays.

Fixed Asset Register not in line with Pertinent Regulations

Management is to ensure that records are thoroughly checked to identify any entries that are inconsistent with standing regulations and these are to be amended accordingly. Moreover, in order to ensure that more effective control is maintained, MF Circular No. 14/99 is to be complied with. In case of any difficulty in maintaining an up-to-date tangible Fixed Asset Register, guidance is to be sought from the Ministry for Finance.

Assets not marked with an Asset Identification Number

Adherence to inventory control procedures is recommended. This entails physically marking items with a permanent identification number, as far as it is practicable to do so.

Room Inventory Lists not evident

In line with MF Circular No. 14/99, room inventory lists are to be produced and hung in the respective rooms. Furthermore, these are to be duly amended whenever items are transferred from one room to the other.

Lack of Effective Control on Inventory

Once an officer in charge of inventory is nominated, ongoing liaison is to be carried out between the latter and other on-site officers, so as to ensure that inventory records are consistently updated with the actual movements.

Heritage Asset Catalogue not compiled

MF Circular No. 14/99 specifies that heritage assets, which in the inventory database are to be denoted as such, are to be separately catalogued

by the entity entrusted with their care. This catalogue is to contain a photograph of the item and a scrupulously detailed description by a Government-appointed expert, who is also to endorse the printed copy of the catalogued sheet for that heritage asset.

Furthermore, Management is to ensure that heritage assets falling under its responsibility are conserved and managed in a sustainable manner. This contributes towards a better appreciation of Malta's cultural identity.

Entity not in possession of a Copy of the Insurance Policy maintained by the Tenant

MCC is to ascertain that the tenants are adequately insured, so that in case of any accidental losses or damages, the cost of the assets will be duly recovered.

Provision and Management of Catering Services

Commission received not validated

For the sake of transparency, amounts receivable are to be substantiated by adequate and complete documentation. With respect to income earned from open bars, MCC is to request the respective company to provide a copy of the cash register end-of-day report.

Clauses stipulated in the Lease Agreement not adhered to by the Lessor

Invoices are to be duly raised and forwarded to the lessee within the stipulated time.

Malta Philharmonic Orchestra

Shortcomings noted in the Electricity Consumption charged to Client

Electricity readings are to be initially taken on the first day the hall is occupied by the client for preparation, whilst a second reading is then to be taken upon dismantling. Furthermore, for the sake of transparency the electrician is to be accompanied by the lessee's representative, who is also required to endorse the respective readings.

This will in return eliminate any disagreements, which might crop up following the issue of the related invoice.

Deposit not paid prior to the holding of the Performances

MCC is to ensure that a deposit duly backs all agreements prior to commencing any work related to the respective event.

Identity Malta

Lease Agreement not signed by the Lessee

Lease of MCC premises is to be covered by valid contracts at all times. Such measures would reduce the potential of disagreements and litigation in case of default by either parties, and also ensure that all services rendered and payments made are legally backed up.

Other Matters

Cash Receipts from the Booking Office not verified on a daily basis

At the end of the day, receipts from the sale of tickets, as disclosed in the computerised report extracted from the booking system, are to be invariably reconciled to the amount of cash and cheques in hand, by an independent officer. Daily cash-out procedures help to uncover discrepancies between actual cash collected and recorded amounts in a timely manner.

Inadequate Insurance Coverage

Management is to safeguard the entity's assets, interests and activities, against any unforeseen loss or damage, by having a proper insurance cover in place, which policy is to be reviewed and updated from time to time.

Electricity Consumption Readings not endorsed by the Auditee

It is important that MCC officers are present whilst the readings are being taken. Invoices for reimbursement are then to be raised accordingly.

Invoices not raised in Sequential Order

The Financial Controller is to ensure that the invoicing system tool provides a continuous audit trail in its method of invoice generation.

Theatrical Performance Agreements lacking detailed provisions

For the sake of transparency, services offered on a complimentary basis are to be clearly spelled out in the theatrical performance agreement drawn up.

Compliance Issue

Statutory Returns not submitted to NAO

Officers in charge of the respective tasks are to be made aware of the statutory returns that have to be compiled, and that accurate and timely feedback is regularly submitted to NAO.

Management Comments

Management acceded to a number of recommendations put forward by NAO and the latter's comments were seen as a positive opportunity to ameliorate and tighten the internal control system in place. Remedial action has already been taken to address the following issues:

- MCC commenced the process to recruit two key persons, a Finance Officer and an Administration Assistant, to strengthen the workforce within the Finance and Administration Department. Meanwhile, the Accounts Executive who was on maternity and unpaid leave has resumed her duties. This will enable MCC to accomplish recommendations forwarded by NAO.
- Management has instructed that deposits at bank are to be effected once a week. This process is being monitored to ensure that they are being performed in a timely manner.
- The process to procure advisory services with the aim of compiling a proper Fixed Asset Register has initiated. Once the

register is compiled, and the Finance Officer position is filled, the necessary measures are going to be taken to ensure that this register will be kept updated. In order to safeguard the assets, adequate control procedures such as physical inspection, are going to be implemented. The new incumbent will also be tasked to ascertain that the provisions laid down in MF Circular No. 14/99 are observed.

- Referring to the weak control on store items, Management in concurrence with NAO's recommendation will be installing a stock system software, followed by the performance of a complete stock-take and inputting in the system.
- Internal control procedures were also communicated to the Operations Department with respect to the electricity consumption readings and the commission receivable from the open bar sales made by the catering provider. Regarding the latter, Management requested the Department to take note of the number of cash-points and the readings from the end-of-day reports, on a prescribed form. Similarly, the meter readings also have to be noted on an official document that has to be endorsed by both parties.
- Management confirmed with their insurance company that the Employers' Liability policy covers MCC against liability at law

to pay compensation and claimants' costs and expenses in respect of accidental injury of its employees. The deposit premium will be adjusted at the end of the insurance period and an additional premium will be due to the insurers depending on the actual payroll figure declared.

MCC made reservations with regard to NAO's comments in relation to the following issues:

- Given that MPO is a cultural entity within Government and a regular business collaborator, Management does not consider it necessary to request a deposit from the former.
- MCC stated that the services mentioned in the observation with respect to the theatrical performance agreements are part of the established fee, given that the contract specifies which services are charged extra. MCC uses the pricing model adopted in the industry so as not to lose much of its business to its competitors.

Management failed to forward its comments with respect to the statutory returns that are to be submitted to NAO.





Ministry for Education and Employment

Ministry for Education and Employment Expenditure

Background

The Finance Department within the Ministry for Education and Employment (MEDE) incorporates two main financial management functions, namely that related to the Ministry itself and that pertaining to the Education Directorates. Financial control measures undertaken by both sections include the following:

- a. internal auditing and monitoring to ensure quality service to clients, both internal and external;
- b. financial management including planning, budgeting and monitoring of revenue and expenditure; and
- c. efficiency gains initiatives, mainly with regard to the reorganisation of current operations and maximisation of available resources.

On the other hand, the Procurement Unit within MEDE is responsible for the preparation and issuing of tenders and calls for quotations, as well as the actual procurement of works, supplies and services.

The 2014 Financial Estimates for MEDE show that the aggregate expenditure of Vote 16 and 17 was €436 million, out of which, €250 million covers items of expenditure falling directly under the Ministry, and the rest, *i.e.* €186 million for the Education Directorates.

Audit Scope and Methodology

The main scope of the audit was to determine the level of internal controls over expenditure, and to ensure efficient administration of public funds, in line with standing laws, regulations, policies and procedures, also making recommendations, where warranted.

A sample of 327 invoices and/or claims, for a total value of more than €2.6 million, was selected for testing, mainly covering expenditure classified under Information, Contractual and Professional Services under Recurrent Vote 16 and Capital Vote VI. Furthermore, analysed the latest inventory database provided, *i.e.* as at 30 June 2014, and any shortcomings noted were reported upon accordingly.

Limitations on Scope of Audit

Since the number of hours required for cleaning and security services at the Malta Libraries and Public Library respectively were not provided for audit purposes, the relative payments could not be validated. Furthermore, testing of translation and proofreading services, as well as research on Maltese entertainment in Australia, was limited since the related files could not be traced.

Key Issues

Public Procurement Regulations continuously by-passed

Throughout the audit testing, comprising a sample of transactions, it was noted that the majority of procurement by MEDE was not made in line with standing regulations. The main areas of non-compliance, which will be discussed separately further down in this write-up under the pertinent observations, include:

- a. services procured direct from the open market, very often without obtaining quotations and/or the relevant approvals;
- b. contract renewed although no option for extension was provided for, in the tender document;
- c. possibility of indefinite contracts, since the call for tenders included the option of extending for further periods without any limits;
- d. expired contract still in use;
- e. contract period not clearly indicated in the agreement; and
- f. additional services rendered not covered by the applicable contract.

Lack of Fundamental Internal Controls

During the audit it transpired that internal controls in various areas are lacking, indicating that little or no monitoring is in place to reduce the possibility of errors. A number of issues, as will be separately reported upon further down in the write-up, could have been avoided if an effective internal control system was in place.

Control Issues

Double Payments

- a. One of the sampled invoices covering publicity, for the amount of €8,167, was settled twice by the Ministry, on 11 July and 10 September 2014 respectively.

- b. Another invoice, amounting to €4,890 and covering consultancy services provided to MEDE during August 2014, was also paid twice on 2 October and 16 December 2014 respectively.

- c. The audit also revealed a further invoice for the amount of €396, covering the Cost of Living Adjustment (COLA) for cleaning services at the Malta Libraries, that was paid on 20 December 2013 and again on 18 March 2014.

Commission Expenses incurred unnecessarily

During the course of the audit, a noteworthy issue that came to light concerned the settlement of invoices in respect of online advertising since it was not possible to process a payment online. Therefore, a third party was engaged and was paid commission accordingly, simply to effect the necessary payment. To this effect, it was estimated that MEDE had incurred commission costs amounting to over €3,000 within an approximate two-year period.

Lost Discount

A 5% discount was applicable to the Directorate for Life Long Learning and the Examinations Department, on prompt settlement of registration numbers for computer tests. However, since procurement was made on a credit basis, which in 2014 amounted to €46,240, total discount forgone was €2,312.

Remuneration to an Interview Selection Board Member

Rather than nominating a person in a managerial position within the Public Service, who is likely to have more experience, an Assistant Principal was assigned as a member on an interview selection board during the period July to September 2013. The interviews were carried out in the summer afternoons and on Saturdays; thus the employee was paid at overtime rate relative to her grade. This triggered the amount of €2,274 in overtime from public funds.

Lack of thorough checking

During audit testing, the National Audit Office (NAO) came across a total of three invoices and five claims, in aggregate amounting to €2,361, which were not endorsed but still processed for payment.

Another 38 invoices in the audit sample were endorsed by an officer in charge and processed for payment, notwithstanding that either amounts invoiced were incorrect, supporting documentation was not available, invoices were not itemised and lacked sufficient detail, or the number of hours recorded was incorrect. Moreover, 15 of these invoices were also wrongly certified as correct while the remaining were not certified at all.

At least in two sampled cases, MEDE was incorrectly calculating the rate of COLA, which was due to the two respective service providers, resulting in a slight inflation of the rate payable. Notwithstanding this, the related 18 invoices in the audit sample were still endorsed by the officer in charge and eventually processed for payment. In addition, 14 out of these 18 invoices were also marked as certified correct.

Furthermore, three attendance sheets covering cleaning services, whose number of hours recorded therein was incorrect, were still endorsed. Consequently, erroneous amounts were invoiced.

Excessive Number of Hours performed

It was noted that various officers worked long hours at a stretch as follows:

- a. Security officers working at the National Library recorded more than the required 12-hour shift, in order to make up for the hours not worked by their colleagues, in one instance up to 21 consecutive hours.
- b. Security officers deployed at the Public Library also recorded excessive number of hours on the attendance sheets, in some instances, up to 19 hours.

- c. From the records provided for cleaning services at the Malta Libraries, it transpired that no break deductions were being effected for working days over the legally established threshold of six hours duration.

Bank Guarantees overlooked and/or expired

Whilst the required bank guarantee relating to cleaning services at the Malta Libraries was not provided, another contract with the same service provider for cleaning tasks at the Ministry was extended; however, the respective guarantee was not renewed. Furthermore, the bank guarantee with regard to the design and production of brochures and similar items was not valid for the full duration of the contract.

Sponsorships

- a. From the relative file provided, it transpired that sponsorships were granted by MEDE during 2014 to various entities and individuals, to the tune of €30,779, comprising 32 cases. However, testing revealed that 12 instances, amounting to €12,474, *i.e.* over 40% of the sponsorships granted in 2014, were not covered by formal requests.
- b. The sponsorships received during the last two years included 11 band clubs from specific districts and/or voluntary groups in the same locality, in aggregate receiving a total of €2,070 and €1,815 in 2013 and 2014 respectively, five of which were sponsored in both years.
- c. According to the Permanent Secretary (PS), a threshold of €250 for each sponsorship was established in consultation with the Ministry's Secretariat, in order to ensure effectiveness in the approval of specific requests for sponsorships from band clubs. However, in 2013, two band clubs exceeded the established amount.

Compliance Issues

Procurement

Procurement of Services not in line with Pertinent Regulations

As already highlighted under Key Issues, the majority of services paid for in 2014 were not procured in line with the Public Procurement Regulations (PPR). The following relate:

- a. Five payments, in aggregate amounting to €77,600, for computer tests and respective registrations, were related to procurement made by direct order from the same supplier, without the necessary approval from the Ministry for Finance (MFIN).
- b. Design and production of brochures and similar items, totalling €11,205, were also acquired direct from the open market, very often even without obtaining quotations and/or the relevant approvals.
- c. Artwork, advertising, printing and production work, covered by seven invoices totalling €8,671, were procured direct from the open market. However, the relevant approval to purchase, as required in terms of PPR Articles 20(1)(a) and 20(1)(b), was not sought.
- d. Marketing services, in aggregate amounting to €8,526, were procured direct from the open market, since the then Director General (Support Services) instructed that purchases up to the value of €6,000 each, exclusive of Value Added Tax (VAT), are to be made from *circa* six service providers on a rotation basis, until the tender was awarded.
- e. The hiring of equipment, set production and installation works for various events, which individual procurement did not exceed €6,000, were procured direct from the open market. However, quotations from other service providers were not obtained.

Follow up on the Provision of a System for the Students' Maintenance Grants

As per letter of acceptance dated 21 February 2001, a company was informed that its offer with regard to the provision of the electronic transfer of funds system for the Students' Maintenance Grants was accepted. In the Annual Audit Report by the Auditor General of 2010, the following observations were made:

- a. No agreement was entered into between the then Ministry of Education and the company.
- b. Documentation evidencing formal extension was not available beyond the official contracted period of three academic years.
- c. Between the period April 2002 and August 2011, no bank guarantee was in place.

Notwithstanding the above observations, the company continued to provide an uninterrupted service to the Students' Maintenance Grants Board up to August 2014 without addressing the shortcomings mentioned above.

Furthermore, according to an amendment to the tender document, this service was intended to be applicable for the duration of three academic years, without the option of renewal. However, since its expiry up to the year under review, the service provider received an aggregate payment of over €1.5 million. Although MEDE continued to use the service of this company, extensions to the original agreement were not formalised. Moreover, although it was claimed that MFIN approval for direct order had been sought by the then Director (Corporate Services), no evidence was provided to this effect.

In addition, 12 invoices amounting to €98,409, paid during the year under review, were not clearly quantifiable and not backed up by the relevant data, making it difficult to corroborate the values and quantities billed. In fact, instances were noted when even the present Chairperson of the Students' Maintenance Grants Board was not in a position to certify invoices as correct, in view of the lack of available information. Following

the service provider's insistence on payment of pending invoices, eight out of these 12 invoices, which were initially not certified correct, were eventually approved for payment by PS in October 2014, given that MEDE intended to close down the system.

Possibility of Indefinite Contracts Extensions

Four departmental calls for tenders that were subject to audit, comprising security services at the Ministry, cleaning services at the Ministry and at the Malta Libraries, as well as design and production of brochures and similar items, included the option of extending the contract for further periods under the same rates, terms and conditions. Up to the end of year under review, the first two contracts were extended for at least a further 12-month period.

Expired Contract still in use

On 23 May 2013, Malta Libraries awarded a contract for the servicing of air-conditioning units. This was valid for a one-year period and expired on 22 May 2014. However, this service continued to be availed of until NAO brought this matter to the attention of Management. The expenditure incurred between July and October 2014, which was not covered by the contract, in aggregate amounted to €1,318.

Furthermore, although the quoted rate covered only the servicing of air-conditioning units, the seven sampled invoices included either repair costs and/or labour charges, which in aggregate amounted to €3,262 and in respect of which no official quotations were obtained. Furthermore, five of them indicated only a global charge, which was not substantiated.

Anomaly in the Contract Period

As from 1 November 2011, Malta Libraries entered into an agreement for cleaning services, which tender stipulated that such service shall run for a period of one (3) years [*sic*]. Following

audit queries, the former confirmed that the contract period is of three years. However, official documentation to clarify this anomaly was not submitted, even though requested by NAO¹. Payments for such service from 1 November 2012 up to 30 October 2014 amounted to over €18,000. Moreover, it transpired that services were provided at least till end 2014.

Additional Services not provided for in Contract

In May 2013, the Department of Contracts (DC) entered into an agreement for three years, on behalf of the National Library, for security services at the premises of the latter. As per email dated 30 September 2013, the same services were extended to the Public Library as from beginning October 2013. During the year under review, payments with respect to the latter location amounted to €15,302, covering the period from October 2013 to April 2014. From documentation made available, it was evident that this was considered as an additional service, wrongly interpreting PPR Article 60(e). Furthermore, NAO was not provided with any evidence that DC was informed of such additional service.

Awarded Contracts not published

PPR Article 20(2) and MFEI Circular No. 11/2011 specify that a list of departmental contracts awarded, including those effected through direct orders procedure, is to be published in the Government Gazette every six months. However, the sampled six departmental contracts and two direct orders were not published accordingly.

Other Matters

Police Private Guard Licences expired or not provided

Security guards providing services at the National Library and the Ministry respectively, were not always in receipt of a valid police private guard licence throughout the period that they were performing such duty.

¹ Since the required bank guarantee was not provided, as already highlighted under the respective observation, the contract period could not be ascertained.

List of Signatories not provided

Various requests were made to MEDE, in order to provide the list of signatories authorised to sign Payment Vouchers (PVs) within the Ministry, in accordance with Treasury Circular No. 5/2008 – ‘Authorised Signatories’, but to no avail. As a result, the authority of signatories on 206 PVs in the audit sample could not be determined.

The Examinations Department also did not have an authorised list of signatories as per mentioned circular. Such information was only compiled after NAO’s request on 12 December 2014. Furthermore, the level of authority of the respective officers, *i.e.* whether in charge of control of expenditure, or authorised to sign vouchers, or both, was not indicated.

Deferred Payments

Fifty-six invoices in the audit sample, raised prior to December 2013 and totalling €59,430, were paid from the 2014 budget. This total does not include 18 invoices and/or claims amounting to €251,091, dated in December 2013 and also paid the following year.

VAT

No Designated Officers

As per MF Circular No. 5/2002, every Head of Department is to designate one or more officers who are to be assigned the responsibility for Departmental compliance with the respective directives concerning fiscal receipts. However, no person was ever officially designated this responsibility.

Fiscal Receipts not provided or not readily available

A total of 103 invoices in the audit sample, in aggregate amounting to €389,401, were neither covered by a fiscal receipt in terms of the Thirteenth Schedule of the VAT Act, nor by a declaration in accordance with MFEI Circular No. 7/2011, confirming that the respective suppliers are exempt from registering for VAT. This implies that MEDE was not in compliance with VAT regulations.

Furthermore, those VAT receipts that were available were not always attached to the relative original PV for ease of reference, as required by MF Circular No. 5/2002. In addition, a number of receipts were dated well after the respective payment, or at times even undated, thus it was concluded that such receipts, covering 33 invoices amounting to €25,406, were requested and obtained subsequent to audit queries.

List of Defaulters not compiled

Quarterly returns with details of defaulters, as required by MFEI Circular No. 2/2012, were not prepared.

Inventory

Inventory Return not submitted

The last inventory return submitted by the Ministry to the Auditor General was as at 31 December 2011, notwithstanding that as per MF Circular No. 14/99, such copy is required at least once a year.

By the end of January 2015, the inventory database of the Ministry was only updated up to June 2014. It was claimed that this was due to a reshuffle and movement of departments and sections.

Recommendations

Key Issues

Public Procurement Regulations continuously bypassed

MEDE is to strive to acquire its goods and services in line with the applicable regulations, thus ascertaining transparency and fairness, as well as ensuring that the most competitive prices are obtained. As far as possible, all service providers and/or suppliers are to be given equal opportunity to submit their quote.

Lack of Fundamental Internal Controls

Strong internal controls are essential in assisting the Ministry to mitigate financial risks and achieve its objectives to manage public funds entrusted to it more efficiently. It is also recommended that

ongoing monitoring activities are carried out, to evaluate and improve on the effectiveness of internal controls.

Control Issues

Double Payments

Adequate internal controls are to be in place to ensure that the respective bill is not paid more than once. MEDE is also to identify any possible double payments and to do its utmost to recoup all overpaid amounts without unnecessary delay.

Commission Expenses incurred unnecessarily

It is advisable that subject to adequate internal controls in place, the Ministry makes the necessary arrangements for a debit card to be available for use in those instances whereby settlement is required to be processed online. In the circumstances, it is recommended that the Ministry seeks guidance from MFIN for the way forward.

Lost Discount

The discount value lost for the entire year accumulated to a fairly considerable amount. Given that purchases of registrations are ongoing, appropriate measures are to be taken to ensure that payment is made in a timely manner to avoid unnecessary costs.

Remuneration to an Interview Selection Board Member

In order to ensure efficiency and to minimise costs from public funds, it is recommended that any public employees sitting on interview selection boards will be in a managerial grade.

Lack of thorough checking

Officers endorsing invoices are to ensure that they are in possession of all the necessary documentation, to confirm that amounts claimed are correct and payments may be effected. Moreover, all officers are to be made aware of their accountability when certifying invoices and/or endorsing any documents. MEDE is encouraged to carry out a comprehensive exercise in order to

identify all the service providers who were paid at incorrect rates and rectify this issue by recouping any undue payments.

Excessive Number of Hours performed

The service provider is not expected to cover the security officer complement by providing staff working excessive long hours. Furthermore, employment regulations are to be adhered to in all instances. On the other hand, MEDE is to ensure that the break period is deducted from the respective payments, where applicable.

Bank Guarantees overlooked and/or expired

It is imperative that the contractor submits the required bank guarantees and makes the necessary extensions to cover the entire period of the contract.

Sponsorships

Formal requests are expected to be in place and invariably filed for future reference. These are to include details of the person or organisation making the request, proposed project or initiative, and the amount of funding being requested.

Without going into the merits as to whether band clubs and/or voluntary groups are to receive a sponsorship from public funds from the Ministry in question, for the sake of fairness, impartiality is encouraged and as far as possible, the Ministry is to be informed of the use of such sponsorships.

Compliance Issues

Procurement

Procurement of Services not in line with Pertinent Regulations

The provisions and thresholds imposed by PPR are to be invariably adhered to. This will not only ascertain that value for money is achieved, but will enable transparency and accountability. While the Ministry may in exceptional cases resort to direct orders after obtaining the appropriate approval, this is not to be considered as best practice in line with MFIN Circular No. 3/2013.

Procurement not exceeding €6,000 (VAT excl.) may be obtained direct from the open market following the required approval. However, it is to be emphasised that PPR Articles 20(1)(a) and 20(1)(b) state that for such practice, one should take into consideration the amount involved, the urgency attached to the procurement and restrictions of choice and availability.

Follow up on the Provision of a System for the Students' Maintenance Grants

Whilst acknowledging that the system was terminated by MEDE, NAO reiterates that in similar future instances, services have to be procured in line with PPR and a formal agreement is to be entered into. The terms and conditions binding both parties are also to be adhered to.

In addition, extension clauses should only be granted if they were already included in the call for tenders. In order to ensure that the best rates and conditions are obtained, a fresh call for tenders is encouraged upon expiry of contracts. In such absence, authorisation from the relevant authority is to be invariably sought in line with the procurement regulations.

Possibility of Indefinite Contracts Extensions

In order to ensure that the best rates and conditions are obtained, the calls for tenders are to include a limit, by period and/or amount, in line with procurement regulations, up to when contracts may be extended.

Expired Contract still in use

In order to enhance controls, it is important to monitor expiry dates of contracts, thus ensuring that a fresh call for tenders is issued in time and no payments are eventually made outside the validity of the contract. Such measures would reduce potential disagreements and litigation in case of default, and also ensure that all services rendered and payments made, are legally backed up.

Anomaly in the Contract Period

Terms and conditions of the agreement are to be clearly spelled out and relevant documents are to be filed for future reference.

Additional Services not provided for in Contract

Any additional services to contracts entered into by DC are to invariably be passed through the latter. In such instances, an addendum is also to be drawn up for the approval of the General Contracts Committee. If further clarification on this issue is deemed necessary, reference is to be made to DC for guidance.

Awarded Contracts not published

Officers in charge are to be fully aware of the relevant regulations to ensure that departmental contracts and direct orders are duly published.

Other Matters

Police Private Guard Licences expired or not provided

Police private guard licences are to be requested and obtained as required by the respective tender. It is also to be ensured that valid licences cover the whole duration of the contract.

List of Signatories not provided

The lists of authorised signatories are to be compiled and updated in line with the relevant circular and the General Financial Regulations Article 91.

Deferred Payments

The Finance Department is to ensure that deferred payments are kept at the absolute minimum, limited to that which is unavoidable, as required by standing regulations.

VAT

No Designated Officers

In line with MF Circular No. 5/2002, specific officers are to be officially designated to ensure that the relevant directives are followed.

Fiscal Receipts not provided or not readily available

As required by MFEI Circular No. 7/2011, Heads of Department and other Accounting Officers are to ascertain that they are invariably issued with a fiscal receipt and/or declaration, as applicable. In cases where service providers fail to adhere to VAT regulations, MEDE is to consider discontinuing purchasing from such defaulters until the situation is rectified. Furthermore, all receipts are to be kept in the relevant file to support the respective payments.

List of Defaulters not compiled

Quarterly returns with details of defaulters are to be submitted to the Audit and Assurance Section of the VAT Department on a quarterly basis, as required by the respective circular.

Inventory*Inventory Return not submitted*

Whilst acknowledging that there was no sufficient time since the incumbent took over the responsibility, it is expected that the inventory database is updated without undue delay. In addition, statutory information is to be forwarded to NAO as required by standing regulations, in order to ensure compliance with the established provisions and enable control over inventory items.

Management Comments

Management submitted an extensive reply concurring with most of NAO's findings. Remedial action has already been taken to address certain areas, while further corrective action in line with NAO's recommendations is intended to be taken. The following comments and reservations were also submitted:

- MEDE is determined to ensure transparency and fairness in all its procurement. A standard office procedure will be circulated in all departments to be aware of PPR.
- Due to lack of human resources in 2014, the desired level of internal control could not be

achieved, however MEDE is in the process of restructuring the Finance Section and one unit in this section will ensure that public funds are managed more efficiently.

- Approval has been sought and granted so that MEDE has a debit card that can be used to procure online.
- In order to avail from applicable discounts, the Examinations Department and the Directorate for Life Long Learning are to coordinate between themselves, in line with directions given by the Operations Department within MEDE.
- The Operations Department will also give clear instructions to the Examinations Department with respect to the setting up of interview selection boards.
- An internal memo will be issued so that officers are made aware of their accountability when endorsing and certifying documents as correct. Furthermore, double payments and overpayments due to incorrect COLA will be offset against pending invoices.
- Employment regulations are to be adhered to at all times and hence Operations Department within MEDE will be giving instructions to the Malta Libraries so that irregularities are not repeated.
- Action has been taken by the Finance Section to ensure that a copy of the formal request and breakdown of expenditure covering sponsorship is kept in the respective file. Furthermore, a Board has been set up by PS to scrutinise requests for sponsorships, in order to ensure transparency and fairness.
- The Director and Assistant Director have been assigned the task to compile and send the VAT defaulters list if necessary. With respect to fiscal receipts collection, two officers have been assigned to follow suppliers so that all receipts are collected and attached to the batches as stipulated by Treasury.

Malta Council for Science and Technology

Background

The Malta Council for Science and Technology (MCST) is responsible for carrying out the objects and functions of the Foundation for Science and Technology. It comprises between 12 to 15 Board members and is the national contact point for the European Union (EU) Research Framework Programme. The Council is responsible for research policy, promoting scientific research and the management of the local research funding programme.

The 2014 MCST Financial Statements show a total of €1,727,260 under the title 'Project Income', 71% of which, amounting to €1,229,999, was derived from the National Research Technological Development and Innovation Programme. The project surplus, which resulted after deduction of relative costs, amounted to €38,783.

Other income of €1,794,728 stemmed mainly from Government and Science Centre subventions, which amounted in total to €1,575,504. On the other hand, an aggregate of €1,569,668 was incurred on administrative expenditure, 75% of which, amounting to €1,184,020, related to staff costs. As a result of investment income of €3,162, the audited accounts for the year ending 31 December 2014 showed a surplus of €267,005.

Audit Scope and Methodology

The objectives of the audit were to verify that there was adequate control on the expenditure incurred by the Foundation during the financial year 2014. Various meetings were held, mostly with Management, in order to obtain an overview of the procedures adopted *vis-à-vis* financial management. A sample of expenditure accounts was identified from the nominal transaction listing, following an analytical review and the identification of material transactions. The salary of a number of officers was also checked against the relevant employment contracts and collective agreements to confirm entitlement.

Key Issues

Lack of Internal Controls

As already indicated, MCST Financial Statements show an expenditure of €1,184,020 on staff costs for 2014. This represented a 10% increase over the previous year, which was mostly due to new appointments. As a matter of fact, the number of employees increased from 37 to 46 during this period.

Audit testing revealed lack of internal controls, especially within the Human Resources and Payroll functions. Instances were noted where payments made to employees were either unauthorised, inadequately supported by evidence, or incorrect. Other shortcomings, particularly but not limited to attendance records and filing of personal documentation, were also evident.

Appointment of Financial Controller on Trust Basis

Background

MCST Terms of Employment Handbook provides for the engagement of personnel on a position of trust basis, in such circumstances where special expertise is required or where the nature of work to be done is considered of a very sensitive nature. Employees reaching retirement age may be engaged from there onwards, on a position of trust basis, when their high level of expertise is required, in order to provide advice and support, thus ensuring a measure of continuity.

Appointment Concerns

On 3 June 2013, the then Permanent Secretary Ministry for Education and Employment, approved the renewal of the contract of the Financial Controller until he reached retirement age in January 2014, following which, a new call was to be issued. However, on 24 December 2013, Ministerial approval was obtained to appoint the Officer on a position of trust upon his retirement. This was decided on the basis that he was instrumental in the setting up of the Council's financial system, and constantly maintained the system to the highest level of quality possible. Nevertheless, the Officer terminated his employment on 12 December 2014, even though the employment contract was due to expire in January 2017.

Remuneration awarded exceeded Ministerial Approval

The remuneration package awarded in the contract of employment of the foregoing Financial Controller engaged on the basis of trust, endorsed on 14 January 2014, was equivalent to the Ministerial approval obtained from both the

Ministry for Education and Employment and also the Ministry for Finance. This was tied to salary scale 6, starting at €24,057 *per annum*. However, within two weeks, the financial package was revised upwards, resulting in an unauthorised increase of €6,709 for the year under review. No further approvals were made available, but Management claimed that the salary of the Financial Controller was brought in line with that of the other Directors.

Further testing also revealed that the Officer's mobile phone bills for 2014 were borne by MCST. Authority for such payment was not provided for audit purposes.

Control Issues

Absence of Attendance Records

MCST was not keeping any attendance records of its employees. Although the responsibility for monitoring attendance is vested in the Directors of the respective Units, such absence hindered any confirmation in this regard.

Failure to record and regularly verify attendance ultimately impacts on the control environment and the respective payment for work performed, as unauthorised absences may remain unaccounted for.

Payroll Concerns

Payroll testing of the 10 officers sampled revealed various mistakes. In view that these remained unnoticed and the respective payment was processed, it confirms that independent verification within the payroll function is lacking. Other concerns, such as lack of supporting evidence to substantiate decisions affecting salary payments and divergence from approvals, were also noted. The following concerns warrant separate mention:

- a. Although the contract of a high ranking officer specifies an entitlement of free fuel up to 150 litres per month, this was being paid as a monthly constant cash allowance instead, amounting in total to €2,484 annually. Besides this fuel entitlement, the financial package also includes an annual car allowance of €4,193. This is an

anomaly considering the fact that, in line with general Government practices, the award of a car allowance is a comprehensive compensation for waiving the entitlement of a fully expensed car, which also comprises the consumption of fuel, and thus any further related allowance is precluded as it is considered as constituting a double payment of the same benefit.

- b. In December 2012, the Office of the Prime Minister granted approval for MCST to commence recruitment procedures in collaboration with the Employment and Training Corporation, for the engagement of a Project Manager on a part-time basis of 20 hours per week, equivalent to 1,040 hours per year. Notwithstanding this condition, the Officer was compensated for a total of 2,119 hours during 2014, which is more than double the amount of hours approved.

Contracts of Employment Concerns

The National Audit Office (NAO) came across various amendments following the finalisation of employment contracts due to the following reasons:

- a. The disturbance allowance, previously granted on the basis of gross annual salary, was subsequently corrected to be based on basic pay through *corrigenda* in two instances.
- b. An officer's title in the organisation chart and that featuring on official correspondence was different to that included in the applicable contract of employment. MCST claimed that this was a mistake which required amendment.
- c. A contract of employment for the position of a Director was valid for three years. Following a request from the incumbent, a private agreement reduced the term of employment to 18 months, with an option to renew under certain terms and conditions and with the possibility of further renewals. The contract was actually renewed for a further year through an addendum. The subsequent contract of employment of the same officer was also amended to change

the employee's designation and taking the advantage of improving the respective financial package.

Overtime

Payroll verification revealed the following shortcomings with respect to overtime:

- a. MCST Terms of Employment Handbook states that claims for overtime payment are accepted only if approval from the respective Director is obtained prior to the performance of overtime. The Human Resources Unit should also be notified *via* email by the respective Director of such approval before overtime is performed. Retrospective approval by Directors may only be accepted in exceptional cases and subject to supporting evidence being provided. However, overtime approval for the entire sample tested was obtained retrospectively and the respective compensation was still effected without any enquiry.
- b. The total compensation for overtime worked during 2014 amounted to €20,157, the majority of which, totalling €16,084, was paid to five officials.

Central Filing System not in place

The Council does not have a central registry system in place to keep track of official correspondence, as well as official files and their movements, leading to a lack of audit trail and business continuity.

Management was not aware of the Management Letters pertaining to external audits for financial years 2012 and 2013, as well as the respective replies by MCST. NAO was informed that such documents could possibly be stacked in a spiral staircase within the Administration Offices. Copies of these Management Letters were subsequently obtained by MCST from the independent auditors.

Article 5 section 5.4 of the Foundation's Charter states that, by the end of June each year, the Council is to submit draft estimates for the following calendar year to the respective Minister. However, no evidence was provided regarding such submissions for 2014 and 2015. Shortcomings

with respect to the filing of documents related to the Human Resources function were also encountered. In the circumstances, the completeness of information made available during the audit has been questioned by NAO.

Adjustments to Payroll not documented

Adjustments to payroll were not properly documented. Thus, various audit queries had to be made in an attempt to obtain the necessary explanations.

Inadequate Inventory Management

Only room inventory lists and a spreadsheet containing details of computer equipment were made available in respect of inventory records. However, these were neither accurate nor complete. The following issues were encountered during audit testing:

- a. A document traced in an officer's personal file revealed that the description (brand, model and serial number) of a laptop, given to him on loan did not correspond to the inventory list. NAO later established that this equipment was in fact replaced in 2012. The previous laptop, claimed to be obsolete but which did not feature on the list, was found in a locked cabinet, which had to be forced open by Management on 5 August 2015, as the key was misplaced.
- b. Another laptop held by another officer was also not included in the spreadsheet made available. Through further queries, it was established that this was transferred from another ex-MCST staff member. However, the records were not updated accordingly.
- c. Although the room inventory lists forwarded to NAO are dated March 2015, the room list hung in one particular room was dated 12 June 2012. As a result, such list did not reflect the actual inventory held in that room, as follows:
 - a projector, a projector screen, as well as a two-door cupboard, were not included. Additionally, the projector was not physically marked with a unique identification number;

- two lamps in this inventory list were not found in the room; and
- the number of tables and chairs physically there did not correspond to that recorded. Some of these were also not tagged with an identification number, or were tagged with a different identification to that on the room list.

- d. Enquiries revealed that there is no documented policy with respect to obsolete items of inventory. Additionally, once inventory records are updated, previous versions were not kept.

Signatories for Procurement lacking Formal Authority

Management claimed that the authority to purchase goods and services is vested in officers occupying particular posts, such that Manager Procurement and Contract Implementation is responsible to authorise procurement above €2,500 excluding Value Added Tax (VAT) subject to approval by the Executive Chairman, whilst the Chief Administrative Officer authorises amounts below €2,500 (VAT excl.). However, the respective signatories were not formally approved.

Bank Signatories

Documentation supporting authorised bank signatories had to be obtained from the bank as this was not available at MCST for audit purposes. According to the Chief Administrative Officer, the payment limit of each transaction is set at €200,000. However, this was not backed up by evidence. Additionally, the official bank authorised signatories provided by MCST on 31 August 2015 still featured the name of the former Financial Controller who terminated employment on 12 December 2014.

Cleaning Services

The following shortcomings were noted with respect to the contract for cleaning services:

- a. On each invoice there is indicated that the service provider's bills were checked for mathematical correctness prior to settlement. However, a record of the actual hours of

cleaning services rendered was not kept on a daily basis. Thus, the hours charged on invoices could not be corroborated.

- b. A copy of the employer's public and products liability insurance cover, for the period 2014 and 2015, was not available and had to be obtained from the service provider following audit enquiries.

General-use Vehicle

During 2014, MCST had one vehicle at its disposal for general-use, which in aggregate consumed fuel amounting to €1,957. The audit revealed certain shortcomings on the use of such vehicle, as follows:

- a. No logbook was maintained. Thus, there was no record over the mileage covered with the result that a periodical certification could not be performed.
- b. The general-use car does not have a Government registration number and also does not display the name of the entity on both sides of the car, as required in terms of MFIN Circular No. 5/2015 – 'Government Transport and Civilian Plates'.
- c. Although vehicles are to be kept within the Government premises during weekends and/or public holidays, it was the norm that the said vehicle was taken by an officer to his private residence. Upon NAO's observation, an agreement was drawn up between MCST and the officer concerned, in order to secure the safekeeping of the car after working hours.
- d. The same officer refuels the car out of his own pocket at his discretion, following which, he is reimbursed by MCST. However, in the absence of a logbook and the necessary certification, no one keeps control on fuel consumption to determine whether the respective expense is reasonable.

Travel lacking Adequate Approval

All official travel by MCST employees, including EU-related travel, requires prior approval of the

respective Director and the Operations Unit, as per section 13.1 of MCST Terms of Employment Handbook. However, the six Travel Request Forms, of MCST employees in the sample selected, did not feature the necessary approval by the Operations Unit.

Research and Innovation Programme Concerns

MCST provides state financing in the form of grants for research, development and innovation in science and technology, through the National Research and Innovation (R&I) Programme. The 2014 Financial Statements show that the project income and expenditure were €1,229,999 and €1,201,537 respectively. The audit revealed the following concerns in this regard:

- a. A budget for the total planned expenditure within R&I Programme for the year 2014 was not available. The outflow of funds in respect of each project was planned individually, but it was not consolidated into a corporate budget.
- b. A walk-through test of a particular project file revealed that hard or soft copies of the relative documents were kept, but these were not filed together in one location.

Compliance Issues

VAT Concerns

The Foundation for Science and Technology is VAT registered under Article 10 of the VAT Act. In this regard, a tax invoice has to be furnished by suppliers who are also registered under Article 10 in line with MFEI Circular Nos. 7/2011 and 2/2012.

In cases where the suppliers are exempt from registering for VAT under Article 11, the suppliers can furnish a non-fiscal receipt or non-tax invoice. However, the responsible officials are to request such suppliers to furnish a declaration confirming that they are exempt from registering for VAT, and also from issuing fiscal receipts.

Entities are to submit to the VAT Department the details of the designated officers responsible for complying with the said circulars. Furthermore,

suppliers who fail to adhere to these requirements are to be reported on a quarterly basis.

The audit revealed that MCST's expenditure was not all supported by the appropriate fiscal receipts. Additionally, up till the time of audit, VAT defaulters were never reported to the pertinent authority. However, NAO was informed that this responsibility has now been designated to a responsible official.

Lack of Compliance with the Data Protection Act

The Data Controller is any person or organisation entrusted with the processing of personal data in line with the Data Protection Act. As at 13 August 2015, the Public Register of Data Controllers featured an officer whose employment with MCST terminated more than 12 years before¹. The Information and Data Protection Commissioner was only notified of such change following NAO's query, and the Public Register of Data Controllers was updated accordingly.

Submissions of Audited Accounts and Annual Reports

As per the Foundation's Charter forming part of the Deed, audited Financial Statements of the previous year are to be submitted to the Minister responsible for Science and Technology Policy by not later than the end of March each year. However, audited accounts for the year ending 2014 were only finalised on 30 July 2015. These were sent to the Minister on 21 August 2015, following NAO query by email earlier, on the same day.

The Charter also requires the submission of the annual report of the activities of the Foundation over the previous calendar year, to the respective Minister, by the end of March of each year. A copy of this annual report should also be submitted to the Prime Minister. However, by the conclusion of this audit, NAO was not informed that this requirement was met.

Recommendations

Key Issues

Lack of Internal Controls

Human Resources and Payroll are particularly important functions within MCST in view of the expenditure involved. In this regard, Management is encouraged to implement NAO's recommendations suggested under the respective observations for robust and transparent procedures.

Appointment of Financial Controller on Trust Basis

An adequate human resources strategy needs to be adopted by Management, in order to ensure continuity for the smooth running of MCST business operations. Furthermore, financial package offered to employees should not exceed the approved amount.

Control Issues

Absence of Attendance Records

Proper management of personnel, which requires both the existence of adequate attendance records and their verification, is a vital aspect of supervision in the workplace. In this regard, NAO recommends the immediate implementation of attendance verification devices and performance of the necessary verification by responsible MCST officials on a regular basis, to ensure that unauthorised absences are duly addressed in a timely manner.

MCST Management may be guided by the Public Service Management Code (PSMC) section 3.1.5 'Attendance Verification Systems and Devices', for the setting up of formal internal control procedures in this regard.

¹ Exact date could not be established by Management.

Payroll Concerns

The incorporation of a robust internal control system within the payroll function is urgently recommended. Management is also encouraged to reassign responsibilities within this Section, in order to have reliable and independent verifications in place during the payroll process, to prevent inaccurate payments.

Adequate authority is to be obtained prior to the award of financial benefits. Payments made are also expected to be adequately substantiated.

Contracts of Employment Concerns

In order to avoid errors and subsequent amendments, official documents, such as employment contracts, should be checked thoroughly prior to be signed.

Overtime

Consistent adherence to the overtime approval procedures stipulated in MCST Terms of Employment Handbook is to be ensured. Additionally, Management is encouraged to consider a long-term solution by conducting a holistic review of MCST operations, with the aim of establishing an optimal cost-efficient arrangement. Overtime work should only be resorted to in exceptional and unavoidable circumstances.

Central Filing System not in place

A centralised filing system should be in place and adequately maintained by MCST.

Adjustments to Payroll not documented

Adjustments to salaries performed for each payroll are to be adequately supported with the necessary workings and filed accordingly. Besides enabling ease of reference and verification by third parties, this ensures a smoother transition in the event of a change in the respective personnel.

Inadequate Inventory Management

Effective controls over the tracking and valuation of fixed assets require the maintenance of an inventory database to ensure that the information

is accurate and complete. Such database is to be safeguarded through adequate backup records. An officer entrusted with the responsibility of inventory management at MCST is also expected to perform periodical physical reconciliations.

Inventory procedures for obsolete items should be formally established and followed. Additionally, previous versions of inventory records are to be filed accordingly. MCST is to be guided by the Inventory Control Regulations established in MF Circular No. 14/99.

Signatories for Procurement lacking Formal Authority

Authorised signatories should be formally documented, approved and filed accordingly for future reference.

Bank Signatories

Bank signatories, respective limits and delegated powers, should be filed accordingly for future reference and updated as necessary.

Cleaning Services

Management is to conduct adequate control and monitoring procedures over third party contracts. This includes keeping record of daily hours of service rendered, to be reconciled with the invoice details prior to effecting payment. It is also to be ensured that any requested insurance policies are in place.

General-use Vehicle

A logbook is to be properly kept for the general-use vehicle, indicating each journey performed, the purpose of trips made and exact mileage covered, in order to enable proper verification.

The attention of Management is also being drawn to the relative guidelines outlined in PSMC to regulate the use of this vehicle. The use of the specimen logbook as found in PSMC Appendix 8.I is encouraged, thus ensuring that adequate details of each journey performed are recorded. Refuelling is to be approved *a priori* and recorded in the logbook accordingly. PSMC also requires that a certificate, as per Appendix 8.II, is entered in

the logbook at the end of each month, confirming that the trips recorded were made on official duty. Additionally, MCST Management is to ensure adherence to MFIN Circular No. 5/2015 and display its name on both sides of the vehicle.

Travel lacking Adequate Approval

All official travel is to be invariably approved in line with MCST policies.

Research and Innovation Programme Concerns

NAO stresses the importance of budgeting to plan and monitor the financial requirements. This ensures that funds are used as intended, whilst also avoiding situations of budget overruns.

Documented information for R&I Projects, including evidence of monitoring throughout the duration of the project life-cycle, is to be adequately filed. This ensures ease of reference and business continuity in the event of a change in roles and responsibilities within the respective Unit.

Compliance Issues

VAT Concerns

Management is to regulate its position by following MFEI Circular Nos. 7/2011 and 2/2012.

Lack of Compliance with the Data Protection Act

The processing of personal data is to comply with the Data Protection Act. The Information and Data Protection Commissioner is to be informed of any changes accordingly.

Submissions of Audited Accounts and Annual Reports

Management is to ensure that the Financial Statements are finalised well in advance for the annual statutory audit to be conducted by external auditors by the established deadline. This facilitates the printing of the annual report of the activities and timely submissions, since this is dependent on the audited Financial Statements.

Management Comments

Management welcomed the opportunity provided through this audit to improve its operations and concurred with a number of NAO's findings and the respective recommendations.

It was stated that in 2014, MCST was undergoing a critical phase in the establishment of *Esplora* Interactive Science Centre. Management together with the respective Permanent Secretary considered the retention of the then Financial Controller of utmost importance, in view of his previous involvement in such Centre. Notwithstanding this, in order to address succession planning in a more efficient manner, MCST recently engaged a full-time dedicated Human Resources Assistant Director.

Promotions and salary increases are within the Executive Chairman's remit, provided the required funds, as approved by the Ministry for Finance, are available. In the case of the previous Financial Controller, it was determined that his salary package would be aligned with that of the other Directors, thus precluding possible legal implications.

An electronic card access control and attendance system, which is planned to be introduced when the *Esplora* Interactive Science Centre is opened in 2016, has now been purchased. However, currently employees report their absences electronically, whilst this is monitored, reviewed and maintained by the Human Resources Unit on a daily basis. The same electronic system also makes provisions for the approval of all out-of-office instances by respective Directors and the Human Resources Unit.

Independent verification of payroll is being achieved through the Finance Unit. Top Management was fully aware of the extra hours the Project Manager was being requested to work on a weekly basis. However, the only option was to carry out the tasks with the resources available due to a lack of staff in the Unit. At that time, 10 projects were being concluded and attempts to increase the staff complement were not approved. The working hours could not have been planned beforehand considering the high level nature of work required.

The Project Manager was deeply involved throughout the intense negotiations of Horizon 2020 legislative packages, which were extremely taxing considering that, aside from structural funds, it was the second largest EU-funded programme, amounting to €80 billion. Following the conclusion of negotiations between Council, Commission and Parliament, the Officer had to continue working with the Ministry for Finance to protect Malta's interests and get the best value for money during budget discussions.

The Director in question requested amendment to the respective contract as she was unable to commit herself to a three-year employment period. Management acknowledged that the situation could have been handled better with adequate planning and thorough negotiations prior to the signing of the contract. The shortcoming in the other contract of employment was amended as necessary.

Pre-approval for the performance of overtime started being rigorously enforced during 2015. Overtime at MCST is only resorted to when work exigencies necessitate it.

MCST acknowledged that a central filing system would be beneficial and will therefore strive to introduce such system in the future. Although Management was unable to present the financial estimates, owing to the untimely termination of the former Financial Controller, one should keep in mind that the annual financial votes allocated are based on these same draft estimates.

Better documentation with respect to payroll adjustments started being kept. Additionally, the Council is currently in the process of procuring fixed asset register software which also handles

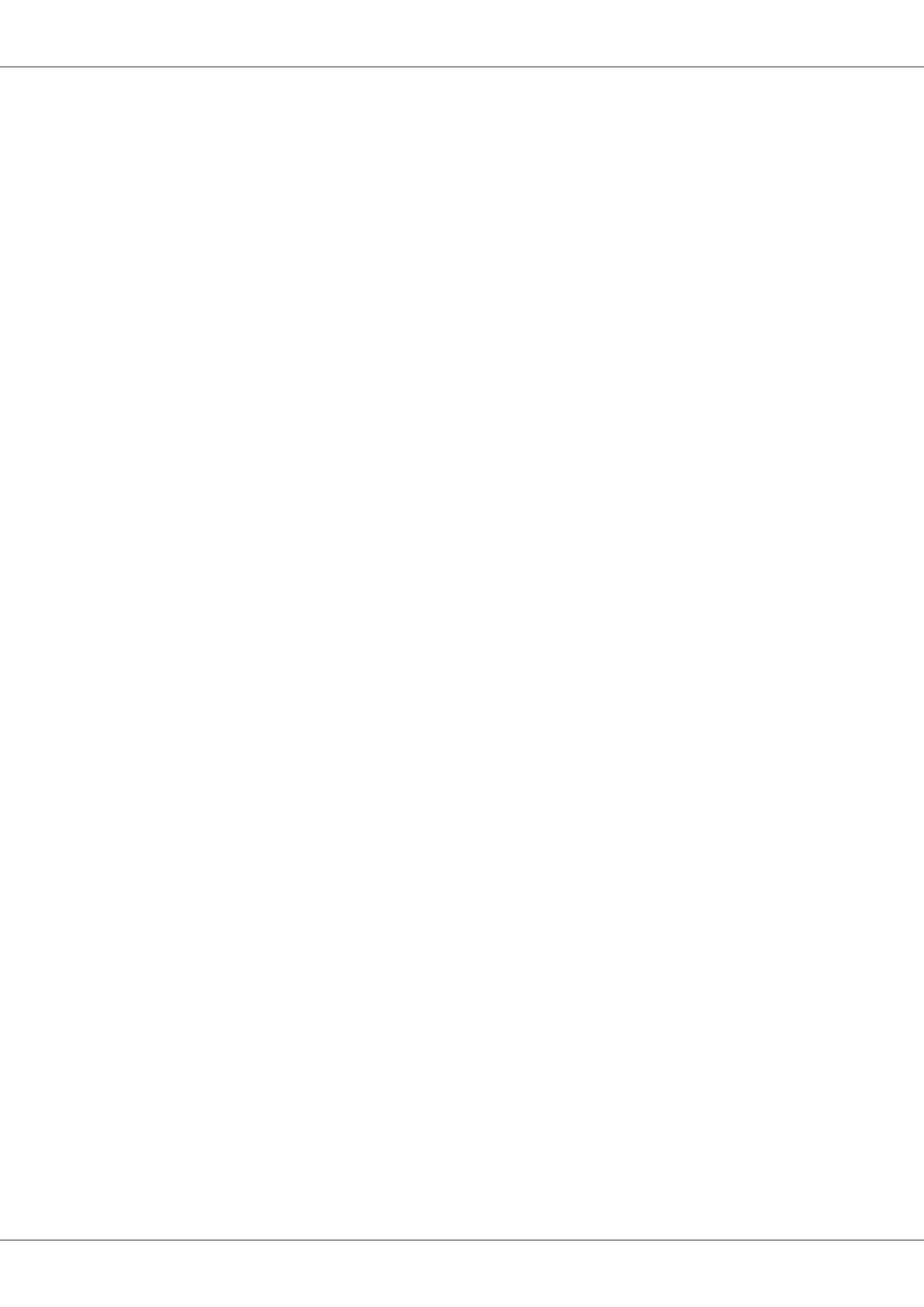
the tracking and valuation aspect. Documents supporting authorised bank signatories for 2015 are in hand, filed and will be updated as necessary.

Timesheets related to daily cleaning, duly signed by a responsible MCST officer, are now being attached to the invoices. A logbook for the general-use vehicle was introduced whilst the necessary arrangements were being made to adhere to the conditions stipulated in the relative transport circular. On the other hand, it was claimed that the Terms of Employment Handbook, *vis-à-vis* travel approval mentioned in the Report, came into force in 2015 as an extra control, and thus, was inapplicable to Travel Request Forms issued in 2014.

The Council started budgeting expenditure for R&I Programme as of January 2015 to ensure that fund allocation is effectively utilised, despite the challenges associated with not being assigned a multi-annual rolling budget. As regards project documentation, soft copies are now being kept in one location on the file server.

MCST never carried out any data processing operations to date, but if such need arises in the future, it would fully comply with the Data Protection Act.

Although the Financial Statements were ready in February 2014, the process fell behind schedule due to delays caused by the private auditors. Management however intends to propose an amendment to the Foundation's Charter so that the annual Financial Statements may be presented to the Minister in June instead of March.





Ministry for Gozo

EcoGozo

Capital Expenditure

Background

EcoGozo is a local Sustainable Development Strategy adopted by Government in 2009, with the aim of transforming the island of Gozo into an eco-island by 2020, thus improving the citizens' quality of life and protecting the island's environment, resources, culture and identity.

The EcoGozo Regional Development Directorate (EGRD), which falls under the portfolio of the Ministry for Gozo (MGOZ), is responsible for implementing the recommendations included in the action plans for years 2010-2012 and 2013-2015, which were prepared following public consultations.

While the budget for 2014 amounted to €1.41 million, actual expenditure incurred during the same period, as per the Departmental Accounting System (DAS), stood at €1.295 million.

Audit Objectives

The main objectives of this audit comprised the evaluation of the internal control system relating to procurement, ensuring that funds were spent for their intended purposes, within the approved limits, and in line with the provisions of standing procurement regulations.

Audit Scope and Methodology

The audit was conducted in accordance with generally accepted auditing standards. Audit procedures were performed in order to obtain reasonable assurance as to whether the internal control structure at EGRD is adequate, transactions are free from material misstatements, and whether standing laws and regulations have been complied with.

A total of 16 Payment Vouchers (PVs), collectively amounting to €677,125 and representing 52% of total expenditure incurred in the year under review, were selected for further substantive testing. Selection of PVs in the audit sample was based on the nature and materiality of the transactions.

Following initial data analysis and a review of relevant standing agreements, a meeting was held with EGRD officials, to identify the policies and procedures in place with respect to the procurement of goods and services forming part of the audit sample. Detailed substantive testing was then carried out to confirm the existence and the correct application of controls.

A site visit was also held on 30 April 2015 to confirm the stage of completion of the projects covered by the aforementioned transactions.

Audit Period

Research on DAS, as well as meetings with various officers and audit testing, were mainly carried out between April and September 2015.

Limitations on Scope of Audit

Fiscal Receipts

Original Value Added Tax receipts could not be made available since these were attached to PVs which were stored in one of the offices that was sealed off following Police orders.

Test Certificates

Auditors could not express an opinion on the results of the test certificates of the respective works, as letters of comfort by Architects or Engineers, depending on the material being certified, were not available.

Key Issues

Governance Weaknesses

A number of issues, which indicate a weak governance structure within EGRD, were noted during the audit. Among these issues, each of which will be discussed separately further down in this Report, are the following:

- a. no independent verifications by the Directorate, on the quality of material supplied for the respective projects;
- b. lack of segregation of duties, resulting in full reliance on one officer; and
- c. non-compliance with tender requirements.

Lack of Segregation of Duties

Testing revealed that there was no effective segregation of duties. As verbally claimed by EGRD, since the Directorate does not have a Quantity Surveyor within its workforce, the bills of quantities relating to various projects were based on measurements taken by the Directorate's Architect, evidenced by the latter's signatures. The said Architect was also responsible to issue

the call for tenders, acting as the Supervisor and/or Project Leader of most of the projects, and eventually certifying the respective invoices. Lack of segregation of duties hinders transparency and increase the risk of abuse.

Continual Delays in finalising Projects

All the projects reviewed experienced long delays, mainly due to the lack of provision of connection services required from other Government entities, or due to tenders issued prior to having obtained the required Malta Environment and Planning Authority (MEPA) permits.

Control Issues

Lack of Compliance with Tender Requirements

Various requirements in the sampled tenders were overlooked, indicating that little or no monitoring was in place to ensure adequate control. Below is a list of instances identified during the audit testing. These will also be dealt in further detail within the Report.

- a. Performance guarantees expired or overlooked.
- b. Copies of insurance policies and proof of payment thereof not available.
- c. Lack of quality certificates and limited verification on the quantities delivered.
- d. Order to start works not raised.

Child Development Centre in Victoria

Background

In 2012, a tender was issued through the Department of Contracts (DC) for a turnkey project involving the construction, servicing, finishing and commissioning of a Child Development Centre in Victoria. Following adjudication, the eventual contract, for a total value of €1,437,929, was signed on 8 March 2013. The contract envisaged that works were to commence two weeks after the issuance of the order to start works; however, no such record was available. According to Director (EGRD), instructions were only given verbally.

From the Works Register, it transpired that work only commenced on 22 July 2013.

Delays in completing Project

As per contract conditions, the project was due to be completed within 14 calendar months from the order to start works. If the date marked in the Works Register is taken as the effective date, works were expected to be finalised by September 2014. However, as at time of audit, *i.e.* August 2015, the project was not yet finalised and commissioned because, as claimed by the respective Director, the provision of electricity from the sub-station by Enemalta Corporation was still pending.

Incomplete Works Register

- a. In terms of Article 37 of the general conditions of the contract, a Works Register had to be kept on site by the Supervisor, who according to Director (EGRD) was a representative of the Contracting Authority, *i.e.* EGRD. However, the responsibility of its upkeep was shifted to the contractor, with the Directorate losing control, and possibly weakening its position in the case of litigation. Moreover, entries in the said register were neither signed by the contractor nor by the Supervisor on behalf of EGRD, to confirm their correctness. As a result, despite that full reliance had to be placed on contractor's Works Register, without any other means of verification, accuracy of information recorded therein by the contractor, which ultimately affected the established timeframes, could not be ascertained.
- b. The relevant article under the special conditions stipulated that the Works Register had to include a daily log of equipment, material and workers on site. However, the required information was rather rudimentary when compared to the contents of the same article featuring under the general conditions.
- c. Although the net difference between the aggregate amount of lost days claimed by the contractor and that shown in the Works

Register was only one day, there were a number of instances where the monthly working days claimed as lost were not in agreement with those recorded in the register for the corresponding period. Furthermore, no records were available to sustain that such delay was accepted by the Supervisor on behalf of EGRD, though this is required by the tender conditions.

No Independent Testing on Concrete

The tender for the building of the Child Development Centre specified that components and materials, including concrete, reinforced steel, *franka* stone and hollow concrete blocks, were to be delivered on site in time to allow the Supervisor to proceed with their acceptance. The latter was also required to inspect, examine, measure and test the components, materials and workmanship, to ensure the requisite quality and quantity. Audit testing revealed the following shortcomings:

- a. Over a period of 17 months, *i.e.* from 22 July 2013 up to 31 December 2014, 10 concrete test certificates requested by the contractor were issued by an accredited laboratory, appointed by the contractor himself, on samples taken over a nine-month period, between 29 August 2013 and 19 May 2014. However, no independent tests were ordered by the Contracting Authority to corroborate results. Furthermore, not even a formal comfort letter was issued by an Architect on behalf of EGRD, to confirm that the quality of concrete was in agreement to that specified by the tender conditions.
- b. The aforementioned test certificates, endorsed by the contractor's Architect, were only received by the Directorate towards the end of June 2015, by which time the payments up to 24 February 2015, amounting to €947,016, had already been issued to the contractor.
- c. It also transpired that, over the seven-month period between 30 May and December 2014, no samples were tested of the concrete delivered on site.

Lack of Documentation supporting Measurement by the Supervisor

The Directorate does not endorse delivery notes for turnkey projects when the respective works are still in progress. Consequently, no delivery notes are forwarded to the Directorate on the supply of goods or services, limiting the possibility to check and confirm the quality and quantity of the items before the respective invoices are paid. This also implies that when confirming bills of quantities, the Architect cannot corroborate his measurements.

Installation of Photovoltaic Panels at Taċ-Ċawla Social Housing Estate

Background

A tender issued through DC for the supply, installation and commissioning of photovoltaic panels with a potential output of approximately 71 kWp, was awarded for the amount of €113,674, on 3 November 2014. The respective contract was signed 15 days later and the project was due to be finalised by 24 February 2015, *i.e.* within 14 weeks from the order to start works.

Delays in finalising Project

Though the actual supply and installation of the photovoltaic systems took place prior to December 2014, on 19 February 2015, the then Project Leader requested Director General DC an extension of 22 weeks for the execution of the project, citing that extraneous factors¹ were hindering the commissioning of the photovoltaic panels.

Addendum signed retrospectively when it was already expired

Though the project of the photovoltaic panels was to be finalised by 24 February 2015, the addendum to the contract, extending the execution period up to 28 July 2015, was only signed on 3 August 2015, when the extension had already expired.

Feed-in Tariff Refund forgone

Though the photovoltaic system was installed in December 2014, refund from the feed-in tariff scheme, due to EGRD from December 2014 to July 2015 was lost since the said panels were not yet connected to the meters. Although by the end of July, approximately half of the energy produced was connected and transferred to the grid, Enemalta Corporation still had to install a three phase meter to connect the remaining six installations.

Landscaping and Maintenance Works at Ta' Isopu, limits of Nadur

Background

One of the projects in the audit sample was the rehabilitation of a quarry at *il-Qortin ta' Isopu* in the limits of Nadur. The venture comprised the supply, delivery and levelling of soil to the quarry, formation of footpaths, construction of rubble walls, landscaping and construction of ancillary facilities. A number of calls for tenders and/or quotations were issued separately in relation to this project. As part of the audit, the departmental tender published for landscaping and maintenance works was reviewed. The contracted value amounted to €38,345 and the relevant Letter of Acceptance (LA) was issued on 27 October 2014.

Permit not in hand

The original application for MEPA permit, covering the afforestation of infilled quarry, as well as the construction of reservoir and pathways, was made in May 2010 and approved in April 2012. A new application for the construction of ancillary facilities on existing committed footprint, as well as installation of signage, was made in January 2014. This latter application was validated on 6 June 2014 and the target date for approval was set for 15 December 2014.

However, although a number of items were dependent on the approval of the relevant permit, EGRD still proceeded with the respective tender

¹ Installation of meters from Automated Revenue Management Services Ltd were pending the transfer of accounts from the Government Property Department and the Housing Authority to MGOZ. According to the Project Leader, this also depended on the successful payment of all pending bills.

which was issued on 19 September 2014. This situation could have easily triggered a number of variations to the original tender from the outset, if not total disbandment.

Unattainable Scheduled Timeframes

Although tender conditions stated that works were to be finalised within two weeks from the order to start works, or by 31 October 2014 at the latest, LA, which was also construed as the order to start works, was only issued on 27 October 2014.

Other Matters

Performance Guarantees

Most of the calls for tenders and/or quotations included in the audit sample required the contractor to provide the Contracting Authority with a performance guarantee. Out of the eight tenders and quotations reviewed during the audit, only two of them were adequately covered by a performance guarantee throughout the required period. The following also relate:

- a. The initial performance guarantee issued in respect of the Child Development Centre was valid up to 5 April 2014. Following the National Audit Office (NAO) requests, an extension, merely covering a period of just over 10 weeks, *i.e.* from 22 April to 5 July 2015, was provided.
- b. Performance guarantees for the remaining five calls for quotations were not traced in the respective files, implying that this specific requisite in the general conditions was completely overlooked.

Insurance Policy

All calls for tenders and/or quotations, except for one, required the contractor to take out an insurance policy, in both his own and the Contracting Authority's name, against any loss or damage for which the said parties could be liable under the contract. The insurance policy was to be effective from the commencement of works and remain in force until final acceptance of the works. In spite of the above, no insurance policy was made available to NAO in respect of seven calls

for tenders and/or quotations, possibly leaving the Contracting Authority liable for any potential losses.

Order to Start Works

- a. All the eight calls for tenders and/or quotations envisaged the importance of issuing an official date of commencement, to ensure that timeframes are maintained. However, no official order was raised to set the commencement date for four of these calls, making it hard for the Contracting Authority to enforce timeframes and impose penalties in cases of non-compliance.
- b. With regard to the construction of rubble walls, according to Director (EGRD), the eight weeks duration was intended for each and every assignment and was not to be linked to LA as the conditions necessitate. However, no order to start works was available in the file for any particular task.
- c. Although works regarding the provision and levelling of good quality agricultural soil were to be delivered within two weeks from LA, which was signed on 5 February 2013, the respective deliveries were made in three batches, namely in April and December 2013, and March 2014.

Test Certificates

All the calls for tenders and/or quotations empower the Contracting Authority to inspect, examine, measure and test the components, materials and workmanship to ensure that they are of the requisite quality and quantity. Though EGRD obtained test certificates with regard to the quality of soil, both from a private laboratory as well as from the Plant Health Directorate, no tests were requested or carried out on works relating to civil works at Marsalforn, as well as on the supply and laying of tarmac next to the Child Development Centre in Victoria.

No Time Limit imposed on Works and Services

The audit sample included five calls for quotations issued by EGRD through the Government Gazette. Projects relating to two of the calls were

to be finalised within an established timeframe. However, the other three sampled calls for quotations were not related to particular projects and had no time limit.

Compliance Issue

Rubble Walls not built in line with Permit

MEPA permit number 2428/2010, highlighting the conditions to be observed when carrying out works at *il-Qortin ta' Isopu*, specifically required that rubble walls were to be constructed in loose, unhewn random rubble stones which stand by gravity and friction without the use of mortar. The foregoing permit also states that no extraneous materials, including concrete, should be incorporated within the walls.

In contrast, the call for quotations with regard to the construction of rubble walls specifically included the use of concrete in the construction of strip foundation, under the description of works.

Recommendations

Key Issues

Governance Weaknesses

It is recommended that EGRD develops its own internal control procedures, having regard to its specific circumstances and characteristics. Ideally, controls are to be embedded in the operations, form part of the overall culture and be capable of responding quickly to evolving risks. These controls are to include procedures for reporting immediately to appropriate levels the weaknesses identified and significant control failings, thus enabling timely corrective action if so required.

Notwithstanding this, sound internal controls cannot eliminate the possibility of processes being deliberately circumvented by the collusion of employees or poor judgement in decision-making. Thus, staff and operations should be supervised by competent officers who are conversant with the processes and procedures that are in place, and who are ready to query such procedures and decisions, if and when necessary, as well as to take any action deemed necessary to address shortcomings.

Lack of Segregation of Duties

Best practice entails that a Quantity Surveyor is appointed to draw up the call for tenders and subsequently also the bills of quantities. Thus, EGRD is encouraged to make use of the services of a reliable Quantity Surveyor, with the aim of reducing reliance on one individual, ensuring effective independent verification.

Continual Delays in finalising Projects

Management should strive to resolve any potential obstacles to the success of the project with related parties, prior to its commencement.

Control Issues

Lack of compliance with Tender Requirements

In dealing with public funds, the Directorate is duty bound to ensure that the interests of taxpayers are safeguarded. Thus, any clauses included in the conditions for service contracts, intended to protect the Contracting Authority, are to be fully observed. Furthermore, transparency and fair competition is to be practiced at all times by all public officials, ensuring no one bidder has an advantage over other interested parties.

Child Development Centre in Victoria

Delays in completing Project

Once an agreement comes into force, the contracting parties should endeavour to initiate the project and ensure that it is finalised within the established timeframe. An official order to start works, including acknowledgement from the contractor, is also highly recommended.

Incomplete Works Register

Management should ensure that the conditions, intended to enhance internal controls and safeguard the interests of the Contracting Authority, are duly enforced. The Works Register is also to be given its due importance. Thus, proper records are to be kept and signed to ensure transparency.

No Independent Testing on Concrete

The Contracting Authority is expected to request its own random sample checks on a regular basis, keeping the contractor constantly aware of being liable to inspections, hence maintaining the required standards.

Lack of Documentation supporting Measurement by the Supervisor

Management is encouraged to request delivery notes from the contractor, with the proviso that responsibility will only be assumed on completion and commissioning of project.

*Installation of Photovoltaic Panels at Taċ-Ċawla Social Housing Estate**Delays in finalising Project*

Consultation with all stakeholders is recommended prior to the issue of tenders to ensure that, as far as possible, divergences are resolved in a timely manner and established timeframes can be kept accordingly.

Addendum signed retrospectively when it was already expired

EGRD is to ensure that any necessary addendum is duly signed before the related contract expires.

Feed-in Tariff Refund forgone

Consultation with all stakeholders at an early stage is strongly recommended, thus ensuring timely collaboration from all parties.

*Landscaping and Maintenance Works at Ta' Isopu, limits of Nadur**Permit not in hand*

It is advisable that, as far as possible, tenders that are dependent on the necessary permits are not issued until these are duly approved. Advance planning is to be undertaken, particularly in cases involving the processing of MEPA permits, in view of the timeframes which may be involved.

Unattainable Scheduled Timeframes

Established timeframes are expected to be realistic and attainable.

*Other Matters**Performance Guarantees*

The Contracting Authority should ensure that valid bank guarantees are duly maintained, as specified in the respective tender document, throughout the period of the contract.

Insurance Policy

Copies of insurance policies and proof of payment thereof are to be requested from the contractor, and kept in file accordingly, enabling independent verifications.

Order to Start Works

Commencement date should be set and confirmed in writing with the contractors to ensure that timelines are maintained accordingly. Conditions imposed by the contract are also to be adhered to.

Test Certificates

The quality of material should be tested on a regular basis to ensure that it is in accordance with the required specifications.

No Time Limit imposed on Works and Services

A time limit is to be included in the calls for tenders and/or quotations, with the possibility of extension for the required works or services.

*Compliance Issue**Rubble Walls not built in line with Permit*

Management is expected to strictly comply with MEPA requirements.

Management Comments

Management stated that the structure of EGRD was designed to be as cost effective as possible when the Directorate was created, so as not to become a repetition of the Works Branch within the Projects and Development Directorate. Thus, EGRD operates as a multi-disciplinary team made up of various professionals. Although the compact size of the Directorate does at times lead to officers having more than one role in a specific project, it was categorically excluded that any officer was single-handedly responsible for all aspects of any project, its procurement and payment.

Although the entire process was not documented, as only the Architect's signature was evident, it was remarked that measurements of works are taken by the Directorate's Draughtsman, with the assistance of the Principal Technical Officer, whose main role is project delivery and site supervision. The said measurements are then discussed with the professional staff, who would then endorse the workings.

Management also indicated that discussions will be initiated to assess the possibility of creating a centralised unit within MGOZ, responsible for project delivery, while the Ministry will seek to fill the vacancy of Senior Projects Administrator, who would monitor the infrastructural projects of the Directorate, at the earliest. This would also ensure that an adequate project monitoring capacity is available to the Ministry, since EGRD does not have the resources to ascertain that all the requirements related to project recording and documentation requested by best practice are adhered to.

With respect to the delays in finalising projects, it was commented that in spite of all preparatory work done during project design phase, most projects will encounter disruptions along the way, requiring continual discussions with stakeholders. It was also stated that proceeding with the publication of calls for tenders, once there is a positive Development Planning Application report, or waiting until the decision by MEPA Board is taken in public, reduces lead times and results in shorter timeframes.

The contract related to the Child Development Centre was signed very close to the March 2013 elections, and the project was put on hold for a period of time, in order to enable the incoming Government to review the project.

On the other hand, in the case of the project concerning the installation of the photovoltaic panels, it was only during the installation phase that it transpired that parts of the estate's roof were private property, forcing the Directorate to redesign part of the installation. To this effect, all parties involved came up with alternative possibilities and solutions during the course of the project. The Directorate admitted that it was rather dissatisfied with regard to the addendum signed retrospectively, but this was beyond its control.

Management maintained that the compilation and management of the Works Register was the sole responsibility of the contractor and his appointed Supervisor (Architect). Notwithstanding this, the Contracting Authority's Project Leader kept a personal record of the days claimed as lost by the contractor, and these were informally discussed and agreed upon. It was further reiterated that the Directorate does not formally endorse the Works Register on a point of principle, so as not to compromise the Contracting Authority in any way on aspects related to payments.

With regard to the issue concerning the testing of concrete, Management stated that the contractor commissioned an ISO-certified laboratory, of which the Contracting Authority has no reason to doubt the competence and independence. It was also maintained that each certificate was endorsed by the contractor's Architect, while the final letter of comfort, provided in October 2015 and stating that the project is completed according to specifications, adds further comfort. The Directorate orders tests whenever its experts highlight the need to do so, or where reasonable doubt arises. The respective results are reviewed immediately by the Directorate's professional officers, although this was not documented when the result, indicated compliance and no action was required. However, the Directorate acknowledges the importance to document this process and to

have test certificates accompanied by a statement by professionals describing the results of the tests in laymen's terms.

It was also claimed that although the test certificates endorsed by the contractor's Architect were received by EGRD towards the end of June 2015, the project was funded through annual allocations, which, if not disbursed within the calendar year, would have been lost. Moreover, the Directorate was still covered by the outstanding amounts payable on the project, the performance guarantee and the retention money. In addition, MGOZ will consider issuing a call for quality assurance and quantity surveying, and will consult DC with the scope of establishing formal guidelines relating to medium and minor projects, possibly establishing threshold values for the sampling and testing of material.

With respect to the observation relating to the confirmation of works, it was stated that the Directorate bases its payments on measurements which are quantified and measured once the work is completed satisfactorily. Measurement of, or assumption of responsibility, for material delivered on site would probably expose the Contracting Authority to the payment of material which can go wasted or is lost from site before being used, among others. Moreover, acceptance

of delivery notes may cause disagreements with the contractors on the quantities, given that significant variances would arise between the amounts of material delivered and the works measured upon completion.

Management remarked that although the output of the installed panels was not being registered by a meter, in most cases, the energy generated was still being transferred to the national grid.

With regard to the use of concrete within rubble wall buildings, it was clarified that strip foundation is laid under, not within the wall. This is to increase the stability of the base where required.

The Directorate also stated that it will continue to strive to operate in line with Government regulations and best practice, and it will be ascertained that the order to start works is clearly communicated. The cases where time limits were not specifically dated involved works which depended on the prior completion of other works.

The issues relating to 'Landscaping and Maintenance Works at *Ta' Isopu*, limits of Nadur' and 'Other Matters – Insurance Policy' were not properly addressed.

**Ministry for Social Dialogue,
Consumer Affairs and Civil Liberties**

Malta Competition and Consumer Affairs Authority

Background

The Malta Competition and Consumer Affairs Authority (MCCAA) was established on 23 May 2011, with the coming into force of Chapter 510 of the Laws of Malta. It merged three former agencies, namely the Consumer Competition Division, the Malta Standards Authority and the Malta National Laboratory, which were replaced by the following Units:

- Office for Competition
- Office for Consumer Affairs
- The Technical Regulations Division
- The Standards and Metrology Institute

Article 4(2) of the Act establishes the functions of the Authority, which include the promotion of competition, safeguarding consumers' interests, encouraging voluntary standards and supporting the national metrology strategy.

MCCAA registered a total income of €5,133,163 in 2014, of which, €3,415,600 was Government Subvention and Grants, with the balance of €1,717,563 generated through the Authority's operations. On the other hand, a total of €4,811,226 was incurred on administrative and other expenditure, of which, the amount of €2,779,611 was related to staff costs borne on an average of 138 employees. As a result, the audited accounts for the year ending 31 December 2014 showed a surplus of €321,937.

¹ Premises consist of offices and underlying garage.

Audit Scope and Methodology

Besides being audited annually by an external auditor, as required by MCCAA Act, the Authority's accounts are also subject to audit by the Auditor General in terms of Article 55(2) of the same Act.

The objectives of the audit were to verify accuracy of the Authority's income, as well as expenditure, during the financial year 2014. Various meetings were held in order to obtain an overview of adopted procedures and controls. Following an analytical review and the identification of material transactions, a sample of revenue and expenditure accounts was selected from the nominal transaction listing. The salary of a number of MCCAA officers was also checked against the relevant employment contracts and collective agreements to confirm entitlement.

Key Issues

Lease of Premises

MCCAA offices are situated in National Road Blata l-Bajda. These premises¹ have been leased from a third party in line with agreement dated 12 October 2011. The following shortcomings relate:

- a. The annual lease, which in terms of the contract started at €375,240, will eventually increase to €725,119 by 2021. By the end of

the lease agreement, *i.e.* September 2021, the Authority will have incurred an aggregate rental expenditure on office premises of €4,421,630 over a 10-year period.

- b. Documentation supporting the decision to lease the offices, such as the consideration of possible alternative premises, and on whose final authorisation was the lease agreement entered into, was not available.

Agreement with Transport Malta

Background

A contract dated 1 May 2014 provides for the supply of various services through a subcontract with Transport Malta (TM), in respect of road engineering, construction, maintenance and related infrastructural works. The total income generated through these services during the year under review amounted to €198,443 excluding Value Added Tax (VAT). The following rates were to be charged:

- a. a monthly retainer fee of €12,000 (VAT excl.) chargeable as from January 2014, which is payable irrespective of the number of tests, samples or calls required;
- b. as from date of contract, *i.e.* 1 May 2014, the cost of tests performed, or parts thereof, chargeable at 50% of the rates (VAT excl.) listed in Annex 5 to the agreement; and
- c. a charge of €50 (VAT excl.) for the first 1.5 hours and a further €50 (VAT excl.) for each additional hour thereafter when specifically requested by TM to work outside normal business hours, or on Saturdays, Sundays, National and Public Holidays.

Signing of the Prevailing Agreement dated retrospectively

Although the agreement is dated 1 May 2014, it was actually signed retrospectively in October. As a result, the Authority only commenced invoicing TM in late October 2014 for charges due since January.

No Formal Extension to Previous Agreement

The previous agreement between the then Malta National Laboratory and TM was valid for three years, from 18 January 2010, with the possibility of a further two-year extension. Addendum No. 1 to this agreement extended the term till 16 September 2013. No evidence was made available to confirm that this agreement was formally renewed to cover services given by MCCA as from this date until the eventual signing of the prevailing contract more than a year later.

Work Orders not formalised

Section 6.9.4 of the agreement states that all orders for work will be by individual task orders, in accordance with a procedure to be mutually agreed upon. However, the Authority confirmed that such procedure was not made official to “... *minimise bureaucracy*”. Moreover, a walk-through test performed on two tasks sampled for audit purposes revealed that a ‘task order’ was not even raised for one of the foregoing tasks. It was claimed that the request was received through a telephone call.

Inconsistencies between Agreed Schedule of Prices and Invoices

The National Audit Office (NAO) could not reconcile the cost of tests performed and eventually charged by MCCA, with the related itemised price list appended to the applicable agreement with TM. This was due to inconsistencies, mainly in the reference and titles of the respective tests. As a result, independent verification could not be performed.

Overtime Work approved retrospectively

Overtime performed by one of the officers was constantly being approved retrospectively. This officer received a total compensation of €6,038 in overtime payments during the year under review.

Management maintained that prior approvals are not necessary as the related cost is ultimately borne by TM. However, this was not always the case as sample testing revealed a particular instance when

not all hours were charged to TM, as some hours were used to clear backlog of work at MCCA.

Double Rate for Overtime not substantiated

A retrospective request for overtime approval, dated 11 September 2014, referred to a meeting with the Union, whereby it was agreed that hours worked between 10 p.m. and 7 a.m. are to be paid at double rate. However, this statement was not substantiated, thus the validity of this rate could not be confirmed.

Certification Services

Background

MCCA registered an income of €154,211 from Certification Services during the year under review. Such income was mainly derived from services given under the following categories:

- ISO 9001 Quality Management Systems
- ISO 14001 Environmental Management Systems
- Organic Farming
- Pest Control
- Language Schools
- Designated Security Authority
- Occupational Health and Safety
- Inspection of Playground
- Certification of Garages

Lack of Control on the Completeness of Revenue

Information pertaining to the majority of services provided by the Standardisation Directorate is kept on the computer system in a fragmented manner. It transpired that it is the prerogative of the respective Director General to instruct the Finance Section to issue an invoice to clients for the amount to be charged for the related services. Controls are neither in place to ensure that the invoiced amounts are correct, nor to ascertain that all clients were actually billed.

Reconciliation of Income not performed

The only income-related database available at the Standardisation Directorate covered the Certification of Motor Vehicle Repair Garages. This service, which involves a charge rate of

€145 upon initial registration and a further €55 for renewals thereafter, is requested by garages which need to be certified in order to provide services to insurance companies. The database for 2014 contained 366 garages. However, no reconciliation was performed by MCCA to ensure the completeness of income and the accuracy of amounts posted in the respective account.

Discrepancy between Fees charged

The pricing schedule provided by Corporate Services Unit, covering the Motor Vehicle Repair Garage Certification, was effective from 20 February 2007. It consisted of a one-time payment for the initial assessment of €137.31 and a further annual charge of €49.43 for the yearly surveillance audit. These charges did not tally with the amounts actually invoiced, which as indicated above, amounted to €145 and €55 respectively.

Control Issues

Absence of a Fixed Asset Register

As per MF Circular No. 14/99 – ‘Government Accrual Accounting: Revised Inventory Control Regulations’, inventory records containing tangible fixed assets should be updated with complete, accurate and timely information.

From correspondence and previous years’ Management Letters issued by the Authority’s independent auditors, it transpired that the latter have been highlighting the importance of implementing and maintaining a Fixed Asset Register since the audit for financial year 2012. In April 2015, NAO was informed that a new server for the existing accounting system was still to be installed, following which, the process of inputting of the relevant data would commence.

Payroll Issues

The personal files of the employees included within the audit sample were not always duly updated. The following issues relate:

- a. Documentation summarising each officer’s employment history, showing the grade and

equivalent basic salary since employment, was not traced in any of the personal files reviewed, leading to a lack of audit trail.

- b. Three officers in the sample were awarded automatic progressions on the completion of five years' service, in line with their original employment conditions. Although these should have been subject to satisfactory performance, no such confirmation was available. Similarly, there was no record supporting the appraisal of four officers even though they were awarded a performance bonus.
- c. In a number of instances, documents in the personal files reviewed were loosely inserted instead of properly filed.

Cleaning Services

Services rendered beyond the Contracted Period

The contract for the provision of cleaning services at MCCAА premises and its three satellite centres² was signed on 2 May 2012 following a call for tender. Section 8.2 of the tender document stipulated that the contract shall be operative for a period of approximately 12 calendar months, with the possibility of two further extensions of six months each. MCCAА confirmed that the contractor continued to render his services up to January 2015, even though the original contract was never formally extended. Furthermore, procurement of services rendered from May 2014 onwards was made by direct order without the necessary approvals.

Lack of Control on Transport and Related Expenditure

No Formal Agreement with the Fuel Supplier

MCCAА procures fuel from a station situated near the Authority's main office. Although total payments made to the supplier in question during the year under review amounted to €23,217,

Management confirmed that an agreement, indicating the necessary details of the vehicles allowed to be refuelled at its expense, was not entered into.

Fuel Expenditure

As per MFIN Circular No. 4/2007 and related information issued subsequently by the Financial Management Monitoring Unit, Government recommended the implementation of the Fleet Management System (FMS), to be the main source of management and control of all vehicles, with the principal function of controlling fuel expenditure through the issue of automated fuel chits.

NAO was informed that the vehicles pertaining to MCCAА are not controlled by FMS, but the Authority monitors transport costs through reports, spreadsheets, sample testing and management accounts. Refuelling of MCCAА vehicles is done through the 'i button'³ facility which has an inbuilt control, limiting monthly fuel consumption for each vehicle as set by the relevant circular. However, Management confirmed that during 2015, there was a fault in the supplier's system. Consequently, an excess of fuel consumption by one of the Directors was not taken into account. Although NAO acknowledges that action has been taken, this was not in line with the circular, which states that the maximum monthly fuel limit is non-cumulative.

Vehicles for General Use

During 2014, the Authority had 10 vehicles at its disposal for general use, which in aggregate consumed fuel amounting to €9,327. Audit testing revealed the following shortcomings:

- a. The Public Service Management Code (PSMC) section 8.2.4 requires Director responsible for Corporate Services to ensure that a logbook, containing details of each journey performed, is kept for each Government-owned vehicle.

² These consist of MCCAА Lab Services in Mosta, MCCAА SMI - Metrology Directorate in Kordin and MCCAА European Consumer Centre in Valletta.

³ The 'i button' is kept by the responsible officers within the Authority and is only handled by the general use car drivers for refuelling. This system does not make use of fuel chits and monthly fuel limits are pre-determined. The supplier issues monthly reports detailing fuel consumption for every vehicle.

Notwithstanding this requirement, no record was kept by the Authority for five out of the 10 vehicles available for general use. Additionally, in another two instances, logbooks available did not cover the entire year.

- b. From the five logbooks presented, only two were kept in conformity to the requirements of PSMC. Besides missing the necessary details, such as mileage covered per trip and the issue of fuel, additional shortcomings encountered in two of the remaining three raised further audit concerns as follows:
- Trips performed by a vehicle were recorded on the logbook of a different car whilst the odometer reading of the latter continued running.
 - Another logbook contained amended odometer readings. Additionally, it was noted that, following a particular journey performed on 9 June 2014, the closing odometer reading was reduced by 4,944 kilometres when compared to that recorded at the beginning of the trip. No further records of trips performed with this vehicle were kept after this date. Records with very limited detail subsequently resumed on 2 January 2015.
- c. Refuelling records on the logbooks were only available for one vehicle. Records maintained for the other cars did not show such important detail.
- d. NAO did not find any evidence to confirm that logbooks are being inspected periodically by a responsible officer to monitor fuel consumption, as well as to ensure that irregular use of cars is duly reported.

Compliance Issues

VAT Concerns

MCCAA's expenditure was not all supported by the appropriate fiscal receipts. Upon enquiry, the Authority declared that it was not aware of

the requirements of MFEI Circular No. 7/2011 – 'Submission of Fiscal Receipts to Government Departments, update to MF Circular No. 5/2002' and the additional requirements as per MFEI Circular 2/2012. As a result, an officer was not designated with the responsibility of compliance with these circulars. Consequently, suppliers and/or service providers who failed to provide the Authority with the fiscal receipts were not duly reported to the VAT Department.

Biannual Return of Allowances not prepared

A biannual return of allowances, in line with PSMC section 2.4.1.2, MFEA Circular No. 4/2003 and Section 2.4 of the Manual on Allowances Payable to Public Officers (August 2014), was not submitted by the Authority to the Ministry for Finance.

This hinders the periodical monitoring and review of all allowances, envisaged to be performed through the preparation and subsequent submission of the aforementioned information.

Recommendations

Key Issues

Lease of Premises

Although the present lease agreement still has six years to expire, Management is encouraged to carry out an exercise in order to identify alternative Government premises that satisfy MCCAA's requirements. The latter is to also determine whether the option of moving to new premises upon expiry of the contract is feasible and more cost effective.

In the event that adequate premises are not available, it is recommended that the Authority issues an expression of interest. The approach taken is to be in line with the requirements of the procurement regulations, to ensure that the best rates and conditions are obtained within the framework of a transparent and fair selection process.

Agreement with Transport Malta

The process of drafting new agreements is to be planned well in advance so that contracts are signed in a timely manner. This will ensure a smooth transition from one contract to another. Management is to invariably ascertain that there is an adequate audit trail of the approved rates, so that amounts charged can be easily corroborated by third parties. This also facilitates business continuity in the event of a change in roles and responsibilities within the Authority.

In line with standing regulations, formal authorisation is to be obtained prior to working overtime, including justification for the request, the total number of hours of overtime being requested, and specific targets to be attained during the extra hours of work.

Certification Services

Management is encouraged to consider implementing a focused income recording system that would provide the benefits of embedded internal controls within the revenue cycle, whilst also ensuring that all services provided are invoiced. Pricing schedules are to be kept updated to reflect prevailing rates and to ascertain that the Finance Section is informed accordingly of any related changes.

Control Issues

Absence of a Fixed Asset Register

Inventory records are to be accurate, as well as complete, and prepared in a timely manner, so as to ensure effective controls over the tracking and valuation of fixed assets.

Payroll Issues

Personal files are to be kept updated with all the necessary documents, especially those relating to emoluments. Besides enabling ease of reference as well as verification by third parties, this ensures a smoother transition in the event of a change in Human Resources personnel.

Cleaning Services

In order to safeguard the provision of the service, the Authority is to ensure that the necessary arrangements, such as applicable contract extensions, are in place. Additional expenditure outside the scope of the contract is to be duly authorised.

Lack of Control on Transport and Related Expenditure

No Formal Agreement with the Fuel Supplier

MCCAA is to ensure that a formal contract is entered into, specifically indicating the registration number of the vehicles authorised to be refuelled at its expense. The binding terms and conditions are also to be outlined.

Fuel Expenditure

The Authority is encouraged to implement FMS in order to benefit from controlling features embedded in the system. These include an audit trail which logs all user transactions, a record of vehicle odometer readings at the time of refuelling, as well as the details of the entrusted employee. The system also provides controls based on the relevant circulars in force, which do not allow further refuelling once the limit is reached.

Vehicles for General Use

Logbooks are to be properly kept for each and every general use vehicle, indicating each journey performed, the purpose of trips made and exact mileage covered, in order to enable proper verification.

The attention of Management is being drawn to the relative guidelines outlined in PSMC to regulate the use of such vehicles. The Authority is encouraged to use the specimen logbook for all vehicles, as found in PSMC Appendix 8.I, thus ensuring that adequate details of each journey performed is recorded. The same guidelines also require that a certificate, as per PSMC Appendix 8.II, is entered on each logbook at the end of each month, confirming that the trips recorded in the logbook were made on official duty.

Compliance Issues

VAT Concerns

Management is to regulate its position by following MFEI Circular Nos. 7/2011 and 2/2012. Thus, all suppliers who have been paid for goods or services are to invariably provide the Authority with supporting fiscal documentation. Other types of receipts are acceptable only when suppliers are exempt from registering for VAT.

Moreover, the VAT Department is to be informed of the designated officer who is responsible for the compliance of the return in line with the above-mentioned circulars. Quarterly returns, highlighting those suppliers not complying with VAT regulations, are to be duly filled and submitted to the VAT Department in electronic format.

Biannual Return of Allowances not prepared

Management is to ensure that all allowances are reviewed regularly in order to ascertain whether the conditions under which they were granted are still valid. The relevant information is to be collated and the return submitted on a regular and timely basis.

Management Comments

Management's reply made reference to the fact that the present Executive Chairman was only appointed on 1 June 2013. On his engagement, the top priority was that of strengthening the Authority, which had various vacant posts at senior levels. MCCA also recently replaced the Head Corporate Services and recruited a Head Human Resources and Head Finance instead, to support the respective Units. These Officers will be able to concentrate on their responsibilities and also ensure that recommendations made in NAO Report are implemented with the utmost urgency.

Management will perform an exercise to consider alternative premises that satisfy MCCA's requirements, as recommended by NAO. The procedure to be used in effecting such move, if necessary, will be in line with the procurement regulations.

Discussion with TM commenced towards the end of the year 2013. The new agreement was back-dated to January 2014; thus, there was only a period of three months that was not formally covered. It was signed retrospectively as discussions in respect of the new agreement took a considerable number of months to conclude, mainly due to the change in the respective charges, from a lump sum to a monthly retainer and a pay-per-test system.

Management made reservation to NAO's observation with respect to work orders. The Authority claimed that it developed an efficient standard online system to register all requests on a database as verbally agreed with TM. However, there are instances where this procedure cannot be followed due to the nature of work. In these cases, requests are usually received through phone calls, which are registered along with the registration of samples. This system has been audited and accredited to the international standard ISO 17025 and has been found comprehensive and effective.

Management acknowledged the fact that the price list needed an amendment. However, it made its reservation on NAO remarks regarding inconsistencies between agreed schedule of prices and invoices.

As regards overtime, although it cannot always be endorsed by the Chairman due to the nature of work, it was stated that it is always performed with the consent of the Director. Furthermore, although compensating overtime at double rate is not provided for in the Authority's collective agreement, such payment was made in line with Union advice.

The Corporate Services Unit manages all the billing and revenue collection procedures in collaboration with the other Sections, while the internal audit function, set up as required by MCCA Act, ensures the proper collection of fees due. Additionally, an internal audit on Motor Vehicle Repair Garage Certification Scheme was also carried out and duly reported upon, in April 2015.

According to Management, the discrepancy in fees related to the cost of the publication of the revised applicable Standard on Motor Vehicle Repair Garages, a copy of which is given on

every inspection. The Schedule of Fees has now been updated and the applicable fees are officially accepted by the clients before each inspection is performed.

Additionally, the new Head Finance and the Internal Auditor intend to discuss with each entity on a uniform income recording system, that would ensure consistent and effective internal controls within the revenue cycle.

The inventory of the Head Office and the other three satellite premises has been updated. MCCA has the Fixed Asset Register Module already in hand and will be proceeding with the necessary training in order to implement the system in the shortest time possible.

In the case of changes in basic pay due to promotion or progression not documented, it was maintained that the present Management always recruited personnel in line with the provisions of the collective agreement and those of PSMC, where applicable. The Authority maintained that the Payroll Section follows the respective annual increments until the maximum is reached.

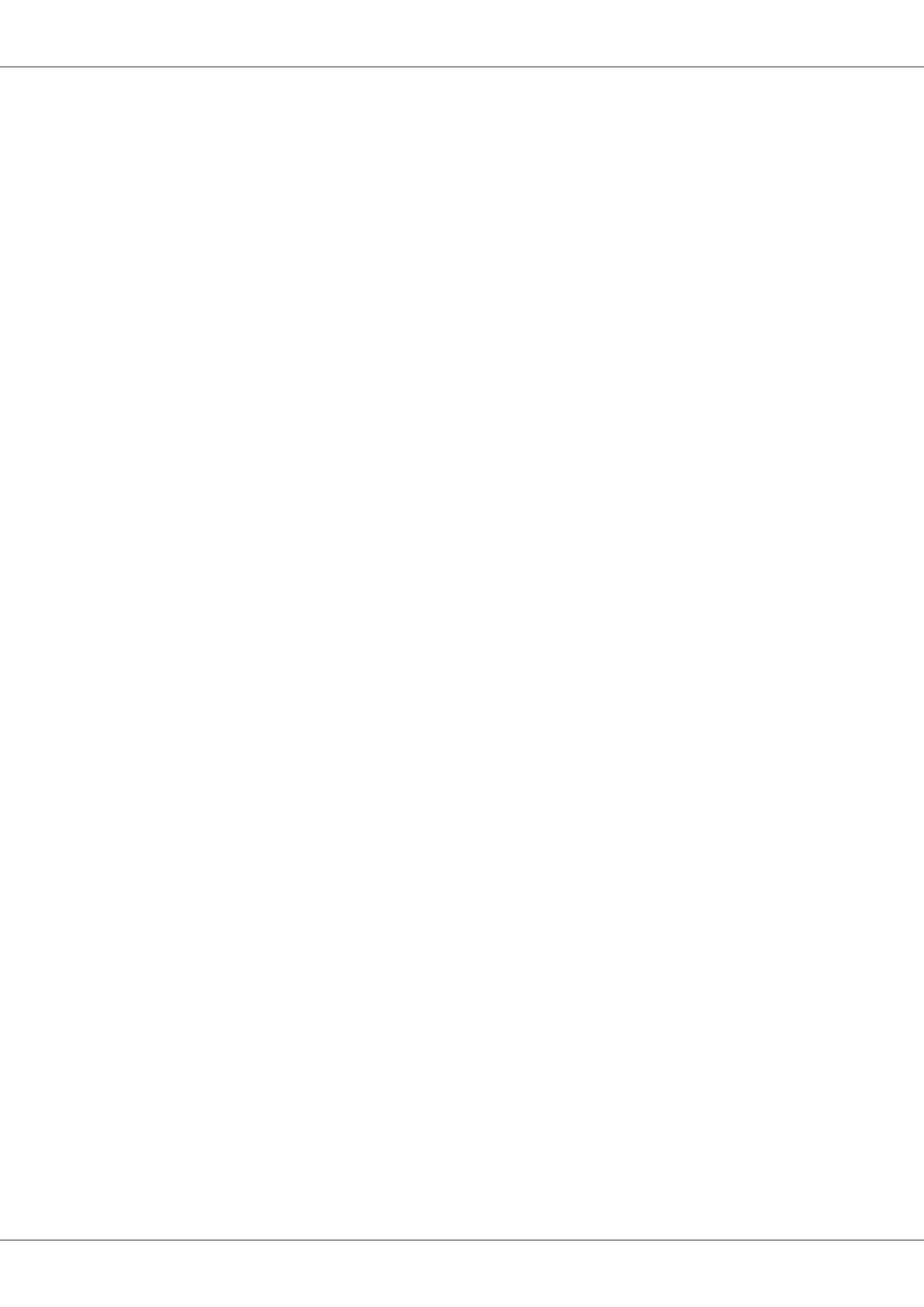
Management intends to address automatic progressions in the following collective agreement. Officials who were originally engaged by the then Malta Standards Authority were considered to merit the progression on the basis of their performance since their appointment with MCCA. As regards performance appraisals, these were carried out by the respective Heads.

Recommended bonuses were submitted for review by the Chairman, who ultimately approved the rate awarded and informed the Head Corporate Services accordingly. Corrective action will be taken by Management to file the performance appraisals accordingly and to remedy the few instances where documents were loosely inserted.

Following a call for tender for cleaning services in February 2014, it resulted that the lowest bidder had been blacklisted by Government, but the same bidder had instigated a warrant of prohibitory injunction. Guidance on the way forward was sought from the Contracts Department in June 2014 where the Authority was instructed to suspend the evaluation process temporarily. In the meantime, the required cleaning continued to be provided by the previous service provider without an official extension to the previous contract, until adjudication.

Management confirmed that a formal agreement with the fuel supplier will be entered into. It also intends to control the use of general use vehicles and expenditure on fuel. To this effect, it will be implementing FMS as per NAO's recommendation.

The responsibility for abiding with VAT requirements in line with MFEI circulars will be delegated to an official within the Finance Unit. Additionally, even though MCCA was never requested to submit biannual return of allowances, the Authority will still commence providing such information.





**Ministry for Economy, Investment and
Small Businesses**

Malta Information Technology Agency

Capital Expenditure

Background

The Malta Information Technology Agency (MITA) is the central driver of Government's Information and Communications Technology (ICT) policy, programmes and initiatives in Malta.

MITA is controlled by the Government, and is considered as an Extra Budgetary Unit. It is listed under Schedule 3 of the Public Procurement Regulations (PPR) through Legal Notice 296 of 2010, as a Contracting Authority who shall administer its own public procurement in accordance with the provisions of the same regulations. Consequently, MITA is defined as a public authority, in terms of the late payments directive.

The Agency falls under the remit of the Ministry for the Economy, Investment and Small Business (MEIB) and is appointed by the same Ministry as an official body. The Financial Estimates for the financial year 2014 for Capital Vote XI show a projected outlay of €12,405,000 for ICT Core Services, €3,945,000 for Personal Computers (PC) Leasing, €750,000 for the Digital Outreach Programme, and €655,000 for e-Government.

The related total actual expenditure incurred by MITA in 2014 on these agreements amounted to €14,285,854 for ICT Core Services, €2,650,989 for PC Leasing, €804,872 for the Digital Outreach Programme, and €795,006 for e-Government.

The difference between the amounts approved in the Financial Estimates, in aggregate amounting to €17,755,000, and the actual expenditure incurred by MITA on these four agreements, totalling €18,536,721, amounted to €781,721. Part of this difference was due to the provision of additional services agreed upon later during 2014, a number of deferred income adjustments, as well as invoices relating to 2013 but paid by MEIB in the following year. In order to fund such additional expenditure, MITA utilised prior year credits.

Information and Communications Technology Core Services

In 2006, the then Malta Information Technology and Training Services Ltd (MITTS) entered into a 10-year contractual agreement as the provider of ICT Core Services with the Government of Malta. This agreement covered a wide range of services which fell under three main layers, consisting of the infrastructure, business and operational efficiency, as well as the application layer.

Personal Computers Leasing

On 25 April 2007, an invitation to tender was issued by the then MITTS for a five-year lease in connection with the provision of leased PC, their maintenance and support services, as well as peripheral equipment. The respective lease agreements with four different suppliers terminated in March and April 2014.

The National Audit Office (NAO) satisfactorily noted that MITA was equipped with a register featuring all PCs leased, further enabling traceability of each PC to its respective Ministry and user assigned. In addition, details regarding each PC included the serial number, identification number, model and hardware support. Upon expiration of the agreement periods, suppliers were forwarded with payments equivalent to the respective residual value of some of the PCs.

Digital Outreach Programme

MITA entered into an agreement with MEIB, whereby the latter commissioned the Agency to provide services relating to Digital Outreach initiatives, e-Skills related initiatives and Innovation Platform services to the Government of Malta. This contract came into force on 1 January 2014 for a period of one year.

e-Government

On 8 July 2013, MITA entered into another agreement with MEIB to deliver and manage the execution of programmes related to the implementation of information technology and related systems in Government. The contract is valid for three years, with effect from 1 January 2013.

Audit Scope and Methodology

The scope of the audit was to verify that capital expenditure incurred by MITA was duly authorised, properly accounted for, as well as in line with existing regulations, policies and procedures.

An introductory meeting was held with MITA's officials with the aim of discussing the audit objectives and obtaining a general understanding of relevant policies and procedures adopted by the Agency, in relation to procurement and payment of different items of capital expenditure.

A further meeting was then held to obtain a more detailed explanation with respect to each of the four agreements. Additional discussions were subsequently held with Management and Administrative Officers during the course of the audit, as necessary. Detailed substantive testing was carried out to confirm the existence and the correct application of procedures and controls.

In the initial stages of the audit, NAO reviewed the revenue that MITA received from Government through MEIB with respect to these four agreements: ICT Core Services, PC Leasing, Digital Outreach and e-Government. Payments made by MEIB to the Agency were traced against the respective invoices and contract agreements.

Subsequently, NAO obtained a breakdown of the actual expenditure incurred for each of these four agreements from MITA. This Office noted that costs mainly comprised charges relating to MITA's labour, as well as investment and other expenditure procured from third parties.

Samples of labour costs, totalling €1,078,029, which related to a number of particular projects for each of the four agreements tested, were chosen for review¹. The labour hourly rate of €27.37 was an average charge determined by MITA to be used for all projects in order to calculate labour cost. Various reports, including detailed lists of persons working on particular projects, were extracted from the Time Recording System in the presence of NAO officers. The total hours listed in such reports were multiplied by the standard hourly rate and checked against the labour costs listed in the actual expenditure breakdown provided by MITA.

Furthermore, individual transactions of investment and other expenditure procured from third party suppliers and included in the audit sample were selected based on their nature and materiality. A total sample of 56² transactions was chosen, collectively amounting to €3,615,970 and representing 34% of actual investment and other

¹ With respect to PC Leasing, this test was not possible since as confirmed by the Agency, the labour effort expended on this programme was not charged for on a time and material basis. Thus, a fixed price per unit was agreed in the contract with the Ministry that covered both the costs related to the suppliers and other expenditure, including the estimated labour charges for the coordination and management of the leasing programme.

² In the case of Core Services and PC Leasing, samples of 20 and 16 transactions were selected respectively. On the other hand, for each of the remaining two projects, a sample of 10 payments was selected for testing.

expenditure incurred by MITA on these projects during financial year 2014.

Testing was carried out to ascertain that procurement was approved by the appropriate authority levels and covered by the necessary documentation. A number of MITA files were also reviewed in order to assess the procurement process.

The selected payments were vouched against the applicable contract agreements and documentation supporting the procurement procedures being followed, including any applicable Guarantees. NAO also ensured that such amounts paid were not in excess of the balances actually due, as specified in the invoices and/or contract agreements, where applicable. Furthermore, payments were traced to related tax invoices, in order to determine whether authorisation was obtained prior to the date of the transaction, and that related invoices were correctly certified for payments to be effected.

Throughout the audit, reference was made to PPR and to MITA's internal procurement and contracting thresholds, outlining the overall procedures to be applied to procure goods and services. Adherence to standing Finance Circulars was also verified.

Good Practice

In general, NAO was satisfied that all documentation relative to the audit was available from MITA upon request. In addition, the Agency's Management and staff were very cooperative at all times during the conduct of the audit. Throughout the audit, it transpired that both the Finance and Contracts Management Departments were being managed and operated in an efficient manner, whereby staff portrayed a professional approach to their work.

In more detail, this Office satisfactorily noted that:

- authorisation for various items of expenditure and investment was duly obtained before the relative purchasing process was initiated, with internal procurement and contracting thresholds being correctly followed;
- backing documentation, such as invoices, were duly certified correct with respect to procurement requirements;
- applicable contracts and Guarantees were properly filed;
- new agreements awarded and/or variations were properly published in the Government Gazette;
- invoices were tallied against prices quoted in agreements;
- tax invoices supported payments selected for the year under review; and
- a good audit trail was present in each case where documentation or additional information was requested.

Management Comments

In its reply, Management ascertained that it will endeavour to continue improving its processes, as well as adhere to all relevant financial and procurement policies and procedures.

Malta Gaming Authority

Gaming Taxes

Background

The Malta Gaming Authority (MGA) is the sole independent regulatory body responsible for the governance of all online and land-based gaming activities in Malta.

In its role, the Authority complements the commercial needs of operators with an understanding of gaming legislation and practice. In fact, its main aims include safeguarding players' rights, promoting responsible gaming, ensuring the integrity of games and gaming devices, as well as protecting minors and vulnerable persons.

MGA is also entrusted with conducting research on various aspects of gaming, including the granting of licences and monitoring licenced games. Apart from ensuring that the sector contributes to the country's development, the collection of licence fees and taxation on behalf of Government is also part of its remit.

According to the 2014 Financial Estimates for the Ministry for the Economy, Investment and Small Business, MGA was expected to make a revenue of €50 million throughout the year under review. The actual amount collected during the year exceeded this budget for a total of €51,227,340.

Licence Classes

Remote gaming licences are subdivided into four main classes:

- A Class 1 remote gaming licence is characterised by the fact that operators manage their own risk on repetitive games, *ex. casino-type games and online lotteries.*
- Holders of a Class 2 remote betting licence manage their own risk on events based on a matchbook, *ex. fixed-odds betting.*
- A Class 3 licence promotes remote gaming in or from Malta, *ex. poker networks, peer-to-peer gaming and game portals.*
- A Class 4 licence, a business-to-business gaming licence, is required to host and manage remote gaming operators, excluding the licensee itself, whereby software vendors provide management and hosting facilities on their platform.

It is also possible to have a Class 1 on 4, Class 2 on 4 or a Class 3 on 4 licence, whereby the licensee operates its games on the software, and in certain cases, through the equipment of a Class 4 licence.

Gaming Taxes

The payment of gaming tax depends on the type of gaming licence held by the operator. In any case, however, the maximum annual gaming tax payable by any one licensee in respect of any licence class, is capped at €466,000. Separate taxation rates also apply for the National Lottery operator and casinos.

Audit Scope and Methodology

The aim of the audit was to evaluate the level of internal controls adopted by the Authority in relation to the collection of gaming taxes on behalf of Government.

A total of 45 licences were selected for testing purposes, amongst which, two belonged to casinos, one pertained to the National Lottery operator and the remaining were held by remote gaming operators. During 2014, these licences were aggregately invoiced a total of €26,476,866 in relation to gaming taxes. *Table 1* refers. MGA invoiced a total of €53,785,256 for the year under review.

Testing on the selected licences was carried out to ascertain whether taxes received by MGA were calculated in line with standing regulations. The operators' Player Liability Report (PLR) submissions, which are required to be filed on a monthly basis in accordance with the Players' Liability Reporting Directive 2012 (Directive 7

of 2011), were also assessed. When available, monthly tax reports, Management Accounts or Financial Statements submitted by the operators, were also considered during testing.

Limitation on Scope of Audit

Management Accounts or Financial Statements with respect to the financial year under review were traced for the majority of sampled Class 2 and 3 licences. Although these were prepared in line with financial reporting requirements, they did not give sufficient detail of the composition of income for the purpose of the calculation of tax in line with MGA's definitions. This lack of detail limited the scope of the audit since it was difficult to verify or otherwise the tax calculations from the information provided by the operators, and subsequent payment forwarded to MGA.

Key Issues

Non-submission and Lack of Verification of Monthly Reports

Player Liability Reporting

In line with the Players' Liability Reporting Directive, remote gaming operators² shall provide the Authority with a PLR, a Clients' Accounts Report, a Funds in Transit Report and a Shortfall/Surplus Report, by not later than the twentieth day of the following month.

Table 1: Types of Licence

Type of Licence	Number of Licences	Amount Invoiced during 2014
		€
Class 1	26 ¹	561,500
Class 2	6	2,208,817
Class 3	8	1,627,079
Class 4	2	20,968
Casino	2	9,957,720
National Lottery	1	12,100,782
Totals	45	26,476,866

¹ Of this amount, 21 licences are of type Class 1 on 4.

² All holders of a remote gaming licence, except Class 4 are required to submit these reports.

These signed reports are intended to serve as a measure for the control of players' money by licencees. Their aim is also to portray, at the end of each reporting month, the balances of players' accounts, the account balances in the relative credit institutions, funds in transit or in the process of being cleared, and a resulting surplus or shortfall balancing figure. A surplus figure signifies that the gaming operator has enough funds in its bank accounts to cover the players' balances, whereas a shortfall figure implies that the players' balances are not covered by the funds in the respective bank accounts.

During testing, the National Audit Office (NAO) noted that 16 companies, which in aggregate, were the holders of 29 licences and were invoiced a total taxation of €3,542,454, did not file such reports with respect to one or more months during 2014. MGA will thus not be in a position to assess whether gaming operators can cover their players' funds, especially if they were to cease operations. Therefore, the risk that MGA cannot take remedial action in a timely manner increases.

Tax Reporting

- a. Together with their PLRs, 12 out of the 14³ Class 2 and 3 licence holders considered for the purpose of this audit, which in aggregate owed €3,566,188 in taxes to MGA, also submitted one or more monthly tax reports throughout the year. These reports showed income calculation on the basis of MGA definitions, and the respective tax payable thereon.

When these figures were compared to the relevant invoices and payments, it was ascertained that the amount paid to MGA was always equal to the amounts calculated in these tax reports. Hence, NAO concluded that in actual fact MGA accepted the amount of taxes paid as declared by the operators, without further questioning. Nevertheless, NAO was not in a position to assess whether the tax payments made by the remote gaming operators were correct, since independent tax calculations, against which these figures could be compared, were not available.

The only documents available for comparison were unaudited Financial Statements, prepared by the same companies that submitted the monthly tax reports. However, as already mentioned under 'Limitation on Scope of Audit', recalculation by NAO of the tax figure on the basis of these reports proved to be extremely difficult since the income reported did not reflect MGA's income definitions.

- b. Similar issues were also encountered when attempting to recalculate the taxation of €22,058,502 due by the two sampled casinos and the National Lottery operator. Testing revealed that a breakdown of these amounts was provided by said licencees in their respective monthly tax submissions. However, even though audited Financial Statements were available in the case of one casino and the National Lottery operator, the figures presented in these statements did not provide a sufficient breakdown of the revenue generated by the different games. As a result, since different taxation rates apply to the various games, the taxation figure could not be recalculated for auditing purposes.
- c. Furthermore, during testing, no evidence of any checking conducted by MGA with respect to taxation collected from licence holders was traced. MGA officials confirmed that during 2014, no procedure was in place for the checking of taxation documents submitted and related payments. Vetting from MGA's end was only being done in specific circumstances, such as upon the renewal of a licence.

Control Issues

Taxation not Paid as it Falls Due

Six Class 2 and 3 remote gaming operators selected as part of the audit sample, which incurred tax at the maximum threshold of €466,000 during 2014, did not pay taxation to MGA on the basis of their monthly revenue, but split the payments equally over the year. In fact, whilst one operator paid tax

³ One licence holder, which owed MGA €260,757 did not submit any tax reports during 2014. A separate licence was non-operational during the year under review.

in four equal quarterly instalments of €116,500, the remaining five operators paid tax at the monthly rate of €38,833.

As mentioned earlier, the Remote Gaming Regulations stipulate that the tax due from each licensee shall be paid monthly by not later than the twentieth day of the following month. Therefore, gaming operators who earn enough income for the maximum threshold to be reached, even if this occurs during the first few months of the year, should pay this tax amount immediately as it becomes due. By not doing so, they would be deferring their tax liability.

MGA officials confirmed that such payments in instalments are being accepted by the Authority. However, in those cases where a request for the termination of a licence is made, MGA confirmed that it does not terminate the licence unless all the dues, including taxation, are settled in full. In these instances, the licence fee and/or any taxes keep accruing until full payment is made.

No Procedure to Address Shortfalls in Player Liability Reports

Testing also revealed that in the case of three licences held by one particular operator, the resulting PLRs reported a shortfall. In fact, shortfalls were reported in all 2014 monthly PLRs. This implies that the players' balances were not covered by the funds in the respective bank accounts held by the licensee.

Moreover, it transpired that no procedures were in place during 2014 to address such PLR shortfalls.

Recommendations

Key Issues

Non-submission and Lack of Verification of Monthly Reports

NAO recommends that internal controls in relation to both PLRs and tax reports are introduced immediately. Particularly, the submission of the latter should be required by regulations, and a procedure put in place to assess these submissions.

Furthermore, MGA should consider requesting an independent auditor's report in relation to taxation due from licenced gaming operators. This report could then be used as a tool to ascertain whether the taxation received is correct.

Control Issues

Taxation not Paid as it Falls Due

It is recommended that MGA closely monitors gaming operators holding either a Class 2 or 3 licence to ensure that their taxation is paid in line with the revenue they earn, in accordance with regulations and within the established timeframes.

No Procedure to Address Shortfalls in Player Liability Reports

The Authority is to ensure that shortfalls are closely monitored, and that necessary action is taken in a timely manner.

Management Comments

In its reply, Management confirmed the Authority's commitment to ensure that its operations are supported by appropriate control processes. Management stated that it took note of the observations and implemented a significant number of the recommendations put forward by NAO. To this effect, MGA has engaged its internal auditor to follow up on the implementation of the new processes and internal controls to make sure that noted risks in this report are properly mitigated. The following additional comments were also made:

Non-submission and Lack of Verification of Monthly Reports

Player Liability Reporting

In October 2015, MGA employed two financial compliance officers within the Compliance Directorate, whose roles and responsibilities include receiving and analysing the newly introduced monthly player liability returns. These officers will also ensure that the non-submission of these returns is reported to the Enforcement

Directorate and that any fund shortfalls are immediately investigated. Due to these actions, MGA can already report a significant increase in submissions.

Tax Reporting

During September and October 2015, MGA has set up a Revenue Assurance Unit, which has developed a risk assessment process to regularly categorise licencees' tax leakage risk as low, medium or high. High risk licencees will be subject to a financial compliance review.

Furthermore, MGA has been working on developing new formal regulatory accounting returns, together with a legal obligation for licenced operators to:

- a. fill and submit a regulatory accounting return provided by MGA instead of submitting six-monthly Management Accounts; and
- b. submit an annual regulatory accounting return together with a set of audited Financial Statements, as well as an audited reconciliation between the two.

Through these submissions, the Revenue Assurance Unit would be able to analyse financial information solely related to Maltese licences and be able to independently compare declared gaming taxes to audited Financial Statements. It is envisaged that this requirement will be introduced in the upcoming legislative overhaul.

Taxation not Paid as it Falls Due

This instalment procedure has been in place for a number of years and MGA will be evaluating the impact of making any changes in the tax collection methodology.

Although MGA acknowledges that in this case it is not following the letter of the regulations, it opines that this presents a very low financial risk, since large operators have always paid their instalments in a timely manner.

No Procedure to Address Shortfalls in Player Liability Reports

MGA confirmed that operators which fail to address a shortfall in players' funds will be passed on to the Enforcement Directorate for necessary action. Furthermore, the current process also includes monitoring of transactions with a view to identifying possible suspicious transactions in client bank accounts, as well as the preparation of regular exception reports for further investigation.





Ministry for the Family and
Social Solidarity

Ministry for the Family and Social Solidarity

Non-Contributory Benefits

Background

The Department of Social Security (DSS) within the Ministry for the Family and Social Solidarity is responsible for the implementation, monitoring and control of the provisions of the Social Security Act, 1987 (Cap. 318) (SSA). DSS aims to actively promote, facilitate and contribute to the ongoing development of an inclusive society, by fighting social exclusion and ensuring equal opportunities for all, with specific emphasis on the most vulnerable members of society.

In Malta, social benefits are classified into the contributory and non-contributory schemes. Whilst contributory benefits depend on the amount of National Insurance contributions made during one's lifetime, non-contributory benefits are paid to eligible persons on the basis of a means test, as well as other provisions in the relevant legislation. This audit focused solely on benefits falling under the non-contributory scheme.

All non-contributory benefits, except for Leprosy and Tuberculosis Assistance, are subject to a financial means test, which is carried out on the entire household. Such benefits are then paid given that the income of the household falls below a certain level. The means test¹ is regulated according to the Second Schedule of SSA, and has two basic components: the Capital Resources Test and the Income Test. Further details will follow in the 'Audit Scope and Methodology' Section.

The main non-contributory benefits, assistances and pensions which are subject to a means test, include Social Assistance (SA), age pension, pension for persons with special needs, carer's pension and children's allowance, amongst others.

The Financial Estimates for Vote 27 – Social Security Benefits show that a total of €174,260,000 (excluding bonuses) was originally estimated to be paid as non-contributory benefits for the year under review. The actual amount of non-contributory benefits paid to beneficiaries during 2014 totalled €183,200,745. Interesting to note that Unemployment Assistance (UA), as opposed to SA and Single Unmarried Parent (SUP) benefits, is paid in arrears, a measure aimed at further reducing advance payments of potential undue benefits.

Audit Scope and Methodology

The main scope of the audit was to determine the level of existing internal controls over the payment of certain selected non-contributory benefits, with particular reference to SA. The audit also aimed to ascertain that such contributions to beneficiaries were made in an accurate, correct and timely manner in accordance with the provisions laid out in SSA.

The systems and procedures in place in relation to SA benefits were documented, and areas of concern and other risks within the current infrastructure,

¹ Such means testing has been modified over the years so as to provide for new exigencies, which from time to time become evident in a dynamic society.

were identified. Following a systems overview, detailed substantive testing was also carried out to verify compliance with existing procedures, as well as their effectiveness.

The National Audit Office (NAO) obtained the full list of individuals benefiting from assistance under the contributory and non-contributory schemes during 2014. From this list, NAO extracted the data in relation to SA, totalling €80,204,186, as presented in *Table 1* below.

SA is payable to heads of household who are unemployed or unable to seek employment either because they have to take care of their dependent children or because of medical reasons, given that their capital and income satisfy the means test. *Table 1* shows that during 2014, the bulk of the payments were given to beneficiaries of SA, SUP and UA. Therefore, the sample of beneficiaries taken for testing purposes was selected from these categories.

The total of individuals within these categories were the holders of Identity Cards with various suffixes. However, the vast majority were of Maltese or Gozitan origin bearing suffixes 'M' and 'G' respectively. These diverse suffixes were also taken into consideration when selecting the sample for testing purposes. Further analysis is illustrated in *Chart 1* overleaf.

A sample of 44 individuals, who were paid a total of €391,878 during 2014 was selected, and the relevant documentation analysed to assess whether the procedures surrounding the application and payment were being correctly followed.

From the sample selected, a total of €89,099 were paid³ to 32 beneficiaries during the year under review in the form of arrears due by the Department. This amount represents 23% of the total sum paid to claimants selected for testing purposes. Further analysis showed that in four cases, arrears totalling €26,804, representing 31% of total arrears paid during 2014, were the result of an Umpire decision in favour of the beneficiary. The remaining €62,295 were paid to various beneficiaries following a change in circumstances or a file re-assessment⁴.

NAO also assessed whether the Capital Resources Test thresholds of €14,000 for single persons and €23,300 for a household of two or more persons, have been correctly considered at the assessment stage for all sampled beneficiaries. The Income Test, which takes into consideration all income of the head of household and his/her partner, was also considered during NAO testing.

Table 1: Social Assistance

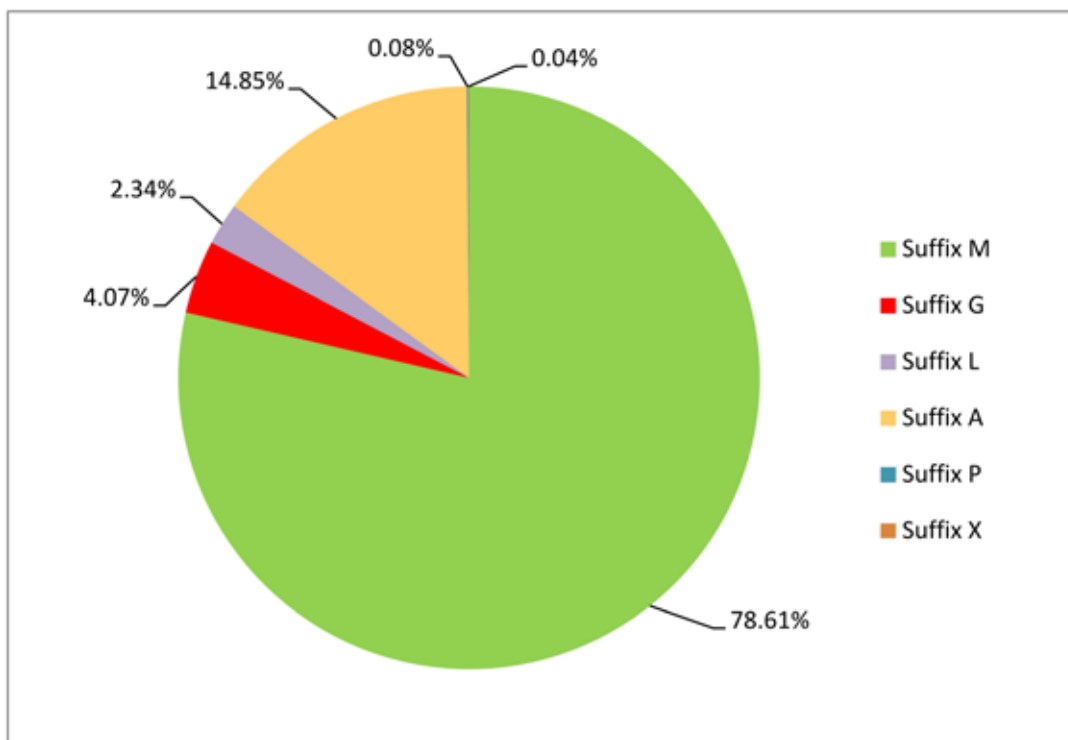
Social Assistance Benefit	Amount paid during 2014	Number of Beneficiaries
	€	
Social Assistance	39,589,588	10,023
Social Assistance (Carer)	1,188,743	358
Single Unmarried Parent	15,065,387	3,585
Unemployment Assistance	22,768,421	5,939
Social Assistance (Board)	29,289	23
Drug Addiction	24,138	63
Subsidiary Unemployment Assistance	564,689	1,404
Unemployment Assistance (Tapering)	973,931	588
Totals	80,204,186	21,983²

² Individuals who benefited from more than one type of SA during 2014 are shown more than once in the total of 21,983 beneficiaries. Exclusive beneficiaries totalled 19,452.

³ Any reference to the payment of non-contributory benefits excludes payments of children's allowance.

⁴ A file re-assessment is triggered in two different scenarios, either the Department makes a re-assessment prior to an investigation, or after a beneficiary informs the Department with a change in circumstance that has an impact on the total benefit receivable.

Chart 1: Identity Card Analysis⁵



NAO also obtained the Taxpayer Profile (TP) issued by the Tax Compliance Unit within the Inland Revenue Department, for each of the beneficiaries selected. This document includes details of the beneficiary’s business involvements, property transfers and vehicle(s) ownership, which were also taken into consideration during testing.

Additionally, information from the Social Assistance and Benefits System (SABS) was extracted in relation to all the payments made to the selected beneficiaries during the year under review. NAO also tested the accuracy and correctness of such payments, including any arrears paid to beneficiaries.

Some of the cases tested also underwent prior investigation by the Benefit Fraud and Investigations Department (BFID), which reports directly to the Permanent Secretary. In such instances, NAO reviewed the investigation report compiled by BFID and followed up on the ensuing action, if any, taken by DSS.

Limitation on Scope of Audit

During the course of the audit, NAO assessed the beneficiaries’ TP and noted that, with respect to ownership of vehicles, this profile is in most cases either incomplete or not duly updated. In fact, vehicles are often listed without a corresponding value, and are sometimes also shown even when such vehicles are no longer in the owner’s possession.

As a result, NAO was not always in a position to ascertain the claimants’ ownership of vehicles and the corresponding effect on the benefits payable.

It was evident that TP was not being updated regularly with changes in ownership of vehicles as registered with Transport Malta. This resulted in incomplete information available for DSS to be able to adequately assess the beneficiaries in question.

⁵ **Suffix M** – Maltese nationals born pre-2000; **Suffix G** – Gozitan nationals born pre-2000; **Suffix L** – Individuals registered in Malta post-2000; **Suffix A** – Individuals having Maltese residence and not nationality; **Suffix P** – Individuals residing in Malta with a provisional identification; **Suffix X** – Individuals with no formal identification.

Key Issues

Lack of Sufficient Verification during the Application and Evaluation Processes

Whenever an individual requests financial assistance from DSS, an application form is to be filled and submitted to the Department for assessment. The applicant is bound to declare all the relevant details at application stage, including details of members within the same household, bank account details, property and vehicle ownership, and inform the Department of any changes thereafter. At the evaluation stage, the assessor will determine whether the applicant is eligible for assistance, based on the given declaration. However, when the information required is not fully available, the assessor may request further details from the applicant.

NAO noted that the declaration by the applicant is taken as given, and at this stage, no further assessment is made by the Department to ascertain that the information is complete and reflects the actual claimant's position/status. In fact, during the year under review, no formal procedure was in place requiring third party confirmation to be obtained at the evaluation stage in order to corroborate the declaration given by the applicant. Although the facility to retrieve bank⁶ and employment details directly from SABS exists, in most of the cases tested, no evidence was traced in the respective files showing that such information was extracted for verification of claims submitted by claimants.

Furthermore, it was also noted that requesting TP upon evaluation was not the current practice during 2014. In fact, NAO testing revealed that TP was being consulted only in cases where there was a substantial change in circumstances, or in situations warranting further investigation. In such cases, benefits were already being paid to individuals before such assessment was conducted.

As part of the testing carried out to verify the correctness and completeness of the applicants' declarations, NAO assessed TP for all the beneficiaries selected. The following issues were noted:

- a. NAO noted that in the last application filed by a particular beneficiary for SA, she only declared that she received financial assistance for her nine children every four weeks and was paying rent every month. During 2014, the claimant received total non-contributory SA payments of €8,845.

Upon investigation of TP, NAO noted that the claimant failed to disclose three transfers of property to third parties, totalling €58,234. TP also showed that the beneficiary was involved in two transactions as a buyer, for a total value of €43,093.

Following a number of anonymous reports, BFID conducted an investigation of the claimant's situation and belongings in February 2015. In addition to the details that emerged from the claimant's TP, as listed above, it was also revealed that the residence she was living in was not being rented. Furthermore, it transpired that the claimant was registered as a farmer from 2006 to 2013 and that during this period, she owned a considerable amount of livestock. Upon enquiry with DSS, NAO was informed that the case was currently being assessed by the Department. However, payments to the beneficiary had not been stopped as at the date of writing of this Report, *i.e.* July 2015.

- b. A number of transactions were traced in a separate claimant's TP in relation to purchase of property and donations. It transpired that the beneficiary failed to disclose three acquisitions from third parties, amounting to €31,664.

The claimant also received another property as a donation for the value of €93,175. Furthermore, it transpired that the claimant's wife had also sold a property for €10,482.

None of this information was declared by the claimant as per application dated 2012 and no changes in circumstances were declared thereafter. Meanwhile, during 2014, the claimant received payments from MFSS

⁶ Beneficiaries' bank account details are uploaded monthly directly from the respective bank institutions in line with Article 133 of SSA. Such information can be accessed through SABS for re-assessment of benefits and further investigations warranted.

amounting to €8,201. Following NAO's testing, DSS stopped the claimant's benefit payments whilst investigating further.

- c. In the case of a separate beneficiary, NAO noticed that a garage was listed in TP as a donation in 2005 for the value of €27,952. However, as per latest application filed with DSS in 2009, the claimant failed to declare this property. No changes in circumstances were declared thereafter. At the time of writing of this Report, DSS stated that this case was to be investigated accordingly.
- d. A review of another claimant's file and TP showed that he was in possession of a field with an estimated value of €8,000, which was donated to him in early 2012. In his latest application dated 2014, the claimant did not declare such information, and no adjustment to his UA was being done in this respect, even though the relative deed had already been presented upon the Department's request in 2013. Up till May 2015, the claimant was still receiving UA.
- e. Audit testing revealed that a separate claimant owned two vehicles, as listed in TP for the year ended 2014, which amounted to €10,136. However, none of these were disclosed with the Department, neither in the latest application filed with DSS in December 2011, nor subsequently.

Payment of Arrears in Excess

NAO noted that a beneficiary first applied for SA in 1996, and she was provided this assistance at 75% of the applicable rate at the time. The applicant gave birth to a child in December 1996 and requested an increase in SA in January 1997. However, a departmental review of the claimant's personal file revealed that no provision was made for the further €8.15 payable with respect to the additional dependant.

The Department also failed to topup the claimant's percentage rate of SA from 75 to 100, as is required when a separated person with a child is forming his/her own household. Eventually, during 2012, DSS decided to pay the difference in SA due to the claimant since December 1996. A total of €21,658 was paid to the beneficiary as arrears in two instalments, one in 2013 and another eight months after.

Payment of Arrears

Following NAO testing, it transpired that the beneficiary was employed for considerable periods of time during the years 2000 to 2006, whilst still in receipt of SA. The claimant did not inform the Department of such employment and no changes were made to her SA rate at the time.

In fact, back in April 2013, the Department requested the claimant to submit the Employment and Training Corporation (ETC) employment history together with all documentation in relation to her employment.

Despite the availability of this documentation, the Department failed to take into consideration the earnings from such employment when calculating the benefits in arrears due to the claimant since 1996. As a result, the claimant was paid arrears for a number of periods during which she was working and earning a weekly wage that was higher than the allowable threshold. NAO calculations show that the claimant was paid a total of €14,002 in excess.

Recoupment of Amount Paid in Excess

The way forward in relation to this case was discussed with DSS officials during the course of the audit, with the latter agreeing that corrective action should be taken in this regard. In fact, DSS established that the balance to be recouped totalled €6,857, representing the 25% top-up with respect to SA paid to the claimant in 2013 and 2014 in the form of arrears. This related to those periods when the claimant was working and exceeded the permissible threshold.

⁷ In line with Article 30(7) of SSA, beneficiaries are allowed to carry out additional employment whilst in receipt of the full SA rate, so long as the sum of their weekly earnings and the weekly SA rate for the beneficiary and one dependant, do not exceed the National Minimum Wage (NMW). Should this limit be exceeded, SA payable to the claimant would be reduced by the amount earned in excess of the said threshold.

The Department's decision not to recover the full amount overpaid was based on Article 102(1) (ii) of SSA, which states that in the case of an overpayment which is not the result of the non-disclosure or misrepresentation of a material fact, "... the Director shall have no right to effect any ... deductions ... in respect of overpayments which have been made prior to the period of two years going back from the date when the Director became aware of such overpayment irrespective of the period to which the overpayment refers ...". Thus, according to this provision, DSS is not entitled to recoup the remaining amount of €7,144.

Transfer of Property not considered for Means Testing

NAO noted that a claimant, who was reviewed for testing purposes, first registered under Part I of ETC Register in December 1987. Since then, the claimant was working intermittently, however, he started registering again in 2013 and received UA throughout 2014.

During 2014, the beneficiary sold his house of residence for €155,000, and acquired a separate property for €115,000, turning a face-value profit of €40,000 from these transactions.

In his application for UA, the claimant declared this transaction, together with a bank balance of €19,753. However, the Department did not consider the claimant's remaining funds from the sale of his property.

Following NAO's review of the receipts presented by the claimant in relation to 2014 and 2015, it transpired that the claimant was not eligible for UA up to the end of 2014. To this effect, the beneficiary received the sum of €804 in UA during the period November 2014 to January 2015, for which he was not entitled.

UA payments were interrupted on 25 April 2015 following NAO testing and communication with the Department.

Control Issues

Change in Circumstances not reported to Department

- a. NAO noted that a particular claimant first applied for SUP in 2004. However, following an investigation by BFID, the benefit payable to the claimant was stopped in 2007 on the basis that she was working. In spite of the claimant's appeal to this decision, the Umpire re-confirmed the Ministry's decision.

The claimant re-applied for SUP in 2008, where she stated that she was going to be working on a part-time basis. No changes were reported to the Department between 2008 and 2013.

From a review of the claimant's file, it transpired that during 2014, MFSS requested copies of the relevant Payee Statements of Earnings (FS3s) for the period 2009 to 2013, together with any other documentation showing the income earned in 2014.

The submitted tax returns showed that during the period 2009 to 2014, the claimant was earning less than she had originally declared she would be earning from her part-time employment. As a result, arrears totalling €9,150 were paid to the claimant in 2014. This amount represented the difference in SA due to the beneficiary after calculating the extent by which she exceeded the allowable NMW thresholds⁸.

NAO is of the opinion that since the claimant did not come forward to declare these changes in earnings as they occurred, arrears should not have been paid since 2009.

⁸ Refer to Footnote 7.

- b. A beneficiary started registering for UA under Part I of ETC Register in 1999. In 2011, the claimant presented medical certificates stating that he was unfit to work. However, as of May 2011, the claimant was still registering with ETC and receiving UA.

Testing revealed that the claimant's spouse had been employed since September 2013. However, this was not declared by the claimant, and was therefore not being reflected in his personal file. As a result, no deductions from benefits paid to the applicant were being made in this respect, and he received total benefits from MFSS of €8,189 during 2014. The case warranted further investigation after audit testing was concluded, and NAO noted that benefits to the applicant were stopped as from 25 April 2015.

Errors in Calculation of Social Assistance

Miscalculation of Unemployment Assistance Rate

The Community Work Scheme is a Government measure that aims to provide the long-term unemployed the opportunity to undertake community work on a 30-hour week basis, for a period of not less than six months, which can be renewed. The participating jobseekers will have their unemployment benefit raised to 75% of the stipulated NMW.

The audit revealed that, from the sample selected for testing, the UA rate due to eight beneficiaries participating in the Community Work Scheme during 2014, was miscalculated to the detriment of the beneficiaries. In fact, NAO noted that DSS did not award the equivalent of 75% of the stipulated NMW for the year under review.

Payment of Benefits in Excess

During NAO testing it was noted that payments to four beneficiaries, amounting in total to €1,251, were paid in excess. Following communication with DSS, corrective action has been taken in three cases, where overpayment is being recouped by the respective beneficiaries at a rate of 5% to 10% of SA amount. Up to the date of writing of

this Report, DSS was still investigating the fourth case.

Non-deduction of Benefits

A beneficiary who was assessed for testing purposes, first applied for SUP in 2000. Up to the date of testing, the claimant had seven children, all of whom were listed as 'unknown father' and she was therefore not seeking financial assistance for any of them. During the period under review, social benefits amounting to €8,257 were being paid in full.

Following a review of the relevant file, it transpired that although the claimant declared who the father of one of her children was, in May 2011, the Department decided that since the child's father was declared as unknown on the birth certificate, the claimant should not press for financial assistance and assistance should be given in full.

NAO however feels that this treatment was not in line with a similar case which was encountered during the audit. In fact, in this case, the claimant knew who her child's father was but still declared him as unknown on the respective birth certificate. The Department deducted the weekly rate with respect to this child, on the grounds that the claimant intentionally precluded herself from seeking any financial assistance.

Compliance Issues

Incorrect Rate of Recovery

Article 102 of SSA provides that any person who has received a benefit from the Department to which he was not entitled, is liable to pay back the sum received by him. To this effect, Article 102(1)(i), states that "... where such overpayment occurs as a result of the non-disclosure or misrepresentation of a material fact (whether the non-disclosure or misrepresentation was or was not fraudulent) the rate of recovery by means of deductions from any benefit, pension, allowance or assistance to which he thereafter becomes entitled shall be determined by the Director but shall in no case be less than the equivalent of 10% of the rate of benefit, pension, allowance or assistance to which he thereafter becomes entitled ...".

NAO noted that in a particular case tested, the rate of recovery in relation to an overpayment of €12,479 was set at 5%. From the respective file, it transpired that the claimant requested that the rate of recovery be reduced from 30% to “... *the lowest rate possible* ...” in spite of the fact that the overpayment was created after the claimant failed to inform the Department of a change in her circumstances, which made her ineligible to receive SA. In fact, the repayment rate was set at 5%, being below the established threshold as set out in Article 102 of SSA.

It was satisfactorily noted that corrective action has already been taken in this case, and the recovery rate has been increased to 10%.

Recommendations

Key Issues

Lack of Sufficient Verification during the Application and Evaluation Processes

NAO recommends that DSS formalises the procedure surrounding the filing of applications, as well as their assessment, to ensure that the Department is adopting a uniform approach in relation to all applications received.

It is important that officers within DSS obtain corroborative evidence to sustain the declarations made by the applicant. This may include, but should not be limited to, the applicant’s TP together with other legal and financial documentation.

Any assessments carried out should also be properly documented in the respective file to ensure that an audit trail is available for future assessments and reviews.

Payment of Arrears in Excess

It is recommended that a periodical review of all personal files is carried out to ensure that any errors are detected as early as possible and corrective action is taken in a timely manner. Moreover, before issuing arrears of benefits, it is imperative that the relative calculations and supporting documentation are thoroughly checked before effecting payment.

Transfer of Property not considered for Means Testing

NAO recommends that the Department gathers all the necessary information and documentation to assess the case concerned. Moreover, the means testing should be reviewed periodically, to assess whether the claimant is still eligible to receive such assistance.

Control Issues

Change in Circumstances not reported to Department

- a. The Department should consider being more cautious when it comes to payments of arrears for a number of years. Notwithstanding the social implications of every case, NAO recommends that the principles of Article 102(1)(ii) of SSA are applied.

In the spirit of the provisions of this Article, in cases where the claimant has failed to inform the Department in a timely manner of a change in circumstances which will result in arrears, the Department should consider only paying back arrears up to the last two years. This would ensure good governance and safeguarding of public funds. Therefore in the first case discussed in this observation, NAO recommends that DSS should recoup part of the arrears forwarded to the beneficiary.

- b. NAO also recommends that the Ministry enhances its operational system by amalgamating its data with real-time information released from ETC and other Government Entities, so as to ensure that all data pertaining to a particular beneficiary is gathered and analysed before any benefits are paid out by DSS.

Periodic reviews of claimants could minimise the possibility of overpayments and ensure that benefits are distributed to those most needing them.

Errors in Calculation of Social Assistance

It is recommended that DSS recalculates the rates of assistance due to all those individuals participating in the Community Work Scheme. Furthermore, the Department is to exercise caution when affecting one-off payments to reduce the possibility of error to a minimum.

Non-deduction of Benefits

In cases where beneficiaries are claiming that their child is registered as ‘unknown father’ but there is evidence to the contrary, NAO recommends that the Department takes a standard approach, such that similar cases are treated in the same manner.

Compliance Issues

Incorrect Rate of Recovery

NAO recommends that, as far as possible, recovery rates are not lowered further than the threshold established by SSA, to ensure that amounts due to the Department are fully recouped within a reasonable timeframe.

Management Comments

In its reply, Management agreed with most of the observations and recommendations put forward by NAO. Particularly, it commented that training within the Department is being offered on an ongoing basis to enhance the officers’ knowledge of the Department’s policies and practices.

The following comments were also forwarded:

Lack of Sufficient Verification during the Application and Evaluation Processes

The Department is holding regular meetings with the Management Efficiency Unit within the Office of the Prime Minister, so as to arrive to the best possible framework to establish the Business

Intelligence Unit, which would further tap cases of fraud by conducting thorough assessments at an early application stage. Moreover, preparations are underway with the Malta Information Technology Agency (MITA) so as to set up an online application framework, which will lead to uniformity during the application process. These initiatives are in addition to courses being attended by DSS staff at the Tax Compliance Unit.

Change in Circumstances not reported to Department

Management disagreed with NAO’s recommendations with regards to the individual benefitting from SUP, as mentioned in paragraph (a) of this observation. The Department maintains that in this case, it applied good governance when paying arrears for the period in question.

Furthermore, Management commented that NAO’s recommendation to enhance the Department’s operational system in terms of amalgamating data with real-time information, has already been embarked upon. Meanwhile, meetings with MITA in relation to the Tapering of Benefits entitlement upon termination of employment, are also ongoing.

Non-deduction of Benefits

The Department is currently reviewing such cases, *i.e.* whereby the child’s father is declared as ‘unknown’, whilst during an investigation, the mother states who the father is. This might involve seeking legal advice from the Office of the Attorney General.

Foundation for Social Welfare Services – *Aġenzija Sedqa*

Background

Aġenzija Sedqa is incorporated within the spectrum of the Foundation for Social Welfare Services (FSWS) together with *Aġenzija Appoġġ* and *Aġenzija Sapport*. It is a government agency that works in the field of drug and alcohol abuse and compulsive gambling. *Sedqa* provides service in health promotion, prevention treatment and rehabilitation to persons and their families with drug and/or alcohol problems and other dependencies.

The approved financial estimate for the year 2014, under Item 6645 – *Seqda*, in Recurrent Vote 39 – Ministry for the Family and Social Solidarity (MFSS), amounted to €3,000,000. *Sedqa*'s Annual Report and Financial Statements 2014 reported the year's recurrent expenditure at €3,083,541.

Audit Scope and Methodology

The main objective of the audit was to ascertain that adequate level of internal controls, over the procurement and payment of selected line items, were in place during the financial year under review. This exercise also aimed to ascertain the efficient administration of public funds in line with existing regulations, policies and procedures, and internal policies. Targeted accounts consisted mainly of Contractees, Legal services, Cleaning services, Conferences and Fuel. A sample of 26 transactions, amounting to €26,498, was selected,

based on materiality and frequency of expenditure. A sample of five transactions of income, totalling €7,925, was also tested.

During the year under review, *Sedqa* was making use of six vehicles for general purposes. Testing of all the respective logbooks and verifications with relative sections of the Public Service Management Code (PSMC) were carried out on all six vehicles.

It was also ensured that personal emoluments for 2014 were appropriately recorded and processed according to the PSMC, other pertinent circulars as well as Collective Agreements in place. The adequacy of internal controls, intended to ensure accuracy and validity of salary payments, was also determined.

Sixteen employees were selected for testing. Testing focused on ensuring the accuracy of salaries paid to the sampled employees, as well as the officers' entitlement to allowances and overtime payments. Out of the 16 employees, eight officers made use of time off *in lieu* (TOIL). It was ascertained that TOIL was calculated correctly, appropriately endorsed and that prior year balances were correctly carried forward.

In the case of Nurses and Care Workers working on a public/national holiday (PH), it was ensured that every officer was correctly remunerated according to the respective rate and that they were on duty, as *per* clockings recorded on the attendance sheets.

Key Issues

No evidence of a Definite Approval for a Direct Order

On 29 November 2014, FSWS held an event in order to commemorate the 20th anniversary of the foundation of *Aġenzija Appoġġ* and *Aġenzija Sedqa*. Various expenses were incurred, including that of catering services at a cost of €18,900.

Approval for a Direct Order was obtained in a timely manner, however it was only granted ‘in principle’ and FSWS had to revert to the Ministry for Finance (MFIN) for a definite approval prior to any commitments being made, once the service providers and actual costs for the provision of catering services were known.

Such definite approval was not made available for review and instead the same ‘in principle’ approval was presented to the National Audit Office (NAO), verbally insisting that this was sufficient. This may imply that the actual costs incurred were not properly authorised.

Fabricated and amended Documents following NAO Queries

During audit testing, various queries in respect of salaries arose; consequently, these were thus forwarded to *Sedqa* for clarification. On five such instances, NAO was provided with either a fabricated or amended document. In two such instances, documents forwarded following NAO query were different to the ones already in NAO’s possession.

After the first instance, NAO requested *Sedqa*’s views on the matter and as *per* correspondence dated 25 August 2015, Management stated that “... *this was an isolated and unfortunate one which was done with absolutely no malicious intent but only was meant to replace a requested document which went somehow missing.*”

Control Issues

Shortcomings in relation to General-use Vehicles

Audit testing revealed lack of control over general-use vehicles. Whilst reviewing whether the logbooks pertaining to the six general-use cars selected were adequately kept, in accordance with PSMC requirements, the following shortcomings were noted:

- a. During the year under review, *Sedqa* was making use of a hired vehicle for general-use by one of the Units within the Agency.

Up to time of audit, the contract agreement entered into with this supplier was not made available for verification. Hence, it could not be ascertained whether a valid agreement was in place and whether chargeable rates were correct or not.

- b. The logbooks of two vehicles were not always adequately compiled. Typical missing information consisted of date of trip, destination, milometer readings, purpose of journey, as well as name and signature of officer performing the trip.

Moreover, in the case of other logbooks of one of these vehicles, there were not enough logbook sheets in order to compile the details of the trips being performed. Officers recorded such details, wherever they found space on the logbook. Additionally, trips performed on other dates were not duly recorded on the respective logbook sheets, but written down on pieces of papers. This resulted in trips not being consecutive, as well as lack of important details.

- c. Out of the six logbooks verified, four of them, did not always contain proper milometer readings, such that the milometer reading at the start of the journey did not always tally with that of the preceding

journey. This denotes details of trips being completely omitted.

Moreover, while verifying two of these logbooks it was noted that journeys performed on certain periods were not traced, consequently having unrecorded milometer readings. Furthermore, journeys carried out on other dates were not made available for review.

- d. Four logbooks did not contain any evidence confirming that these were being inspected periodically by a responsible officer, to monitor fuel consumption and to ensure that any irregular use of cars is duly reported.

In the case of other logbooks pertaining to two vehicles, certification was not always adequately compiled, whereby the date was sometimes lacking.

- e. The logbooks pertaining to all the six vehicles, lacked certain important information when refuelling. Even though there was an indication when fuel was purchased, other information, such as the requisition number and amount of litres taken was lacking.

Timesheet lacking Endorsement in respect of Nursing Service

Testing carried out during the audit focused on one invoice amounting to €1,458, relating to an agreement entered into between FSWS and a private company, for the provision of nursing services on a 'when required basis'. The payment was in respect of 90 hours nursing service carried out at one of *Sedqa*'s Units during October 2014.

Attached to the documents was the respective timesheet indicating the date, time, as well as particulars of the nursing officer on duty. However, the timesheet lacked the necessary certification, as stipulated in the contract agreement. This may imply that no checking was carried out in order to ascertain that hours performed were correct and that the service was rendered to full satisfaction.

Shortcomings related to Fuel Reimbursement

Two claim sheets relating to reimbursements of fuel expenses, having a total of €58, were not endorsed by the respective Manager or Unit Leader. Additionally, two payments, totalling €176 were erroneously reimbursed as fuel expenses.

Upon verifying the payroll transactions of a Care Worker, it transpired that three fuel claim sheets lacked the certification/rubber stamp indicating that these were verified by *Sedqa* Administration, before officer was reimbursed in respect of fuel for using his own transport during office hours.

Manual Attendance System still in place

Aġenzija Sedqa uses a system of attendance sheets, which are filled-in manually by each officer, to log hours worked.

Throughout the audit, NAO encountered various discrepancies and weaknesses related to the upkeep of the manual attendance system, which are outlined further on in this Report. Manual records do not give concrete evidence of an employee's attendance hours on the job. The risk of both intentional and accidental incorrect records is further increased since most of *Sedqa* employees work on different work schedules.

Therefore, NAO verbally suggested the use of an Attendance Verification System (AVS). However, FSWS claimed that the costs to install a proper centralised AVS are relatively high due to the number of different Units which are spread in various locations, and which need to be integrated in one system.

Lack of Certification of Attendance Sheets

All the attendance sheets pertaining to an Enrolled Nurse were endorsed by himself, instead of a superior officer. On the other hand, none of the attendance sheets pertaining to a Charge Nurse was certified, except for one which was signed by himself.

Other instances were encountered whereby some of the attendance sheets of a Nurse and three Care Workers were not duly endorsed by the respective Unit Leader.

Weaknesses related to Time Off In Lieu

Entitlement of Time Off In Lieu exceeded

From the sample tested, it was noted that during 2014, a Care Worker and an Enrolled Nurse utilised more hours than their available balance. This led to both officers exceeding their yearly entitlement by an aggregate balance of approximately 90 hours.

Other Discrepancies related to Time Off In Lieu claimed

- a. Two officers, one in the grade of a State Registered Nurse and another as Enrolled Nurse, had various discrepancies between hours worked according to clockings as *per* attendance sheets, against TOIL claimed. Such difference mainly related to break time which was not deducted accordingly.
- b. Moreover, with respect to the same State Registered Nurse, there was an inconsistency when TOIL was calculated in respect of a particular shift. NAO was informed that when an officer is on this type of shift, the morning shift is taken as 5.5 hours. However, upon verifying the officer's TOIL, it was noted that the calculation of this shift was sometimes taken as six hours, and at other times as seven.

Shortcomings related to Vacation Leave

Entitlement of Extra Vacation Leave Hours not supported by Source Document

Six Care Workers, were each entitled to 203 hours as annual vacation leave (VL). NAO enquired *Sedqa*, why these officers were being granted 11 hours in addition to the 192 hours as stipulated in their respective Collective Agreement 2012–2016.

Nonetheless, no source document was made available in order to substantiate the additional leave hours granted. The only explanation

forwarded was, that this practice had originated a number of years ago, and has been the same since.

Lack of Authorisation of Vacation Leave Records

- a. The annual VL entitlement forms, with respect to a Charge Nurse and an Enrolled Nurse, were not certified by their superior.
- b. In two instances, the VL of a State Registered Nurse and a Nurse was authorised once, so as to cover all the leave availed of throughout the whole year. Moreover, the date of approval was lacking with respect to the VL pertaining to the latter.
- c. Similarly, all the VL utilised during the year under review by a Care Worker, lacked the date of approval, therefore it could not be ascertained whether leave was approved prior to utilisation.

Discrepancies between Attendance Sheet Details and Vacation Leave Records

With respect to eight of the selected employees, various discrepancies were noted between the records as *per* VL entitlement form and remarks noted in the respective attendance sheet. Typical discrepancies were: hours recorded on VL entitlement form not traced to attendance sheet, amount of hours taken as VL not tallying against hours recorded on attendance sheet and cancellation of VL not recorded accordingly.

Incorrect Calculation related to Working Hours falling on a Public Holiday

Out of a sample of 16 employees, four Nurses and six Care Workers were being paid for duties carried out on a PH.

While verifying the supporting documents against the actual amounts paid as *per* payslip, various discrepancies were noted, which resulted in an overpayment of €86 in respect of differences pertaining to four officers.

Moreover, a Charge Nurse, also acting as Unit Leader, who was signing the duties performed by nurses, was automatically endorsing his own working hours.

'Break Leave Allowance' not supported by the current Collective Agreement

Six out of the seven Care Workers chosen in the audit sample, were being paid a 'break leave allowance' *per* pay. This allowance was being given as a compensation for the 45-minute break time not availed of, during their 12-hour night shift, on the basis that only one staff member is on duty.

Upon enquiring about the source document of such allowance, NAO was provided with an extract of the Collective Agreement 2001–2003. However, a similar clause does not feature in the current Collective Agreement 2012–2016.

Inadequate Control and Various Weaknesses on Overtime performed

During the year under review, nine employees out of a sample of 16, performed overtime duties. Testing revealed various weaknesses and discrepancies.

One of the main issues noted was that when employees performed their 12-hour shift as overtime, during the night and weekends, the officer concerned was being reimbursed the whole amount of hours, without deducting the 45-minute break time. This practice, used throughout the whole year 2014, is in breach of Articles 5.1 and 5.3 of Subsidiary Legislation 452.87 'Organisation of Working Time Regulations'. It entitles every worker to a rest break of not less than 15 minutes after working more than six hours at a stretch. Management confirmed that this practice was stopped after the first quarter of 2015.

Other observations include:

- a. On various instances, the calculation of overtime performed by all the seven selected Care Workers was not correct. There were cases whereby the break time was not taken into consideration, overtime was not paid and on other occasions overtime was incorrectly calculated. This resulted in six Care Workers being overpaid an aggregate of €862, while another was underpaid by €799.
- b. The overtime performed in December 2013 by a Care Worker was claimed twice during 2014, on two separate claim sheets. Both claim sheets were endorsed by the Unit Leader and this resulted in an overpayment of €71.
- c. Various claim sheets were not duly endorsed by the respective Manager or Unit Leader.
- d. On two instances, two Care Workers claimed 11.25 hours and three hours respectively as *per* claim sheets, however these were not traced to the respective attendance sheets. On the other hand, two other Care Workers, worked 17.25 hours and 16.25 hours overtime as *per* attendance sheet, but these were not traced to claim sheet, and thus not paid.
- e. During January 2014, a Care Worker claimed six hours overtime as *per* claim sheet, and clockings were duly recorded on the respective attendance sheet. However, on the same date, but on a different attendance sheet, the officer accumulated three hours TOIL. Both overtime payment and accumulation of TOIL were effected.
- f. During the year under review, a Care Worker was engaged in one of the Units, from Monday to Friday, from 6am to 2pm. After his working hours, the same officer performed overtime duties in another Unit, at a different location. Clockings with respect to this overtime were duly recorded on a separate attendance sheet, however most of this overtime started at 2pm. Therefore, no provision for travelling time was being made.
- g. During 2014, a Charge Nurse and a Nurse were being paid the maximum rate of Salary Scale 7 and 9 respectively. Paragraph 3.2.1.3 of the PSMC stipulates that officers in Salary Scale 7 and below, should be paid overtime at the maximum rate of Salary Scale 10. Nonetheless, both officers were paid an overtime rate congruent to their salary scale. Additionally, on certain instances, the break time was not taken into

consideration when overtime was being calculated. All this resulted in an aggregate overpayment of €592.

- h. With respect to overtime performed by a Charge Nurse, the hours claimed as *per* claim sheets could not be tallied against the attendance sheets, since there was no indication on the latter that the hours worked related to overtime. This shortcoming was noted on attendances sheets covering four periods.

Payment of Allowances not supported by the respective Documentation

Two officers received a ‘tutorship allowance’ during 2014. This allowance was paid upon submission of claim sheets in order to substantiate tuition performed by the said officers.

Four payments in respect of this tutorship allowance, having a total of €538, could not be justified, since the respective claim sheets were not made available for verification.

Recommendations

Key Issues

No evidence of a Definite Approval for a Direct Order

When requesting Direct Order approvals, Management is to ensure that instructions from MFIN are adequately observed, so that the actual costs to be incurred are brought to MFIN’s attention, before granting definite approval.

Fabricated and amended Documents following NAO Queries

It is invariably unacceptable to provide altered documents to NAO following queries raised during the audit. Replies should always be honest, accurate, factual and original documents should be forwarded without any type of modification or change.

Management is to ensure that officers entrusted with the upkeep of records are aware of their

responsibilities and that any type of information forwarded to third parties should be trustworthy. It is also important to maintain proper records for a sound system of internal control, as well as a reliable audit trail.

Control Issues

Shortcomings in relation to General-use Vehicles

Any supporting documentation, especially contract agreements in respect of hired vehicles, are to be appropriately maintained for future verification.

Management is recommended to refer to the PSMC, in particular section 8.2.4 to regulate the use of general-use vehicles, possibly augmented with a vehicle tracking system. These guidelines stipulate that a proper logbook should be kept for each vehicle to record the exact mileage covered and other journey details.

It is also recommended to refer to section 8.2.5 of the PSMC, which requires each logbook to be certified by the officer in charge transport at the end of each month, to ensure that the trips recorded in the logbook were made on official duty and fuel consumption is reasonable.

Moreover, full details regarding fuel intake are to be clearly recorded on every logbook as *per* Appendix 8.I of the PSMC, as a means to verify each vehicle’s fuel consumption.

Timesheet lacking Endorsement in respect of Nursing Service

Management is to ensure that any supporting documentation on which payment is based, is vetted for correctness and properly certified, before being processed for payment, more so if specified on the contract itself.

Shortcomings related to Fuel Reimbursement

Every effort is to be made to ensure that claim sheets are duly endorsed, verified and tallied prior to effecting payment, in order to avoid any discrepancies.

Manual Attendance System still in place

Even though it is understood that the installation of an AVS in all the *Sedqa* Units concerned will be costly, Management is still encouraged to review its current attendance record system and adopt an electronic system which best suits its needs.

An electronic system will not eliminate all risks, but will drastically reduce errors which are more prone to arise from the manual system. Moreover, in addition to providing reliable and accurate records, such system may also result in better perception of transparency and fairness for all employees.

Lack of Certification of Attendance Sheets

For control purposes, all attendance sheets are to be supervised on a daily basis by the respective Unit Leader/Manager and certified by same. Under no circumstance whatsoever should officers certify their own attendance sheets.

It is also important that Management acknowledges the fact that when endorsing attendance records, it is assuming responsibility that these are correct in every detail.

Weaknesses related to Time Off *In Lieu*

Controls over recording of TOIL is expected to be strengthened to ensure that records are appropriately updated. Moreover, no authority is to be granted to officers to avail of TOIL, if the latter have not accumulated sufficient hours to cover their request.

Shortcomings related to Vacation Leave

If the extra hours given to Care Workers are considered justified, FSWS is recommended to draw up guidelines or else incorporate a provision in the forthcoming Collective Agreement, stipulating the eligibility of such entitlement.

It is recommended that for control purposes, all VL is properly authorised by the respective superior, by noting the date of such approval. Moreover, VL is to be authorised ideally prior to utilisation.

Regular reconciliations, of attendance sheets against VL entitlement forms, are to be performed by the officer in charge on a regular basis, to ensure that any divergences are tackled in a timely manner.

Incorrect Calculation related to Working Hours falling on a Public Holiday

More attention and adequate verification should be carried out on a regular basis, between attendance sheets and the related records, to ensure they all portray the same correct details. This enables any variations to be tackled in a timely manner prior to payment.

Moreover, as far as possible, segregation of duties is to be established, so as to include independent checking of records.

'Break Leave Allowance' not supported by the current Collective Agreement

If the allowance in question is considered justified, FSWS is to coordinate with the Union, to incorporate a provision that clearly stipulates the eligibility and payment of this allowance in the forthcoming Collective Agreement or issue an agreed upon Addendum.

Inadequate Control and Various Weaknesses on Overtime performed

The maintenance of proper, correct and reliable records is a fundamental element of a sound system of internal control over personal emoluments. *Sedqa* may consider reviewing the record-keeping process so as to ensure enhancement of the present manual system. Records should be double-checked in order to avoid as many discrepancies as possible.

Moreover, NAO is again recommending FSWS, to reconsider the introduction of an AVS, so that typical weaknesses, as outlined above, are minimised.

Payment of Allowances not supported by the respective Documentation

It is imperative that any supporting documents on which payment is effected, are appropriately maintained for any future review.

Management Comments

Management affirmed commitment to improve its internal audit and reporting systems in order to enhance control and minimise risks. The Agency also stated that the findings highlighted in the Report were a result of inadequate administrative support capacity within *Aġenzija Sedqa* since repeated requests for capacity building were not accepted.

In this reply, Management concurred with the majority of findings and confirmed that corrective measures to address certain issues have already been taken, while other reported shortcomings will be checked and rectified at a later stage. The following comments further refer:

No evidence of a Definite Approval for a Direct Order

Management maintained that, with regards to catering services, FSWS obtained more than three quotes and eventually went for a better price from the provider who was chosen. This was done to secure the best price for the public purse. Management also said that, in such circumstances, FSWS will in future ensure that a definite Direct Order approval from MFIN is obtained.

Shortcomings in relation to General-use Vehicles

The Foundation pointed out that this lease was made in 2005, when none of the present Management team was involved in the procurement of this service. Management claimed that, the verbal agreement was renewed in this manner over the years as all the vehicles in the fleet were replaced by new vehicles, while the price remained unchanged. Furthermore, Management also stated that this lease will be terminated and the service will be procured as *per* General Procurement Regulations.

In reply to the observations concerning the inadequate upkeep of logbooks, Management replied that leased vehicles are operated in services that consistently require prompt response to emergencies, therefore such interventions are mostly unplanned. In addition, there are instances whereby carers, social workers or professionals accompanying clients, have to intervene promptly and may not be in a position to log each single vehicle trip. Management ascertained that “... *very close monitoring is kept to ensure that vehicles are used exclusively for work reasons.*”

With respect to lack of refuelling information recorded on the logbooks, Management remarked that such detail is not requested, since it is compiled electronically on the Vehicle Fleet Management System operated by MFIN.

Timesheet lacking Endorsement in respect of Nursing Service

Management commented that whilst the timesheet *per se* is not endorsed, the purchase order authorising the related payment is generated following receipt of the invoice. This document is endorsed by the appropriate Service Manager and Operations Director and thus, the timesheet is being endorsed in this manner.

Manual Attendance System still in place

While Management agreed with the recommendation relating to this observation, it also highlighted that, a pilot AVS had been introduced within FSWS. However, at that time, Management considered such system as impractical, since the system could not support extra hours performed off-site. These hours had to be logged manually and counter-signed by the respective Manager, thus completely defeating the scope of the electronic system.

Other Discrepancies related to Time Off In Lieu claimed

With regards to the encountered inconsistencies when TOIL was calculated, Management stated that, following discussions with the Health authorities concerned, this particular shift is to be quantified to six hours and no longer as 5.5 hours as originally indicated.

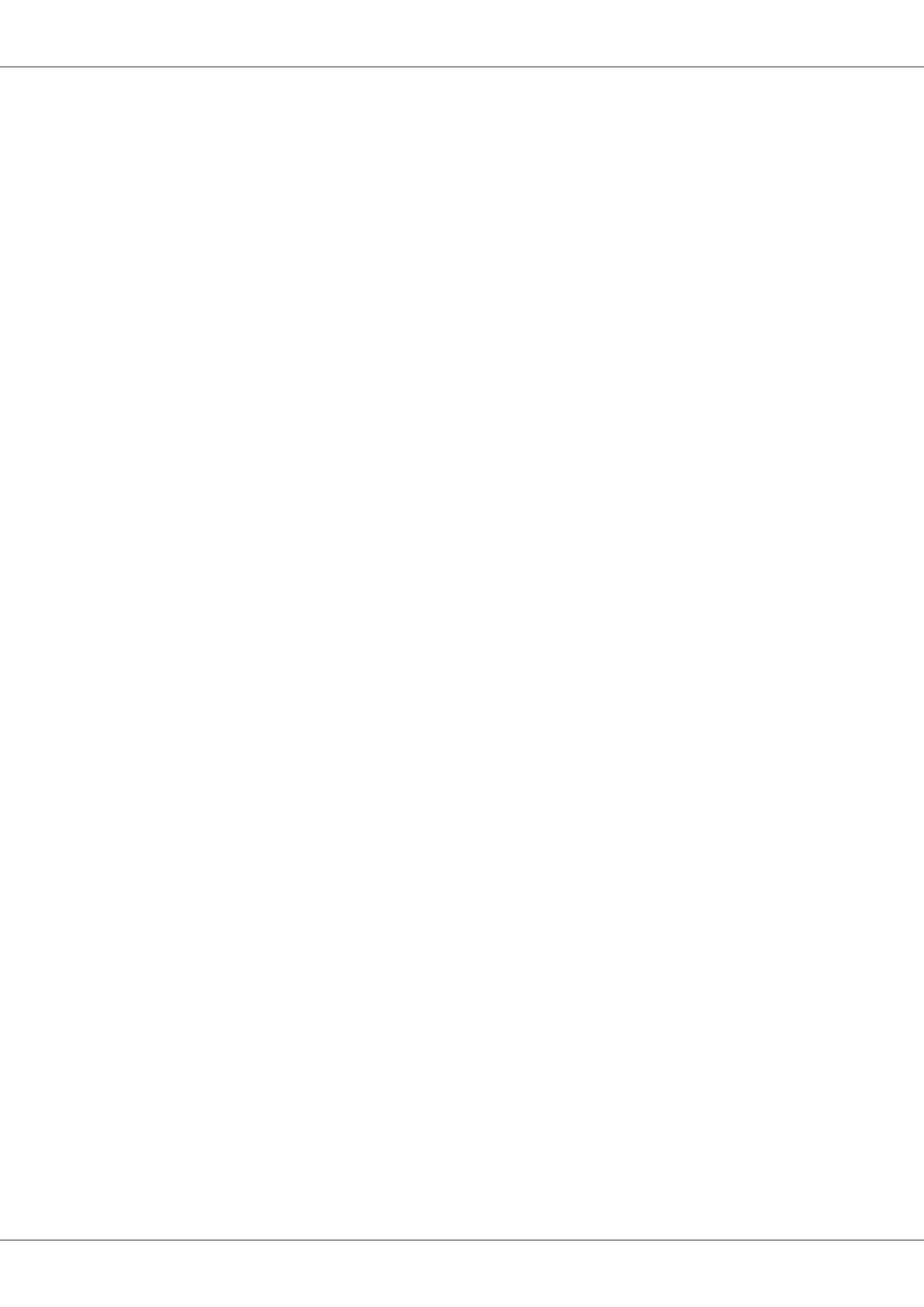
Entitlement of Extra Vacation Leave Hours not supported by Source Document/‘Break Leave Allowance’ not supported by the current Collective Agreement

Management pointed out that the observations under these captions refer to the same issue, where Care Workers work their night break, since they are on duty on their own. This issue has been discussed several times during the Collective Agreement negotiations with the respective Union. Management acknowledges that in fact, these employees are double compensated for worked breaks, however until FSWS would be in a position to have two workers on night duty, it

was agreed that the compensation would remain unchanged. Moreover, FSWS iterated that it was not given additional capacity building and consequently this issue cannot be concluded yet.

Inadequate Control and Various Weaknesses on Overtime performed

Management affirmed that it is to apply the necessary financial corrections and record them in the respective employees’ personal file. Furthermore, these employees will also be notified of their relevant financial corrections.





Ministry for Home Affairs and
National Security

Office of the Permanent Secretary

Personal Emoluments

Background

The main functions of the Ministry for Home Affairs and National Security (MHAS) are the preservation of peace, order and security in the country, the management of immigration and asylum-related issues, as well as civil protection.

The 2014 Financial Estimates show that the aggregate budgeted expenditure on Personal Emoluments for MHAS was €4,334,000 from Vote 30, which covers five cost centres, namely the Ministry, Office of the Permanent Secretary (OPS), Research and Development, Central Visa Unit, and the Citizenship and Expatriate Affairs. The audit focused on the original budgeted expenditure of €2,875,000¹ assigned to OPS, namely cost centre 02.

OPS is mainly responsible for the overall coordination of the activities of the respective line departments, agencies and entities, that together execute the aforementioned functions and contribute to the effective fulfilment of the Ministry's and Government's objectives in this regard.

During the year under review, at one stage the original budgeted expenditure for this cost centre was revised downwards to €2,670,000. However, by the end of the year, following the issue of a warrant and several virements, allocation

increased to €3,127,633. Through these funds, OPS paid a total of €3,088,018, constituting the emoluments of an average of 86 employees on its payroll, together with the salary, allowances and/or overtime, forwarded to other entities falling under its responsibility.

Audit Scope and Methodology

The main scope of the audit was to assess the internal control systems in place, relating to the payment of personal emoluments, and to obtain reasonable assurance that allowances paid are accurate and in line with the applicable regulations and agreements. Other objectives were to ensure that allowances have been approved from the right levels of authority and that payments thereof are supported by appropriate documentation.

Audit work performed covered a sample of 20 officers with different designations, whereby salaries and allowances paid to them throughout 2014 were verified. In addition, a review of the policies and procedures for the administration of vacation leave, sick leave, study leave and time off *in lieu* (TOIL), availed of by another 48 officers, was also carried out.

Audit verifications were extended further to incorporate the remuneration paid to members appointed on Boards and Committees, as well as the salary, allowances and payment of overtime

¹ Out of this total, the amount of €850,000 was allocated to allowances, of which €623,698 was transferred to the Malta Security Service.

to five employees of the Industrial Projects and Services Ltd (IPSL) deployed with OPS. Audit procedures were also carried out on the salary paid to the 10 student workers under the Student Placement Programme for Information and Communication Technology related projects, who during the summer period were engaged with the office of the Chief Information Officer (CIO).

Limitations on Scope of Audit

Documentation to substantiate a number of sampled transactions was not provided for audit purposes, as the relevant records were either not available or could not be traced.

In view of this, testing carried out was limited since it was not possible to ascertain that expenditure incurred in the areas indicated hereafter was in line with the applicable laws and regulations.

The limitations encountered are highlighted in further detail under Control Issues.

Key Issues

Lack of Fundamental Internal Controls

During the audit process, it was noted that internal controls in various areas were lacking, indicating that insufficient, if any, monitoring was in place to ensure efficient financial management. Below is a list of instances of internal control failure identified during the audit testing. Each issue will be discussed separately further down in the Report, under the pertinent observations.

- a. Several cases of incorrect basic salary payment leading to overpayments.
- b. Number of hours actually worked not even adding up to the officer's official working schedule.
- c. In a number of instances, vacation leave records were not updated.
- d. Temporary Absences Record Sheets not kept.
- e. Payments made to members on various Boards were only substantiated by a claim for remuneration endorsed by the Board Secretary, whilst no details were given on the actual work carried out.

Anomalies in the Employment and Salary paid to a High-Ranking Officer

Background

Up to 13 December 2013, an officer in scale 5 was assigned a headship position within a Unit falling under the remit of MHAS and was receiving a salary equivalent to scale 4, with the difference between the two scales to be received as a non-pensionable allowance.

The Ministry did not renew the respective contract on its expiry, and hence the officer was reverted back to his substantive scale, and transferred to a Government Agency with effect from 8 January 2014.

a. Lack of transparency

From an e-mail correspondence, it transpired that with effect from 3 February 2014, the officer in question was struck off from MHAS payroll, and on the same day employed with IPSL where he was deployed in a Department falling under the responsibility of the same Ministry, *i.e.* MHAS. However, at least up till March 2015, the latter still forked out the salary paid to the respective officer uninterruptedly by means of a reimbursement to IPSL.

Moreover, OPS failed to update the personal file of the foregoing officer with the necessary documentation. Though this Office enquired on the rationale on which IPSL was instructed to act as an intermediary *vis-à-vis* such deployment, a satisfactory reply was never received.

b. Officer still enjoying a Higher Salary on reverting to his Substantive Grade

Notwithstanding that as from 13 December 2013 the officer should have had his salary reverted back to that of an officer in scale 5, he was still receiving a salary from IPSL and refunded accordingly by MHAS, equivalent to that entitled to officers in scale 4, amounting to €2,417 per pay period. Thus, at least for the year under review, *i.e.* from

January to December 2014, this individual was overpaid the amount of €3,714.

c. **Salary paid from Two Different Sources for the Same Period**

- It was only on 22 April 2014, that the Accounts Section notified the Central Salaries Section in Gozo that, with effect from 3 February 2014, the officer was to be struck off from the payroll system of MHAS retrospectively. Consequently, for the months of February and March 2014, the individual received his salary from two different sources, *i.e.* from MHAS and IPSL. Action was only taken after the officer notified IPSL, which in return brought the issue to the attention of OPS.
- Although the officer refunded the net salary that was paid to him through the payroll system, corrective action to recoup the respective tax and social security contribution, paid on behalf of the employee in question, was only taken during the audit when the National Audit Office (NAO) drew the attention of the officer in charge.

Control Issues

Documentation requested not provided for Audit Purposes

a. **Remuneration paid to Board Members**

Section 2.5.2 of the Public Service Management Code (PSMC) specifies that the payment of remuneration to Board and Committee Members is to be jointly authorised by the Public Administration Human Resources Office (PAHRO) and the Ministry for Finance (MFIN). However, the relative approvals were not provided for audit purposes. Consequently, the basis on which officers were certifying the claims raised by the respective Board Members and issued subsequent payments could not be determined.

b. **Appointment of Secretary of one of the Boards**

In view that an individual, who was officially appointed as Secretary of one of the Boards declined such appointment, another person was appointed in his stead. However, no formal documentation evidencing the appointment of the incumbent was provided by the conclusion of the audit.

c. **Payee Status Declaration Forms of Board Members**

In the absence of the Payee Status Declaration Forms (FS4s) of Board Members, NAO officials could not ascertain that the tax withheld on remuneration forwarded to Board Members was in line with the tax rate indicated by the latter.

d. **Contract of an Officer on the Departmental Contracts Committee**

During the year under review, the gross amount of €3,500 was paid to an individual for services rendered to the Departmental Contracts Committee within MHAS. Failing to provide a copy of the contract of the respective engagement, NAO could not ascertain that the amounts paid were in line with the agreed terms.

e. **Workings of Vacation Leave Entitlement**

Enquiries on how the balance of vacation leave entitlement of an officer was arrived at, following a relatively long period of sick leave, maternity leave and vacation leave, remained unanswered.

Recording and Verification of Attendance

Absence of Attendance Verification System

In line with OPM Circular No. 14/2009 – ‘Procurement of Attendance Verification Systems’, Government was bound to introduce such systems in all its places of work by not later than December 2010. However, the necessary devices were not installed within MHAS by the

time the audit fieldwork was concluded in February 2015. Consequently, officers were required to record their attendance manually by signing the attendance registers.

Attendance Records not verified on a regular basis

The attendance records were not always checked for correctness at least on a weekly basis. For example, the attendance registers kept at the Office of the Manager Airport Security (OMAS) in Malta and the Defence Matters Directorate were only being endorsed on a monthly basis. On the other hand, those drawn up for officers availing themselves of teleworking facilities, as well as that for messengers and IPSL workers, were not being endorsed at all.

Attendance registers of certain Divisions, such as the Policy Development Unit, the Office of the Regulator of the Individual Investment Programme and OPS, were endorsed. However, the date of endorsement was not indicated, with the consequence that it still could not be ascertained that these were verified on a regular basis.

Attendance Records certified correct as a way of formality

Audit verifications carried out on the attendance records held at the Defence Matters Directorate revealed that certification of these documents was being carried out just for formality, as certain deficiencies were overlooked.

For example, notwithstanding that 18 April 2014 was a Public Holiday, and thus both Executive Officers (EOs) at the aforementioned Directorate were off-duty, they still recorded their attendance, as if it was a normal working day. This also implies that attendance records were not being signed by the respective employees on a daily basis.

Shortcomings noted during an Onsite Inspection

On Monday 16 March 2015, NAO carried out a physical inspection at the Defence Matters Directorate and at OMAS at 8:15 and 8:45 respectively, whereby a copy of the attendance records maintained at both offices was requested for the necessary audit verifications.

- a. At the Defence Matters Directorate, only one officer was manning the office at the time of inspection. According to this officer, the respective Director was abroad on duty whilst the other EO was on vacation leave from 8:30 till 13:00.

At the time of inspection, the following issues were noted:

- Both EOs retain their personal manual attendance sheet themselves, and they only pass it on to their Director for scrutinisation and endorsement at the end of the month.
- On several instances, both attendance records for the first two weeks of March were left blank, *i.e.* no signature, time in or out were recorded.
- The foregoing officer did not sign in her attendance on 16 March, even though she was at the place of work. However, in contrast, the other EO who was on vacation leave in the morning, had her attendance for the day already signed in at 13:00 and out at 13:45. Telework from 14:00 till 17:30 was also noted down.

- b. On inspection day before 9:00, at OMAS, it was noted that two employees had already recorded the time out on their respective manual attendance sheet.

It was further observed that the attendance records of this Section were also kept by the officers signing the attendance sheets, rather than maintained securely at the Manager's Office.

Two Separate Attendance Sheets drawn for the Same Period

For the period 6 to 12 January 2014, two separate attendance sheets were drawn up by the CIO's Office. Whilst one of the attendance sheets included only three officers, the other sheet also included two other employees. The Manager in charge certified both attendance sheets as correct. However, the date of certification could not be

established as this was not indicated in either of the cases.

Leave and Temporary Absences

Vacation Records not updated

Upon comparing the manual attendance sheets and the leave records extracted from the payroll system, a number of instances were noted whereby absences were not always being recorded accordingly in the system, which data is inputted manually.

Excessive Sick Leave before the Commencement of Maternity Leave

It was noted that pregnant employees were regularly, and in some cases excessively, resorting to the use of sick leave. Moreover, a medical certificate was not always forwarded to substantiate sickness absences, by some of the employees in question.

Time Off In Lieu

Necessary Approvals obtained retrospectively

Authorisation to work additional hours beyond the normal working schedule, which hours were accounted for as TOIL at overtime rates, was not sought prior to the execution of such work. For example, extra hours worked by a Senior Manager between 2012 and 2014 were only approved by the Director retrospectively on 30 September 2014.

In breach of the standing regulations, claims requesting TOIL for extra hours worked in excess of the normal working schedule were not substantiated by certified attendance records and details of work performed. However, notwithstanding the lack of supporting evidence, the respective TOIL claim forms were still endorsed by two officers, namely the Head of Section and the Director. This implies that the necessary verifications on the correctness of details therein were not being carried out.

Compensation for Extra Hours worked not in line with the Applicable Guidelines

a. Time Off In Lieu granted to Ineligible Officer

On 30 September 2014, the respective Director approved 265 hours of TOIL, covering additional hours worked from year 2012 up to the first two quarters of 2014 by the Senior Manager at the Accounts and Office Management Section, who is pegged to salary scale 5, as per Schedule of Grades for 2014. This is in breach of section 3.2.1.3 of PSMC specifying that officers above salary scale 7 are not entitled for compensation in respect of any additional hours worked.

b. Officer approving his own Time Off In Lieu

Testing carried out revealed that 10 out of the 13 requests for TOIL, raised by an IPSL employee during 2014, were not endorsed by the respective Director. The only signature evidenced on the request form was that of the incumbent, as Head of Section, implying that the latter granted to his good self a total of 94.50 hours in TOIL during the year.

c. Attendance to Board Meetings during Office Hours compensated by Time Off In Lieu

On 25 August 2014, an officer in scale 10 requested 18.75 hours TOIL for attending five sessions of two and a half hours each between 28 May and 3 June 2014, held by a particular Board. Despite that these sessions were held between 12:30 and 15:00, thus falling within the officer's normal office hours², the request was still approved by the Director Corporate Services (DCS) on 21 August 2014, *i.e.* four days before the claim was actually raised.

² As per attendance records, the officer works on a flexi-timetable between 6:30 and 15:30.

Shortcomings in the Application Forms for the Utilisation of Time Off *In Lieu*

Application for the utilisation of accumulated TOIL is made on a specific form. A sample of the applications filed during 2014 was reviewed and the following weaknesses were encountered:

- a. In a number of instances, requests for TOIL were not endorsed by the respective Director in due time, with the consequence that officers availed of their TOIL without having the necessary approvals in place.
- b. In certain cases, the data disclosed on the application form was misleading. By way of example, TOIL balance brought forward was not updated to reflect the balance carried forward in the prior form. Consequently, there was no correlation between the balance brought forward, the number of hours applied to be availed of, and the resulting balance carried forward.

Family Friendly Measures

Non-adherence to Flexi-time and/or Telework Conditions

From a review of the attendance records of five employees falling within the audit sample, who availed themselves of flexi-time and/or telework during 2014, it transpired that there is lack of control on such attendance. By way of example, one of the officers was noted to be working less hours than those required to be performed by Government employees, whereas another employee was working as per flexi-time schedule that was approved in an agreement that expired by end 2013 and which was not renewed thereafter. Moreover, it was also observed that the foregoing agreement, which covered the period January to December 2013, was only approved retrospectively on 29 September 2013.

Instances were also encountered whereby officers, who were transferred to the Ministry during 2014, from the very first day availed themselves both of flexi-time and telework facilities.

Boards and Committees

Lack of Transparency in the Claims for Payment raised by Members on Boards and Committees

A review of a number of claims for payment raised by Members on Boards and Committees during the financial year under review, and the subsequent settlement thereof, revealed the following:

- a. Claims for payment, raised by the respective Boards' Secretary on a quarterly basis only certified that, during respective given period, the Chairperson and the related Board Members have attended meetings of three or more hours duration, but did not indicate the number of sessions actually attended by the Members.
- b. Members of the same Board were not claiming the same number of sessions in the respective period. This implies that certain Members were requesting extra payments beyond the actual meetings held. By way of example, the Board Secretary and the Chairperson of a particular Board repeatedly claimed extra payment for additional work carried out in preparation for the sittings. However, no evidence to this effect was traced.
- c. On certain instances, payments were claimed for sessions held on a Sunday. Given that such requests were not raised by all Members of the Board but only by one member, one questions such claim.
- d. The Chairperson's claim that Board Members carry out work from home in relation to judgements, as well as other research on European Union directives and policies, was not substantiated. Moreover, notwithstanding that no one was certifying such claims, these were honoured in full and paid out of public funds.
- e. Though Board minutes were drawn up in respect of the sittings held, NAO was given to understand that OPS was not in receipt of a copy of the minutes in question. In fact,

these were only requested by DCS following NAO's enquiry for such documentation. A review of a sample of the said minutes also revealed the following deficiencies:

- Minutes were neither endorsed by the Board's Chairman nor Secretary.
- Although Members were actually paid on an hourly basis, the time when the meeting commenced and when it was concluded was not indicated, thus making it impossible to determine the duration of the said meeting.

- f. OPS was not always in possession of a copy of the resignation letter, filed by individuals who relinquished their appointment on the Board.

Remuneration paid to Board Members in excess of the Approved Amounts

- a. Through a letter dated 19 November 2002, the then DCS at MHAS was notified that PAHRO, together with MFIN, approved that the Chairperson and Members of one of the Boards were to be remunerated at €32.61 and €27.95 respectively per three hours sitting.

Notwithstanding this, given that very often between two to four sessions were being claimed in one day, from the payments reviewed it was concluded that the approved rate was being paid on an hourly basis rather than per session. It was further noted that the hourly rate applied to the Chairperson was €34.94 instead of the €32.61 per session. As a result, for the sittings held between 1 January and 31 December 2014, the respective four individuals forming the Board were in aggregate overpaid the amount of €37,967.

- b. Similarly the rates approved by PAHRO and MFIN, payable to the Chairperson and Members on another Committee, stood at €18.63 and €13.98 respectively per three hour sitting. However, it transpired that the Chairperson was paid €25.62, whilst the other Members were remunerated at the

rate of €18.63 per session, which very often lasted only for two hours. Consequently, in this case, at least the aggregate amount of €1,430 was overpaid during the financial year under review.

No Official re-appointment of the Board of Visitors for Detained Persons

Following the expiration of its term of office in June 2013, no official re-appointment was traced with respect to the Board of Visitors for Detained Persons. Nonetheless, between August 2013 and December 2014, the respective Board Members still held their regular meetings, for which they were paid the aggregate gross amount of €14,232.

Incorrect Tax Deductions from Payments made to Board Members

Notwithstanding that MFEI Circular No. 2/2009 – 'Remuneration paid to Persons sitting on Boards, Tribunals, Committees, Commissions and similar bodies', specifies that payments to Board Members are subject to tax at the standard rate of 20%, instances were encountered whereby tax deductions from such remuneration were made at the fixed rate of 15% and declared under Part Time Employment when such income does not qualify under this category.

Delays in drawing up Reports on Firework Factories after Inspection

In line with MPO Circular No. 71/2008 – 'Engagement of Fireworks Inspectors with the Explosives Committee', upon carrying out inspections of firework factories, the inspectors within such Committee are to furnish the latter with a report, outlining the status of the respective factories in relation to the legislative commitments and highlighting the necessary recommendations.

From the verifications carried out on three inspection reports, it transpired that two of them, which were not even endorsed by the inspectors, were drawn up, on average, a year after the inspection was actually carried out; one was compiled after 13 months, whilst the other was concluded after 11 months.

Personal Emoluments

Inaccurate Calculations

Testing carried out on the personal emoluments paid to the employees in the audit sample revealed various inaccuracies in the payments effected. Such discrepancies included:

- a. a double payment to two employees for an aggregate total of 17 overtime hours;
- b. an overpayment to two Selection Board Members due to miscalculations of the amounts owed shown on the request for payment. These errors passed by unnoticed by the officer certifying the respective document as correct;
- c. no deductions from the salary paid to three employees, covering four days sick leave on half pay;
- d. two officers still received the full basic salary whilst on unpaid leave;
- e. basic salary paid to Detention Service officers not in line with PAHRO's instructions *vis-à-vis* the respective increment; and
- f. overpaid shift allowance to two Detention Service officers due to incorrect rate paid.

Other Matters

Expenditure falling outside the Remit of the Office of the Permanent Secretary

Personal emoluments paid to at least 11 officers at the Ministry and/or other entities during 2014, in aggregate amounting to €112,595, were partly or at times fully financed from funds allocated to OPS.

Compliance Issues

Temporary Absences Records not held

No Temporary Absences Record Sheets were maintained during 2014 in line with standing regulations, to record absences from the place

of work on personal business. Consequently, although OPS stated that the required authorisation was given by the respective Head of Department, it cannot be ascertained that such absence was duly approved.

Necessary Approvals not sought for the Engagement of an Adviser

In breach of section 1.4.7.7 of PSMC, approval from the Prime Minister and the Principal Permanent Secretary was not sought prior to the engagement on trust basis of an adviser.

Postings to Incorrect Line Items

Twenty-seven transactions in the audit sample, amounting to €20,487, were posted to the wrong line item.

Recommendations

Key Issues

Lack of Fundamental Internal Controls

Strong internal controls are essential in assisting OPS to mitigate financial risks and achieve its objective to manage public funds entrusted to it more efficiently. It is also recommended that ongoing monitoring activities are carried out, to evaluate and improve on the effectiveness of internal controls. Spot-checking transactions or basic sampling techniques can provide a reasonable level of confidence that the controls are functioning as intended.

Anomalies in the Employment and Salary paid to a High-Ranking Officer

Management is to ensure that remedial action is taken to regulate the employment of the officer in question and to recoup the unjustified salary overpayments without delay. Moreover, for the sake of transparency, it is important to ensure that the position of this officer within the Ministry is regulated through the Public Service Commission. In addition, personal files are to be kept updated with all the necessary documents, especially those relating to personal emoluments. These are to be adequately filed for ease of reference and to enable verification by third parties.

Control Issues

Documentation requested not provided for Audit Purposes

Controls are to be in place for the proper checking of claims raised. Hence, Management is to ensure that source documentation forming the basis of payments is properly filed for future reference.

Recording and Verification of Attendance

Absence of Attendance Verification System

Besides being an effective means of capturing employee attendances, the use of electronic reading devices simplifies payroll calculations. In this regard, MHAS is encouraged to take action for such systems to be installed without unnecessary delay.

Attendance Records not verified on a regular basis

In line with section 3.1.2.1 of PSMC “*attendance registers are to be inspected and certified correct at the start of each week by Directors or senior officers authorised by them, who are to see that the previous week's record of attendance is complete in every detail, and all employees are accounted for*”. Once such checks have been carried out, the attendance records are to be endorsed, clearly indicating the date, as well as the name and the grade of the officer performing the respective verifications.

Attendance Records certified correct as a way of formality

Attendance sheets are to be supervised on a daily basis to ensure completeness and accuracy of the reported times.

Shortcomings noted during an Onsite Inspection

NAO reiterates the importance of an electronic device to record staff attendance, in order to mitigate the inherent risk of a manual system.

Two Separate Attendance Sheets drawn for the Same Period

Management is to acknowledge the fact that when endorsing attendance registers, it is assuming responsibility that such records are correct in every detail, and that the respective employees have all been duly accounted for.

Leave and Temporary Absences

Vacation Records not updated

Regular reconciliation between attendance reports and vacation leave is to be performed by the officer in charge of Human Resources (HR), to ensure that the respective records are updated accordingly.

Excessive Sick Leave before the Commencement of Maternity Leave

Whilst acknowledging that this is a delicate issue, Management is to ensure that this course of action does not become the norm. Pregnant employees are to be reminded that, in line with section 5.2.4.1 of PSMC, eight weeks maternity leave may be availed of before or after confinement.

In addition, as outlined in section 4.3.1.2 of PSMC, Managers are to ensure that days of sick leave are not paid for unless covered by a valid medical certificate, timely submitted to HR Section, covering the number of days taken. Disciplinary proceedings should be initiated against officers who fail to abide by these procedures.

Time Off In Lieu

Necessary Approvals obtained retrospectively

OPS is to be reminded that TOIL also comes at a cost to Government and thus is to be adequately certified and controlled.

Management is to ensure that extra hours worked are properly logged. Head of Section is then to counter-check the hours detailed in the relevant request form against the attendance records,

before endorsing his/her signature and passed to the respective Director for his final approval.

Furthermore, requests for TOIL are not to be processed unless employees provide complete information in support of their claims.

Compensation for Extra Hours worked not in line with the Applicable Guidelines

The provisions of PSMC are to be invariably adhered to. OPS is also to ensure that any TOIL granted to ineligible officers is immediately recouped. Furthermore, it is to be ascertained that all requests for payment of extra hours are independently endorsed by the officer's superiors.

Shortcomings in the Application Forms for the Utilisation of Time Off In Lieu

Management is to ensure that internal controls are operating effectively and are not being by-passed. This can only be achieved if all officers involved in the process understand their role and are held accountable in case they fail to carry out their duties properly. Moreover, officers entrusted with the monitoring and authorisation of TOIL are to ascertain compliance with the policies and procedures in place, prior to approving the respective requests and updating the related records.

Family Friendly Measures

Non-adherence to Flexi-time and/or Telework Conditions

Before approving any telework and flexi-time arrangements to new employees, Directors are to ensure that the guidelines and regulations set in PSMC are abided with. Thus, OPS is encouraged to instruct employees to regularise their positions. The personal files are also to be updated with all relevant documentation.

Moreover, telework arrangements are to be revisited. Hours worked from home are expected to be monitored closely so as to avoid possible abuse.

A new telework agreement is to be signed only after evaluating the various factors that may

affect the performance of the section in which the employee is posted.

Furthermore, agreements are to include full details and are to be signed prior to the commencement of such measures.

Boards and Committees

Lack of Transparency in the Claims for Payment raised by Members on Boards and Committees

OPS is to ascertain that unless claims for payment are duly supported by a proper copy of the Board minutes, and where possible by a detailed description of the work carried out, especially in the case of extra sessions, these are not to be honoured.

This Office acknowledges the stand taken by OPS during 2015, whereby a memo was issued by the Permanent Secretary (MHAS), outlining the new procedure to be adopted when drawing up a claim for remuneration for each Member of the Board and/or Committees. In such correspondence, particular emphasis was given to the fact that the respective Chairpersons are to certify all claim forms as true, correct and complete, and that any detail included therein is to be easily corroborated with the respective Board minutes.

Furthermore, it is to be ensured that OPS keeps the required documentation in relation to the formation of Boards and Committees, which is to be filed for future reference.

Remuneration paid to Board Members in excess of the Approved Amounts

Strong internal controls are to be implemented in order to ensure that the claims submitted by Board Members are thoroughly checked and certified correct prior to the issuance of the respective payments.

Moreover, OPS is to carry out a thorough exercise on the amounts paid to Board Members, since inception of the respective Boards, and any overpaid amounts are to be recouped without undue delay.

No Official re-appointment of the Board of Visitors for Detained Persons

In line with the Board of Visitors for Detained Persons Regulations, the Board is to be appointed annually.

Incorrect Tax Deductions from Payments made to Board Members

OPS is to ensure that the tax rate of 20% as stipulated in the pertinent circular is deducted from the income paid to Board and Committee Members. In the event that the payee, other than a pensioner, is aware that he falls in a lower tax band, authorisation is to be sought from the Inland Revenue Department to reduce the withholding tax from the foregoing default rate.

Delays in drawing up Reports on Firework Factories after Inspection

To ascertain that the submission of the relevant results is not prolonged unnecessarily, Management is to release the related payment solely upon presentation of the respective reports.

Personal Emoluments

Inaccurate Calculations

In order to establish an efficient system, a review of the payroll processing procedures is to be carried out. The Accounts Section is to ensure that any amendments to salaries are passed to the Central Salaries Section in Gozo instantaneously, so that necessary changes are processed in due time. Furthermore, to achieve a reasonable level of efficiency without compromising accuracy, independent checking is recommended.

Moreover, all documentation on which payments are based is to be vetted for accuracy before this is certified correct and passed for payment, as stipulated in Article 52(3) of the General Financial Regulations.

With respect to the issues related with the officers at the Detention Service, it is recommended that for proper management of public funds, any unjustified payments are withheld until pending developments on the applicable agreement are

cleared and a decision on whether these funds are to be offset or refunded is eventually taken.

In addition, OPS is encouraged to review all overpayments issued and recoup all amounts which were not due.

Other Matters

Expenditure falling outside the Remit of the Office of the Permanent Secretary

Expenses are to be borne by the entity that is actually incurring them.

Compliance Issues

Temporary Absences Records not held

Temporary absences are to be resorted to only in urgent and exceptional circumstances. Furthermore, Management is to ensure that, in line with section 3.1.2.3 of PSMC, such absences are recorded in the Temporary Absences Record Sheet and authorised by the senior officer in charge, who should initial the entry. Disciplinary action is to be taken in cases of unauthorised absences.

Necessary Approvals not sought for the Engagement of an Adviser

In line with standing regulations, approval from the right level of authority is always to be sought before engaging advisers.

Postings to Incorrect Line Items

More diligence is to be exercised when allocating expenses, to ensure that amounts spent are correctly reported under the pertinent line item, as this could affect future budgets.

Management Comments

OPS stated that it has taken note of comments drawn up by NAO and it will strive to ensure that all relevant procedures and regulations are invariably adhered to. Action has already been taken to rectify a number of shortcomings, amend current operating procedures and introduce new ones, whilst strengthening monitoring and compliance.

Management also provided further comments and reservations with respect to the following issues:

Anomalies in the Employment and Salary paid to a High-Ranking Officer

OPS provided documentation indicating that IPSL has commenced recouping the said overpayments as from May 2015. A repayment agreement is in place and refunds will be settled in full by end 2015.

Documentation requested not provided for Audit Purposes

Management explained that all measures were taken to try to find the FS4s of the Board Members concerned, however these could have been misplaced following the physical migration of the Ministry from one premises to another, as well as the staff turnover that the Department for Support Services within OPS had to endure. Nonetheless, the Board Members whose FS4 was missing were asked to provide the Accounts Section at MHAS with a new filled in copy of the FS4. All Board Members abided by the instructions given to them and sent a completed copy of the FS4 anew.

OPS did not furnish an explanation for the various other documentation that was not provided; however it was stated that the necessary measures will be taken in order to ensure that background records will be kept up to date.

Recording and Verification of Attendance

It was stated that in July 2014, the Ministry initiated steps to look into the procurement of an Attendance Verification System. However, the value for money aspect of introducing and maintaining such system in offices with a small number of workers needs to be properly assessed.

Meanwhile, Management has taken all NAO's recommendations on board with respect to the manual attendance records, with exception to NAO's comments in relation to the attendance records held by the Defence Matters Directorate. OPS claimed that the officers are delegated by their respective Director to keep track of their personal attendance, since there is no viable alternative given that the latter has to fulfil several travel commitments.

Leave and Temporary Absences

OPS took the necessary steps and deducted the instances of absences from the vacation leave entitlement, where these were not covered by written approvals.

In relation to the excessive sick leave availed of prior to the commencement of maternity leave, OPS stated that during 2014 MHAS had introduced a sickness verification service provision to facilitate efforts to instil greater care and curb any possible abuse. MHAS HR Section will ensure greater compliance and monitoring.

Time Off In Lieu

All issues related to TOIL have been discussed with HR Personnel and action has been taken in order to avoid such anomalies. Furthermore, Management will ensure that Temporary Absences Record Sheets will be duly filled in.

With respect to the 265 hours of TOIL compensated to a Senior Manager, OPS provided an explanation to justify its actions but also stated that such compensation will not repeat itself henceforth.

Family Friendly Measures

Management submitted justifications with respect to the officers in sample. However, it also took note of NAO's recommendations made in this regard.

Boards and Committees

In order to increase transparency in the payments effected to Board and Committee Members, the Accounts Section at MHAS took action to rectify the matter by formulating and forwarding new templates to claim the respective remuneration; one for Board Members who are paid according to the number of sessions worked and one for those who are paid periodically. Payments will only be effected once the templates are duly filled and endorsed by the respective Chairperson.

OPS did not manage to obtain a copy of the resignation letters filed by the two individuals who relinquished their appointment as Committee Members. Management explained that the Board

in question was briefly included in MHAS portfolio until it was re-assigned under the responsibility of the Ministry for Transport and Infrastructure.

Management also could not trace approvals from PAHRO and MFIN with respect to the rates paid to the Chairpersons and Members of the other Board and the Committee referred to in the observation. Furthermore, no indication was given as to whether a thorough exercise was going to be carried out to recoup the overpaid amounts.

Action will be taken to request additional details on the works carried out by Members on Boards and Committees claiming additional compensation. However, Management found reservation on the

disclosure of the minutes of meetings, as this could have negative implications owing to the sensitive nature of the matters under consideration by the various Boards and Committees within MHAS.

Other Matters

With respect to the issue relating to the personal emoluments paid to officers engaged at the Ministry but paid out from OPS funds, Management commented that the employees in question did not formally form part of the Ministry Secretariat and therefore OPS deemed it inappropriate to charge expenses from the Ministry's cost centre.

Public Broadcasting Services Ltd

Background

The aim of the Public Broadcasting Services Ltd (PBS), being Malta's national broadcasting station, is to fulfil its mission by offering a wide spectrum of high quality radio and television programmes, as well as precise and fair news. PBS also provides extended public service obligation programmes for the cultural, social and educational development of the society. Whilst the company generates revenue from attracting sponsorships and airtime sales, the Government annually also provides a grant of around €3 million, in view of its Public Service Obligation. Following Malta's win at the 2013 edition of the Junior Eurovision Song Contest (JESC), a further subvention of approximately €1.4 million was granted to organise such event on the island, as the host country.

Audit Scope and Methodology

The main scope of the audit was to determine the level of internal controls over expenditure incurred, primarily in organising JESC on 15 November 2014, as well as the Malta Eurovision Song Contest (MESC) for the year 2015, which was held a week later.

The sample selected, covering expenditure in relation to JESC and MESC, was analysed, mainly to ensure that payments were backed up by the necessary documentation, duly verified and authorised. Furthermore, a surprise cash count

was carried out and any shortcomings noted were reported upon accordingly.

Audit Disclaimer

In terms of Public Procurement Regulations S.L. 174.04 Article 17(1)(g), these regulations shall not apply to public service contracts for the acquisition, development, production or co-production of programme material intended for broadcasting by broadcasters and contracts for broadcasting time. In view of this exemption, the National Audit Office (NAO) will not express an opinion on procurement procedures adopted with regard to both song contests.

Key Issue

Deteriorating Working Capital

As per audited accounts for the years ending 30 September 2013 and 2014, substantial losses before tax were registered, amounting to €954,285 and €1,378,912 respectively. In the subsequent year, according to the latest management accounts for the first six months, *i.e.* up to 31 March 2015, the incurred loss had already reached €1,164,858.

Due to such losses, working capital as per audited accounts has been deteriorating over the years, recording a negative amount of (€757,022) as at 30 September 2013, substantially increasing to (€2,851,188) by the end of the following financial year. Furthermore, the management accounts for

the first six months of the succeeding period also indicate a critical working capital of (€2,626,652).

The overall deficit of €481,899¹, incurred on the organisation of JESC and MESC, has contributed further to expose PBS to liquidity problems. In fact, as highlighted further down in the Report, payments to service providers and/or suppliers with regard to both song contests were not being made in a timely manner.

Control Issues

Cash not accounted for

During a petty cash inspection on 23 September 2015, this Office found eight envelopes in the safe, containing €1,498 cash, together with two immaterial stale cheques. The supporting tickets, relating to a programme aired from a private venue in December 2011, were also found. Whilst reconciling the cash and cheques in question with the respective tickets, a trivial discrepancy of €10 was also noted. The Financial Controller claimed that such event was never accounted for, due to an oversight. Whether due to negligence or otherwise, this may be the result of lack of audit trail thus increasing the risk of misappropriation of funds.

Substantial Amounts paid from Petty Cash

It was observed that petty cash float balance was kept substantially high, at one point reaching €48,347 on 22 November 2014. The amount of €22,600 was subsequently utilised to pay three foreign individuals providing their respective services during JESC and MESC.

Deferred Payments

Payment Terms disregarded

Notwithstanding the payment terms as per applicable agreements, eight invoices in the audit sample, amounting to €193,484, were paid

substantially late, in one instance with a lapse of four and a half months over and above the allowable credit period.

Long Outstanding Invoices

It was also noted that 87 invoices amounting to €254,245 were still pending as at end of May 2015². The majority of these bills were dated in November 2014. Moreover, certain invoices and/or applicable agreements clearly indicated the respective payment terms and that interest may be charged accordingly.

Documents not readily available

On 20 May 2015, NAO specifically requested all supporting documentation related to the sample selected. However, documents such as timesheets and agreements were provided relatively late, in some cases even more than two months later. This caused undue delays in audit testing. Furthermore, the required information was provided sporadically.

Lack of Verification

The following cases indicate that proper checking of what the service provider was invoicing was not carried out and as a result, officers in charge endorsed documents notwithstanding that details recorded therein were incorrect:

- a. In certain instances, the timesheets for security services featured the same individual more than once, on the same day with similar timings. This made it difficult to quantify the number of hours that were actually performed. A copy of the respective request for quotes for such services, indicating the required number of security officers, dates and timing, was also not provided. In the circumstances, it was concluded that proper verification of the amounts charged could not be performed.

¹ Disclaimer: In line with the accruals concept and the opportunity cost element, NAO took into consideration the loss of €165,009 on barter activity. Furthermore, since the Eurovision Song Contest (ESC) held in May 2015 was outside the scope of the audit, the respective positive contribution of €85,603 was not taken into account.

² As per Suppliers Transaction History provided during the audit.

- b. Two invoices were paid for accommodating a particular foreign guest from 29 October to 26 November 2014 and from 31 October to 25 November 2014. Subsequent to audit queries it was stated that the name on one of the invoices was not correct. Although *prima facie* there was an overlap of days for the same guest, both invoices were still endorsed without being questioned. This also implies that proper checking was lacking.

Compliance Issues

Hours performed without a Rest Break

As per the Organisation of Working Time Regulations, S.L. 452.87, “*every worker shall be entitled to a rest break where the working day is longer than six hours*”. A review of all time sheets in respect of cleaning services, for both song contests covering the period 4 to 25 November 2014, was carried out. It transpired that in the majority of the cases, cleaners recorded more than six hours, in nine instances up to 10 consecutive hours and in another case 12 hours. Notwithstanding this, rest break was not deducted and the service provider was paid accordingly, in contravention with the said legislation.

Non-compliance with VAT Legislation

Whilst carrying out the necessary verifications on the invoices falling in the audit sample, it transpired that in 46 cases, amounting collectively to €341,756, the Value Added Tax (VAT) number of either the supplier, or the client, or both, was not indicated on the invoice, in line with the Twelfth Schedule of the VAT Act, Cap 406.

Recommendations

Key Issue

Deteriorating Working Capital

PBS is to resolve its liquidity problems as it is important to ensure that it has adequate working capital.

Control Issues

Cash not accounted for

Cash is to be accounted for immediately upon receipt and deposited to bank accordingly. Furthermore, appropriate internal controls are to be in place, such as reconciliation of cash received and deposited, against the number of tickets sold, as well as periodic physical checking, to reduce the risk of misappropriation.

Substantial Amounts paid from Petty Cash

Whilst acknowledging that approvals were obtained to increase the cash float, petty cash is expected to be used solely for trivial everyday costs. Conventional bank transfers should be preferred to payments in cash.

Deferred Payments

Invoices are to be settled on time in order to avoid any possible extra charges. Deferred payments are to be kept at the absolute minimum.

Documents not readily available

Documentation is to be filed appropriately for ease of reference, as well as for audit purposes, to ensure that the required documents are always available in a timely manner.

Lack of Verification

Endorsing officers are to be held accountable in the eventuality that they fail to carry out the necessary verifications properly before payment is made.

Compliance Issues

Hours performed without a Rest Break

It is advisable that the regulations outlined in the pertinent employment legislation are adhered to. This will not only ensure regularity but will benefit the employees themselves, since taking assigned breaks is necessary to recover from fatigue.

Non-compliance with VAT Legislation

Officers in charge are to ensure that they are furnished with proper tax invoices meeting the criteria set out in the VAT Act. Invalid tax invoices provided by the supplier and/or service provider are not to be accepted.

Management Comments

Management made reservations on three issues as indicated hereunder:

- It was remarked that, from a commercial point of view, ESC is to be taken into consideration to justify the overall deficit. It also maintained that barter activity is to be excluded as this will have a nil effect on the bottom line of the company's funds.

During the past years, PBS also held a number of meetings with the Ministry for Finance to increase the Public Service Obligation funds. Moreover, Management is successfully adopting a more aggressive advertising strategy year after year.

- Management stated that proper checking and internal controls, which ensure that the former does not make any overpayments to suppliers, are in place.

- The Finance Department at PBS established a commercially viable approach how to mitigate payment terms with suppliers, without incurring interest.

The following comments were also submitted:

- A cash handling procedure manual is to be compiled. Amongst other, this will include a provision that the contents of the safe are to be checked and documented on a regular basis.
- The recommendation with regard to bank transfers will be taken on board with immediate effect, *i.e.* ensuring that all foreign expenditure will now be paid only by bank transfers.
- As regards rest break, Management will take the recommendation on board in line with health and safety standards.
- In relation to future suppliers, PBS will ensure that in all cases it will demand invoices drawn up in terms of the VAT Act prior to proceeding with payment.



Ministry for Finance

Customs Department

Personal Emoluments

Background

The budgetary allocation for 2014 in respect of Personal Emoluments for the Customs Department (CD) stood at €8,788,000, an increase of €38,000 from the previous year's allocation. During the year, this estimate was reduced by €110,000, resulting in a final budget of €8,678,000.

By the end of the year, payments for Personal Emoluments totalled €8,524,477 (*i.e.* 98% of the revised budgetary allocation), leaving an unutilised balance of €151,448. The largest portion (84%) was expensed on salaries and social security contributions, while payments of allowances totalled €1,091,142, equivalent to almost 13% of the final budget.

Since the number of officers employed within CD as at end November 2014¹ stood at 360, the Department spent a crude average (including overtime and allowances) of €23,700 per employee.

Audit Scope and Methodology

The main scope of the audit was to ensure that Personal Emoluments for 2014 were appropriately recorded and processed according to the Public Service Management Code (PSMC) and other pertinent circulars. The adequacy of internal controls, intended to ensure accuracy and validity of salary payments, was also reviewed.

Following a preliminary review of the detailed breakdown of amounts paid to each CD officer during 2014, a sample of 16² officers (covering a total gross salary payment of almost €400,000) was selected for testing. These included officers entitled to allowances; others who received overtime payments; employees engaged on a contract basis; officers on a reduced hour timetable or with a telework agreement; a newly recruited employee; and officers who retired or resigned.

Testing was focused on ensuring the accuracy of salaries paid to the sampled employees, as well as the officers' entitlement to allowances and overtime payments. Attendance and leave records were also reviewed to ascertain that these were being adequately maintained, and that the information held was correct and reliable.

Key Issue

Delays in replying to NAO Queries

During the audit, various meetings were held between the National Audit Office (NAO) and different CD officials, with the scope of providing documentation for testing purposes, as well as explanations and clarifications to the queries resulting from testing. Although these meetings were primarily intended to include the participation of key personnel, officers who could actively contribute towards matters raised during

¹ The list of CD employees for audit purposes was obtained as at this date.

² One officer was on responsibility leave up till February 2014, after which he resigned and thus received no salary payment in the year under review.

the audit were only present in the final meeting. Hence, their intervention became possible solely towards the final stages of the audit.

Furthermore, in most instances, the required information for audit purposes was not made available within a reasonable timeframe. Notwithstanding NAO's constant reminders, various delays were still encountered. Moreover, information submitted by CD had to be continuously vetted for completeness and correctness by NAO, before it could be utilised for audit testing. Such information was often found to be insufficient and had to be returned to CD for correction, thus contributing to further delays in the audit process.

Control Issues

Salaries

Incorrect Amounts paid to Officers

Out of an audit sample of 15 salary payments, two instances were encountered whereby the officers were placed on the incorrect step of the Salary Scale. This led to erroneous calculations in their respective basic salaries. In both cases, the situation was rectified during the audit.

Had such errors not been timely detected, these could have spilled over to future years, thus becoming even more difficult to identify and correct.

Allowances

Inaccurate Allowances paid to Officers

The audit revealed a number of cases, in which incorrect amounts of allowances were paid to the entitled officers. A Customs Officer who joined CD during the year under review was underpaid, following erroneous calculations in the *pro rata* entitlement to flexibility and clothing allowances. A similar underpayment of flexibility allowance was also noted in the case of an officer who was promoted to Senior Inspector in 2014. The incorrect rates used for calculating the stand-by-

at-home allowance due to an Inspector of Customs resulted in another underpayment.

On the other hand, a Senior Inspector was overpaid three days' clothing allowance following untimely notification of termination of entitlement to this allowance.

Some of these errors were rectified during 2015.

Hours worked in compensation for Flexibility Allowance not always evidenced

According to the applicable Memorandum of Understanding, all Customs Class employees are entitled to an all-encompassing flexibility allowance, with the amount payable varying according to the respective officer's grade. In order to be paid this allowance, each Customs Class officer is expected to work an additional two hours a week, both during the winter and summer periods.

During the audit, NAO noted that the extra hours in compensation for the flexibility allowance were not always performed in the year under review. In fact, non-compliance was evident on at least one occasion by four officers within the audit sample who were paid flexibility allowance. No deductions from the annual entitlement were effected in this respect.

Incorrect Deduction from Flexibility Allowance Entitlement

The above-mentioned Memorandum of Understanding further stipulates that *pro rata* deductions to the flexibility allowance are to be made for all absences in respect of which deductions are due. These reductions in allowance are not to be made for 15 days of sick leave.

During 2014, a Manager at CD was on sick leave for 60 days³, and therefore, the deduction from his entitlement to flexibility allowance should have been calculated on 45 days. However, the deduction was erroneously based on 43 days. Although in this case, the overpaid amount might not be deemed material, similar errors on a larger

³ In calculating the number of days, weekends and Public Holidays not falling at the beginning or end of the sick leave period were taken into consideration.

pool of employees could have a more significant impact on the Department's finances.

Overtime

Supporting Documentation for Overtime and Allowances not made available for Audit purposes

In the majority of cases, relevant supporting documentation was not forthcoming, thus hindering the verification process of the accuracy of overtime performed at merchants' request, as well as a number of allowances, paid to the officers selected in the audit sample. When queried on the matter, CD stated that forms intended to include all the details of the officers' attendance for additional work such as location, time and officers' names, endorsed both by the merchant and the attending officers, were not always utilised. Requests for merchants' overtime were at times received by telephone and logged in a 'register'⁴ kept by the respective Head of Section.

The absence of supporting documentation could result in errors in the computation of overtime and allowances payable to officers, as well as in the corresponding amounts charged out to merchants. Furthermore, without documentation endorsed by both parties, the officer's presence on site cannot be ascertained.

Requests for Approval of Overtime Work not raised

The PSMC requires Government Departments to formally request the approval of any required overtime work from the respective Permanent Secretary. This is to be done on a prescribed application form, indicating the details of the extra hours, as well as the personnel and respective grades required to carry out the proposed overtime work for the Department in question. No such requests were prepared by CD in respect of overtime worked during the year under review. To this effect, CD stated that they started being compliant with this procedure with effect from December 2014 for overtime carried out during the first three months of 2015.

Incorrect Payments for Overtime performed at Merchants' Request

During the audit, NAO encountered two instances where officers were underpaid for overtime performed at merchants' request. CD confirmed that both errors were the result of inaccuracies when inputting the details from the supporting documentation into the database.

Apart from effecting the respective officers' salary, incorrect inputting of details relating to overtime at merchants' request could have repercussions on the amount eventually charged by CD to the respective merchants for such work.

Attendance Sheets

Manual Attendance Sheets still in place

All officers selected in the audit sample recorded their clockings on manual attendance sheets. This procedure is not in line with the Government strategy on the introduction and installation of an integrated payroll/Human Resources (HR) system across the Public Service. Furthermore, little control can be exercised over employees' timely attendance to work, particularly in view of the various shortcomings noted in the maintenance of attendance sheets.

Attendance Sheets not endorsed by a responsible Officer

In verifying attendance records pertaining to the officers falling within the audit sample, NAO noted that a number of attendance sheets were not endorsed by a responsible officer. Therefore, no assurance can be obtained on the validity and accuracy of attendance records.

Shortcomings in Attendance Records

A review of officers' attendance sheets revealed a number of shortcomings. Very often, rather than recording the actual 'time in' and 'time out', officers were only noting the times during which

⁴ CD verbally confirmed that this was not an official document.

they were expected to be at work. This was particularly evident when officers had conducted overtime work in addition to their normal hours of work, whereby additional hours were not recorded on the respective attendance sheets. Moreover, the 'time out' was not always indicated on the respective attendance sheets.

NAO also noted that the clockings on a number of one of CD's Sections' attendance sheets were pre-printed. On another instance, although the attendance sheet indicated that an officer was on vacation leave, the clocking was still evidenced, possibly implying that the clocking of times in and out was done at an earlier stage.

Missing Attendance Sheets

A number of attendance sheets were not made available for audit purposes. As a result, 8.75 hours of vacation leave deducted from one of the sampled officer's entitlement could not be confirmed against attendance sheets. Furthermore, it cannot be excluded that vacation leave availed of during periods for which attendance sheets were not provided, was not deducted from the respective officers' entitlement.

Apart from hindering testing on vacation leave, in the absence of attendance sheets, the validity and accuracy of salaries paid to the respective employees could not be ascertained.

Leave

No Formal Application for Vacation Leave

Except for in the case of one officer, vacation leave availed of by the remaining 14 sampled officers, was not supported by application forms as per PSMC. It transpired that different procedures for recording requests for vacation leave were in place within different CD Sections/Units. These ranged from the applicant sending an electronic mail to CD's HR Office, officers calling the Detail Office to book for leave, and applications for vacation leave noted on the Section's daily diary.

This lack of uniformity for vacation leave booking by the Department's employees could pose difficulties in monitoring the system and ensuring that the correct procedures were being adopted.

Furthermore, in the absence of formal application forms, it cannot be ensured that the vacation leave availed of by the officers falling in the audit sample was timely and duly authorised.

Requests and Approvals for Accumulation of Vacation Leave not made available for Audit purposes

As at end 2013, eight officers out of the 15 selected in the audit sample had a vacation leave balance of more than six hours. The request for accumulation of leave from 2013 to 2014 by four of these officers, and the respective approvals, were not made available for audit purposes. CD stated that the data relating to three of the officers was lost following a system upgrade, while in the fourth case, the relevant documentation could not be traced. Nonetheless, a total of 175.50 hours unutilised in 2013 were added to the respective officers' 2014 vacation leave entitlement.

Vacation Leave availed of not deducted from Entitlement

Unrecorded entries of vacation leave were noted in four out of the 15 vacation leave records for 2014 selected in the audit sample. In fact, although the attendance sheets indicated that these four officers did not report to work, the respective vacation leave records were not updated accordingly. Consequently, a total of 61.50 vacation leave hours availed of were not deducted from the yearly entitlement, resulting in unutilised hours as at 31 December 2014 being overstated.

Discrepancies between Absences Reports and Attendance Sheets

Audit testing on vacation leave records revealed that in four instances, although these records indicated that the officers availed themselves of vacation leave, such absences were not noted on the respective attendance sheets. Hence, it could not be confirmed whether the mentioned vacation leave hours, as recorded in the system, were correct or even authorised.

Incorrect Deduction of Sick Leave for Pensionable Staff

According to the PSMC, sick leave availed of by pensionable officers is to be computed in terms of days, while Saturdays, Sundays and Public

Holidays occurring at the beginning or at the end of any period of sick leave are not considered as sick leave. However, audit testing revealed that this clause was not always adhered to by CD. During 2014, an Inspector falling in the audit sample, and who is considered as pensionable by the provisions of the PSMC, was on sick leave for a period of time, which included also a Public Holiday. However, the number of sick leave days recorded in the system failed to include this latter date, and thus were understated.

Other Matters

Unauthorised Accumulation of Time Off *In Lieu*

Due to the absence of necessary documentation, it could not be ensured that the accumulation of Time Off *In Lieu* (TOIL) was authorised from the right level of authority. In fact, the availing of TOIL did not seem to be supported by a formal request which is duly endorsed, hence increasing the risk that TOIL records were not properly updated. During the audit, CD officials confirmed that, although the hours performed by some of the sampled officers were constantly being monitored, there were no formal authorisations for time-off.

Furthermore, the daily accumulation of time-off, resulting from the working hours of one of CD's Sections, was leading to a constant increase in TOIL balances, thus leading to a higher probability that once these hours are utilised (ex. due to retirement), disruptions in the Section's smooth operation may arise.

Clauses of Telework Agreements not adhered to

A review of the attendance sheets revealed that two officers with teleworking arrangements reported at the workplace on days other than those stipulated in the respective agreements.

In both cases, no documentation indicating the change in working schedule was traced to the respective officers' personal file. Therefore, no assurance could be obtained that the changes in telework schedules were duly authorised.

Records of Personal Emoluments not centralised

During the audit, NAO noted that documents and workings supporting the payment of salaries, overtime and allowances, as well as other records relating to personal emoluments, were not kept at a centralised location. Instead, this information was compiled and stored at the respective Customs' offices at different locations around Malta.

As was evident throughout the audit, when documentation is dispersed at various locations, the retrieval of information and calculations of amounts payable to officers as personal emoluments is largely hindered. Furthermore, the current system for retaining documentation increases the probability that such important records are misplaced.

Recommendations

Key Issue

Delays in replying to NAO Queries

Auditees are to cooperate with NAO and forward any required documentation or information on a timely basis. This facilitates NAO work in identifying inefficiencies, and present appropriate recommendations to the entity being audited.

Control Issues

Salaries

Incorrect Amounts paid to Officers

More attention is to be placed when implementing changes in salaries, in particular those related to promotions and progressions, thus limiting, as much as possible, errors in the respective computations.

Allowances

Inaccurate Allowances paid to Officers

CD is to ensure that the rates and amounts of allowances due to officers are thoroughly checked, so as to minimise adjustments to subsequent salaries. Allowances are to be paid to officers strictly up to the day they are entitled to receive them.

Furthermore, CD is to ascertain that the Gozo Salaries Section, responsible for processing salary payments, is timely informed of all changes which effect such payments, and that all allowances are paid in the period when they are due.

Hours worked in compensation for Flexibility Allowance not always evidenced

Customs Class employees' attendance is to be thoroughly monitored to ensure that the additional two hours per week are being performed without fail.

Incorrect Deduction from Flexibility Allowance Entitlement

Whilst deductions to the flexibility allowance entitlement are to be effected as per the relevant Memorandum, more attention is to be placed when calculating the actual amounts to be deducted, thus reducing the incidence of errors.

Overtime

Supporting Documentation for Overtime and Allowances not made available for Audit purposes

CD is to ensure that the forms recording the relevant details when overtime is performed at merchants' request are duly raised. These forms are to be appropriately filled in, endorsed by the parties involved, as well as adequately filed for ease of future retrieval.

Requests for Approval of Overtime Work not raised

A detailed analysis of the necessary additional hours and required personnel is to be prepared prior to the performance of overtime work. CD is also to ensure that these overtime requests are duly authorised by the Permanent Secretary, as per PSMC.

Incorrect Payments for Overtime performed at Merchants' Request

Overtime performed at merchants' request is to be thoroughly vetted against the original source documentation, in order to ensure that the correct amounts are paid to officers and charged to merchants. This should avoid having to resort to additional corrective measures, which could be time-consuming, as well as cause an unnecessary strain on the Department's resources.

Attendance Sheets

Manual Attendance Sheets still in place

CD is to consider more effective means of recording attendances.

Attendance Sheets not endorsed by a responsible Officer

An officer from each Section is to be held responsible for ensuring that the details contained in the respective attendance sheets are correct.

Shortcomings in Attendance Records

All officers are to be instructed to clearly log the actual clockings, including overtime hours, as well as any absences from the normal work schedule without absence or fail. Prior to certifying attendance sheets, the responsible officers are to ensure that these have been adequately filled in. Any missing details are to be looked into and, if necessary, an explanation provided in the remarks column.

Missing Attendance Sheets

All attendance sheets are to be appropriately filed for future reference.

Leave

No Formal Application for Vacation Leave

In order to facilitate vacation leave management, including application for leave by employees, authorisation and the eventual updating of records, CD is to consider investing in an electronic system for recording vacation leave. This would ensure that authorising officers are immediately notified of any requests for vacation leave, and the HR Section is timely informed of the respective approvals.

Requests and Approvals for Accumulation of Vacation Leave not made available for Audit purposes

All requests and subsequent approvals for accumulated vacation leave are to be systematically filed and retained for future reference.

Vacation Leave availed of not deducted from Entitlement

Since at present vacation leave records are updated solely from information obtained from attendance sheets, more care is to be placed when manually inputting such information.

The occurrence of errors would be largely reduced if an electronic vacation leave management system is implemented.

Discrepancies between Absences Reports and Attendance Sheets

As already recommended, CD is to consider more effective vacation leave management systems, which would largely reduce the incidence of such discrepancies.

Incorrect Deduction of Sick Leave for Pensionable Staff

Whilst all provisions of the PSMC are to be adhered to, CD is to strive to maintain accurate sick leave records and provide the correct treatment for officers employed within the Department, taking

into account whether an officer is pensionable or otherwise.

Other Matters

Unauthorised Accumulation of Time Off In Lieu

More control is to be exercised over the accumulation and availing of TOIL, and both procedures are to be duly authorised. Furthermore, time-off is to be resorted to only in exceptional cases. If work exigencies necessitate that officers perform additional hours on a daily basis, the Department may consider different options from the current arrangement.

Clauses of Telework Agreements not adhered to

In the event that telework arrangements need to be changed due to work exigencies, such amendments are to be duly authorised and recorded in the respective officer's personal file.

Records of Personal Emoluments not centralised

The Department's procedures on the maintenance of records relating to personal emoluments are to be reviewed and the centralisation of related processes thoroughly studied. Any possible improvements to simplify the retrieval of records, identified from this exercise, are to be implemented accordingly.

Management Comments

In its reply, Management concurred with most of the observations and recommendations put forward by NAO, and confirmed that it would be addressing any issues for which corrective action had not yet been taken.

Management also forwarded its comments on a number of NAO's observations:

- The Department explained that any delays in replying to NAO queries and in the submission of information requested during the course of the audit was not due to lack of cooperation "... but merely a question of logistics, especially given the sometimes large amounts of information

requested by NAO". It further remarked that CD's control was limited or lacking on inaccessible computer systems (such as the payroll system), requiring third parties' intervention.

- Although Management acknowledged the errors made in the allowances paid to officers, it claimed that in most cases, the Gozo Salaries Section would have been notified of any changes as soon as possible. However, amendments are not always carried out on time by the latter.
- As regards the forms intended to record the performance of overtime at merchants' request, CD commented that their absence "*... may not necessarily hinder operations. Nor will it instigate errors*". The Department further explained that any mistakes related to such overtime are normally detected immediately "*... due to automatic balancing checks that take place*".
- CD confirmed that the possibility of introducing an Attendance Verification System had been examined but no action had been taken due to the large financial costs involved in installing such system at the different Sections situated in various locations throughout the country. Moreover, Management mentioned "*... the possibility of infringement of the Data Protection Act ...*", stating that "*... during recent HR Seminars, it was learnt that palm readers are not in line with this Act*".

Management also explained that an absence module in the payroll system "*... is currently being developed and the CD is awaiting further information and instructions with OPM prior to taking any further action*".

- On the absence of formal application for vacation leave, Management commented that its "*... Detail Office is manned 24/7 and therefore is always in a position to ascertain that all stations have the necessary manpower*". It further explained that the Department could not implement its own absence management software as this falls under the remit of Central Government.
- Management clarified that it was practically impossible to gather all records relating to personal emoluments in one place due to physical space restrictions.

On the other hand, Management disagreed with the total hours of vacation leave not deducted from the respective officers' entitlement as portrayed by NAO, and forwarded a document to the latter showing that 26.25 hours out of the 61.50 indicated in this Report were in fact recorded in the system. However, in the documentation made available to NAO examiners during the audit, these deductions did not feature, thus raising doubts on whether the data was inputted at a later stage. Furthermore, Management failed to properly address NAO's observation on the unauthorised accumulation of TOIL.





Ministry for Energy and the
Conservation of Water

Ministry for Energy and the Conservation of Water

Expenditure Audit - Energy

Background

The Ministry for Energy and Health (MEH) was set up in April 2014 to integrate the then Ministry for Energy and the Conservation of Water (MECW) and the Ministry for Health. Due to their different nature, the operations within these portfolios were still kept separate. To this effect, the Energy portfolio strives to achieve excellence in energy and water infrastructures, for better competitiveness and quality of life.

The Financial Estimates for Vote 46 show an approved estimate for 2014 of €20,698,000 for Capital Expenditure, and €42,199,000 for Recurrent Expenditure. Out of the latter, a projected outlay of €1,526,000 was assigned for Personal Emoluments, whilst €488,000 were voted for Operational and Maintenance Expenses.

Audit Scope and Methodology

The main scope of the audit was to assess the level of existing internal controls over the procurement and payment of expenditure incurred for Energy, falling under MEH during the period January to October 2014. The audit also aimed to ascertain the efficient administration of public funds in line with existing regulations, policies and procedures, including the prudent use of public resources.

Detailed substantive testing was carried out to confirm the existence and the correct application of procedures and controls. Targeted accounts

consisted mainly of Contractual and Professional Services, Transport, Travel, Hospitality and Equipment. Individual transactions included in the audit sample, relating to the period under review, were selected based on their nature and materiality. A total sample of 23 transactions was selected, collectively amounting to €340,305 and representing 50% of actual Operational and Maintenance Expenditure.

In general, audit testing was performed to ensure compliance with the Public Procurement Regulations (PPR) as set out in Legal Notice 296 of 2010, related provisions within the Public Service Management Code (PSMC) as duly updated, as well as various other related Circulars.

Moreover, the National Audit Office (NAO) selected 11 officers employed with MEH, and tested the accuracy and validity of their gross emoluments, totalling €240,813. Verification was done against supporting documentation made available by MEH, and also against general regulations and guidelines for employment issued by the Office of the Prime Minister.

NAO also analysed overtime costs for the 13 officers employed with the Ministry, who for 2014, were allowed to work extra hours in excess of their basic daily schedule. Such overtime costs amounted to a total of €82,784.

Furthermore, NAO tested inventory held by MEH for the year under review, against the standing Circular. This involved a physical inspection

which was held by NAO, whereby the Inventory List available as at 31 October 2014, was checked for accuracy and completeness. A sample of 56 inventory items located at *Auberge de Castille* and *Sa Maison*, was selected for testing purposes.

Testing was also conducted in relation to the Ministry's general-use cars. During the audit, MEH held a maximum of five general-use vehicles.

Good Practice

NAO satisfactorily noted that all fiscal receipts in relation to the sample selected were available at the Ministry.

Key Issues

During audit testing, NAO noted that internal controls in a number of areas were lacking, indicating weak monitoring on the efficiency of public spending. The instances outlined below indicate lack of compliance with PPR, as well as other shortcomings in relation to personal emoluments.

Non-compliance with Public Procurement Regulations with respect to Legal Services

Legal Services in connection with Enemalta Corporation

A legal advisor was engaged by the then MECW to provide legal services in connection with the establishment of a Maltese company to which the assets and liabilities of Enemalta Corporation were to be transferred. A Letter of Engagement dated 2 January 2014 was issued and signed for the provision of such services, at the hourly rate of €170, excluding Value Added Tax (VAT). A superseding Letter of Engagement for the provision of additional services, dated 12 March 2014, was then issued and signed at the reduced rate of €156 *per* hour (VAT excl.).

Direct Order issued retrospectively

Internal correspondence within MECW revealed that a draft Engagement Letter for the provision

of legal services was available on 3 December 2013, which was prior to the request for approval for the engagement of this service provider. In fact, correspondence with the Direct Orders (DO) Section within the Ministry for Finance (MFIN) requesting the approval of such engagement, was dated later, on 6 December 2013. To this effect, NAO may conclude that the Ministry had already made commitments with the legal firm in question, before forwarding a DO request. This practice is not in compliance with MFIN Circular No. 3/2013 – 'Public Procurement Regulations – Direct Orders'.

No Evidence of Control over Fees charged

In a reply from MFIN dated 10 December 2013, MECW was requested to justify recourse to a DO, as well as the choice of this service provider. Moreover, the Ministry was advised to set a maximum threshold for such services, since the proposed rate of €170 (VAT excl.) was deemed to be "... quite substantial and ... could spiral out of control".

In its counter-reply, besides providing the reasons for resorting to a DO¹, MECW stated that, "... this is an average rate charged for the services of the top notch in respect of professionals and juniors working on this assignment". The Ministry also stated that the legal firm will be asked to forecast the hours of work required on a monthly basis in order to ensure that expenses are kept in check.

Notwithstanding this statement, no evidence was traced, showing that the monthly forecasts which the service provider was to provide to the Ministry, were actually submitted for verification.

Letter of Engagement lacking Maximum Threshold

NAO noted that an approval 'in principle' was granted to MECW on 14 January 2014 to place a DO with the supplier in question, at an hourly rate of €170 (VAT excl.). However, as stated above, MFIN strongly opined that a maximum value for these services should be negotiated. MECW was urged to request a definite approval from MFIN once the actual cost was known.

¹ "The decision to go for a Direct Order was taken on the basis that the services being asked for requires extensive knowledge of government to government agreements commissioned in the past and the time frames required to meet the deadlines of the MOU [Memorandum of Understanding] in place which do not permit the issue of a tender process and finally the level of trust required due to the sensitivity of the negotiations [sic negotiations]".

In spite of the above-mentioned MFIN's instructions, MECW still endorsed the Draft Agreement with the supplier on 11 February 2014, which did not make any reference to either a maximum value to be paid for the services provided, or an engagement period. The same issue re-emerged with the second, superseding Letter of Engagement with this legal advisor, dated 12 March 2014. NAO also noted that MECW's formal approval was dated 11 February 2014, whereas the signed Letter of Engagement was dated 2 January 2014, thereby implying that negotiations with the service provider were already underway prior to the formal approval.

Lack of Definite Approval from Direct Orders Section

In the initial DO approval granted by MFIN in January 2014, the Ministry insisted with MECW to submit the actual costing so that a definite approval for legal services may be granted. However, testing revealed that no definite approval from MFIN was traced in relation to two of the three payments selected for review, which amounted to €84,031 and €63,622 respectively. In contrast, a DO approval was traced in relation to the third payment, covering up to €53,537.

It transpired that total payments made to the supplier during 2014 in relation to the legal services in question, totalled €260,494. Since this amount by far exceeded the €120,000 limit established in PPR, a tender should have been issued for the procurement of these legal services, subject to the regulatory and other functions of the Department and Director of Contracts, apart from publishing such Contract Notice in the Official Journal of the European Community (OJEC).

Legal Services in connection with the Enemalta Energy Project

NAO traced a quotation dated 25 July 2014, which was submitted by another legal advisory firm for the provision of legal services in connection with the Enemalta Energy Project. The fees quoted ranged from €235 to €900 *per* hour (VAT excl.), depending on the grade of the legal advisor allocated to the job. No further quotations from other legal advisors were traced in file, and MEH resorted directly to DO procedure for approval.

In its DO approval request dated 30 July 2014, the Ministry stated that, besides the urgency situation, the firm selected was a top legal advisor with an undisputed reputation, with whom the Maltese Government had worked in the past on similar issues.

Retrospective Direct Order Approvals

Audit testing revealed that this firm had been contracted to provide such services from at least 25 July 2014, being the date on which same confirmed *via* email that it had been instructed by MEH to assist on this project. Further correspondence dated 29 July 2014 also stated that MEH had "*mandated*" the legal advisory firm on behalf of Enemalta in relation to the new power station project.

Both dates preceded the date of issuance of the first DO approval from MFIN, being 30 July 2014, for the amount of €20,000 (VAT excl.). Moreover, the invoice for this amount, dated 3 September 2014, further revealed that work on this project had already started a week prior to DO approval, *i.e.* 22 July 2014.

Subsequent DOs were granted by MFIN on 16 and 26 September 2014 for €30,000 and €80,000 (both amounts VAT excl.), respectively. The last approval during the year under review was dated 22 October 2014 for €110,000 (VAT excl.), bringing the total DO approvals to €240,000 (VAT excl.).

Upon further assessment, NAO noted that DO approvals dated 16 and 26 September were also granted retrospectively, as the service was already being carried out before date of approval.

Since the total approved amount by DO Section exceeded the €120,000 limit as established in PPR, this implies that a tender by the Department of Contracts should have been issued for these services. During 2014, an amount of €117,269 was paid to this service provider. However, more invoices and payments in relation to these services are still expected by MEH, as confirmed in correspondence dated 12 January 2015.

In this case, NAO is not in a position to ascertain whether the request for services should have also been published in OJEC. This is due to the fact

that, up to January 2015, no payments against the October 2014 DO were issued.

No binding Contract Agreement for Legal Services

A Contract Agreement for the services in question was not drawn up to bind both parties with respect to the hourly fees for services to be delivered by the service provider, as well as a maximum amount payable to the same provider.

Non-compliance with Public Procurement Regulations in connection with Energy Conference

MEH was involved in the organisation of a conference entitled ‘Security of Gas Supply: The Role of Gas Development in the Mediterranean Region’, held on 10 and 11 July 2014. The European Commission and the Republic of Cyprus collectively paid €18,000 towards the costs involved, whereas a local bank contributed €5,000. The Government of Malta covered the remaining expenditure, mainly relating to the venue, logistics and marketing.

Lack of Evidence supporting selection of Service Provider

A supplier was engaged by MEH to provide lighting and multimedia equipment during the July 2014 Energy Conference. NAO did not trace any quotations in relation to the mentioned service, neither from the engaged supplier nor from other similar service providers. Hence, no evidence was available to justify the selection process, in terms of both the rate charged and the services offered.

Retrospective Direct Order

It transpired that MEH resorted directly to MFIN for a DO approval of €6,571 (VAT excl.). This approval was granted retrospectively on 21 August 2014, which was after the dates of both the event, and the invoice, being 5 August 2014.

Payment in excess of Original Quotation

Another service provider was engaged to supply outside catering services during a reception held as part of the Energy Conference on 10 July 2014. NAO noted that quotations were obtained

from three different suppliers. The cheapest offer of €3,190 was selected, however an additional amount of €2,477 was allocated to include extra expenses (beverages and rental of a marquee tent), increasing the total budgeted cost to €5,667.

Nevertheless, it transpired that the actual cost as *per* invoice dated 16 July 2014, for the services originally quoted, amounted to €12,249. This resulted in an increase of €9,059 over the original quotation of €3,190.

It was noted that the invoice also included additional costs (flowers, candles, transport, chair covers and beverages) for a value of €3,310, resulting in a total invoice value of €15,559. This led to an aggregate increase of €9,892 over the total original budgeted cost of €5,667. No explanation for such increase in costs was traced in file.

Direct Order Approval lacking

Following receipt of invoice, MEH requested a DO approval for €13,200 (VAT excl.) to settle payments due. Nevertheless, MFIN did not consent to this DO, stating that it is not in a position to grant retrospective DO approvals. Subsequently, NAO noted that an instruction for payment of such services was given on 9 September 2014.

Shortcomings in relation to Personal Emoluments

Inadequate Overtime Approvals

NAO noted that two Permanent Secretary’s approvals for overtime were granted on 6 January and 26 June 2014, for the periods January to June and July to December 2014, respectively. Both approvals were granted to 13 MEH officers to perform work related to Human Resources, Accounts, Procurement and Registry Services, and other general administrative duties. The second approval also included messenger driving responsibilities, as well as Reception and Customer Care duties at the Ministry.

Therefore, it is evident that both approvals relate to general office day-to-day duties, and go against the provisions of Section 3.2.1.1 of PSMC, which states that “*Overtime work should be resorted to only in exceptional circumstances*”.

Additionally, both approvals were granted for periods of six months, being contrary to Section 3.2.1.2 of PSMC, which states that overtime can be approved “...for periods not exceeding 3 months...”.

Overtime Hours in excess of Permanent Secretary’s Approval

Testing revealed that the approval granted in January 2014 allowed a maximum of two hours daily to be worked as overtime by the authorised officers. Upon further inspection, it was noted that this threshold had been regularly exceeded during the first six months of the year, without covering approval. In fact, NAO noted that four MEH officers were in breach of these guidelines. This excess overtime amounted to 511 hours, approximately totalling €5,871.

Increase in Overtime Costs

Contrary to the first overtime approval, the second one dated 26 June 2014 allowed the authorised officers to carry out overtime up to “*A maximum of 2 Hours daily or as required*”. NAO noted that overtime increased substantially during the last six months of 2014. It transpired that overtime increased by 50% from 2,958 hours in the first six months, to 4,436 hours, with a resulting additional cost to MEH of €15,555.

Unauthorised Overtime Hours

NAO testing further revealed that during the periods January to June and July to December 2014, overtime amounting to €7,449 was worked by various MEH officers, without adequate prior approval. In fact, upon assessment of the relevant files, NAO traced a total of 626 unauthorised overtime hours, which pertained to 12 officers.

Breaks not deducted from Overtime Worked

Subsidiary Legislation 452.87 – ‘Organisation of Working Time Regulations’ states that every worker should be entitled to a break for at least an uninterrupted period of 15 minutes, in those cases where the working day is longer than six hours.

Testing revealed that during the year under review, no breaks were deducted from overtime hours. As

a result, NAO analysed overtime worked during the period 18 June to 30 September 2014, being the period with reduced summer hours, to estimate the extra amount paid by MEH with respect to breaks foregone. For the purpose of this calculation, NAO analysed the overtime hours worked by the 13 authorised officers. The estimation of break periods amounted to approximately 217 hours and resulted in a total of €2,566 paid in excess.

Control Issues

Shortcomings in relation to General-use Vehicles

In April 2013, the then MECW obtained three quotations in relation to the rental of general-use cars. The cheapest service provider of car rental was selected at the rate of €310 *per car per month* (VAT excl.).

Lack of Finance Approval for Rental of General-use Vehicles

On 23 April 2013, the then MECW obtained an approval from the Financial Policy and Management Division within MFIN, for the rental of three vehicles for one month. This approval also instructed that two vehicles should be procured after expiration of the period in question, whilst the rental of the third car should be terminated, unless a specific request for such rental is made to the Office of the Prime Minister, stating the reason for this requirement.

However, NAO noted that the rental of all the general-use vehicles went ahead, despite the fact that MFIN only granted approval for a month’s rent for three vehicles. In fact, rental of general-use cars was still being provided by the same supplier, at least up to November 2014. In total, this supplier was paid an aggregate amount of €17,692 during 2014. Audit testing further revealed that no contract with the selected supplier was available in relation to the rental of such vehicles.

No Logbooks kept in relation to General-use Cars

During testing, MEH confirmed that no logbooks were being kept to record the journeys made by general-use cars used during 2014. This goes against the provisions of Section 8.2.4 of PSMC.

Discrepancies in Inventory

NAO noted a number of discrepancies between the list of assets provided by MEH and the inventory on-site. Notwithstanding the requirements of MFIN Circular No. 14/99 – ‘Government Accrual Accounting: Revised Inventory Control Regulations’, testing revealed that 19 items present at the offices were not traced to the inventory list. Furthermore, six furniture items valued at €1,924 listed in the aforementioned list were not traced on-site.

NAO also noted that all inventory items inspected were not tagged with a unique code contrary to the requirements of the above-mentioned Circular.

Compliance Issues

Lack of Compliance with Standing Travel Regulations

Travel Documentation not available

A sample of five trips made by MEH officials, in aggregate amounting to *circa* €29,000 were tested. In all instances, no boarding card stubs were traced. Additionally, in two of the cases tested, no agenda was available to indicate the reason for travel.

A report containing the purpose and benefits achieved from these visits, as required by MFEI Circular No. 5/2012 – ‘Travel on Official Duty’, as well as other related information, was lacking for all the five visits.

No Quotations available

In the case of two trips held during 2014 to the People’s Republic of China, no quotations were traced in file. This goes against the provisions of Section 8.7.1.4 of PSMC. Furthermore, in both cases, flight tickets were purchased directly from a particular travel agent and the respective invoices were then forwarded to Directorate Corporate Services for payment to be affected.

VAT Returns not submitted

Upon NAO enquiry, MEH confirmed that it did not forward the quarterly Returns reporting fiscal receipt defaulters, which it should be submitting to VAT Department in accordance with MFEI Circular No. 2/2012.

Recommendations

Key Issues

Non-compliance with Public Procurement Regulations with respect to Legal Services

Local and European Union procurement regulations, where applicable, are to be followed in order to ensure transparency, accountability and to provide equal opportunity to all interested parties. It is also highly recommended that projections of total costs are made prior to engagement of any service provider, and where applicable, a call for tenders for such legal services is to be considered.

Moreover, whenever a DO is required, such requests are to be forwarded prior to the engagement of the service provider. It is also recommended that any conditions laid out by MFIN on DO approvals are to be invariably followed.

Also, the Ministry is to ensure that procurement of services is at all times supported with a valid Contract Agreement.

Non-compliance with Public Procurement Regulations in connection with Energy Conference

The Ministry is to ensure that, whenever possible, quotations are obtained prior to the supplier selection. Otherwise, adequate approvals are to be obtained prior to the engagement of the service provider.

Furthermore, the Ministry is to enforce budgetary control measures to, as far as possible, minimise variances from the original budget. This will enable more flexibility and control on the available funds.

Shortcomings in relation to Personal Emoluments

It is recommended that overtime hours are justifiable and reduced to an acceptable low level. Approvals are to be in line with PSMC requirements, not to instigate any form of abuse or ethical misconduct. Whenever possible, overtime should be limited to *ad hoc* assignments with specific targets to be attained.

Moreover, break periods are to be taken by all officers working for more than six consecutive hours, as required by law, whilst all overtime must be adequately approved in advance. This will render a more efficient environment *vis-à-vis* personal emoluments, to ascertain value added to MEH and Government in general.

Control Issues

Shortcomings in relation to General-use Vehicles

It is recommended that the Ministry follows the provisions of MF Circular No. 4/2005 – ‘Purchase/Lease of Motor Vehicles’, and abides by the directions given by MFIN with respect to the rental or purchase of such vehicles.

MEH is also expected to maintain a proper logbook for each of its general-use vehicles, in line with Government standing regulations.

Discrepancies in Inventory

It is recommended that periodic checks are carried out on inventory items to ensure that any discrepancies are recognised. Moreover, inventory items are to be identified with a unique code for ease of reference.

Fixed asset additions are to be immediately forwarded to the officer in charge of inventory for eventual recording in the respective records, to safeguard assets owned by Government.

Compliance Issues

Lack of Compliance with Standing Travel Regulations

The provisions of PSMC are to be invariably adhered to with respect to travelling expenses, to

ensure that appropriate budget provisions are made and the most competitive prices are obtained.

Additionally, reports on each visit are to be compiled by the attending officer(s) by not later than one month after the visit, to enhance accountability and to make sure that any issues are adequately followed up.

VAT Returns not submitted

Management is to ascertain that pertinent regulations are adhered to and Returns are submitted to VAT Department on a regular basis to report defaulters. Nil Returns are also to be forwarded accordingly.

Management Comments

In its reply, Management took note of the observations and recommendations put forward by NAO and forwarded the following additional comments:

Non-compliance with Public Procurement Regulations with respect to Legal Services

The Ministry maintained that procurement regulations were followed appropriately in relation to the engagement of both legal advisors referred to in NAO’s observations and were in adherence to the principles of sound governance and financial management. MEH stated that these projects required the provision of high-level expertise with utmost urgency. Given their complexity, it was premature and difficult to determine the number of hours required prior to the commencement of the work.

In relation to legal services in connection with Enemalta Corporation, the Ministry claimed that it did not enter into any legal and contractual obligations prior to the DO request and approval. Furthermore, with regards to the legal advisor engaged in connection with the Enemalta Energy Project, the Ministry forwarded ‘Terms of Business’ with the legal advisor, signed solely by the Permanent Secretary on 6 August 2014.

The Ministry clarified that although the word “*mandated*” might imply so, this was only “*in principle*” and MEH did not enter into any

contractual obligations with the law firm in question prior to the approval of DO.

Non-compliance with Public Procurement Regulations in connection with Energy Conference

MEH forwarded two quotations for the provision of lighting and multimedia equipment during the July 2014 Energy Conference. The cheapest quotation, which at the time did not exceed €6,000 (VAT excl.), was selected, however additional equipment costs were then incurred bringing the total up to €6,571 (VAT excl.). The Ministry explained that since the threshold was exceeded, it had to revert to a retrospective DO.

Likewise, costs relating to outside catering increased significantly due to the fact that a few days prior to the conference, following consultation with the European Commission which were co-organisers of the event, a decision was taken to host a gala dinner at the Upper Barrakka Gardens, instead of a reception. By that point, the Ministry had already engaged the catering services and therefore had to resort again to a retrospective DO.

As a way forward, MEH Circular No. 1/2014 – ‘Requests for Works, Services and Supplies’, dated 22 September 2014, was circulated amongst all Ministry’s staff to highlight the importance of following the relevant procurement procedures.

Shortcomings in relation to Personal Emoluments

As a general comment, the Ministry explained that since it was set up in March 2013, MEH lacked the necessary structures and staff capacities. Overtime was therefore necessary to cope with the Ministry’s various functions.

By way of corrective measures, as from 2015, all overtime approvals were requested in advance for periods not exceeding three months, as *per* PSMC requirements. Furthermore, clear reasons were provided stating that overtime was being requested in view of exceptional circumstances and tied to specific tasks.

With respect to one of the officers for whom NAO did not trace any overtime approval, the Ministry provided a copy of the request for approval of overtime for the period April to December 2014,

signed by the Permanent Secretary. In the other cases mentioned, MEH stated that approvals were granted verbally by the Permanent Secretary.

The Ministry also ensured that with immediate effect, a 15-minute break is deducted from the overtime payments to be in line with applicable regulations. According to the Ministry, “*The officers in question were not aware of the obligatory 15 minute break and therefore they kept working throughout the whole overtime period*”.

Shortcomings in relation to General-use Vehicles

MEH stated that during 2014, due to lack of budget allocations, it was not in a financial position to purchase the general-use vehicles as instructed by MFIN.

However, by way of corrective measures, in 2015 the Ministry is considering replacing some hired cars with Hire Purchase Agreements for new general-use vehicles. Moreover, logbooks are being maintained for all Ministry cars.

Discrepancies in Inventory

The Ministry attributed the audit observations to settlement issues, besides continuous movement and lack of staff. NAO was informed that a comprehensive inventory exercise is underway, together with periodic checks to ensure that all inventory items are tagged with a unique serial number in line with Government standard procedures.

Corrective Action in relation to Compliance Issues

With regards to travel and VAT Returns, MEH stated that it will be taking the necessary corrective action to ensure that standing regulations are adhered to. The Ministry also remarked that no formal report was submitted following the high-level duty abroad missions, as “*... dealings involved confidential information of a sensitive and commercial nature*”.





Ministry for Health

Mount Carmel Hospital

Personal Emoluments

Background

Mental Health Services incorporates Mount Carmel Hospital (MCH), Psychiatric Unit at Mater Dei Hospital, the Community Mental Health and the Mental Health Services at Gozo General Hospital.

MCH assists persons with mental health problems through a comprehensive and integrated range of health services, which are also extended within the community. Besides general psychiatry, the services offered also include specialised psychiatric services for children and adolescents, rehabilitation, old age, learning disability and forensic psychiatry. The Hospital's portfolio of services was also broadened to include the care of the elderly.

Personal emoluments paid out by MCH account to *circa* 70% of the Hospital's recurrent expenditure. *Table 1* analyses the total emoluments paid to employees on the Hospital's payroll, which during the year 2014 amounted to €20,669,976. It shows that total allowances of €5,379,659, and overtime amounting to €1,738,851, accounted to 26% and 8% of total emoluments respectively.

Audit Scope and Methodology

The main scope of the audit was to verify that salaries paid to employees through the first 10 payrolls¹ of 2014, including payments for overtime and allowances, were correct. The level of internal controls, as well as adherence to applicable regulations and agreements, were also to be determined.

An overview of the 2014 payroll² revealed that the highest allowances were paid to the Medical Class, with the uppermost, amounting to €81,450, paid to a Higher Specialist Trainee. Another 221 employees received allowances in excess of €10,000, whilst the average allowance per employee during the period stood at €6,801.

On the other hand, the highest overtime payment for the year, amounting to €27,146, was received by a Charge Nurse, whilst another 61 employees received overtime payment in excess of €10,000. Additionally, others had high accumulation of balances of Time Off *In Lieu* (TOIL), running into thousands of hours, in a number of instances.

¹ Payroll 10 covering up to 7 October 2014.

² Information covering all 13 payrolls was available by the time the audit was finalised.

Table 1: Analysis of Payroll Costs for the Year 2014

	Emoluments paid	Percentage
	€	%
Basic Salary	12,086,791	58.47
Allowances	5,379,659	26.03
Bonus	336,988	1.63
Overtime	1,738,851	8.41
Fringe Benefits	3,202	0.02
Social Security Contributions	1,124,485	5.44
Totals	20,669,976	100.00

Various meetings were held with Management and Administrative Officers during the course of the audit, in order to gain knowledge about internal controls and adopted procedures. A sample of 10 employees, spread out amongst the classes of Consultants, Medical Doctors, Nurses, Care Workers, Nursing Aides and Health Assistants, was selected for testing, based on the materiality of allowances and overtime payments received. Employees on reduced hours, teleworking procedures and TOIL were also reviewed.

Limitations on Scope of Audit

The objectives and the completeness of the audit examination were hindered as the following information was not presented for audit purposes:

Time Off In Lieu Records

The audit fieldwork revealed considerable paperwork relating to TOIL, grouped by ward, which was still in process of being updated by the officers in charge. Furthermore, individual records, consisting of each employee's opening balance, additions, deductions and the resulting balances, were not available upon request. These balances were subsequently provided following a significant number of attempts.

However, Management confirmed that, to eliminate the backlog, the balances on the individual TOIL cards, which are kept by each officer, were taken as correct, regardless of the records maintained by MCH. Reconciliation of these balances was intended to start only from there onwards. Thus, audit testing on individual balances was deemed futile.

Consultants' Attendances

The payments to consultants, for attendance during 'extra sessions' and 'extra ward visits after normal hours', could not be corroborated since no attendance records were kept for consultants.

Key Issues

Weak or Lack of Internal Controls

Audit testing revealed lack of internal controls in various areas relating to salary payments. Instances were noted where overtime payments and allowances granted to employees were either unauthorised, inadequately supported by evidence, or incorrect.

Below is a list of internal control weaknesses identified during the audit, which will be discussed separately further down in the Report, under the pertinent observations:

- a. concerns with respect to on-call allowance;
- b. inexistence of official policies regulating overtime;
- c. prior requests to perform overtime not made;
- d. lack of control over TOIL;
- e. lack of attendance verification;
- f. lack of segregation of duties;
- g. inadequate filing of documentation; and
- h. teleworking regulations not followed.

Table 2: Annual Overtime Cost

Year	Amount
	€
2010	1,127,085
2011	1,213,520
2012	1,286,101
2013	1,389,983
2014	1,738,851

Consistent use of Overtime

The Public Service Management Code (PSMC) section 3.2.1.1 states that “*Overtime work should be resorted to only in exceptional circumstances. Periodic reviews of overtime work should be made, with the aim of changing or adapting work patterns, so as to economise on overtime and increase productivity by other means*”.

Table 2 portrays MCH’s annual overtime expense, which increased by 54% over the last five years.

The annual overtime expenditure of €1,738,851 confirms that, with an average monthly cost of €144,904, overtime was resorted to consistently by MCH during 2014.

Claims that Management was presented with an analysis, showing that it was more cost beneficial to employ new staff as against incurring overtime, could not be confirmed as supporting documentation was not available. However, calculations made available by MCH for audit purposes revealed that the cost of direct employment of 23 nurses and 19 nursing aides, compared to the cost of overtime to perform the same work, would have generated savings amounting to the tune of €555,000 during 2014.

Excessive Extra Duty Hours worked

As per Medical Class Agreement, doctors are obliged to work 40 hours per week, but in view of the Hospital’s requirements, coverage by medical staff is required around the clock. Therefore, extra hours are included in doctors’ weekly rosters by a rotation, planned beforehand by the Chairman

of Psychiatry’s Office and updated every month, according to commitments and availability of doctors. Extra Duty Allowance (EDA) is paid at the rate of 1.5 for hours exceeding 45 hours in a given week, double rate for Sundays, and Public Holidays at the rate of 2.5. Doctors record their attendance for work by signing the register and manually logging their arrival and departure times.

During the year under review, a Higher Specialist Trainee and a Resident Specialist worked a total of 3,740 and 1,669 extra hours respectively, over and above their normal duty hours³. This triggered EDA of €76,450 and €36,355 respectively in addition to their salary.

Detailed testing of these material allowances, in particular that paid to the Higher Specialist Trainee, revealed that the Doctor, in many instances, worked for a number of days incessantly, even up to 102 hours⁴ straight in one particular instance. From a review of the Doctor’s payroll for the year 2014, it transpired that total allowances amounted to €81,450, 94% of which related to EDA. Thus, in aggregate; allowances earned amounted to more than three times his basic pay of €25,846.

Lack of Control over Time Off In Lieu

Absence of Official Guidelines

Notwithstanding requests and subsequent reminders for official guidelines which regulate the management of TOIL within MCH, these were not made available. Subsequently, the National Audit Office (NAO) was verbally informed that these were inexistent.

³ Normal duty hours over a one-year period amount to 2,080 hours (52 weeks at 40 hours weekly), not taking into account any leave entitlement.

⁴ Excluding the one-hour break for each 24-hour shift.

Records not readily available

TOIL balances were not made available upon request. Following various audit enquiries and conflicting replies, Management confirmed that due to a technical error, TOIL balances in the payroll system were incorrect. As a result, MCH assumed the balances, as maintained by each individual employee, as correct as on 2 December 2014, without taking any consideration of the official records. As already indicated under 'Limitations on Scope of Audit', no testing on individual balances was performed by NAO in view of this.

Excessive Accumulation of Balances

An analysis of TOIL balances revealed excessive accumulation of the foregoing. In fact, by the end of the year, 47 employees claimed an accumulation of over 1,000 hours each. In one of these instances, the available TOIL balance stood at 5,206 hours. As at the end of the year 2014, employees had accumulated a total of 168,759 hours as TOIL, which were estimated by MCH to cost €1,437,937. This amount could not be verified.

Staff Shortage increasing Abuse of Wrong Work Practices

MCH Circular No. 60/2003 states that nurses and nursing aides, who are not in a position to take their break during overtime, will be compensated with an extra hour of TOIL. This implies that the current shortage of staff is necessitating overtime work, which in turn is resulting in further increases in TOIL.

Furthermore, the Auditors noted a trend whereby employees tended to use their accumulated TOIL balance to avoid working their shift duty by roster, and then opting to work overtime in a different shift period. This system is conveniently being used by certain employees to generate an ongoing requirement for more overtime hours, to cover absences in shift duty by roster. The following instances, encountered from the relatively small audit sample, warrant mentioning:

Nursing Aide

A Nursing Aide availed of TOIL instead of working his shift duty by roster in 31 instances, which, when taking into consideration the 219 times⁵ that he was expected to report to work, is equivalent to an overall disruption of 14%. During 2014, he was also paid the amount of €21,184 for working 1,731 hours of overtime. Additionally, as at year-end, according to MCH, the Officer had managed to accumulate 1,389 hours⁶ of TOIL with an estimated value of €10,805.

Moreover, testing of a four-week period revealed that on 22 and 27 June, the Officer availed of TOIL when he was duty by roster to work from 7 am to 6 pm. Instead, he worked overtime during the night shift on both days, *i.e.* from 7 pm to 7 am, thus commenced work one hour after his actual shift should have ended.

Health Assistant

A Health Assistant availed of TOIL instead of working his shift duty by roster on 56 out of a total of 219 instances⁵ during the year, leading to a total disruption of 26%. He also worked 1,597 hours overtime, which are equivalent to an average of 31 hours weekly and received an aggregate of €15,501 in this respect. Additionally, the accumulated TOIL balance of 74 hours as at year-end was valued at €475.

Testing of a four-week period revealed that the Officer resorted to TOIL to avoid working night duties on 23 July and 2 August, but instead worked the respective preceding 12-hour day duties and also the shift duty following his original roster, in both instances claiming overtime.

Control Issues

Attendance Verification

- a. Article 8.4 of the previous Collective Agreement for Employees in the Public Service, which was valid until the year 2010, required the introduction of attendance verification devices by not later

⁵ Any authorised absences, such as vacation or sick leave, have not been taken into consideration.

⁶ NAO could not analyse the time span over which this balance was accumulated due to the inadequacy of information made available.

than the end of the same year. Upon the introduction of these devices in a particular work place, they were expected to be used by all employees therein. Notwithstanding these requirements, all 10 officers selected for audit testing registered their attendance manually instead of using the palm reader installed at MCH, with the exception of consultants, whose attendance is not recorded.

- b. Health assistants simply note their attendance manually on the punching cards, with no actual punching being made. Furthermore, these cards are not even endorsed.

Nursing Management remarked that such practice for this category of workers emanated from Union issues. Eight employees were identified as falling under this category and were signing on the punch cards. However, the possibility of other categories of workers doing the same cannot be excluded since the related query remained unanswered.

- c. Consultants' actual presence at MCH is not recorded on any attendance verification system. As a result, payment for extra sessions performed by the two Consultants in the audit sample, amounting to €30,555 and €14,690 respectively, could not be validated. Similarly, extra payment for ward visits over and above basic and extra sessions by consultants could also not be validated. During 2014, seven consultants were paid an aggregate allowance of €19,567 for such visits relating to the previous year.
- d. Normal working hours for the Higher Specialist Trainee and the Resident Specialist sampled for audit testing were 7:30 am to 2:30 pm Monday to Friday, and 7:30 am to 12:30 pm on Saturday. However, it was noted that, in addition to MCH, both Doctors performed duties in other locations, but details of work carried out are included on attendance sheets retrospectively upon return to MCH.

Absence of Standard Guidelines for Overtime

Notwithstanding the regular use of overtime, official standard guidelines, indicating the manner in which it is compensated by MCH, were not available. The following situations encountered, which indicate an inconsistent approach in compensation, substantiate such requirements:

- a. NAO could not confirm why a span of 10 hours overtime was compensated in full, whilst only 11 hours were paid for 12 hours overtime.
- b. Nursing Management claimed that compensation for overtime of a Senior Nursing Manager was in line with a verbal agreement in place. Moreover, the related explanations that were obtained following audit queries were still not consistent with the respective payments made.
- c. The verbal agreement mentioned under the previous observation brought about situations where the Senior Nursing Manager left work at around 3 pm following a shift of approximately nine hours, to return within a short time interval and perform another night shift as overtime. In one instance, the Officer performed two 12-hour shifts, which were only separated with a time interval of just 30 minutes.
- d. The Senior Nursing Manager, who worked day shifts, commencing at 6:15 am in line with his approved roster application form, also performed night duties as overtime. However, during the four-week period tested, the Officer availed himself of three days vacation leave in order to be able to work the extra night duties, which spanned until 7:00 am. This means that effectively, the Officer was compensated for overtime during overlapping periods of 45 minutes each when it was his normal shift duty.

Concerns over Overtime Records

Overtime paid not adequately substantiated

Testing revealed that overtime records are compiled daily by the Nursing Administration Office. These consist of pre-printed sheets, listing all nursing and nursing support employees, which are filled-in manually to record overtime details and the signature of the respective officer. They are subsequently endorsed and forwarded to the Payroll Section to issue payments accordingly. However, this Office has reservations regarding these manual records as they can be easily tampered with.

Lacking Controls on Overtime

Given the manual records, internal controls were found to be lacking due to the following reasons:

- a. The Payroll Office performs limited checking, if any, to reconcile overtime documentation to attendance sheets prior to processing of overtime payments.
- b. No evidence was made available to confirm that checks and reconciliations were made by MCH, to verify whether extra hours worked by an officer were not compensated through the payment for overtime, as well as added to TOIL balance at the same time.

Prior Requests and Approvals to perform Overtime not official

The performance of overtime work is not officially requested and approved. Instead, nursing staff "... who wish ..." to perform overtime duties write their names on the overtime form at the Nursing Administration Office on a daily basis. Subsequently, the respective staff allocates overtime work whilst employees need to confirm the time and location of the overtime required, if any, by looking at the form. This form is not endorsed by anyone.

Overtime Rate not confirmed

Agreement between the Government and the Malta Union of Midwives and Nurses (MUMN) states that when Management requests overtime

from certain nursing categories who hold positions in salary scale 6, 7 or 8, and whose duties are at par with the officers' level of responsibility, this is remunerated at the overtime rate of the respective salary scale held. Overtime for other additional duties not in line with their grade is compensated at the maximum of salary scale 10.

Testing of a four-week period revealed that a Charge Nurse was paid in line with his salary scale for all 121 overtime hours claimed as performed. On the other hand, a Senior Nursing Manager was compensated in line with his salary scale for 58 out of 140 overtime hours, with the remaining balance paid at the maximum of salary scale 10. However, NAO could not confirm that the rates paid were correct in the absence of official requests clearly defining the overtime work needed.

Officers certifying own Overtime

Senior nursing managers are authorised to endorse the sheets for daily overtime performed in wards. This means that they can even approve the payment of their own overtime when it relates to the performance of staff nursing duties in wards.

Staff Complement Ratios not substantiated

Nursing Management stated that the caring staff complement at MCH is pre-determined, reflecting official staff to patient ratios, established following discussions with the respective Unions around the year 2000. This complement is adjusted depending on the number of patients under constant watch, mostly in acute wards. However, this claim, together with its basis and validity, could not be corroborated as the relative documentation was not made available for audit review.

Adherence to Staff Complement Ratios not evidenced

It was claimed that adherence to staff complement ratios is checked daily by top Nursing Management Officials through the 'Staff Detail', which consists of pre-printed sheets listing the officers detailed to work in each ward. However, such checking was not evidenced. Adjustments to the 'Staff Detail' were also made in pencil.

Entitlement to On-Call Allowance not confirmed

Following audit enquiries, it was stated that Senior Nursing Managers are required to be on-call as part of their duties and they may be requested by Management "... to report for duty outside normal working hours due to various urgent needs or surprise inspections". Although it was claimed that this emanated from an agreement between the Health Department and MUMN, the relative documentation was not available.

Inconsistent Information received from Mount Carmel Hospital

According to information made available by the Payroll Office, only one officer in the grade of Senior Nursing Manager was awarded an on-call allowance. In contrast, Nursing Management stated that each of the three Senior Nursing Managers receive on-call allowance in connection with their duty.

Lack of Segregation of Duties

The three officers within the Payroll Section input information from the manual records to the payroll system for the eventual computation of salaries. No independent checks were being carried out. In fact, the following errors relate:

- a. An error in the progression of a group of seven Nursing Aides, which was discovered by the latter early in 2014, resulted in a collective underpayment of €25,600. This underpayment, which related to the years 1993 to 2000, was rectified during the year under review, *i.e.* over 14 years later.
- b. Following a promotion effective from 28 February 2013, a Senior Nursing Manager received an increment on 1 January, instead of 1 April 2014 in line with PSMC section 2.3.2. The resulting overpayment was recovered as soon as NAO brought this matter to the attention of the Payroll Section.

Personal Files not updated

Instances were encountered where the personal files of the employees included within the audit sample were not being properly updated. Moreover, audit

concerns were raised as information requested, particularly in relation to the effective dates of transfer of employees from other entities within the Health Sector, remained unanswered. Furthermore, a copy of the certificate, confirming that a Senior Nursing Manager was entitled to a diploma allowance, was not found in the personal file kept at MCH.

Backdated Roster Application Forms

Employees (excluding doctors) are given the opportunity to opt for particular roster through application forms, which are then subject to Management approval. These forms are retained in personal files and a new form has to be completed, approved and filed every time an employee changes his roster.

NAO examined seven such forms during the review of personal files, two completed in respect of a Care Worker and one each for the other five employees included in the selected sample. In one instance, a revised roster actually came into effect seven weeks before the respective form was drawn up, thus raising concerns as to the controls performed on the officers' attendance by MCH.

Moreover, the form template included a section addressed to the Chief Executive Officer, requesting approval of the allowance relative to the roster. NAO noted that the application form which was backdated by seven weeks was not duly endorsed.

Compliance Issues

Unclear Source for Rates of Extra Duty Allowance

Even though the latest Memorandum of Understanding between the Government of Malta and the Medical Association of Malta, entered into on 27 February 2013, supersedes all prior agreements and written understandings, this does not include any details of EDA and the respective rates payable. Such details were only included in the amendment to the Medical Class Agreement of 2 August 1993, which was issued on 1 January 2002, stating that doctors who are required to work in excess of 45 hours per week will be paid at the rate of 1.5 for any extra hours.

Moreover, this amendment did not indicate the rates payable for extra hours worked on Sundays and Public Holidays. It was even noted that although PSMC states that staff eligible for overtime, who attend for work on a Sunday and Public Holiday, is remunerated at double the basic hourly rate, doctors at MCH are correctly compensated at the applicable rate for Sundays, but at the rate of 2.5 for Public Holidays. On enquiry about the source of such rate for Public Holidays, no feedback was provided by MCH.

Biannual Return of Allowances not prepared and submitted

In accordance with PSMC section 2.4.1.2, Directors responsible for Corporate Services should submit, twice yearly to the Ministry for Finance, on behalf of all the Departments within their Ministry, a return providing detailed information regarding the payment of allowances in the respective Departments, as on 30 June and 31 December.

Although MFEA Circular No. 4/2003 – ‘Payment of Allowances’ and section 2.4 of the Manual on Allowances Payable to Public Officers (August 2014) also spell out this requirement, such returns, pertaining to the year under review, were not sent. Management stated that a return was last submitted in June 2013 upon Ministry for Finance’s request.

Unauthorised Payment of Care Workers’ Allowance

The Agreement on the Payment of an Allowance to Care Workers, dated 19 July 2007, stipulates three types of weekly allowances, *i.e.* €2.33, €5.24 and €8.74, to this category of employees, depending on the area where the officer is assigned to work.

However, testing of a sampled Care Worker revealed that the actual annual allowance paid in 2014 was of €1,150. This was equivalent to that payable to nursing aides and health assistants in accordance with the Interim Agreement on the Nursing and Paramedical Class – (Nursing Support Services Grades), dated 6 March 2008. Further enquiry revealed that the same allowance was also paid to a group of four assistant care workers. However, the agreement in question does not contain any provision entitling such allowance

to care workers or assistant care workers. Thus, the respective payments, amounting collectively to €5,296, are considered as not authorised.

Telework Practices not according to Standing Policies

PSMC requires an ‘Application for Telework’ to be filled in annually, by both the applicant and the Director. When the application is duly endorsed, the decision is communicated to the applicant and all parties concerned, informing them of the approval. Finally, a ‘Telework Agreement’, valid for a period of 12 months, must be signed by both the employer and employee, outlining the work conditions.

Following audit enquiry, NAO was informed that nine employees were working on a telework arrangement during the period under review. A review of the personal files of a sample of three of these employees revealed the following:

- a. A Principal Social Worker had only utilised the teleworking facility during 2013, following which the working schedule was revised. However, the Human Resources Department was not aware of this change before audit queries were raised, in January 2015.

It also transpired that during the teleworking period, the arrangement was for the Officer to leave MCH premises at 1:30 pm whilst commencing telework, performed at her residence in Mellieha, at exactly the same time.

- b. The documents filed with respect to a Senior Principal Occupational Therapist and an Executive Officer were also not in line with PSMC requirements, even though they were still making use of the teleworking facility during the year under review. Furthermore, the arrangement was noted to be unreasonable with respect to the latter, as the employee leaves MCH premises at 2 pm and also commences telework from her residence in Mosta at exactly the same time.

Minimum Daily Rest Period not taken

Evidence made available by MCH, to support TOIL additions⁷ from August to November 2014, contained a considerable number of entries reflecting compensation for work performed during the break period.

Working during the break period contravenes Article 7(1) of the Hospitals and Clinics Wages Council Wage Regulation Order, S.L. 452.54, which stipulates that “*Whole-time employees in any hospital shall be allowed intervals for meals and rest of not more nor less in the aggregate than one hour on any one day*”.

Recommendations

Key Issues

Weak or Lack of Internal Controls

MCH should immediately strive to establish effective measures to implement robust internal controls and reduce unnecessary costs. Thus, especially in view of the amounts involved, one may consider to set up an internal audit section to assist Management in attaining its goals.

Consistent use of Overtime

A long-term solution is required to address this issue, bearing in mind the recurring costly overtime expense. In this regard, Management is encouraged to conduct a holistic review of MCH operations, with the aim of identifying a realistic staff complement required, and to establish the optimal cost efficient arrangement.

Excessive Extra Duty Hours worked

Planned rosters are to limit, as far as possible, the extra hours of duty for doctors up to a reasonable amount, in order to safeguard the health and safety of the latter. As a result, excessively long working hours will be avoided.

Lack of Control over Time Off *In Lieu*

Management is reminded that although TOIL does not involve the outright disbursement of funds, in actual fact its widespread use is shifting the burden to the future. Additionally, the hourly cost of TOIL will continue to rise due to annual increases in salary, and even more so, when officers are promoted. MCH is encouraged to introduce official guidelines to regulate the use of TOIL and limit the possibility of accumulating balances to be carried over at the end of each year.

Staff Shortage increasing Abuse of Wrong Work Practices

Besides disturbing shifts, employee absences when availing oneself of TOIL necessitate more overtime work, which in turn create higher TOIL or extra payment. This leads to a vicious circle where the problem emanating from the shortage of staff is exacerbated. In this regard, measures are expected to be taken to avoid the possibility of having employees habitually availing themselves of TOIL with the scope of claiming overtime.

Control Issues

Attendance Verification

Management is to overhaul the current manual procedure and resort to a system whereby all employees, including consultants, start using electronic attendance verification. This will strengthen controls over attendance and ultimately on the respective compensation. During the transitory period, manual attendance records are expected to be maintained for consultants, whilst also ensuring that attendance is recorded and monitored in each respective location.

Absence of Standard Guidelines for Overtime

The introduction of official standard guidelines is encouraged to ensure that the procedures for overtime work are officially regulated and harmonised across the Hospital.

⁷ From the limited information made available, NAO could not establish what portion of TOIL hours related to breaks and which part related to extra time during 2014.

Concerns over Overtime Records

MCH is to implement an adequate internal control system to ascertain that proper records are kept, thus substantiating the performance of overtime prior to the respective payment.

Prior Requests and Approvals to perform Overtime not official

The performance of overtime is expected to be officially authorised from the right level of authority prior to the commencement of the respective work. Disbursement for the payment of overtime should not be effected unless the necessary approval is obtained.

Overtime Rate not confirmed

The overtime documentation raised is to have a clear distinction from the outset, to enable the Payroll Office to pay the correct rates accordingly.

Officers certifying own Overtime

Management is to address this concern by segregating duties, as far as possible, in order to prohibit employees endorsing their own overtime.

Staff Complement Ratios not substantiated

Adequate audit trail for all the significant issues surrounding MCH's operations is to be ensured. In particular, the source of the ratios in question, the related communication between the parties concerned, and a copy of the prevailing agreement, should be filed for future reference, business continuity, as well as for audit purposes.

Adherence to Staff Complement Ratios not evidenced

The responsibility for confirming the staff ratios is to be entrusted to accountable officers and such checking is to be endorsed accordingly. Additionally, any changes on official documentation are to be made in permanent ink to prevent unwarranted tampering.

Entitlement to On-Call Allowance not confirmed

MCH is to ascertain that a copy of the relevant agreements is available to ensure authorisation and correct disbursement of funds.

Inconsistent Information received from Mount Carmel Hospital

Enhancing the communication between the Payroll Office and Nursing Management, to ensure that information available is consistent, will reflect better performance of the respective functions, and ultimately on the running of the Hospital's operations.

Lack of Segregation of Duties

A robust internal control system is necessary in view of the extent of manual intervention essential for the function of the Payroll Section. Thus, Management is encouraged to reassign responsibilities within this Section, in order to incorporate reliable and independent verification during the payroll process.

Personal Files not updated

Personal files are to be kept updated with all the necessary documents, especially those relating to emoluments. This will enable ease of reference, as well as verification by third parties.

Backdated Roster Application Forms

The forms are to be dated and submitted within a reasonable period prior to the effective date, to allow the necessary time for the required administrative arrangements to be implemented. Management is to ensure that the respective change does not hinder the efficiency of operations. The change of roster forms are, in all instances, to be forwarded to the Chief Executive Officer for approval.

Compliance Issues

Unclear Source for Rates of Extra Duty Allowance

The Payroll Office is to ensure that source documents are available to substantiate payments or, in this case, the rate of payment applied. It is also advisable to include eligibility details of EDA and the respective rates payable in an official agreement.

Biannual Return of Allowances not prepared and submitted

All authorised allowances are to be reviewed regularly in order to ascertain whether the conditions under which they were granted are still valid. The relevant information is to be collated for the timely submission of the biannual return to the Ministry for Finance.

Unauthorised Payment of Care Workers' Allowance

Management is to ascertain that disbursements are in accordance with established agreements, duly endorsed by the parties concerned, particularly Government and Union representatives. Copies of such agreements are to be filed for ease of reference.

Telework Practices not according to Standing Policies

Irregularities noted are to be rectified without delay and the employees' personal files are to be updated with all relevant documentation. Moreover, telework arrangements are expected to be revisited on an ongoing basis. Hours worked from home, as well as relative output, are to be monitored closely so as to avoid possible abuse and irregularities.

It is of utmost importance that requests for changes in rosters and working conditions are immediately communicated to the Human Resources Department.

Minimum Daily Rest Period not taken

NAO acknowledges that due to potential staff shortages, pressures from the workload may accumulate. However, individuals will benefit from taking assigned breaks since it allows a person to recover from fatigue and return to work more refreshed. Therefore, it is advisable that the regulations outlined in the specific Wage Regulation Order are adhered to.

Management Comments

Management concurred with the majority of observations highlighted in this Report and with the proposed recommendations. Relevant feedback is being reproduced hereafter.

In the case of attendance verification, it was noted that the matter requires discussions at Ministerial level, as well as with the respective Unions, due to the fact that the conditions of work will be effected. The matter will be addressed during negotiations of the next sectoral agreements, which will expire in 2016.

EDA will also require to be addressed at Ministerial and Union level. Exorbitant amounts are paid to a very small group of doctors, especially in view of the shortage at MCH. It was proposed to address this issue with the introduction of a roster, which includes nights, costing approximately €6,500 per doctor annually, instead of the amounts currently being paid.

Management agreed that a long-term plan should be implemented to solve the consistent use of overtime and outlined the following strategy:

- relocating patients into the community and closing down wards at MCH;
- establishing a clear policy on level one supervision that needs to be strictly adhered to and enforced;
- opening the Psychiatric Intensive Care Unit in order to limit level 1 supervision to one ward only, whilst providing also specialised care;

- admission and/or discharge policy which needs to be strictly implemented including patients 'on leave'; and
- a scheme to assist mental health patients who have been under long-term institutional care unnecessarily, including those considered 'on leave', to be discharged, followed and treated in the community.

TOIL was administered entirely by the nursing staff and the respective balances were accumulated over the years. In January 2015, a dedicated Unit which was entirely made up of administrative staff, and thus completely independent from nursing personnel, has been set up in order to monitor each request for TOIL, vouch for its justification, and to alert Management when exceptions arise. The necessary measures will be implemented to reduce TOIL balances. However, MCH will also request a one-time cash injection for partial settlement of these balances to avoid the amount payable to continue to increase annually in line with hourly rates payable.

The abuse of wrong work practices will be rectified by the implementation of policies. It will be ensured that any extra hours required are equally distributed among all employees, whilst addressing the problem of availing of TOIL to work overtime during immediate off-duties. Eliminating the persistent problem of staff shortages will also reduce the need for overtime and TOIL.

Management will also ensure that controls are in place so that staff is not compensated for overtime during duty by roster. However, despite the fact that there was an overlap in the hours worked by the Senior Nursing Manager mentioned, it was claimed that the Officer was not paid more than he deserved.

The Chief Nursing Manager meticulously checks each overtime hour worked with manual records before approval. The necessary changes will be implemented such that a provisional amount of hours will be pre-approved to cater for any urgent nursing overtime required.

MCH could not settle payment to the nursing aides earlier to compensate for the error in the progression, as the Union was also involved. On the other hand, the respective Sections will keep striving to maintain personal files updated, however information sometimes takes long to be obtained.

Management also stated that it is customary that care workers and assistant care workers are given the same allowance as nursing aides when they are in contact with patients, since they are classified as paramedic aides.



Gozo General Hospital

Contractual and Professional Services

Background

The Gozo General Hospital (GGH) offers diagnostic treatment to both in and out-patients through a mix of acute care wards. It also includes geriatric and long-term psychiatric wards, delivering long-term care and mental health care respectively.

With effect from March 2013, GGH was shifted from the portfolio of the Ministry for Gozo to the then Ministry for Health, now referred to as Ministry for Energy and Health (MEH). The overall management of the Hospital falls under the responsibility of the Chief Executive Officer (CEO), however each unit within GGH is directly managed by a Head of Section.

Financial Information

For financial year 2014, the budget earmarked for Contractual and Professional Services stood at €1,500,000 and €20,000 respectively, with actual expenditure totalling €1,401,528¹ and €123,882¹. In this latter case, the amount allocated for Professional Services was exceeded by €103,882 compared to what was estimated; *i.e.* 519%, with the main contributors to this variance being Medical Services (€65,942), Religious Services (€27,282) and Engineering Services (€16,191).

Of the expenditure incurred on Contractual Services, €823,821 (59%) was paid for patients and staff meals, and €382,442 (27%) covered laundry and other cleaning services.

Audit Scope and Objectives

The audit focused on Contractual and Professional Services, where the net expense incurred during 2014 amounted to 6% of GGH's total net recurrent expenditure.

The main objectives of the audit were to evaluate the control system relating to the procurement of Contractual and Professional Services, ensuring that funds were spent for their intended purposes, within the approved limits, and in line with the provisions of standing Procurement Regulations.

Other objectives were to ascertain that payments effected were accurate, duly covered by supporting documentation, and in line with applicable agreements.

Audit Methodology

The audit was conducted in accordance with generally accepted auditing standards. Planning and audit procedures were performed in order to obtain reasonable assurance as to whether the internal control structure at GGH is adequate, transactions are free from material misstatements, and that standing laws and regulations have been complied with.

A total of 19 Payment Vouchers (PVs), collectively amounting to €321,705, and representing 21% of total expenditure on Contractual and Professional Services incurred during 2014, were selected for substantive testing. Selection of PVs in the audit

¹ As per Departmental Accounting System data on 16 April 2015.

sample was based on the nature and materiality of the transactions.

Limitations on Scope of Audit

- a. Since GGH did not retain a copy of the original menus showing the meals ordered by patients, testing had to be based on the 'Menu Selection Summary' documents raised by the service provider and endorsed by an officer in charge, which documents constitute the basis of payment.
- b. Given that no records were kept by GGH with regard to staff meals, the National Audit Office (NAO) was not in a position to confirm whether meals, as recorded in the report drawn up by the service provider, were actually availed of.

Audit Disclaimer

Albeit various requests, no written confirmation was provided by GGH with respect to the liability for payment of water and electricity expenses incurred by the catering contractor on GGH's premises.

Key Issues

Inadequate Controls over Payments for Catering Service

- a. Testing carried out by NAO revealed significant weaknesses and discrepancies in payments covering both patients and staff meals. Shortcomings were noted at the delivery document stage, as well as at the invoice verification stage, implying that although invoices were certified correct, controls in place were not effective. The frequency and materiality of the identified shortcomings were a cause of serious concern.
- b. NAO queries addressed to the Chief Operations Officer concerning the 'Menu Selection Summary' document were forwarded to the contractor, whose reply was then provided to NAO. This indicates

that GGH was not fully conversant with the procedures and actual process in place.

Divergences from the Catering Tender Document Conditions

Reduced Performance Guarantee

The tender document specified that the contractor shall return a signed copy of the contract, together with a performance guarantee amounting to 10% of the total contract price of €4,298,790, covering a five-year period. Following a request for the required performance guarantee of €429,879, the winning bidder wrote to GGH asking the latter to waive their request and accept a pledge for €85,976, being 10% of the yearly contract value. It was further indicated that such appeal was being put forward after talks held with the former Director General – Financial Monitoring and Control Unit within the Ministry for Health, who confirmed that such an arrangement could be executed.

Following this communication, the CEO at the Central Procurement and Supplies Unit (CPSU) within the Ministry for Health, requested the Director General – Department of Contracts (DC), to change the amount of the performance guarantee, however, such request was refused. Nonetheless, on the same day, the aforementioned CEO asked the Director – Public Procurement Procedures within DC to "... *consult internally with DG-Contracts to possible re-visit this decision*". Still, once again, DC informed the Ministry that the request could not be entertained and the decision is final. Notwithstanding this, the respective Permanent Secretary wrote to DC yet again, asking for the Department's reconsideration of the ruling given.

On his part, the Director General DC drew up a 'Memorandum to the General Contracts Committee' for the latter to consider approving the reduction in the performance guarantee in terms of Regulation 78 of the Public Procurement Regulations (PPR), which request was approved.

- a. Although it was clearly stipulated in the tender document that the performance guarantee shall be 10% of the contract price,

this provision, intended to safeguard GGH's interests, was changed, notwithstanding the objections of DC.

- b. Ministry officials have exceeded their authority by confirming to the bidder that a requirement in the tender document could be waived. The issue was more serious as confirmation was given to the bidder more than six weeks prior to the approval from DC, which in turn led to significant pressure being exercised by the Ministry over DC staff to get the requested authorisation.
- c. In contrast to the reference quoted by Director General DC, Regulation 78 of the PPR relates to variations to the awarded contract value and does not provide for changes in established performance guarantee value.

Change to the Proposed Staff Meals' Ordering System

The winning bid stipulated that "*Staff members will be given a card which will be swiped ... once they are served their meal ...*", and "*A summary of the billing for each day ...*" will be provided with the monthly invoices. During a meeting held with GGH officials, it transpired that the data collection method eventually proposed by the contractor consisted of a fingerprint reader that takes count of the individuals availing themselves of meals. However, data protection concerns in relation to the foregoing proposed system were raised by the Malta Union of Midwives and Nurses, and as a result, it was not implemented. Instead, meals were provided to staff on the provision of their identity card numbers. This has led to several shortcomings as explained further down in this write-up.

Other Provisions not applied

Individual Food Items

- a. The tender's Technical Specifications requested bidders to "*... submit a price quote for single items such as clear soup and dessert if ordered apart from a main meal ...*". In such a case, "*... the chosen contractor will charge the hospital accordingly*". However,

although the individual prices for single items were provided in the financial bid, these were not being applied. As a result, any one item ordered was being treated as a full meal and charged at the rates applicable for a full lunch and dinner.

- b. The respective article also required bidders to quote a price for snacks, and stipulated that these options should always be shown on the menus, giving staff the possibility of ordering these *in lieu* of the full course meal. Accordingly, hot and cold snack prices were provided by the contractor, however, the actual snack options were not included in the menu cards.

Operational Expenses

The tender document clearly sets out that "*The contractor shall also take full responsibility for all installations necessary for the proper equipping of premises and for the purposes of supplying the Catering Services and the Ancillary Services*". However, as verbally confirmed by GGH officials, water and electricity expenses incurred by the contractor on the Hospital's premises were being borne from public funds.

Control Issues

Catering Services

Background - Patients' Meal Ordering System

The patients' meal ordering system involves daily pre-printed menu cards indicating the choices available for lunch and dinner. After being filled in by patients, these are collected by contractor's staff and scanned by the service provider's electronic system, providing totals of the menu choices. Meals are then plated based on the preferences of each individual menu card, and a delivery note referred to as the 'Menu Selection Summary' is printed, showing the menu counts, as well as the choices for each ward. This document is endorsed by the officer in charge of the respective wards, confirming that the number of meals delivered tallies with the menu count indicated thereon.

Payments for Patients' Meals not supported with the Actual Orders placed

Since the menus showing the actual orders placed by patients were not available, delivery notes, which form the basis of payment, could not be confirmed with source documentation to ensure correctness of details included therein.

Lack of Control on Expenditure for Patients' Meals

A review of two invoices, covering the provision of patients' meals for a period of eight weeks, revealed significant shortcomings. Control weaknesses included delivery documents being endorsed by ward representatives without checking the details for correctness, as well as invoices and PVs certified without appropriate independent verification.

Identification of Menu Counts

- a. Menu counts as recorded on the 'Menu Selection Summary' form the basis of invoicing. However, no concrete explanation was provided by GGH as to what constitutes a menu count. A physical inspection of the scanning process revealed that the latter represents the number of menu cards scanned, irrespective of the actual items ordered.
- b. Further to the above, it transpired that blank menus were still accepted by the system and recognised as a menu count. Moreover, such menus can be scanned more than once, without limitation. In view of this, and in the absence of source documentation, correctness of counts, as indicated on the delivery documents and eventually paid, could not be ascertained.
- c. For the eight-week period under review, the menu counts as per the 'Menu Selection Summaries' were checked against the 'Items Chosen' recorded in the same document, supposedly representing patients' selections. It transpired that on a regular basis, the menu counts were in excess of the individual

items chosen; claims by GGH, that patients tend to order a full meal, comprising three items and two items for lunch and dinner respectively, are also questionable. Adverse discrepancies were also noted in the case of breakfasts, notwithstanding that these are counted on a simple individual basis.

- d. With respect to the above, the contractor contended that the selections of the patient are not always captured by the scanner, and this may in turn lead to them not being reflected on the delivery note. However, given the possibility of scanned blank menus, as well as the absence of source documentation showing the actual orders placed, such justifications could not be confirmed.

In view of the above circumstances, NAO had no other means to ascertain the correctness of the delivery documents, as well as that of the respective payments effected.

Menu Counts exceeding Number of Patients

On several instances, the menu counts showing the meals provided in any one day were in excess of the number of patients on that particular day, as extracted from the Clinical Patient Administration System. This was particularly evident in the Short Stay Ward, where such a situation was taking place on a daily basis. Due to lack of documentation, it could not be confirmed whether GGH is applying Article 4.2.7 of the tender document, stipulating that "*The client reserves the right to alter the meal order as required, with due notification being forwarded by an agreed time*", which time has been set as 10 am.

Different Delivery Documents for Same Day

It transpired that at times two delivery documents were raised for a particular day. While the items chosen were identical in the two documents, the menu counts were different, with the higher count always taken into consideration for payment purposes. Moreover, in such instances, the two documents were in the majority endorsed by two different officers.

Number of Meals invoiced not substantiated by the Delivery Documents

- a. The two sampled invoices, amounting to €59,369 and €51,580 respectively, included a number of meals which were not substantiated by 'Menu Selection Summary' documents. This resulted in considerable variances between invoiced quantities and meals actually delivered as per the delivery notes. Notwithstanding this, both invoices were certified correct and paid.
- b. Amongst the aforementioned unsubstantiated meals were breakfasts and dinners supposedly provided to the Occupational Therapy Unit. Despite that the respective invoices were paid, it was confirmed by the officer in charge, that only lunches are offered to the respective service users.
- c. Testing carried out by NAO on one of the sampled invoices, covering the period 13 October to 9 November 2014, revealed that it included 84 breakfasts over and above those confirmed by the delivery documents. On the other hand, 210 lunches and 230 dinners, which according to the delivery notes were distributed during the said period, were not charged for. Meanwhile, two separate credit notes, dated 1 January 2015, were issued by the supplier to make up for overcharges in the foregoing invoice. However, this further increased the discrepancy, resulting in an overcharged breakfast and an undercharge of 263 lunches and 269 dinners.

Given that the records were not considered reliable, and actual orders placed were not available, an accurate figure of the discrepancy could not be established.
- d. To try and rectify the situation, the contractor issued another invoice, claiming payment for 231 lunches and 226 dinners, which were reportedly undercharged during the period under review. Although this invoice was not paid as at date of conclusion of the audit, if settled, the amounts in question still would not reconcile.
- e. Another sampled invoice covered 5,629 breakfasts, 6,561 lunches and 6,358 dinners.

The amount invoiced was paid in full by GGH, despite that breakfasts, lunches and dinners were overstated by 22, 507 and 619 respectively, when compared to 'Menu Selection Summary' quantities. The only two credit notes traced with respect to this discrepancy covered overcharges for 19 breakfasts, three lunches and three dinners, leaving a total of three breakfasts, 504 lunches and 616 dinners overpaid, at a total cost of €4,550.

- f. Notwithstanding these shortcomings encountered in the two invoices reviewed, GGH certified both claims and paid them in full. Moreover, as verbally stated by a GGH officer, credit notes were raised by the supplier, of his own will, rather than on the request of GGH, as would be expected. This implies that any control mechanisms in place at GGH were definitely not effective.

Staff Meals

Background

The swipe card system indicated by the contractor in the tender document had not been installed as at time of audit, and there was no indication that it would actually be implemented. Instead, the approach was one whereby, staff who turned up for the meals provided their identity card number to the contractor's representative, which number was entered into the electronic system in place, and the cost of the requested meal was deducted from the employee's daily entitlement covering breakfast and lunch. Once the meal is provided to the employee, this is accompanied by a receipt, indicating the meal availed of and its cost. Although invoices were supported by a report drawn up by the contractor, comprising staff members who availed of meals during the period in question, no reconciliation was carried out by GGH with the aforementioned receipts.

Inadequate Control over Expenditure on Staff Meals

- a. During a walkthrough exercise, the supplier's representative declared that installed software could confirm staff meals availed of. In spite of this, at the initial meeting held

with GGH officials, minutes of which were also confirmed by the latter, NAO Auditors were informed that the system in place is not automated, but employees' identity card numbers provided to the contractor's representative are manually crossed-off a list.

- b. During a second meeting held with GGH Management, the latter claimed that, for reconciliation purposes, they were considering posting staff members in the canteen at breakfast and lunch to take note of those employees who turn up for the meals, so that they will be able to reconcile to invoiced quantities. However, this is not considered an efficient approach. Moreover, Management may not be aware of the embedded controls in place.
- c. Although the aforementioned receipts are meant to be endorsed by the staff as confirmation that the breakfast or lunch has been availed of, when NAO Auditors requested a sample receipt, the contractor's representative picked one from the litterbin. Thus, albeit these receipts provide the only means of verification of invoiced quantities, they were being discarded. Hence, full reliance was being placed on the contractor when processing invoices for payment, as there was no other evidence enabling independent confirmation that staff meals were actually availed of. As a result, correctness of the amounts claimed by the service provider, and paid by GGH, could not be ascertained.
- d. Notwithstanding the set criteria concerning eligibility for free staff meals, namely that staff shall have direct contact with patients, and be on duty for 10 hours or more, the contractor was not being notified of the specific rosters, and thus, all employees who turned up were offered the meal, provided they were included in the contractor's electronic system. In this case, the onus was placed on the employees to ensure they only avail of the free meals when they satisfy the aforementioned conditions. Although it was claimed by the Chief Operating Officer that the information in the report provided by the

contractor is verified with the daily report of staff, no evidence could be traced that such checks were carried out during 2014.

- e. Despite that the contractor's list of eligible employees was based on records provided by GGH, on comparing the two records, it transpired that several employees were included in the contractor's list but not in that provided by the Hospital. It was confirmed that the employees in question, which amount to 82, were not entitled to free staff meals.

Lack of Verification of Invoiced Amounts

Two PVs amounting to €5,975 and €6,234, covering staff meals availed of from 3 to 30 March, and 27 October to 2 November 2014 respectively, were selected for testing. The following transpired:

- a. One of the invoices included 1,397 breakfasts and 1,577 lunches, which were supposedly consumed by staff during the seven-day period between 27 October and 2 November 2014. On the other hand, the supporting report, showing a breakdown of the meals availed of during the same period, only indicated a total of 290 breakfasts and 325 lunches, a discrepancy of 1,107 breakfasts and 1,252 lunches, for a total adverse variance of €4,947. Notwithstanding this unexplained considerable variance, the invoice was nonetheless certified correct and paid.
- b. In reply to queries raised about such discrepancies, the officer that was in charge when the audit was in progress, provided the Auditors with documentation presented by the contractor, which however, further increased the variation. It transpired that another invoice was raised, covering additional meals, comprising 85 staff breakfasts and 88 staff lunches, which according to the contractor were consumed during the period 1 and 2 November 2014, but were undercharged in the invoice included in the sample. On 1 January 2015, a credit note was raised to make up for just part of this variance. This covered 69 overcharged staff lunches availed of during the first two days of November.

- c. The data in the report, provided by the contractor in support of the invoices, was entered in a way which rendered verification extremely problematic. There was no systematic approach to data input, and as a result information was all jumbled up, the same columns sometimes containing both name (without surname) and identity card number, without any numerical or alphabetical sequence whatsoever. In view of this, NAO had to draw up again the report supporting the invoices reviewed, in order to carry out basic checks on the data contained therein.

Data analysis revealed that 17 employees, two of whom were not even entitled to staff meals, were included more than once in the said report covering the period 3 to 30 March 2014, very often with a slight modification to the identity card number. Although many did not avail themselves of any meals during the sampled period, the possibility of double charging cannot be excluded. By way of example, meals consumed by an Enrolled Nurse on 23 March 2014 were included twice, and therefore paid for accordingly.

- d. NAO was informed that a list detailing the doctors who will be on duty for more than 10 hours is provided to the contractor on a monthly basis. However, no such lists were forwarded to the service provider during the year under review. As a result, meals availed of by doctors during the tested periods could not be corroborated for justification.
- e. When verifying the attendance records of staff featuring in the contractor's report to ensure compliance with the established criteria, it transpired that both reports included a significant number of employees who were either on vacation leave, sick leave or off duty, and others who worked less than the 10-hour threshold. None of the instances identified by NAO were detected by GGH, and all respective meals were paid for.
- f. In view of the limitations of the system in place it could not be confirmed whether (i) the employees who did not report

for work on the dates in question really consumed meals on these days; or (ii) meals were consumed by other employees after providing the identity card number of the 'eligible staff' who were not working on the respective days; or (iii) no one consumed the respective meals and they were overcharged by the contractor.

Laundry Services and Koperattiva Linen Service Ltd

Procurement by Direct Order

- a. As reported in the Auditor General's Report for the year ending 2010, *Koperattiva Linen Service Ltd* (KOLS) has been providing laundry services uninterruptedly since the year 2000. Notwithstanding the recommendation in the said report to follow PPR, up till date of audit, no call for tenders was issued by GGH for the provision of such service.
- b. According to clause 4 of the standing agreement, which expired on 1 April 2015, "... the agreement shall be subject to renewal if agreed by both parties", provided that such indication shall be given in writing to the other party six months prior to the contract's termination. Notwithstanding this, although during an exit meeting it was implied that GGH intends to issue a call for tenders, no communication has been provided confirming the Hospital's intention not to renew the contract.

Salaries' Reimbursement of Koperattiva Linen Service Ltd

- a. During the year under review, GGH paid the amount of €68,246 to Mount Carmel Hospital (MCH) as reimbursement of basic pay and allowances in respect of salaries pertaining to KOLS employees, notwithstanding that no such provision was included in the respective agreement.
- b. Following meetings with both GGH and MCH officials, it transpired that KOLS salaries are paid by MCH, who in turn

apportions the cost involved on the entities within the Health portfolio, based on the proportion of service usage. KOLS then provides these entities with credit notes to cover the amount paid in respect of the salaries. However, the audit revealed that GGH was not refunded the amounts in question by KOLS, thus resulting in the former being a net contributor, forking out funds over and above the actual laundry charge, without getting any reimbursement.

Internal Checks and Controls

Double Payment of an Invoice

During 2011, following a public call for quotations, GGH entered into an agreement with a private company for preventive maintenance services, including replacement of spares, emergency maintenance visits and compliance certification of the Hyperbaric Chamber. The following shortcomings were encountered:

- a. An invoice amounting to €23,395 was paid twice. Although the amount was eventually set-off against another invoice from the same supplier, this shows that internal controls in place, if any, were not effective.
- b. The invoice, against which the second payment was set-off, amounted to €33,248. Notwithstanding the significant amount involved, it was not certified correct but the payment was still processed.
- c. An attempt to verify the rates charged with those submitted in the quotation revealed a significant discrepancy in the rate for the lining of the fire-fighting tank. While the rate for 2014 was quoted at €2,094, the rate invoiced and paid for amounted to €5,540 both exclusive of Value Added Tax (VAT). No adequate explanation was provided to justify the difference in the price charged.
- d. Other items purchased, costing €3,798, were not traced in the quotation. As a result, correctness of the amount in question could not be verified.

Cleaning Services

- a. Cleaning services required at GGH were incorporated into an existing agreement entered into by CPSU. Such additional services, amounting to €46,117 for the period October to December 2014, were thus considered as awarded by direct order.
- b. For the sampled period under review, namely October 2014, details on the invoice were tallied with the attendance sheets maintained by GGH. Although such records were being endorsed, implying that information included therein is correct, name and grade of the officer performing such checks were not indicated, since only the signature was included.
- c. Close inspection of the attendance records of the sub-contracted employees revealed that, in a number of instances, the respective signatures for the period under review differed significantly, thus their authenticity is questionable.
- d. Although cleaning services for the month of October 2014 were paid by GGH on 18 December 2014, at least up to April 2015, *i.e.* the date when the audit was concluded, no VAT receipt was submitted by the service provider.

Compliance Issues

Non-compliance with Public Procurement Regulations

The service contract covering maintenance services to medical equipment, costing €24,608 *per annum*, was awarded to a private company through a direct order approved by the Ministry for Finance. However, no reasons were included in file to justify the request for direct order. Furthermore, according to a minute in the respective file, the quoted price was deemed to be “... *fair and reasonable and technically recommended*”, but such claim could not be validated as only the quotation from the selected bidder was traced.

Deferred Payments

Invoices amounting to €202,736, *i.e.* 13% of the expenditure incurred on Contractual and Professional Services, were paid out of the budget allocated for 2014, albeit these related to 2013 and prior years.

Recommendations

Key Issues

Inadequate Controls over Payments for Catering Service

In order to be effective and enhance operational efficiency, controls are to be embedded in the operations and form part of the overall culture, to ensure the capability of responding quickly to evolving risks. They should also include procedures for reporting immediately to appropriate levels, as well as to identify weaknesses and significant control failings. Moreover, controls are to be reviewed on a regular basis so as to maintain their relevance and validity over time.

However, sound internal controls cannot eliminate completely the possibility of processes being deliberately circumvented by the collusion of employees or poor judgement in decision-making. Thus, staff and operations should be supervised by competent officers who understand the processes and procedures that are in place, query such procedures and decisions, if and when necessary, and take appropriate measures to address any shortcomings in a timely manner.

Divergences from the Catering Tender Document Conditions

Reduced Performance Guarantee

The contracting authority dealing with public funds is duty bound to ensure that the interests of taxpayers are safeguarded. Thus, any clauses included in the tender document, intended to protect the contracting authority on behalf of Government, are to be fully observed. Furthermore, transparency and fair competition is to be practiced at all times by all public officials,

ensuring that no bidder has an unfair advantage over other interested parties.

Change to the Proposed Staff Meals' Ordering System

Action is to be taken by GGH to ensure that all provisions spelled out in the tender document, as well as in the bid provided by the winner, are implemented.

Other Provisions not applied

The provisions of the tender document are to be fully observed. Adequate internal controls should be in place to ensure an economic and efficient service.

Control Issues

Catering Services

Payments for Patients' Meals not supported with the Actual Orders placed

Random checks are to be performed, enabling timely action to be taken in cases of discrepancies. Management is to consider maintaining a spreadsheet reflecting the daily orders, which would eventually enable internal reconciliations with delivery documents and invoiced quantities, as well as external verifications.

Lack of Control on Expenditure for Patients' Meals

GGH is to establish whether overcharging is intentional and, if in the affirmative, apply the relevant conditions provided in the General Conditions for Service Contracts.

Staff Meals

Inadequate Control over Expenditure on Staff Meals

An internal control review is recommended to be carried out at the earliest, to determine what controls need to be implemented. A measure that can be adopted immediately, is to instruct staff who avail of the meals, to endorse the receipts.

The contractor is then to be obliged to present such receipts with the invoice.

GGH may also consider adopting the system in place at Mater Dei Hospital, whereby the contractor is provided with a roster report, detailing the staff entitled to free meals on a daily basis, thus ensuring that only eligible employees are provided with such benefit. Officers applying for vacation leave or change of duty are to inform GGH at least two days in advance, to leave ample time for the service provider to be notified of the necessary changes. This would also give the contractor a reliable measure of meals required, eventually resulting in less wastage.

Lack of Verification of Invoiced Amounts

The whole system needs to be immediately reviewed, with the aim of strengthening the internal control structures within GGH. Variances are to be brought at once to the attention of the contractor to be revised before the respective invoices are paid.

Laundry Services and Koperattiva Linen Service Ltd

Procurement by Direct Order

GGH is encouraged to abide with PPR and issue a fresh call for tenders, giving the current service providers due notice that there is no intention of renewing the agreement.

Salaries' Reimbursement of Koperattiva Linen Service Ltd

It is recommended that the funds paid by GGH are recouped since these were not due according to the terms of the applicable contract. Furthermore, the current system is to be reviewed, to eliminate the current bureaucratic process and to ensure fair treatment for each and every entity.

Internal Checks and Controls

Double Payment of an Invoice

Adequate controls are to be implemented, enabling verifications to be carried out prior to payment of invoices. Moreover, every invoice

is to be certified correct by an authorised officer, confirming accuracy of details included therein.

Cleaning Services

Records are to be duly checked and explanations sought from the supplier where divergences in signatures are clearly evident. Moreover, officers endorsing public records shall clearly indicate their name and grade and be held accountable accordingly. GGH is also encouraged to abide by PPR and issue a public call for tenders for cleaning services.

Compliance Issues

Non-compliance with Public Procurement Regulations

The procurement process is to be duly followed in a fair and transparent way, as much as possible treating all interested operators equally. Thus, while direct orders may be resorted to in exceptional cases, this is not to be considered as best practice.

Deferred Payments

Deferred payments are to be kept to the absolute minimum, limited to that which is unavoidable, as required by standing regulations.

Management Comments

Management concurred with most of the observations raised by NAO, and has already implemented rectification measures, aimed primarily at enhancing internal controls and introducing checks, which may have been lacking. Amongst the actions adopted by Management are the following:

- The appointment of an Assistant Principal Officer, who shall take charge and overall responsibility of the reconciliation and verification work in relation to the catering tender, covering both patients and staff meals. The said officer shall also take the appropriate action in the event of variances, unreconciled figures and questionable meals, and will also be reviewing and certifying,

on a sample basis, the work carried out by the officer in charge of verification to ensure that work is performed in an efficient and effective manner.

- The above will be complemented by the introduction of a Meal Order Register, which will be kept in each ward, wherein the number of meals ordered, as well as the amendments effected thereto, will be recorded to enable both internal and external verifications to be carried out. Management maintained that the upkeep of this register will ensure that the contractor does not bill the Hospital for a whole lunch and/or dinner in the event that only one or two components of a meal are ordered. This will also eliminate the possibility that the contractor charges for blank menus.
- On the other hand, with respect to staff meals, Management further stated that it remains concerned that there may be legibility and authenticity issues with signatures on receipts as per the recommendation proposed by NAO. Thus, another register will be kept at the dining room, which will include the name and identity card number of the person taking the meals, the type of meal, as well as a signature of the person picking up the meal. Details in the register will then be reconciled to the list of staff entitled to meals, human resources attendances and daily records of staff, as well as the list of staff meals billed by the supplier.

Management sought legal advice in relation to the observation titled ‘Other Provisions not applied – Operational Expenses’:

- It was concluded that, although the contract does not enter into the merit of who should pay utility bills, these are to be considered as a direct cost, which should be automatically billed with output. It was also stated that “... *the only logical interpretation is that the contractor, when he tendered the price for the service, had already done such calculations, and hence, any further additional payments might be deemed as payments ex contractu, which may be used as a springboard for further extra contractual payments*”. No

other comments were provided by GGH, indicating actions to be taken in view of this advice.

Management also highlighted a number of challenges faced by GGH with respect to the catering system:

- Despite several requests for the use of information technology in the implementation of the internal control system for the catering function, as a means to address the risks inherent in the system and automate the internal control structure, these were not made available and therefore one had to rely on manual control procedures.
- The new catering system started operating in October 2013. As with any other new system, internal control mechanisms might not be 100% effective from the start. Furthermore, the then officer in charge of the respective verifications, who was instructed by the Financial Controller to reconcile the total meals invoiced with the menu counts as per delivery documents, had to learn and adapt to the new work.
- The workload involved in checking transactions relating to the catering service turned out to be too much for the said officer to handle on his own. Moreover, as the workload increased, the contractor chased the Accounting Department for amounts due to him.
- The Clinical Patient Administration System, which provides access to daily patient records and was intended to be used to verify the menu counts with the number of patients to ensure correctness, also turned out to be a limitation. The program, which was installed recently across MEH, still contained a number of software bugs. In view of this, the officer in charge of verification did not get access to patient records in wards, and thus, checking with the program was temporarily not being carried out.
- The identification and recording of staff entitled for free meals was not an easy

exercise and it was fraught with industrial action implications, particularly owing to the many differences and discrepancies between the various health entities.

- Another limitation was encountered with respect to meals consumed by consultants, in view of the fact that it is established practice across MEH that consultants do not sign their attendance. As a result, the officer in charge could not reconcile the meals consumed to their attendance.

The following comments were also expressed by GGH:

- With reference to the observation ‘Menu Counts exceeding Number of Patients’, Management commented that with respect to the Short Stay Ward, the number of patients is lower than that of meals ordered because, although some patients with mental health issues do not necessarily reside at the Hospital premises and occupy a bed, they would still benefit from meals. Similarly, the Long Stay and Male Geriatric Wards involve a significant element of respite care, whereby meals are provided to patients who are not actually registered as Hospital patients.

- Management claimed that it was DC’s decision to approve the request for the performance guarantee to be reduced, hence it was not in a position to comment on this matter. Similar replies were provided for the observations ‘Laundry Services and *Koperattiva* Linen Service Ltd – Procurement by Direct Order’, and ‘Internal Checks and Controls – Cleaning Services’. It was maintained that in both cases the tender is administered by CPSU within MEH.

- The issue relating to the ‘Salaries’ Reimbursement of *Koperattiva* Linen Service Ltd’ was discussed with officials from MEH, who instructed MCH to stop invoicing KOLS salaries to GGH. However, it was decided that this measure would not be applied retrospectively and therefore, funds that were already transferred by GGH to MCH were not to be reclaimed.

No comments were provided in connection with the overpayments related to the preventive maintenance service at the Hyperbaric Chamber.

Koperattiva Linen Service Ltd

Income and Expenditure Audit

Background

Koperattiva Linen Service Ltd (KOLS) is a public sector worker Co-operative under scheme B, working “... under the auspices of the Health Division but regarded as an autonomous business entity running its own business”¹.

Prior to the set-up of KOLS in 1999, the laundry, situated within the grounds of Mount Carmel Hospital (MCH) was operated by the Health Division to provide linen and laundry services to the hospitals managed by the State. During 1995, the Department of Policy and Planning, within the same Division, embarked on a project to reform the laundry, with the aim of making it more cost effective and efficient. This decision eventually led to the setting up of the Co-operative on 1 September 1999.

KOLS’ main activity is the provision of linen and laundry service to its clients, which entails the daily supply and collection of clean and soiled linen respectively, sewing-room service and provision of linen articles, such as uniforms. However, other services could be provided from time to time. Although priority is to be given to works related to the Health Division, as well as other Government Departments, the Co-operative’s services are not limited to these entities, but can also be provided to private companies.

Statistics and Financial Performance

Revenue generated by the Society during the year 2014 reached €3,889,241, of which €3,268,170 related to amounts invoiced to entities falling under the responsibility of the Health Division. Furthermore, revenue figures for the six-year period 2009 to 2014 indicate that turnover has been continuously increasing, resulting in an overall upward movement of 30%.

The Society’s profitability has also been improving year on year. In fact, at least for the last four years, KOLS has registered consecutive surpluses²; these increasing by 28% over the period 2011 to 2014. The surpluses were distributed to the members as patronage refund, after taking into consideration the contribution of 5% towards the Central Co-operative Fund (CCoF).

Human Resources

Upon the set-up of KOLS, 56 out of 117 Government employees, who up to 1999 were working in the Government’s laundry, opted to join this Co-operative. By end December 2014, the number of members decreased to 36.

In 2010, the said members set-up a separate private company, through which other workers, totalling 10 during 2014, were engaged to carry out duties at the laundry.

¹ Source: <http://www.kolsld.com/>.

² Surplus for the year before patronage refund.

Audit Scope and Methodology

The main objectives of the audit were to ascertain that the provisions of the Co-operative Societies Act, as well as the Co-operative's statute, are being adhered to. Other aims were to assess the operating effectiveness of internal controls, as well as the reliability of the financial information provided for audit purposes, and to make recommendations where warranted.

The audit was conducted in line with generally accepted auditing standards. A review of the Co-operative's financial position was carried out, comprising mainly of an in-depth analysis of the audited Financial Statements for the period 2009 to 2014. Audit concerns were further refined through interviews held with the Co-operative's Management, and information obtained from the latter.

Audit Period

Testing, as well as meetings with the Co-operative's officials, were carried out between February and May 2015, and covered the years 2009 to 2014.

Key Issues

Hybrid Set-up of the Co-operative

Circular No. 12/1996 issued by the Office of the Prime Minister provides two schemes under which a Co-operative society may be set up, namely A and B. The main difference between the two lies in the fact that, while under scheme A, public officers involved are granted unpaid leave on grounds of public policy to set up the Co-operative, those opting for scheme B set it up in co-operation with their respective directorate. In view of this, they continue to receive their Government salary while also benefiting from a share of any profits generated by the Co-operative. In both cases however, while working for the society, these employees will retain all of their rights as public service officers. The following concerns relate:

- a. While KOLS is registered as a scheme B Co-operative, this was not reflected in its set-

up, since as at time of audit, it constituted a hybrid one, reflecting a mix of elements from both schemes.

A case in point was the payment of wages, being one of the main distinctions between the two schemes, as outlined above. The provisions related to scheme B imply that workers opting for this choice will remain on Government payroll. Notwithstanding this, KOLS was bearing the cost of wages and salaries, bringing it more in line with a scheme A Co-operative.

- b. The above is coupled by the fact that, although the provisions of the aforementioned circular indicate that a scheme B Co-operative is of a temporary nature, KOLS has been running since 1999 and there are no indications that operations will be ceasing anytime in the near future.

Governance Weaknesses

A number of issues, pointing towards a weak governance structure within the Co-operative, were noted during the audit. Among these issues, each of which will be discussed separately further down in this Report, are the following:

- a. conflict of interest in the Director's roles;
- b. no auditor rotation;
- c. lack of segregation of duties;
- d. no proper independent oversight by the Surveillance Board³; and
- e. expenditure records not traced or not supported by adequate documentation.

Control Issues

Conflict of Interest

- a. As at time of audit, the Director of KOLS was carrying out a dual role, a situation prevailing since the inception of the Co-operative, in 1999. On one hand, in view of his position as Director of the Co-operative, he represented KOLS in the service level agreements entered into with the respective clients; in the majority these being entities

³ *Bord tas-Sorveljanza*

falling under the Ministry for Energy and Health. On the other hand, as a result of the position held with the said Ministry, the same individual endorsed the agreements in his capacity as Director Policy and Planning within the Health Department (entered into by the latter with KOLS), specifying the conditions related to the setting up and operations of the Co-operative.

- b. An account, which was to be administered by the Director on behalf of the Health Department, for the benefit of the latter, was in fact used to finance part of KOLS' expenses. Verifications revealed that while monies payable by KOLS into this account were not being effected in a timely manner, significant disbursements were related to the operations of the Co-operative itself. Though KOLS' private Auditor highlighted some of the respective irregularities, no action was taken to remedy the situation.

Auditor Independence

As per the provisions of the Co-operative Societies Act, as well as the Co-operative's statute, KOLS' Financial Statements shall be audited on a yearly basis, by an auditor appointed and/or re-appointed at each General Meeting. In addition, the Act stipulates that the Society shall keep proper books of account, as well as records of its transactions and affairs, and shall prepare and submit the Financial Statements to the auditor. The following shortcomings were noted:

- a. In addition to statutory audit services, the same audit firm also provided KOLS with accounting services. Notwithstanding that concerns about the Auditor's independence were raised in July 2003 in a report drawn up by the Internal Audit and Investigations Department (IAID), the recommendations provided therein, mainly either to appoint another Accountant or change the Auditor in question, were not implemented up to date of audit.
- b. Several accounting shortcomings, as well as instances of non-compliance with the provisions stipulated in the agreement entered into with the Health Department, were identified by the National Audit

Office (NAO) during this audit. However, these were not included in any of the six Management Letters reviewed by NAO covering the period 2009 to 2014.

- c. In response to NAO's request for copies of Management Letters covering the aforementioned period, six identical and unsigned copies were provided to this Office, one for each year. The only thing that differed was the date of the covering letter. Moreover, whilst only two issues, titled 'Purchasing Procedure' and 'Stock Control' respectively, were included in such Management Letters, no remarks were noted under the 'Management Response' column, implying that no action whatsoever was ever taken by the Co-operative's Management over a period of six years, with respect to the highlighted observations.
- d. The audit firm in question has been providing services to the Co-operative since its inception in 1999, meaning that no auditor rotation has taken place over a period of 16 years. Moreover, a review of the Financial Statements for the period 2009 to 2014 revealed that, while the audit fee of €825 remained constant for the past six years, the accountancy fee varied between €2,233 and €2,418 over the same period. The amounts charged for accounting work could imply that such task was not merely limited to the finalisation of Financial Statements.

Lack of Independent Oversight

The Co-operative's statute provides for the setting up of a Surveillance Board, whose main aim is to exercise oversight over the Management Committee and other officers involved in the management of KOLS, ensuring that operations are in line with standing provisions and regulations. It is also responsible for examining the Co-operative's accounting records at least monthly, ascertaining that all transactions are duly recorded in the books, and to draw the Management Committee's attention with respect to any identified discrepancies.

- a. KOLS' statute stipulates that members on the Surveillance Board do not necessarily have to be members of the Co-operative, and

shall ideally possess accounting knowledge. Nonetheless, all appointed members, at least for the periods between 2012 and 2015, were members of the Co-operative.

- b. Further to the above, the statute stipulates that the Surveillance Board is appointed for a period of two years and that a serving member may be re-appointed. The article, however, does not specify whether a cooling period is required prior to a member's re-appointment to the Board, as well as the maximum term a member may serve on such Board.
- c. In reply to a request for a copy of the minutes of meetings held by the Surveillance Board, NAO was informed that, as from 2014, members of the Board attend the Management Committee meetings, and thus, one set of minutes reflecting the outcome of these meetings is prepared. Moreover, pre-2014 minutes of the Surveillance Board meetings were still not provided. Consequently, the impact of the Surveillance Board, with respect to the monitoring that is expected to be performed, could not be assessed.

Contributions to the Central Co-operative Fund

- a. Despite that the Surplus on Ordinary Activities increased by 28% over the six-year period 2009 to 2014, the 5% contribution due to CCoF was not being paid in full, resulting in a balance of €266,300 still payable to the fund in question as at 31 December 2014. This notwithstanding that, over the said six-year period, the Co-operative distributed over €7.5 million as patronage refund to its members.
- b. The Statement of Comprehensive Income for year-ends 2012, 2013 and 2014 show that €70,298, €71,410 and €83,447 respectively, being 5% of Surplus on Ordinary Activities, were contributed towards CCoF. The same amounts were depicted as cash outflows in the Statement of Cash Flows, implying that the contributions due were fully paid.

However, in contrast, CCoF creditor balances have been on the increase at least since 2011, implying that the contribution was not paid in full. Queries addressed to KOLS' private Auditor about this anomaly remained unanswered.

- c. Notwithstanding the above anomaly, the independent Auditor appointed by the Co-operatives Board, to scrutinise and report upon the audited Financial Statements submitted by the various Co-operatives, wrongly indicated that KOLS had contributed the entire 5% of the surplus for both 2013 and 2014.

Patronage Refund

A co-operative may, after keeping aside the necessary amount for the relative contributions, distribute the remaining net surplus among its members.

In the case of KOLS, the only deduction from the Surplus on Ordinary Activities covers the contribution to CCoF. During 2014, the average patronage refund share per member, paid in addition to salaries, increased by 21% over a period of six years. When compared to the high amounts distributed, the increase in Accumulated Fund⁴ over the period 2009 to 2014 was negligible, increasing by only 0.4%, ending 2014 with a closing balance of €507,220, from €505,109 in 2009.

Following concerns raised by NAO during meetings with Management, in contrast to the above, the draft Financial Statements for the year 2014 depicted a drop of 18% in patronage refund distribution. However, the audited figures approved by the members in the respective General Meeting, still showed an increase of €28,335 over 2013 distribution, which in aggregate amounted to €1,384,901. This translates into an average distribution of €37,429 per member, which distribution is only taxed at 15%, in line with Article 62 of the Income Tax Act.

⁴ Accumulated Fund refers to a portion of the Co-operative's net surplus, which is retained by the latter rather than distributed to its members by way of dividend or patronage refund.

Payment of Wages and Salaries to Members

- a. The system in place as at time of audit involved a very bureaucratic process, wherein MCH issued the wages to KOLS employees and recouped the same funds by invoicing the various entities using KOLS services, based on an established usage percentage. KOLS then issued credit notes to a number of entities⁵, supposedly equivalent to the amount contributed for wages, while the respective entities had to ensure that the amounts credited tally to the actual amount paid. Besides adding a workload on MCH and also impinging on their cash flow, this system was very prone to errors which could remain undetected.
- b. No reconciliation was available to confirm that the amounts paid by MCH in 2014 were equivalent to the credit notes issued by KOLS. The relevant exercise was only carried out by MCH's Financial Controller on NAO's request during the audit.

Operating Expenses of the Co-operative

- a. Although MCH pays the Land Department a yearly rental fee of €413,329 for the entire land occupied by the Hospital, reimbursements effected by KOLS, as specified in the observation below, did not take into consideration the rental expense for the area occupied by the Co-operative. This implies that in addition to the payment for the services being provided, the Government was also indirectly contributing to operational costs, thus tipping the surplus in favour of the members of the Co-operative.
- b. Records of payments effected by MCH on behalf of KOLS only started being maintained as from 2013. These indicate that the former paid the amount of €44,177 in respect of electricity consumed by KOLS during the period December 2013 to September 2014, as well as €13,604 for meals provided to the Co-operative's staff

between December 2013 and October 2014. Thus, both amounts significantly exceeded the monthly fixed payments of €2,329 and €646, disbursed by KOLS for electricity and staff meals respectively, in line with the conditions of the agreement entered into between the Health Division and the Co-operative in 2010.

- c. The fixed monthly amount of €2,329 for electricity was originally set in 1999 and remained unchanged up till date of audit. As a result, inflation and all other relevant increases in tariffs were not reflected therein, consequently these were borne by MCH from public funds.
- d. In a separate correspondence dated 8 May 2015, MCH's Financial Controller stated that the Hospital stopped recharging KOLS in September and October 2014 for electricity and staff meals respectively. It was indicated that the latter had reached a verbal agreement with the previous Hospital administration and decided that the cost of steam supplied by KOLS to MCH's kitchen, together with credit notes issued to MCH, will compensate for electricity and other running costs. However, the calculation provided in the said communication is not considered reliable since amounts are based on average rather than actual consumption.
- e. Besides that the said agreement was verbal, and as a result the highlighted affirmations could not be confirmed, it significantly increases bureaucracy through reconciliations and the possibility of errors.
- f. The charge of €7,680 included in the original agreement, intended to cover steam costs, was removed from the renewed agreement entered into in 2010.
- g. No payments were made by KOLS for water consumption, which is extracted from a borehole situated underneath the Hospital's grounds. It was stated that the Co-operative has an agreement with Water

⁵ KOLS issued credit notes to Mount Carmel, Mater Dei and Sir Paul Boffa Hospitals and to Public Health Centres.

Services Corporation (WSC) to this effect; however, no such evidence was provided to NAO for audit purposes.

- h. While turnover increased by 30% over the six-year period 2009 to 2014, water and water treatment costs as per Financial Statements decreased by 12% and 26% respectively over the same period. Moreover, the last invoice issued by WSC was dated 18 March 2010. This implies that water expenses are not actually being paid, but merely accounted for as an accrued estimated cost, which as at end 2014 stood at €86,594. This is very likely to be far from accurate.

Equipment Reserve Fund

In accordance with the agreement entered into with the Health Division, KOLS shall transfer a monthly sum of €5,874 into a fund titled Equipment Reserve, which is to be used specifically for the purchase of new and replacement of existing equipment. However, by virtue of this agreement, any equipment purchased by KOLS shall remain the property of the Department of Health.

- a. According to KOLS' Operations Manager, the Co-operative intends to invest the amount of €450,000 to extend the laundry and to procure a tunnel washing machine. However, as at 31 December 2014, the amount accumulated in the Equipment Reserve, as per KOLS' Financial Statements, totalled €308,148. Moreover, the recorded amount could not be corroborated since no separate bank account is maintained in this regard.
- b. Although the amount disclosed as Equipment Reserve in the Statement of Financial Position as at end 2014 is of €308,148, in contrast, the Cash at Bank note of the same Financial Statements, indicates that only €58,836 is maintained for fixed asset investment purposes.
- c. No adequate records were being kept by the Co-operative, indicating the fixed assets acquired through the Equipment Reserve fund over the years. In reply to NAO's

queries, two records were provided by the Operations Manager, namely 'Inventory of Equipment 2014', comprising equipment purchased, installation date and cost, and 'List of works carried out by KOLS since inception'. This latter record merely lists the items and works carried out, without indicating the cost, date of purchase and a basic description of the asset. Reference to source documentation, such as invoices to corroborate the purchases, was also lacking.

- d. Significant variances were noted between the Equipment Reserve figures as reported in the Financial Statements, and amounts disclosed in the Inventory List. According to the former, over a period of six years, €600,974 was expensed from the Equipment Reserve, however, when corroborating this amount with the Inventory List, it transpired that the cost of assets included therein merely amounted to €31,325.

Skema ta' Tahrig Current Account

According to the conditions of agreement entered into between KOLS and the Health Division in 2010, covering a five-year period till 31 December 2014, 15% of the profits generated from external clients, *i.e.* clients not included in the agreement, should have been transferred to a fund titled Department of Health, Policy and Planning (DHPP) *Skema ta' Tahrig*. In line with the provisions of the same agreement, this fund had to be used specifically to cover educational and training expenses for employees of the Health Division, and be administered by the Director Special Initiatives, previously known as Director Policy and Planning, who also happens to be Director of KOLS.

- a. Albeit as specified in the aforementioned agreement, the account in question was managed by the Director Special Initiatives on behalf of the Health Division, a review of the respective bank statement revealed that this was held in the name of KOLS. This notwithstanding that, as verbally stated by the private Auditor, the said account is not included in the books of the Co-operative as it pertains to the Health Division.

- b. As shown in the Co-operative's Financial Statements, KOLS' share from external clients for 2014 amounted to €33,962. However, a creditor balance of €15,838 was recorded in the Statement of Financial Position for the year, with respect to *Skema ta' Tahriġ* current account. This implies that the respective amount was not fully transferred to the Training Fund in question. It also transpired that such delays in transfers were persistent over the six-year period under review.
- c. NAO was informed that, following a major fire which the laundry suffered in 2010, part of the premises was condemned by the architects. Thus, KOLS took the opportunity to undertake major restructuring to expand the laundry and bring it in line with the European Union (EU) standards regulating Healthcare Laundries. However, it was also declared that since no financial help was forthcoming from the Health Division, Director KOLS decided to transfer €1,500 monthly from DHPP *Skema ta' Tahriġ* account to the Equipment Reserve account in order to help in the restructuring of the laundry. Yet, no evidence was traced in the bank statements to cover the transfers in question for financial years 2010 to 2014.
- d. The records provided with respect to payments effected from DHPP *Skema ta' Tahriġ* account consist of spreadsheets maintained by KOLS' Operations Manager. These records, however, contained only minimal detail, without any reference to corroborating evidence, substantiating the amounts included therein. It also transpired that these funds were not used in line with the established provisions of the agreement.
- e. A review of the above records revealed a significant number of unrelated payments, and unsubstantiated amounts forwarded to various individuals, in aggregate to the tune of €195,000 over a period of five years. Although as reflected in the said spreadsheets, KOLS external Auditor had recommended that some of these payments are to be reversed and charged to KOLS account, no such adjustments were traced

up to 31 December 2014, leaving only the balance of €1,584 in DHPP *Skema ta' Tahriġ* account.

Operations Manager's Salary and Lack of Segregation of Duties

Prior to being seconded with the Co-operative, the Operations Manager was an officer within DHPP, at that time headed by KOLS' Director. Since the former retained the salary package he had as a scale 6 civil servant, it was felt that there was no need or scope of having a contract with KOLS. However, once he retired from the public service in 2012, the officer in question was appointed as Director of a private company, set-up in 2010 together with the members of the Co-operative, and an official contract regarding his position and remuneration was entered into. The following concerns relate:

- a. Although the Operations Manager maintained that he was seconded with the Co-operative under the same work conditions and benefits he had as a civil servant, this secondment was not formalised.
- b. Notwithstanding that as a public officer in scale 6 he was not entitled to overtime payment, the full amount of the allowances received by the officer in question, totalling €44,147 and €48,196 in 2013 and 2014 respectively, covered 'extra duty' and 'attendance'.
- c. The contract, entered into following the Operations Manager's employment with the private company, merely indicated that the Manager will be entitled to the same conditions and benefits he enjoyed as Manager KOLS, together with any other Cost of Living Adjustments, without specifying what such benefits consist of.
- d. While on various occasions the Operations Manager maintained that his salary is in line with that of scale 6 in the public service, significant variances were identified between gross amounts earned and the maximum salary applicable for the said grade. According to the Payee Statement of Earnings (FS3) filed by the incumbent, gross emoluments received by the latter

stood at €78,875 and €81,968 in 2013 and 2014 respectively, comprising the salary as well as the allowances in question. An analysis of these amounts revealed that the portion of allowances charged to KOLS exceeded the salary elements borne by the private company, by €9,419 and €14,424 in 2013 and 2014 respectively.

- e. This same individual performed various tasks within the Co-operative. Amongst others, these included engineering and marketing duties, attending and preparing minutes of meetings of the Management Committee, as well as other administrative tasks.

Recommendations

Key Issues

Hybrid Set-up of the Co-operative

KOLS is recommended to obtain a written ruling from the Co-operatives Board with respect to the interpretation of scheme B co-operatives, as specified in OPM Circular No. 12/1996. Its position could then be reviewed by the Management Committee, together with the Health Department, in line with the said ruling.

Governance Weaknesses

In addition to helping overcome conflicts of interest inherent in the corporate form, good governance increases transparency and enhances the value of the Co-operative. It is thus suggested that recommendations provided in this Report, aimed at establishing effective control measures, are given their due consideration. Moreover, once implemented, the defined procedures should be reviewed on a regular basis to ensure they remain applicable over time.

Control Issues

Conflict of Interest

In order to ensure that decisions taken are without bias and made on legitimate reason to safeguard Government's interests, the Ministry is recommended to appoint an autonomous official

within the Health Department as Director of KOLS, for a fixed time-period, at the elapse of which, rotation is recommended to ensure that independence is preserved. Furthermore, the bank account is expected to be administered directly by the Health Department, following the transfer of funds from KOLS in agreement to the contract, and following verification of the respective amount.

Auditor Independence

Appropriate safeguards are to be adopted by members to ensure that the private auditor's opinion is free from any form of bias. Thus, Management is encouraged to rotate the auditor after a maximum period, which is to be established by the Board. Besides adopting good governance, such rotation can also bring fresh perspectives on board. Furthermore, if not performed in-house, accounting work is expected to be conducted by a separate and independent body.

Lack of Independent Oversight

It is recommended that the Surveillance Board be composed mainly of independent individuals, who are not members of the Co-operative, and who have the right skills and knowledge to contribute to its success. The Health Department is expected to have the prerogative to appoint the Chairman of this Committee in order to safeguard its interest.

Further to the above, while this Office finds no objection to members of such Board attending the meetings of the Management Committee, it is recommended that separate meetings of the Surveillance Board are also held, enabling any operational shortcomings to be discussed by Board members prior to them being communicated to the Management Committee. All meetings held are to be duly minuted to enhance transparency, while providing corroborating evidence of decisions and actions taken.

Contributions to the Central Co-operative Fund

KOLS is expected to give priority to statutory dues. Only after all such amounts are settled shall the balance be distributed to members as patronage refund. Furthermore, better scrutiny is expected from the independent Auditor, highlighting such issues.

Patronage Refund

Management is encouraged to review the current strategy in order to ensure that adequate reserves are maintained. Moreover, members are to be duly informed that reserves are necessary for further investments and enhancement in operations, as well as to cover losses should the need arise.

Payment of Wages and Salaries to Members

Given the fact that members on scheme B remain on Government payroll, it is recommended that the current system is reviewed and brought in line with applicable provisions. Moreover, prior period reconciliations are to be carried out between salary payments effected by MCH on behalf of KOLS, and credit notes issued by the latter, and any variances recouped.

Operating Expenses of the Co-operative

It is recommended that the provisions of the conditions of agreement are updated so that any costs incurred by MCH on behalf of KOLS are recouped in full. Furthermore, all agreements are to be supported by endorsed documentation, enabling verification. It is also suggested that the claims about the borehole are investigated by the Health Department, and action is to be taken to ensure that it is used in a regulated manner in line with standing legislation.

Equipment Reserve Fund

It is highly recommended that the Co-operative maintains a separate bank account for the Equipment Reserve fund. Moreover, amounts utilised from such fund should be duly reflected in the respective Inventory List, to enable verification.

Furthermore, the Health Department is encouraged to revise the provisions of the agreement, in order to increase the sum to put aside for the purchase of equipment to a more reasonable amount and necessitate the Co-operative to retain additional funds should an abnormal capital investment be required. A proviso may also be included to specify that any amount in the reserve is transferred to the Health Department on termination of the contract.

Skema ta' Tahrig Current Account

It is recommended that an independent senior official from the Health Department investigates the reported matters under this caption, to establish whether there has been a breach of contract. If in the affirmative, funds due by the Co-operative in line with established provisions are to be immediately recouped by the Health Department. Moreover, safeguards are to be implemented to ensure that no officer acts beyond the powers of his or her official position. Furthermore, any payments effected are to be duly corroborated by documentation to enable independent verification.

Operations Manager's Salary and Lack of Segregation of Duties

Amounts due to the Operations Manager are to be clearly stipulated in the contract, enabling verifications by third parties. Moreover, adequate succession planning is to be undertaken. A new position may be instituted within the Co-operative with the aim of reducing reliance on one individual and introducing, as far as possible, segregation of duties, which should at least include independent checking of records.

Management Comments

Legal advice sought by the Ministry for Energy and Health stipulated that KOLS is a body corporate with a distinct juridical personality to the said Ministry. It was also specified that according to the Co-operative Societies Act, the Management of the Co-operative is exclusively vested in the Management Committee elected by the members of the same Co-operative. In view of this, the Permanent Secretary (Health) opines that the observations of the Management Letter should be addressed and replied to by KOLS Management Committee.

Management rebutted many of the observations included in the Report, claiming amongst others erroneous conclusions by the Auditors, and comments which are not in line with the law. The most salient issues are reported hereunder.

The Management Committee, in its reply, emphasised on the fact that all management decisions are legally vested in the Committee

and that KOLS, like any other private company, is funded from revenue generated from services rendered to Government and other entities. Consequently, all funds generated or debts incurred by KOLS pertain solely to its members.

It was maintained that the affirmation stating that KOLS should have progressed from scheme B to A, was not correct. The Management Committee remarked that this would have been very beneficial for the members as they would have been free to operate in which market they deem fit, without any interference from the Health Division. To this effect it was alleged that, in line with NAO's recommendation, they have requested a ruling from the Co-operatives Board in this regard.

Management also claimed that the Director does not receive financial remuneration from KOLS and has no conflict of interest in his dual role as an employee of the Health Division and as Director of the Co-operative, stating that his position is in line with EU and local legislation governing in-house entities. It also stressed that the Director receives no financial remuneration whatsoever from KOLS, and limits his relationship with the members of the Co-operative to a strictly professional basis.

According to the Committee, the Director's role is limited to providing strategic direction and cannot interfere with the day-to-day management issues. However, in his role as the representative of the Contracting Authority, he is the legal representative of KOLS. Hence, any service level agreements between the Health Division and KOLS are signed by him. On the other hand, this person, being also the person responsible to safeguard the interest of the Health Division, signed the agreement regulating KOLS' internal operations.

Notwithstanding that it was brought to KOLS' attention by IAID, in reply to the concerns raised about KOLS' private Auditor, the Management Committee maintained that it has never been censured for having the same firm providing accounting and auditing services. Moreover, it was claimed that the respective observations and recommendations are not legally sound, as it is the members of the Co-operative who, through the Annual General Meeting, appoint, change or re-affirm the auditor.

With regard to the Surveillance Board, it was emphasised that it is the members who have the legal right to appoint this Board in the Annual General Meeting and the law does not compel a co-operative to have such Board. Thus, the recommendation to appoint independent technical members on the Board, who are not part of the Co-operative, is considered as not legally correct, according to KOLS.

Management stated that the verbal agreement reached in 2011, to withhold some payments in view of the hefty expenditure incurred with respect to the fire damage, is being formalised. It was also claimed that the outstanding balance due to CCof, stood at €162,000, as at August 2015.

KOLS claimed that most of its members work over 70 hours a week and are not paid any overtime. Such costs are considered as extraordinary and cannot be claimed as ordinary expenditure in terms of the Co-operatives Act. Thus, all the extra work is compensated as patronage refund. Management remarked that if, from the patronage refund, one was to exclude the remuneration for the extra hours worked by the members, the gross profit is *circa* €120,000, which is mostly generated from sales and services to the private sector.

“On the initiative of FCMU ...”, the process of refunding wages has been simplified as from April 2015.

With respect to the observations raised on the operating expenses, Management stated that a new agreement⁶ was entered into in April 2015 between KOLS and MCH, to regulate rates covering rental fees, electricity and stores consumption by the Co-operative, as well as the steam utilised by MCH. It was also claimed that KOLS is now paying MCH far less than before, implying a previous undercharge for the steam. According to the former, the savings in water costs were mainly due to efficiency and curtailing of wastages, as well as innovative technology and processes.

The issue of maintaining adequate capital reserves for the purchase of equipment was not properly addressed since KOLS maintained that it have an Accumulated Fund⁷ of €500,000, which was

⁶ Copy of agreement was not provided to NAO.

⁷ KOLS' Management Committee erroneously referred to this balance as Working Capital.

earned by the members and never distributed, and which is needed to cover shortcomings in cash flow. An incorrect reply was also provided with respect to the balance of €58,836, maintained for fixed asset investment purposes. KOLS claimed that NAO misinterpreted the respective note in the Financial Statements, and that the amount of €58,836 would have to be refunded to the Health Division together with any circulating linen stock, in the eventuality that the Co-operative is liquidated. The Management Committee also did not agree with the recommendation that amounts in the Capital Reserve account be credited to the Health Department on termination of the contract. It was reiterated that these funds belong to KOLS' members, and such a statement would only make sense if the Government was to fund the Co-operative.

In view of the recommendation to keep separate bank accounts, KOLS stated that debtors, mainly Government, rarely pay on time. Thus, according to the Co-operative, the recommendation would lead to a situation where two accounts, namely the Equipment Reserve and DHPP *Skema ta' Tahrig*, will be adequately funded, while the main operative account will be short of funds, forcing KOLS to make use of its overdraft facilities.

With respect to DHPP *Skema ta' Tahrig* current account, it was argued that since it is the Co-operative who is generating these profits, this money belongs solely to its members, and consequently, it is the same members who are to decide on how to spend the income generated. It was also claimed that, following the fire damage to the laundry, the respective clause in the agreement was amended in January 2011 to allow for the use of such funds for investment purposes, reiterating that KOLS has a right to alter the aims of this fund or even abolish it. However, this agreement was

not made available to NAO. KOLS also claimed that extensive payments were made to contractors and professional persons engaged to rebuild the laundry.

Furthermore, KOLS also reported that the Co-operative had to resort to the Equipment Reserve fund since Government never allocated any funds for the laundry premises and its equipment. It was further highlighted that since the inception of the Co-operative, all capital expenditure was financed by its members; however, all fixed assets are immediately transferred to Government and deemed to be property of the latter.

According to KOLS, the Manager was always paid in line with scale 6. However, it was maintained that he is entitled to roster, Sunday and Public Holiday allowances. Further to this, the Management Committee decided to remunerate him for his excellent performance and the additional tasks he performed beyond his role as Manager. On the other hand, it was claimed that although he works an average of 70 hours a week, and is on call 24/7, he never received payments for overtime or any on-call allowance.

With regard to segregation of duties, KOLS remarked that although NAO's comments may make sense in an effective and efficient control environment, one has to understand the level of risks involved, as well as the potential costs.





Other Reports

Government's Capital Programme

Scope of Write-up

Year in year out, millions of Euro are budgeted as Capital Expenditure (CapEx) in our annual budget, indeed a continuous increase in this amount is registered practically every year. Actual CapEx for 2013 and 2014 amounted to approximately €354.7 million and €420.4 million respectively, followed by €557.9 million budgeted funds for 2015.

The CapEx between 2005 and 2010, which includes the December 2007 – June 2009 Great Recession period, is shown below¹:

2005	2006	2007	2008	2009	2010
€	€	€	€	€	€
305.1 million	319.2 million	257.9 million	222.2 million	271.3 million	311.5 million

(Source: Budget Office)

The desire and expectations of the citizens from their government is that available resources are used efficiently and effectively to provide the highest level of public services possible. The effectiveness of CapEx can be explained in terms of whether targets are met or not, and whether the right work is being completed. In order to be effective, it is not enough to work hard, but one has to deliver what is needed. Effectiveness is measured by setting out clear targets and objectives before commencement of work and then evaluating whether the objectives have been met or not.

One can appreciate that today, because of finite resources, financial management is more important than ever both for public as well as private entities, thus budgeting plays an enormous role in controlling operations efficiently and effectively.

Although this report is not intended to provide comments from a restricted auditing perspective, its aim is to act as a starting point, with insights, one may consider during the budgeting process of future CapEx.

¹ As Budget Office (BO) remarked, there might not necessarily be a direct link involved.

Introduction to Public Investment

A country's stock of human and physical capital, public and private, can be thought of as the most tangible representation of the nation's wealth. It is the most valuable economic legacy we pass on to future generations.

Public investment by the state builds the nation's capital stock by devoting resources to the basic physical infrastructure, such as roads, bridges, airports and water distribution; innovative activity *ex.* basic research; green investments dealing with clean power sources and weatherisation; and education, both primary and advanced, as well as job training, that leads to higher productivity and/or higher living standards.

While the private sector also invests in these areas, it does so to a much smaller degree, in part because the gains from public investment accrue not just to those undertaking the investment, but to a wide range of people and businesses. Economic evidence demonstrates that apart from providing a near-term boost to a depressed economy, public investment is a significant medium term driver of productivity growth, and hence growth in average living standards. Additionally:

- investments in public capital have significant positive impacts on private sector productivity;
- public capital offers a higher social rate of return than most forms of private capital;
- public investment could increase the nation's potential growth over a number of years. Studies showed that between 40 to 75% of the plan's budgetary cost could be essentially self-financing; and
- public investment has benefits that extend beyond simply increasing measured Gross Domestic Product (GDP). It also offers benefits that are more broadly shared by all citizens, such as safer water and cleaner air. It includes also investment in public goods which cannot be provided optimally by the private sector.

Planning of Government of Malta Capital Expenditure

Categorisation of Government of Malta Capital Expenditure Reporting

Up to Financial Year 2014, Government of Malta's CapEx was categorised under three headings; namely Productive Investment, Infrastructure and Social. According to BO, Productive Investment included investment in industry, factories, freeport and shipyards. Infrastructure included the sewerage system, public transport, roads and water services. Social referred mainly to health, education and housing.

These classifications were discontinued as from the 2015 Financial Estimates. The CapEx has been retained in aggregated form through the abstracts of the Financial Estimates, backed by specific details at Line Item level as provided under the Capital Votes of the respective line ministries. BO opines that such level of detail provides sufficient representation of the nature and scope of the capital budgetary allocations.

BO plans to continue budgeting for and reporting such items as they are, insofar as the Financial Estimates are concerned. Hence, the National Audit Office (NAO) concluded that the likelihood of having the 'human capital' aspect (*ex.* teachers and early-childhood education), energy efficiency, and research and development, quantified and reported as part of CapEx is highly unlikely.

Through the ongoing assessment of monthly expenditure data, commitments relating to contracts entered into, as well as the Business and Financial Plans, it is possible to effect necessary shifting of funds within the same ministry or, if necessary, from one year onto the following, depending on the level of progress implementation registered with respect to the given capital projects. To this respect, BO is of the opinion that the financial reporting information is thus adequate to enable prompt identification and appropriate corrective action of budgeted CapEx over accomplishment.

The Current Situation

Although at the time, no Committee was set up with the remit of setting *a priori* the ratios for each category of CapEx, BO reasoned that such expenditure forms part of the annual budget process which, together with the recurrent expenditure requirements, is planned within the parameters of the fiscal ceilings. In so doing, the forecasted revenue required to finance the expenditures is also taken into account. Fiscal rules, laid down through Part II of the Fiscal Responsibility Act, 2014, now form an integral part of the annual budget process. Application thereof is monitored by various institutions, including the Fiscal Council.

Each ministry, department or entity submits details on CapEx projects through its Business and Financial Plans, which are subsequently assessed by the Ministry for Finance (MFIN) before proceeding for bilateral discussion with the respective ministries throughout the various stages of the budget preparatory process, and determine the draft budgetary allocations to be factored into the budget. Apart from the project timeframes, details on the future recurrent costs associated with the capital programmes, as well as expected revenue, if applicable, are requested. This process aims at strengthening further the medium term perspectives of the budget process. At times, projects might need referral to the Cabinet for necessary decisions, which may be required in terms of the programme of Government.

Apart from this, projects which are co-financed by the European Union (EU) are subject to particular evaluation, such as that relating to cost-benefit analysis and others, which is carried out and presented to the respective managing authorities within the Ministry for European Affairs and Implementation of the Electoral Manifesto. Prior evaluation of these reports is carried out by the Ministry when submitting their requests for funding to MFIN, as part of the budget process.

In submitting their requirements for physical capital, line ministries would need to take cognisance, in certain cases, of the private physical capital being undertaken in each of the respective sectors. This is done to ensure that no overlap or crowding out occurs in sectors that are otherwise adequately covered by the private sector.

BO remarked that there is no standard pre-set analysis (*ex. economic, fiscal, cost-effectiveness, etc.*) undertaken, at MFIN level, in support of proposed investment ratios. It is at the discretion of each line ministry to carry out any analysis of projects being proposed, through the Business and Financial Plans, as deemed necessary. It was further noted that although investment appraisal models ratios might not be always readily applicable to public sector projects, emphasis is placed on expenditure containment as dictated by the relative spending ceilings. This, in turn, gives rise to the need for undertaking efforts towards maximising output within the allocated budget. This process is aimed at addressing the EU 2020 targets.

According to BO, the budgetary process includes a separate assessment of human capital requirements, also within the parameters of the above-mentioned fiscal ceilings. Due attention is always necessary to check that the facilities and equipment used across the public sector are adequate to ensure that employees can function properly. Matched with trained personnel, this would enhance the potential of providing an efficient public service.

Suggested Improvements over the Current Capital Investment Budgetary Process System

In order to ensure financial prudence and accountability, in particular over public investment, it is important that the practice of establishing the political, social and financial priorities of Government is maintained as this drives the most appropriate measures to be used and leads to best effectiveness.

An effective mechanism to make progress would be to develop financial reporting information which will be useful for all senior officials within the Government, enabling Government to be further accountable for its management of public funds. Making the budget process more responsive to priorities, requires the establishment of priorities across expenditure. This according to Asiodu (2000), is amongst others, based on aligning budget allocation with policy priorities to reduce budget fragmentation.

Having identified the different entities responsible and involved in the capital programme budgetary process, the following are recipes for bringing about effective execution of the related budget:

- There must be competent and dedicated personnel who should collect, process, analyse and apply data adequately to the budgetary process.
- There must be an effective and strong communication network in the entire budgetary process.
- All involved in the planning budgetary process should have regard for law, rules and regulations.
- There should be honesty of purpose. Whilst acknowledging the fact that political consideration cannot be completely removed from the budgetary process, proposed policies and investment projects, and the execution thereof, should be non-partisan.
- Datelines, conditions and standards set for each of the units involved in the budgetary process should be documented and standardised.
- The budgetary personnel must have the capability through some built-in mechanism to check certain uncertainties in the economy.
- There must be an up-to-date knowledge of the progress and weaknesses of implementation processes. If up-to-date reports are not available, it becomes difficult to maintain effectiveness in the economy.
- Infrequent revisions of plans and targets could create uncertainties and if the economy is not kept in control, it could be disastrous for future planning and budgeting.

The capital budget is largely concerned with the creation of long term assets. One major test of a capital outlay is whether it adds substantially to the value of Government's assets. It is one most appropriate means for planning for capital projects, supported by a capital improvement² program designed to provide new or additional Government facilities for public services. Since the objective is to provide major public facilities that have a relatively long life within the limits of available public resources, capital budgeting should involve planning, programming and formulation of policies in terms of the desired levels of public service to be provided goals and objectives. These goals and objectives should be related to population and economic levels and economic trends and projections to ascertain future demands for public services and facilities.

Additionally, in its evaluation of proposed investment on economic growth, BO may also consider:

- whether public physical capital is included along with private physical capital and human capital as an input in the steady state production function;
- the means of financing public capital is allowed to affect the level of productivity; and
- the efficiency of use of public capital, along with the quantity of public capital, is taken to determine the effective public capital stock.

² This term refers to projects of relatively large size, nature and/or long life usually a minimum of 15 to 20 years.

The Local Scenario

Factors that affect the Level of Capital Spending

Government revenue, tax levels³, investment cost⁴, cost of borrowing⁵, the discount rate, existing capital stock, population growth and macroeconomic issues are some of the factors affecting the level of capital spending.

The main factor affecting capital spending in Malta is government revenue which, having now assumed even increased relevance due to the provisions of the Fiscal Responsibility Act, determines the level of funds available for Government's spending programme. Furthermore, CapEx is also dependent on the availability of EU funds and the structural reform agenda as documented in the National Reform Programme.

Macroeconomic assessment serves as the basis upon which projections in respect of the main local revenue and expenditure items are compiled. As the revenue forecasts in turn serve as the basis to establish the spending ceilings, it is also necessary for each ministry to factor in other relevant economic parameters, for example demographic trends in the education and elderly sectors, when submitting its expenditure programme as part of the budget process.

Government's Policy Priority – Cutting Government Spending versus Increasing Capital Expenditure

BO stated that both CapEx and expenditure containment are relevant in the setting of budgetary targets. It opines that one does not necessarily take higher priority over the other. The main purpose of prioritisation is for the maximum social benefit and public good to be derived out of the financial resources available. As detailed earlier, all spending plans are undertaken within the context of the revenue available which, in turn, is also dependent on the macroeconomic position prevailing at the time, amongst other factors.

Within the fiscal context, the medium term goal is to approach a balanced budgetary position, also as legislated through the Fiscal Responsibility Act. Obviously, with the exclusion of the corresponding national co-financing element, the EU-funded part of the CapEx is considered as deficit neutral.

Research findings published in the Economic Policy Institute (EPI) April 2012 Briefing Paper⁶ strongly suggest that increasing public investment is a more urgent policy priority than cutting spending. NAO opines that the benefits of cutting on wasteful expenditure is not to be underestimated. A significant increase in public investment spending could potentially boost jobs in the short run and pay enormous dividends in more rapid productivity growth in coming decades. In contrast, the payoff to spending cuts would be depressed job growth in the next few years and foregone productivity gains in the longer run.

³ In a steady state, the government must raise tax revenues equal to (a) the interest charge associated with the initial purchase of government capital and (b) the ongoing gross investment necessary to maintain the public capital stock against technological progress, population growth and physical depreciation.

⁴ This may be inclusive of the interest charge associated with the initial purchase of government capital, the ongoing gross investment necessary to maintain the public capital stock against technological progress and physical depreciation.

⁵ This factor applies for all deficit financing, including recurrent expenditure, and is determined by the Treasury Department, depending on the borrowing market.

⁶ Source: Bivens, J.: *Public Investment The next 'new thing' for powering economic growth*, Economic Policy Institute Briefing Paper No. 338, April 2012.

When an economy is operating at or near potential, reducing budget deficits should lead to downward pressure on interest rates, as the public sector is no longer competing with the private sector for loanable funds. Lower interest rates should then allow private firms to undertake more investment in plant and equipment, and this subsequent capital deepening should boost productivity. This case for reducing budget deficits does not hold for those economies that are not in full employment, with little or no competition for loanable funds.⁶

Concluding Remarks

Research on the impact of public investment continues to show large returns to private sector productivity, GDP growth and even deficit reduction. If public investment is sacrificed in the rush to reduce future budget deficits, the result will be less productive capital for future generations. The EPI Paper concludes that today policymakers should “*win the future*” by giving higher priority to public investment.

Impacts of Capital Expenditure

Just how productive is Public Investment?

In the early 2000s, the majority of studies on the productivity of public investments confirmed Aschauer's (1989) finding that public investment is a significant predictor of productivity growth. In fact, the new research shows that public investment is at least as productive as private, and several strands of the research seem to indicate that it is substantially more productive. Compellingly, most of the studies showed significant positive impacts of public investment on private sector productivity.

Yet, improving private sector productivity is just one reason to support expanded public investment. If, for example, public investment had no impact at all on private sector productivity but allowed public goods to be delivered more efficiently, there would be a benefit. Further, the possibility that the benefits of public investment are more broadly shared than the benefits of private sector investment, constitutes another compelling reason to support it. Studies suggest that countries with larger public capital stocks tend to have greater equality of income.

In the presence of positive externalities, the marginal social return on investment exceeds private returns. As mentioned earlier, many possible benefits of public investment may not show up as increases in cash incomes. Clean water and air provide clear economic benefits, but these benefits do not generally show up in measurable cash income.

In short, public investment should boost measured economy-wide productivity while also spreading the benefits of this growth more broadly and increasing quality of life that is not captured in productivity statistics. These insights should ideally be taken in account when dealing with the nation's budgeting and priorities.

The Local Rate of Return

When queried about the rate of return of CapEx, both as a whole and for each of the three types of CapEx, BO replied that it is not straightforward to measure the value to society emanating from public investment. As the public service is generally not marketed, attempting to quantify outputs and measure same against a set rate of return is a complex matter. According to same, cost-effective analysis is, in fact, sometimes more prevalent, whereby analysis is carried out of the various options available for achieving a given project target, minimising the capital cost as much as possible. It is also relevant to undertake economic analysis in order to assess the desirability of a capital investment from the perspective of the public good it is intended to serve.

Furthermore, changes in capital spending can be considered from a fiscal consolidation perspective in the short term. The effects of increases in productivity, brought about by further CapEx on the local debt ratio depends on the multiplier effect, which in turn is dependent on the import content. A larger multiplier means that fiscal consolidation through capital spending is more damaging to economic growth, such that it can lead to a rising rather than falling debt ratio for a number of years. Hence, in the presence of large multipliers, investment spending can actually reduce debt burden in the short term.

A look at the nature of CapEx undertaken by Government from the Financial Estimates shows that, in the main part, such investment gives rise to benefits which are non-monetary and not always readily measurable. Examples include improvement to public buildings and infrastructure which leads to improved accessibility and aims to attain better service provision.

Interesting to note that substantial evidence supports the view that some investment opportunities, such as early childhood education, research and development, and energy efficiency, offer very high returns that have yet not been exploited.

Further economic insights on local policy considerations are dealt with in *Appendix A*.

How to finance Public Investment

It is sometimes argued that even if increased public investment can increase an economy's growth performance, the necessary financing of the investment may introduce economic distortions that reduce growth. However should increased public investment be financed by reduced spending in wasteful spending categories, it will produce net benefits.

Thus, it matters not just how much public investment is undertaken but also how it is financed.

In Malta: Self-financing or Debt-financed?

As CapEx is expensed in public financial accounting, then any capital investment gives rise to an increase in the deficit, according to BO. If, on the other hand, investment is undertaken in a project, through which it shall be possible to reduce costs to Government (*i.e.* asset replacement or adoption of more efficient processes), then in the medium to long term, this investment will lead to a reduction in recurrent expenditure. By increasing potential growth, it also increases potential tax revenue in the future, which finances the initial cost of investment and interest payments.

NAO queried, amongst other, what percentage of budgetary 2015 CapEx is self-financing as opposed to debt-financed. BO commented that any difference between public sector expenditure and revenue, taking into consideration also the financing items, is funded as the public sector borrowing. Whilst the budgetary data distinguishes in detail between the different expenditure and revenue types, public sector borrowing is not directly attributed to the financing of particular categories of expenditures, *ex.* CapEx.

Studies show that in the short run greater public investment would provide valuable support to both the economy and the job market. In the short run, if an economy is operating below potential, public investment should be debt-financed to maximise job creation⁷, as detailed in the EPI Paper.

New spending in the near term would essentially put idle resources back to work without displacing any other economic activity. Indeed, by supporting overall economic activity without increasing interest rates, debt-financed capital spending in the next couple of years might even 'crowd in' private sector activity, since studies show that a primary determinant of business investment is the current state of the economy.

In the long run, as the economy returns to potential, deficit financing of capital spending can be considered in more restricted terms and only when the marginal social rates of return clearly exceed private returns. In this context, the Economic Policy Department (EPD) noted that Government's strategy is to target a balanced budget in structural terms, *i.e.* over the medium term, public investment should not be deficit financed.

Alternative Financing Mechanisms

Rationale behind Government Financing

Public finance theory stresses that a basic rationale for government provision of goods and services is that, for one reason or another, economic agents in the private market economy are unable or unwilling to accomplish the task. Government is thus justified in investing when the private sector under-invests. This situation arises when the marginal social benefit exceeds the marginal private benefit.

⁷ In fact, even if these public investments had no long run payoff, they would be worth doing in those economies facing the jobs crisis.

The inability to exclude brings with it the inability to charge and receive a price such as to yield a competitive return to the producer. Consequently, the private market would fail to properly allocate resources to their most efficient uses. Other reasons for public intervention, and perhaps provision, arise from the presence of market failures, externalities and provision of public goods.

As discussed hereunder, MFIN may explore the below-mentioned financing mechanisms in order to increase private sector participation.

Innovative Financing Mechanisms to engage the Private Sector in Infrastructure Investment

One way to address the need for more infrastructure investment is to attract more private capital for direct investment in transportation infrastructure. Increased reliance on the private sector to finance transportation infrastructure investments can also improve the efficiency of project selection and drive greater returns on investment. For example, in order to attract private financing, many projects incorporate dedicated revenue streams, often from user fees or other forms of usage-based pricing. Since these revenue streams link investment returns directly to user demand, they can help to guide capital towards the most efficient projects. In general, innovative financing mechanisms have the potential to engage the private sector in infrastructure investments with important public benefits.

The following are three innovative approaches to private sector engagement:

1. Public-Private Partnerships (PPP)⁸, particularly in the area of public transport.
2. Project Bonds that can attract new sources of private funding into the market for financing infrastructure projects.
3. Development Bank⁹ that has the potential to leverage private capital into projects of national significance.

In its reply, BO stated that it has no knowledge of other financing mechanisms, apart from PPP, which may be planned to attract more private co-investment in infrastructure investment.

1. Public-Private Partnerships

Even in a network based on private ownership, there are important public benefits that can be realised through investments that improve the flow of public transport across the road network. These benefits include reduced congestion, greater safety, and reduced pollution thereby improving air quality all along the route. These may help to reduce transit time and improve overall reliability of service.

2. Project Bonds

Taxable bonds attract direct subsidy to the issuer to offset borrowing costs for public capital infrastructure projects. Such bonds appeal to a broader class of investors, including non-profits, pension funds and other institutional investors. A study found that governments that issued these bonds realised considerable savings as compared to the cost of issuing tax-exempt bonds, and that expanding this program would lead to continued savings on borrowing costs for state and local governments.

⁸ PPP is a government service or private business venture which is funded and operated through a partnership of government and one or more private sector companies.

⁹ According to official reports, development banks are government-sponsored institutions concerned primarily with the provision of long term capital to industry.

3. Development Banks

Another innovative approach to increasing private sector participation in infrastructure investment would be the creation of a Development Bank. This bank would help to increase overall investment in infrastructure by attracting private capital to co-invest in specific infrastructure projects, and would help to improve the efficiency of infrastructure investment by relying on a merit-based selection process for projects. The risk inherent in these projects is typically not suited for financing by private banks alone. Government's capital invested in the Development Bank allows risk sharing and therefore encourages private involvement.

Besides ensuring substantial leverage of private capital, it would also fill in an important gap in the infrastructure funding system, by focusing on projects of national or regional significance, and would be a valuable complement to existing sources of funding.

Rationale and Scope of setting a Development Bank in Malta

As mentioned in the Maltese Central Bank's Annual Report 2014, the Maltese Government has actively started looking into the setting up of a Development Bank in Malta. Following the 2007/8 recession, defendants see development banks as an important tool to solve market failure leading to suboptimal productive investment. Thus, development banks can help solve market imperfections that would leave either profitable projects or projects that generate positive externalities without adequate financing due to their risk profile. Moreover, in economies with significant capital constraints, development banks can alleviate capital scarcity and promote entrepreneurial action to boost new or existing industries as they do more than just lending to build large infrastructural projects or typically invest in the long term land reclamation sector.

They also lend to companies that would not undertake projects if it were not for the availability of long term, subsidised funding of a development bank. This does not mean that the use of a development bank will be like using a blank cheque, but the risk appetite of a development bank is better suited for provision of credit to firms with capital made conditional on operational improvements and performance targets.

In such circumstances, we would expect to see such firms which borrow from development banks increasing capital investments and overall profitability after they get the necessary financing. Of course, there is a negative attitude towards the existence of development banks since they help finance risky investments. They thus require scrutiny and accountability given that public funds are supporting the risk whilst returns are shared with the private sector.

The Local Situation

A task force has been appointed to carry out the necessary studies outlining the viability of this initiative. In fact, in September 2015, local media reported the Deputy Prime Minister (DPM) as stating that "*Malta is set to get a development bank in the near future*". The studies have to report on how a Development Bank would operate in Malta, to ensure that it complements, rather than competes with, commercial banks. "*It will be there to address market failures and provide support where commercial banks may not be willing to*", DPM said.

Globally, we see how development banks helped in mitigating the effect of the 2008 crisis, which adversely affected various economies around the world and forced non-EU countries to undergo internal currency devaluations. In fact, financial experts claim that Malta has been lucky to ride the storm during the crisis and this is commendable and may be partly due to a conservative lending policy, and of course the excess liquidity offered a safe haven.

The Governor of the Central Bank of Malta opines that once established, the Development Bank could take sectors off the Government's books, particularly ones relating to funding and development, including social housing. Local media reported that he also proposed that the Development Bank could issue bonds to raise money which could then be used to finance projects. According to the Central Bank Governor, Malta needs a development bank in order to fill national financial gaps that commercial banks are not bridging. Such a bank would provide long term financing for public projects, making it easier for the Government to use underutilised assets in its possession and extend credit to sectors starved for liquidity. He stressed that while wealth funds might not be interested in investing in projects, they might be interested in buying such bonds.

The Central Bank Governor even suggested that the proposed bank would be backed by a Government guarantee and borrow money on the basis of the country's sovereign rating. However, he cautioned that the authorities had to ensure that any eventual bank adhered to EU State Aid Regulations and that its promotions did not distort market competition. To this respect, the task force will need to discuss its proposals with the European Commission.

This tactic has proved very successful overseas. Similar infrastructural development initiatives are currently being undertaken on a continental level in Europe and Asia. Discussions relate to the setting up of the European Fund for Strategic Investments and the Asian Infrastructure Investment Bank. As a full EU member and a prospective founder member respectively, Malta is actively involved in these plans and this involvement can pave its way to effectively carry out a similar initiative on the national level in order to achieve the desired targets for its economic and social progress.

Once set up locally, the Development Bank can add to existing competition for credit by promoting new avenues for savings and investments in the public domain, undertake successfully a role in promoting the economy and help in assisting the Government in social and environment projects. This in turn will lead to important infrastructural private sector development and naturally secure sustainable jobs.

The setting up of a Development Bank would help in filling the funding gap that currently exists in the Maltese financial sector and in creating important dynamics to fund large projects. DPM further explained that following the economic crisis in recent years, banks might not be willing to give loans for particularly high-risk projects, so a Development Bank would be created to fill this gap. The European Commission Vice-President for Jobs and Growth said that high-risk projects were essential for the economic development of a country, and core investment was necessary in this respect, considering the 15% drop in the investment sector since 2007.

In conclusion, it would ease the difficulty faced by larger companies, as well as Small and Medium sized Enterprises, when it comes to both sourcing funds and access to finance, and providing relief to the costs incurred, especially to enterprises in the tourism sector.

Infrastructure Investment

Introduction

“Infrastructure investment is about the most efficient fiscal support one can provide to a depressed economy” – a finding supported by nearly all macroeconomic models and forecasts.

The policy detailing over which new infrastructure investments funds are to be targeted is not required at MFIN level, according to BO, because prioritisation is not determined by MFIN, but by Government according to its programme. As detailed earlier, funds required to realise targeted projects are then identified, subject to the budgetary process, up to the extent permitted by the financial resources available. BO is of the understanding that costs relating to inadequate transportation infrastructure are taken into consideration by the Ministry for Transport and Infrastructure when submitting their capital investment plans as part of the budget process. NAO was also informed that when each ministry submits its CapEx plans, relevant econometric parameters would need to be reckoned with, *ex. demographic trends in the education and elderly sectors.*

Economic Benefits from Investing in Infrastructure

Needless to say, without a well-functioning system of roads, public transit, seaports, and aviation, much of the activity in the Maltese economy would grind to halt. Economic research has shown that investments in transportation infrastructure can have substantial economic benefits, in both the short and the long run, in particular the long run performance of an economy. Investments that create, maintain or expand transportation networks are likely to promote improved economic efficiency, higher productivity, and more rapid growth of economic activity.

Malta has recently proposed five infrastructural projects to benefit from EU funding in terms of an EU-wide infrastructural plan. These are a monorail system, a breakwater in Marsamxett, a grass airstrip in Gozo, a mechanism for the procurement, storage and distribution of medicines, and social housing. The Government is proposing that all these proposals should be PPP.

The projects are to be carried out over a number of years, with the monorail being the most expensive at €1.42 billion over some eight years. It is also the first hint at a private effort towards proposing the *“ultimate solution for urban mobility”* in Malta.

These investments result in the following benefits for our economy:

- Reduced congestion in key bottleneck areas.
- Improved road safety, which can both save lives and reduce bottlenecks on key thoroughfares.
- Expanded public transport services to emerging communities, which get commuters and other travelers to their destinations in more efficient and less congestion-prone ways.
- Rehabilitated and much-needed maintenance of ageing infrastructure, which often results in the some of the highest returns on infrastructure investment.

In order to meet the needs of a growing economy, there is an ongoing need for new investments to maintain, upgrade and expand the nation's stock of transportation infrastructure. Moreover, the value of making such investments is especially great at that time when the economy faces a situation of substantial underutilised resources.

In addition to the long run effects on economic growth and productivity, investments in infrastructure can have short run benefits by supporting employment in construction and in the production of materials. Moreover, increased spending by the workers hired in these sectors can have positive ripple effects

throughout the economy. However, these short run effects can vary greatly depending on the state of the overall economy. At the peak of a business cycle, when the economy is operating at or close to its full potential, the benefits from hiring workers for infrastructure projects will be partially offset by the diversion of these workers from other productive activities, and the investment of public funds may 'crowd out' some private investment. Many valuable infrastructure investments will still be justified during such times, but the opportunity costs of diverting economic resources from other activities would reduce the net benefits of such investments.

Recent macroeconomic research confirms the intuition that the expansionary effect of public investment spending is likely to be significantly greater during times when there is substantial slack in the economy. Overall, with idle resources, the opportunity costs of using those resources for infrastructure investment are greatly reduced.

Maintenance or Replacement?

Again, depending on the availability of funds, BO stated that decisions on new infrastructure are taken at that point when the maintenance of existing infrastructure is less cost effective than replacement.

While infrastructure investments generally provide substantial positive benefits, economists have shown that not all infrastructure investments are equally valuable. As Fernald (1999) notes "*Building an interstate network might be very productive; building a second network may not.*" In order to maximise the net benefits of additional infrastructure investment, new investments should be targeted towards projects where the return on investment is likely to be particularly high.

Types of Infrastructure Investment yielding High Returns

The following are four types of infrastructure investment that can have particularly high returns:

1. Expanding capacity by targeting investments towards key bottlenecks.

One of the most significant costs of inadequate transportation infrastructure is the congestion that arises when the demand for transportation exceeds the physical capacity of the available infrastructure.

In many instances, substantial congestion is caused by specific bottlenecks or 'chokepoints' in the network. As a result, substantial net benefits may be available from targeted investments to expand capacity at those chokepoints, allowing the network to accommodate a greater flow of traffic.

- Congestion related costs in Malta

For the last decades, Malta started showing signs of high levels of motorisation and car dependence. This increase in vehicle fleet, however, was not reflected in new supply of infrastructure and the urban road network became embedded in a dense and compact urban fabric, which did not allow further growth. German Consultants reported in 1998 that 88% of the strategic network was over-designed, being too wide for the amount of traffic carried on them, whilst the remaining 12% were under-designed with carriageways that were too narrow. The total land wasted in over-designing the main road network was calculated to amount to 0.896km², most of which were prime development areas (GTZ, 1998).

This car dependence was coupled with changes to the socio-demographic fabric of the islands' population, a lack of integration between land use and transport planning, a lack of investment in the public transport service, continued provision of road infrastructure and a relative dearth of

policies aimed at promoting modal shift. Attard (2006) reports the lack of coordination between transport and land use as one of the most critical factors to impact car use (and dependence), growth in motorisation rates and subsequently congestion on the network.

A study by the Institute for Climate Change and Sustainable Development from the University of Malta found that unless nothing changes, by 2020, Malta will experience a total of €89 million in costs related to traffic accidents¹⁰, €15.3 million in air pollution costs¹¹, €51.2 million in climate change costs, €10.4 million in noise costs, and a massive €151 million in costs resulting purely from traffic congestion.

Traffic in Malta is already costing the country an estimated €274 million a year, as *per* the above study. The increase traffic in Malta is estimated to cost the country a total of €317 million by 2020 unless the Government and transport authorities improve public transport, reduce private car ownership and change school hours.

Malta has 9.5% of the total network heavily congested when compared to the EU average of 1.7%. Peak hour congestion is a major problem in Malta, when compared to other European Member States. The European Commission's Joint Research Centre preliminary results for traffic congestion in Malta show the average number of seconds of delay *per* kilometre is estimated at 16.93 seconds whereas the European average is 5.74 seconds in 2012. The lost hours *per* commuter/driver *per* year was estimated at 52 hours.

The results further suggest an ongoing deterioration in the congestion situation in Malta. Although improving roads could “*ease temporarily congestion levels*”, the report states that this will not have significant impacts on reducing congestion. “*Road pricing and paid parking¹², aided by complementary educational, environmental and planning measures in specific areas, could be considered as policy options but their effectiveness and impacts need to be studied in depth.*” Experience from the EU also seems to suggest that an effective and affordable public transport system may be a prerequisite for road pricing and paid parking. Furthermore, studies are needed to investigate the policy on land use and how this affects transport patterns and what policy can be taken to improve land use development.

Based on the findings of the University of Malta study, it is safe to conclude that the level of car use in the Maltese Islands is not sustainable and results in considerable cost to society, caused mainly by congestion. Put differently, the effects of air and noise pollution, greenhouse gas emissions, congestion and road accidents, may have negative economic impacts that would need to be addressed. The longer it takes to implement effective decisions, the more severe and expensive the policy response will be.

¹⁰ Road traffic accidents cause social costs including material damages, administrative costs, medical costs, production losses and immaterial costs (lifetime shortening, suffering, pain, sorrow, *etc.*). Market prices are available for material costs and they are often insured. However, no market prices are available for any immaterial costs and many a times these costs are not covered sufficiently by private insurance systems. Other approaches in the literature (*ex. using willingness-to-pay surveys*) have been used for the purposes of estimation.

¹¹ Greenhouse gases (CO₂) that accumulate in the atmosphere and contribute to potential climate change are not included in the air pollution costs since they do not have any direct toxic effects. External air pollution costs quantified are health effects, building and material damage, and eco-systems and bio-diversity effects, amounting to around 0.2% of GDP.

¹² Road pricing and/or paid parking could be viewed as efficiency maximising taxes to relieve congestion, and could provide funds for further upgrading of roads and improvements in public transport. However, one would need an estimate of demand elasticities to determine the sensitivity of demand to pricing. There are other considerations that need to be factored in, including equity (*ex. the impact on low income households*) and effects on business competitiveness.

2. Improving road safety by addressing hazardous locations.

Investments that reduce road safety risks, particularly in the most hazardous areas, can have substantial net benefits. One way to improve safety is to reduce congestion. With more cars on the road, and more dangerous stop-and-go driving conditions, congested roads are often also the most hazardous.

Hence, investments that reduce congestion can have additional payoffs through improvements in safety. Similarly, many investments targeted at increasing safety have the added benefit of increasing the flow of traffic by replacing or upgrading obsolete infrastructure. The kinds of investments that can efficiently improve safety on roads include reconstructing hazardous interchanges, since a significant portion of crashes occur during lane crossings and other maneuvers at interchanges; and upgrading hazardous roads with safety features, such as broader shoulders.

3. Investing in public transit to move commuters more efficiently.

Investments that extend public transit to new locations can also have substantial public benefits. They may help to reduce highway congestion and pollution by enhancing the opportunities for the use of public transit in major commuter corridors, and hence reducing the number of vehicles on the roads. They can also create benefits by providing workers with access to a broader set of potential employment opportunities, promoting economic development in new areas, and improving mobility for residents, including the elderly and disabled.

4. Providing needed maintenance to existing infrastructure.

One important finding from the economic literature on the economic impact of infrastructure investments is that, in countries having a relatively well-developed transportation network, the highest return investments will often arise from the maintenance of existing infrastructure, rather than from investments in new infrastructure. Investments that maintain existing infrastructure include, for instance, the resurfacing of ageing roads.

Concluding Remarks

NAO concurs with Hulten (1996) remarks that:

- those countries that fail to use their infrastructure effectively pay a penalty in the form of lower growth rates; and
- international aid programs aimed only at new infrastructure construction may have a limited impact on economic growth, and may have a perverse effect if they divert scarce domestic resources away from the maintenance and operation of existing infrastructure stocks.

Management Comments

In their comments, both MFIN and EPD welcomed proposals aimed at enhancing the current processes and promote better use of scarce public resources.

The Ministry further remarked that:

- although consolidation of the budget is encouraged in order to avoid fragmentation, translating the policy priorities established at each budget into the Financial Estimates necessitates, to an unavoidable extent, that the allocation of the funds required is shown under the respective line ministry responsible, thus ensuring implementation of the priority by the respective budget holder;
- insofar as the comments on the budget processes and qualities possessed by MFIN staff are concerned, the suggested improvements are already in place and being applied, particularly with respect to the first six points. It would be cardinal to an effective budget process, if it is ensured that the same characteristics are also applied across the line ministries which submit their budgetary requirements to MFIN, and are subsequently responsible for implementing the capital budget programmes in respect of which provision would have been made in the annual Financial Estimates;
- monthly monitoring of the budgetary allocations is carried out by MFIN, based on expenditure trends and known commitments, and reports submitted by line Ministries. The extent of effectiveness achieved through such monitoring depends on the quality of data provided by line Ministries and possible solutions which they wish to propose in order to ensure that budgetary shortfalls are managed in a manner which does not jeopardize the fiscal targets of Government;
- revisions are to be kept at a minimum as much as possible. At the same time the budget process, through necessity, must include an element of flexibility, without which it would not be possible to respond to changes not only in the economic environment, but also those brought about by any factors having a bearing, directly or less so, on public finance; and
- no direct relation between the budget allocated towards capital expenditure projects and the deficit reduction targets is found in the annual Financial Estimates. Through each year's budget, it is ensured that sufficient funds are made available for capital investment responsive to the national priorities and needs. The amounts allocated depend on the revenue expected to be generated as based on macroeconomic forecasts, as well as the funds necessary for recurrent expenditure which is non-discretionary in nature.

EPD commented that:

- investment opportunities, such as early-childhood education, *etc.*, are structural reforms. However, not all such reforms are capital investments; and
- there is yet no intention to cap the deficit to the level of public investment. This is limited by EU rules and now also by the Fiscal Responsibility Act.

Appendix A – Fiscal Consolidation Efforts and Public Investment: Local Policy Considerations¹³

Despite the vast economic literature on the subject matter there is very little pertaining directly to the effects of fiscal consolidation on growth in Malta. Work relating to the short-term effects of tax policy on economic output stems from analysis carried out by EPD involving the Structural Annualised Econometric Model for Malta (SAMM). This analysis shows that the effects of fiscal policy on economic output depend heavily on the type of fiscal consolidation measure being considered.

The success of consolidation in reducing the debt ratio depends heavily on the value of the fiscal multiplier¹⁴ which measures the impact of consolidation on growth. Empirical evidence suggest that in the case of Malta, as long as fiscal multipliers do not exceed 0.9, fiscal consolidation could be successful in reducing public indebtedness even in the short-term. Depending on the type of fiscal consolidation measures, EPD estimates that short-term fiscal multipliers in Malta typically range from 0.4 to 0.7, though specific cases where the multiplier has exceeded the 0.9 threshold have also been noted. This suggests that in general, fiscal consolidation in Malta causes less damage to economic growth and can be successful even in reducing public indebtedness in the short-term, though one cannot generalise this conclusion to all types of fiscal consolidation.

The results also suggest that despite the openness of the Maltese economy fiscal multipliers are not always insignificant as the literature review may have indicated for open economies like Malta's.

A recent study by Borg (2014) suggest that fiscal consolidation in bad times is best undertaken through tax measures whilst counter cyclical fiscal policy is best carried out through expenditure. In particular, carrying out fiscal consolidation through expenditure measures is likely to increase (rather than reduce) the debt ratio in the first two years in view of a fiscal multiplier which exceeds the 0.9 critical threshold. This does not apply for tax measures where cumulative multipliers are below the critical threshold. Nevertheless, one should not dismiss the possibility that the long-term effect of revenue-based fiscal consolidation on growth could be more persistent, though such findings are not consistent throughout the empirical evidence. More research is however needed on alternative forms of fiscal consolidation and their impact on long-term growth.

¹³ Source: Arpa, E.; Vella, K.: *Economic Growth and Debt Dynamics*, August 2015.

¹⁴ The fiscal multiplier shows the extent by which GDP reacts to a change in a fiscal variable, *i.e.* a low income multiplier would be most desirable for fiscal consolidation but less desirable for counter cyclical fiscal policy in a recession.

Arrears of Revenue 2014

Background

In terms of Article 49(i) of the General Financial Regulations 1966, all officers charged with the supervision of the collection or other moneys due to Government are required to submit an annual Arrears of Revenue Return (ARR), in duplicate, to the Accountant General, for transmission to the Auditor General. Treasury Circular No. 4/2015 – ‘End of Year (2014) Statements of Account’ also required officers to forward Returns, including ‘Nil’ Returns.

All Returns were to reach Treasury by not later than 2 April 2015. As *per* the foregoing Circular, officers had to forward a copy of the Statement of Arrears to the Budget Affairs Division, Ministry for Finance (MFIN).

Ministries and Departments are obliged to submit the position of Debtors on a quarterly basis, on specified templates, to be uploaded on the Accrual Accounting Financial Reporting System. In this regard, the same Circular also states that “*Heads of Departments are requested to note the link between this return and the end of year Debtors template sent to Treasury as part of the Accrual Accounting data submission programme*”.

As also noted during last year’s review, Departments were required to submit details of payments received during January 2015 relating to balances due as at 31 December 2014. This data allows for the calculation of amounts due as at 31 December 2014 still unpaid on 31 January 2015. Information submitted revealed that an amount of €24,966,984 was collected during January 2015, with a resulting unpaid balance of €470,267,761 pertaining to amounts due as at 31 December 2014.

Returns

Details of Arrears of Revenue included in the Table on page 314 have been compiled only from Returns forwarded to the National Audit Office (NAO) by Treasury. The following submitted ‘Nil’ Returns:

- Office of the President
- House of Representatives

- Office of the Prime Minister (OPM)
 - Public Service Commission
 - Electoral Office
- Ministry for European Affairs and Implementation of the Electoral Manifesto
- Ministry for Social Dialogue, Consumer Affairs and Civil Liberties (MSDC)
 - Consumer Affairs
- Ministry for the Family and Social Solidarity (MFSS)
 - Department of Corporate Services
 - Department of Social Policy
- Ministry for Home Affairs and National Security
 - Department of Corporate Services
 - Correctional Services
 - Probation and Parole
- Ministry for Finance
 - Treasury Department
- Ministry for Energy and the Conservation of Water
 - Department of Corporate Services

Notes and Comments on Arrears of Revenue¹

Office of the Prime Minister

The gross/net closing balance as at 31 December 2014, reported by OPM in its ARR, amounted to €14,239. This outstanding balance, due from four individuals, is made up as follows:

- a. €791 is in respect of overpaid salaries to an employee.
- b. €2,238 is to be reimbursed from an employee after failing to resume her duties and work the stipulated uninterrupted period of six months, after availing herself of Maternity Leave.
- c. The amount of €11,211 is to be refunded from two employees who failed to fulfil their obligations in connection with a sponsorship of a Masters Degree.

Except for the balance of €2,238, which fell due in 2010, all pending amounts are being paid gradually.

Ageing of debtors can be classified as follows:

Amounts outstanding for less than one year (2014)	€ 11,211
Amounts outstanding for over one but less than two years (2013)	-
Amounts outstanding for over two but less than five years (2010 – 2012)	<u>3,028</u>
Net Closing Balance	14,239

¹ Figures may not add up due to rounding-up.

Department of Information

The outstanding balance of arrears as at 31 December 2014, disclosed by the Department of Information, amounting to €64,420, is all due from Government Departments and Entities, out of which the amount of €44,475, *i.e.* 69%, is in respect of Government Gazette adverts.

The ageing of the Department's debtors is categorised as follows:

	€
Amounts outstanding for less than one year (2014)	48,983
Amounts outstanding for over one but less than two years (2013)	12,785
Amounts outstanding for over two but less than five years (2010 – 2012)	<u>2,652</u>
Net Closing Balance	64,420

By the end of January 2015, €26,167 had already been recouped.

Government Printing Press

The net closing balance as at 31 December 2014, as provided by the Government Printing Press consists of:

	€
a. Revenue	290,037
b. Revolving	<u>157,522</u>
Net Closing Balance	447,559

The majority of this amount is due from Government Departments and other Entities.

An ageing of the net collectable arrears can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	195,536
Amounts outstanding for over one but less than two years (2013)	27,877
Amounts outstanding for over two but less than five years (2010 – 2012)	133,989
Amounts outstanding for over five but less than ten years (2005 – 2009)	<u>90,157</u>
Net Closing Balance	447,559

Government Property Department

The gross closing balance as at 31 December 2014 reported in the ARR of the Government Property Department (GPD), amounted to €27,364,302.

In 2013, GPD reported an amount of €11,458,542 as arrears from Government Departments, Parastatal Entities and Local Councils, whereas Treasury reiterated that the amount reported to them from the respective Entities amounted to just over €2,000,000. Since both figures appeared to be non-realistic at the time, GPD agreed with Treasury that the difference of €9,458,542 was to be deemed as not collectable, thus resulting in net collectable arrears of €2 million.

In the meantime, GPD commenced a data cleansing exercise on the properties allocated to Government Departments, Parastatal Entities and Local Councils, to reconcile the data held at GPD with that obtained

from the respective Government Department/Entity. This resulted in net collectable arrears of €5,359,490 as reported in the 2014 ARR. GPD also pointed out that this exercise is still ongoing, and that this amount may change depending on the adjustments required on each of the remaining accounts to be reviewed by GPD.

Moreover, the arrears due by Government Departments, Parastatal Entities and Local Councils were not being reported in the Debtors' Template up to end of 2014, following instructions from Treasury. However, since the closing balance of €5,359,490 is considered a more realistic figure, GPD was informed by Treasury to start including such amounts in the Debtors' Template as from January 2015.

Ageing Analysis

The net collectable arrears can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	6,353,382
Amounts outstanding for over one but less than five years (2010 – 2013)	8,967,414
Amounts outstanding for over five years (– 2009)	<u>6,735,929</u>
	22,056,725
Less unallocated credit	<u>(51,913)</u>
Net Closing Balance	22,004,812

This analysis excludes the balance of €5,359,490 pertaining to the unsupported net collectable arrears due from Government Departments, Parastatal Entities and Local Councils.

Additionally, the amount of €51,913 reported as unallocated credit, relates to payments made on account, for which the relative invoices had not been issued. These instances may arise when instructions to stop rent or to refuse payment are in place, or else when the tenant pays the due rent before the invoice is issued. An exercise to reconcile these credits to their relative invoices is still ongoing.

Revisions

A total of €270,594 was reported as revisions in the 2014 ARR. GPD confirmed that the adjustments made related to amounts, which have changed from one charge code to another in view of the data cleansing exercise, mentioned earlier.

Collection Efforts

In its efforts to recover outstanding amounts in respect of rent due on Government-owned properties, constant monitoring of accounts is carried out in order to avoid any chances of prescription.

A mailing system is used in the collection of arrears, whereby a statement is sent to tenants who fail to pay their rent within the stipulated period, followed by adequate reminders and phone calls, where applicable. Furthermore, Enforcement Officers are also sent out to deliver final notices for payments by hand. If tenants still fail to affect payment, legal proceedings will be initiated accordingly.

Attorney General

The original ARR submitted by the Attorney General's (AG) Office was revised following a thorough exercise carried out by NAO on the records held for each debtor.

The actual opening balance was increased by €4,346 since a number of debtors were erroneously omitted from last year's Return. The net collectable figure by year-end amounted to €26,305, which sum is due by 62 individuals with respect to court cases.

Ageing Analysis

	€
Amounts outstanding for less than one year (2014)	7,874
Amounts outstanding for over one but less than two years (2013)	12,601
Amounts outstanding for over two but less than five years (2010 – 2012)	3,706
Amounts outstanding for over five but less than ten years (2005 – 2009)	<u>2,124</u>
Net Closing Balance	26,305

Judicial

As reported in previous years' reports, since 2009, the Courts of Justice (COJ) Department, together with Malta Information Technology Agency (MITA), have embarked on a project to prepare a new computerised system, which is expected to improve the revenue reporting functions and allow for better collection of revenue falling in arrears. By the end of the year under review, this task was still in progress. According to MITA, the contracted date for completion was June 2015. Therefore, COJ had to carry out another rigorous exercise on the reports extracted from the unreliable Lecam and Cortex computerised systems². Each fine and fee was reviewed and amendments were made accordingly, resulting in a net downward revision of €1,283,542. The revised opening balance now stood at €10,199,466.

During the year, the amount of €1,307,059 (*i.e.* 13%) was collected, whilst revenue newly accrued totalled €2,307,512.

Approvals were obtained in 2014, to write off the total amount of €191,426. The majority of the amount written off pertained to fees due from deceased defaulters, whilst the remaining balance related to a number of fees of immaterial amounts from untraceable individuals.

An amount of €102,762 was considered uncollectable as at year-end, as explained further on in this Report, bringing the net collectable arrears figure due from individuals, down to €10,905,731, out of which, by end of January 2015, the amount of €190,251 was recouped.

The gross closing balance as at 31 December 2014, reported in the Return, which has been analysed hereafter, amounted to €11,008,493, an increase of 8% over the same figure for 2013. Details will be given further on in the Report, under the pertinent subtitle.

	€
a. Court Fines – Judges	4,762,456
b. Court Fines – Magistrates	3,960,586
c. Court Fees	2,225,662
d. Civil Fines – Superior Registry	27,780
e. Civil Fines – Inferior Registry	<u>32,009</u>
Gross Closing Balance	11,008,493

² Whilst the Lecam system issues reports with respect to the fines, the Cortex relates to court fees.

The ageing of net debtors as at year-end 2014 can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	2,307,513
Amounts outstanding for over one but less than two years (2013)	1,001,797
Amounts outstanding for over two but less than five years (2010 – 2012)	1,220,668
Amounts outstanding for over five but less than ten years (2005 – 2009)	895,646
Amounts outstanding for over ten but less than fifteen years (2000 – 2004)	1,986,078
Amounts outstanding for over fifteen but less than twenty years (1995 – 1999)	3,323,913
Amounts outstanding for over twenty years (1969 – 1994)	<u>170,116</u>
Net Closing Balance	10,905,731

Court Fines

Judges

The opening balance of €4,789,299 for 2014 was revised downwards by €200,509. According to COJ, this revision was mainly due to the reasons depicted in *Table 1*.

Table 1: Revisions to the Opening Balance

	€	€
Opening Balance		4,789,299
Upward Revision		
Four fines were converted into imprisonment in the past and therefore the amount was no longer due. However, during the year under review, the respective individuals paid the fines that were inflicted on them and hence, they had to be reinstated in the system.	25,738	
Two fines erroneously omitted from last year's arrears.	891	26,629
Downward Revision		
19 cases converted into imprisonment and therefore the amount is no longer due.	(199,530)	
Four fines which are no longer due following Act No. XIV of 2013 (An Act to amend the Value Added Tax (VAT) Act, Cap. 406).	(26,365)	
Three cancelled fines.	(1,043)	
One revoked fine.	(200)	(227,138)
Revised Opening Balance		4,588,790

During 2014, the amount of €142,908, *i.e.* 3%, was collected, whilst the revenue newly accrued totalled €348,840. The amount of €32,266, relating to nine fines dating between 1970 and 2011, was written off. This included two fines, in aggregate amounting to €28,968, which were due from two individuals who passed away.

Out of the €4,762,456 gross closing balance, the amount of €24,462 (*i.e.* 0.5%) relates to 10 fines due from untraceable debtors and hence, they are being considered as not possible to recoup, leaving a net collectable balance of €4,737,994.

From the outstanding balance, the amount of €3,960,508, *i.e.* 84%, is due from only four individuals. Whilst the amount of €1,141,288 is due from one debtor and relates to a fine inflicted in 2004, the remaining balance represents three fines imposed in 1998 on three persons, each owing the sum of €939,740.

Magistrates Courts

COJ indicated a downward revision of €1,033,920 to the opening balance of €4,384,329. Hence, the revised opening balance now reads €3,350,409.

COJ submitted a detailed report to NAO, illustrating the reasons for every variance, as depicted in *Table 2*.

Table 2: Revisions to the Opening Balance

	€	€
Opening Balance		4,384,329
<i>Upward Revision</i>		
Three forfeited bails that amount to €24,044, as well as several fines that were inflicted in the past but were erroneously not recorded in the system.	84,652	84,652
<i>Downward Revision</i>		
239 fines which are no longer due following Act No. XIV of 2013 (An Act to amend the VAT Act, Cap. 406).	(884,361)	
225 cases converted into imprisonment and therefore the amount is not due anymore.	(124,765)	
18 cancelled fines.	(34,594)	
181 revoked fines.	(35,702)	(1,079,422)
Various other adjustments to the opening balance, mainly due to problems encountered in the faulty system.	(39,150)	(39,150)
Revised Opening Balance		3,350,409

The amount of €904,335 was collected as Magistrates Court Fines during the year under review, whilst the newly accrued debts amounted to €1,538,280. Write-off approvals were obtained from the respective level of authority for the amount of €23,768.

The ARR indicated a gross closing balance of €3,960,586, out of which the amount of €78,301 relates to fines that are considered as not possible to be recouped, since they are due from either deceased defaulters or untraceable debtors, some of which are residing abroad. This leaves a net collectable balance of €3,882,285.

Court Fees

The database reflecting the amendments to the figures, as issued from the Cortex system, indicated an opening balance of €2,255,809. However, this amount was revised downwards by €50,960 due to various anomalies in the malfunctioning computerised system.

During the year, the amount of €250,495 was collected, and €135,392 was written off. Arrears newly accrued amounted to €406,700, leaving a net collectable balance of €2,225,662 as at 31 December 2014.

Civil Fines

Superior Registry

The opening balance of €26,961, was revised downwards by €1,456, mainly due to six revoked fines by a Court decree.

The Superior Registry collected only the amount of €284 during the year, whilst €2,560 was newly accrued, resulting in an outstanding balance of €27,781 as at year-end.

Inferior Registry

Nineteen fines that relate to cases of 2013 but were entered in the system in 2014, as well as seven revoked fines by a Court decree, were the main reason for the upward revision by €3,303 to the opening balance of €26,610. During the year, the amount of €9,037 was collected whilst revenue newly accrued amounted to €11,133, leaving a net closing balance of €32,009.

Ministry for Foreign Affairs

For the first time, the Ministry for Foreign Affairs submitted the ARR, namely that for 2014. Testing carried out by NAO revealed a number of adjustments that were required due to various shortcomings noted. A revised Return disclosed a closing balance of €61,299.

The nil opening balance was revised upwards to read €8,565. This amount relates to three debtors, which in the past were never reported to the Treasury Department. This comprises the amount of €1,276 due by an ex-employee who had his salary overpaid in 2012, and the refund of settling-in allowances amounting to €2,648 and €4,641, due by two officers following their early termination from diplomatic duties in 2007 and 2012, respectively.

A total of €12,959 is considered as difficult to recoup. The Ministry is prudently making a provision for such amount since the two diplomats in question, together with a newly accrued debtor owing €5,670, are disputing the refund of the settling-in allowance.

Out of the net collectable balance of €48,340 as at end December 2014, the amount of €27,408 was settled in January 2015.

The remaining outstanding arrears are all due from individuals and relate to the following:

- a. The amount of €17,138 expected to be recouped from an individual who failed to honour a contract with respect to joinery works. The amount was decided following a Court sentence handed down in 2014, in favour of the Ministry.
- b. Overpaid salary and qualification allowance, in aggregate amounting to €2,642.
- c. An amount of €1,152 due by an employee following an accident with the Ministry's vehicle.

The ageing of the net collectable arrears as at December 2014, can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	47,064
Amounts outstanding for over one but less than two years (2013)	-
Amounts outstanding for over two but less than five years (2012)	<u>1,276</u>
Net Closing Balance	48,340

Ministry for Tourism

The Ministry for Tourism reported a gross closing balance of €1,720,325 for the year ended 31 December 2014, comprising:

	€
a. Dues to Malta Tourism Authority	1,665,960
b. Dues to ex-White Rocks Holiday Complex	<u>54,365</u>
Gross Closing Balance	1,720,325

A long outstanding provision for the amount due to the ex-White Rocks Holiday Complex, which has been due since prior to 1995, has not yet been written off. Though the current reporting system generates an aged debtors list, all the debts relating to 2011 and the years before are shown as one figure, limiting the possibility to establish how long the respective amounts have been due. Thus, the net closing balance owing to the Malta Tourism Authority, which relates to unpaid licences, can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	514,732
Amounts outstanding for over one but less than two years (2013)	289,143
Amounts outstanding for over two but less than three years (2012)	230,471
Amounts outstanding for over four years (– 2011)	<u>631,614</u>
Net Closing Balance	1,665,960

Collection Efforts

During 2015, a number of initiatives were taken in order to ameliorate debt collection, namely:

- a. the development of a new licensing management software system, that was expected to be available by late 2015, which will issue the annual licences and enable credit control to be exercised more efficiently and effectively;
- b. commencement of the process to recruit a legal advisor whose duties, amongst others, relate to debt collection;
- c. continuous communication between top management and monitoring of all arrears in order to implement the necessary actions to collect dues;
- d. the deployment of a full-time credit control clerk; and
- e. enforcement officers, besides carrying out routine inspections, are also being trained to chase operators for revenue falling in arrears.

Institute of Tourism Studies

NAO was informed that the figures reported in the ARR submitted by the Institute of Tourism Studies were incorrectly compiled.

Despite a number of requests, an amended Return was not provided. As a result, verification of the arrears of revenue reported by the Institute of Tourism Studies, as at end December 2014, could not be performed by NAO.

Ministry for Education and Employment

The €677,122 gross closing balance as at 31 December 2014 disclosed by the Ministry for Education and Employment (MEDE) in its amended ARR can be analysed as follows:

		€
a.	Directorate for Educational Services (DES)	
	<i>Overpayment in Salaries</i>	172,638
	<i>Breach of Contract</i>	125,325
	<i>European Union (EU) funded Travel</i>	51,154
	<i>Running of Tuck Shops</i>	34,970
b.	Maintenance Grants Section	
	• University of Malta	169,962
	• Malta College of Arts, Science and Technology (MCAST)	
	<i>Stipends Overpayment</i>	96,266
	• Junior College and Giovanni Curmi Higher Secondary	12,396
c.	Examinations Department	
	<i>External Examinations</i>	10,058
d.	Ministry – Administration	
	<i>Breach of Contract</i>	4,120
	<i>Salary Overpayment</i>	<u>233</u>
	Gross Closing Balance	677,122

Further details are given hereafter, under the pertinent subtitle.

Out of the aforementioned gross closing balance, €140,563 relates to dues that are being considered as difficult to recoup. This leaves a net collectable balance as at end December 2014 of €536,559, out of which €8,471 is due from Government Departments, while the remaining balance of €528,088 is expected to be collected from individuals and/or private companies.

An ageing of the net collectable arrears can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	96,392
Amounts outstanding for over one but less than two years (2013)	65,077
Amounts outstanding for over two but less than five years (2010 – 2012)	137,471
Amounts outstanding for over five but less than ten years (2005 – 2009)	154,377
Amounts outstanding for over ten but less than fifteen years (2000 – 2004)	76,405
Amounts outstanding for over fifteen but less than twenty years (1995 – 1999)	5,055
Amounts outstanding for over twenty years (1994)	<u>1,782</u>
Net Closing Balance	536,559

Following meetings held with the recently appointed Director for Finance and Administration, in an effort to obtain an update on these outstanding debtors, it emerged that the hand over given by former officials who were responsible for such revenue falling in arrears, was limited. It was also confirmed that during 2014 no efforts were made in trying to recoup the amounts outstanding. In fact only €48,787, *i.e.* 8%, were recouped out of the unsettled balance of €636,481 which was due at the beginning of the year.

Directorate for Educational Services

Arrears due to Government, falling under the responsibility of DES, amounting to €384,087 by year-end 2014, mainly arose as follows:

Overpayment in Salaries

During 2014, DES collected the total sum of €14,202, *i.e.* 9% out of the amount of €157,918 due at the beginning of the year. The net closing balance of €167,552 includes the amount of €28,922 newly accrued. Action planning to recoup the latter balance initiated in mid-July 2015.

Out of the gross closing balance of €172,638, which is due from 108 ex-employees, the amount of €5,086 is being estimated as difficult to recoup. The sum of €4,805 pertains to arrears due for over 20 years, whilst the remaining balance relates to an overpayment that materialised in 2004. MEDE declared that it was only informed of such overpayment seven years later and the amount was first claimed in January 2012, *i.e.* approximately eight years after. Due to the lapse of time, no further action was taken by the Ministry in an effort to recoup the said amount.

Breach of Contract

Out of the amount of €125,325 owed for breaching the contract of employment by eight debtors, DES reported the amount of €48,081 under 'Estimated Amount considered as not collectable'. This amount has been featuring for several years, out of which, €12,329 have been outstanding since 1972, whilst the amounts of €6,488 and €29,264 have been due since 1993 and 1995 respectively.

During 2014, neither collection efforts were made, nor follow-ups could be traced within the Directorate, albeit in 2013 MEDE informed NAO that these cases were referred to AG.

Following queries raised, the Director for Finance and Administration informed NAO that immediate legal advice was going to be sought in an effort to collect the net collectable arrears, amounting to €77,244. The estimated amounts considered as not collectable will also be written off since these are now time-barred.

European Union funded Travel

During 2014, DES showed a revised opening balance of €47,346 in its Return. This amount relates to claims for reimbursement from the Centre for Development, Research and Training (CDRT), within OPM, with respect to travelling expenses of officers sponsored from EU funds, to complete a course of study abroad. In 2013, this amount was erroneously recorded as due to the Ministry, however this year MEDE and DES amended their respective Returns to illustrate the correct amount of arrears due to them.

The gross outstanding balance of €51,154 is being claimed as still to be reimbursed from CDRT. However, the latter is contesting the amount of €45,083, since it is being maintained that DES did not forward the original invoices for reimbursement, as required by the regulations binding the sponsorship. On the other hand, DES is sustaining that the original documentation was submitted as required.

Running of Tuck Shops

The recoverability of the receivable amount of €34,970, due as at year-end from three debtors with respect to rent of school tuck shops, is doubtful.

DES still did not manage to recoup the aggregate amount of €7,851 from its respective two debtors, out of which the amount of €5,683 has been due for over 23 years. As reported in the Annual Audit Report (AAR) for 2011, NAO was informed that AG's Office was going to proceed to issue a Garnishee Order against these individuals. However, there were no developments on this subject since then. According to the Directorate, the matter will be discussed with the respective legal officer.

Another lessee is contesting the tuck shop rent payable of €27,119 that was due for scholastic year 2013/2014. DES stated that it is doing its utmost to recoup this amount.

Maintenance Grants Section

During a follow-up visit at the Maintenance Grants Section, NAO noted that a number of recommendations, that were highlighted in AAR 2012, were taken on board and various shortcomings were addressed by Management.

University of Malta

Following a review of the Statement of Arrears as at December 2014, as well as the supporting documentation submitted by the University's Stipends Office, it was observed that the latter commenced to address the various anomalies that were reported upon in previous years by NAO.

The closing balance of €177,656, reported for year ending 2013, was slightly revised downwards, to correct the payment of outstanding balance due by nine debtors that were inadvertently not reflected in the Return of the previous year. The opening balance for 2014 now reads €176,941.

During the year, the University's Stipends Office managed to recoup the aggregate sum of €23,345, *i.e.* 13% out of the balance due at the beginning of the year. Out of the outstanding amount of €169,962 at year-end, the balance of €16,366 relates to overpaid stipends to students who resigned from their University courses during 2014.

Malta College of Arts, Science and Technology

The gross closing balance of arrears of revenue, reported as at end December 2013 by MCAST was revised downwards, with the opening balance for 2014 reading €68,456.

During the year, the amount of €5,717 was collected, whilst arrears newly accrued amount to €33,527. This gives a gross amount of €96,266 as at end 2014, out of which €3,222, is estimated as not collectable.

Junior College and Giovanni Curmi Higher Secondary

Following an audit exercise, it transpired that the Return relating to maintenance grants overpaid to Junior College and Giovanni Curmi Higher Secondary students was not accurate, since an amount paid in 2013 was omitted in the previous year and was thus amended accordingly.

It was also noted that out of the €10,849 due at the beginning of the year, only €809, *i.e.* 7%, was collected, whilst during the year, an aggregate sum of €2,356 was newly accrued from seven students who resigned during 2014.

Examinations Department

Due to an incorrect rate of currency conversion, the closing balance as reported the previous year was revised upwards by an immaterial variation. During 2014, the amount of €3,201 was settled out of the €3,361 outstanding at the beginning of the year.

The closing balance for 2014 of €10,058 was mainly made up of balances due from eight educational institutes, comprising both local and overseas. These represented 98% of the amount newly accrued which stood at €9,898.

Ministry – Administration

The outstanding balances as at year-end are made up of €4,120 relating to breach of contract, and the remaining €233 representing an overpaid allowance. The former amount is being considered as difficult to recoup and the case was passed on to MEDE's legal advisors.

Conclusion and Recommendation

MEDE's attention was drawn to the aged debtors analysis and to the prevailing prescription legislation. In this respect, the Ministry has been encouraged to conduct a comprehensive exercise in order to assess all outstanding dues and establish a realistic amount of net receivable debtors.

Ministry for Sustainable Development, the Environment and Climate Change

The Ministry for Sustainable Development, the Environment and Climate Change reported a gross balance in its ARR of €1,570,888. Of this, an amount of €29,762 was reported as not collectable, leaving a net balance of €1,541,126, which was split under the following categories:

	€
a. Plant Health	1,967
b. Veterinary Services	195,655
c. Paying Agency	36,643
d. Salaries	28,571
e. Aquaculture	522,667
f. Fisheries	719,154
g. Parks	33,469
h. Other Revenue	<u>3,000</u>
Net Closing Balance	1,541,126

Newly Accrued Arrears

In the 2014 ARR, the figure of €33,188 was reported as newly accrued in relation to the Paying Agency. This amount was almost three times as much as the opening balance for the same category (€11,105). The Department confirmed that the main reason for this increase was due to two individual cases of breach of commitment as regards to investment measures. Whereas typical cases of arrears in this category usually relate to small amounts, these two cases totalled €15,895 and €7,555 respectively. In both cases, the Paying Agency sent legal letters to the debtors concerned, and started charging interest on the outstanding amounts. Future considerations may include taking legal action.

Write-offs

Amounts written off amounting to €5,552 and consisting of 61 cases, were listed under the Paying Agency for the year under review. These related to dues, which could not be recovered from beneficiaries in receipt of financial aid under various EU co-funded measures. However, a review of the relevant approvals could not be conducted by NAO, because this information was not made available by the Department, in spite of numerous reminders.

Estimated Amounts considered as Not Collectable

An amount of €19,029 considered as not collectable with regards to the Pitkali Markets related to two amounts owed from two separate sellers, which have been due since 1989 and 1994 respectively.

A separate amount of €4,500 was listed as not collectable under Other Revenue. The Department confirmed that this amount is currently being handled by AG's Office and is now at arbitration stage.

Ageing Analysis

An analysis of the amounts outstanding at the end of 2014 revealed the following:

	€
Amounts outstanding for less than one year (2014)	829,013
Amounts outstanding for over one but less than two years (2013)	62,222
Amounts outstanding for over two but less than five years (2010 – 2012)	63,799
Amounts outstanding for over five but less than ten years (2005 – 2009)	420,218
Amounts outstanding for over ten years (– 2004)	<u>165,874</u>
Net Closing Balance	1,541,126

Collection Efforts

Various measures are being taken by the Department to collect the amounts overdue. These include the issuing of legal letters, judicial actions, agreements for the possibility of set-offs and agreements with the debtors for payments to be settled by instalments.

Ministry for Transport and Infrastructure

The ARR submitted by the Ministry for Transport and Infrastructure (MTI) for 2014, incorporates the following revenue categories and the net closing balance of €1,267,497 comprises dues:

	€
a. From Local Councils issued by the Central Districts Department	84,885
b. From Local Councils issued by the Cleansing Services Department	165,315
c. To Manufacturing Services Department	934,950
d. From Breach of Contracts, Damages, Maintenance and others	67,829
e. To Salaries Section	<u>14,518</u>
Net Closing Balance	1,267,497

Ageing of net collectable arrears at the end of the year, can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	480,366
Amounts outstanding for over one but less than two years (2013)	251,190
Amounts outstanding for over two but less than five years (2010 – 2012)	394,997
Amounts outstanding for over five but less than ten years (2005 – 2009)	59,566
Amounts outstanding for over ten years (– 2004)	<u>81,378</u>
Net Closing Balance	1,267,497

Past Arrears Collected

Past arrears collected during 2014 amounted to €216,346. Of this amount, €52,523 and €151,261 (in total 94%) related to the collection of ‘Dues from Local Councils issued by the Cleansing Services Department’ and the collection of ‘Dues to Manufacturing Services Department’ in respect of a number of years since 2007.

Newly Accrued Arrears

Out of total newly accrued arrears of €480,365, €431,831 (90%) related to ‘Dues to Manufacturing Services Department’ for fuel supplied to a company. Until 2013, this company and MTI formed part of the former Ministry for Resources and Rural Affairs, with the Ministry and the company both having outstanding dues with each other. To this effect, an exercise was carried out during 2014 to prepare a set-off agreement between MTI and the company. Management stated that the balance during 2015 is in favour of MTI and will be settled by means of monthly instalments.

Amounts Estimated as Not Collectable

Dues from Deposit of Waste and Rubble – Cleansing Services Department

Balances of outstanding dues, totalling €17,512, were considered as not collectable. The Ministry confirmed that a number of small amounts will be referred for write-off since it is not feasible to continue legal action to recoup such claims. On the other hand, legal action was duly taken and payment of €8,218 was effected in August 2015 in relation to four claims dating back to 2001. Furthermore, agreements were drawn with the respective debtors of four other claims, totalling €7,431, which are being settled.

Dues to Manufacturing Services Department

The amount of €17,969 which was considered as not collectable for this Department, is made of several claims totalling €6,965, of which €3,034 is to be referred for write-off, since it was acknowledged that the debtor was invoiced by mistake. The remaining balance is made up of 10 other claims that were difficult to recoup, even after several attempts.

Dues from Breach of Contracts, Damages and Others

From the total estimated as not collectable of €20,772, one claim amounting to €1,688 has since been paid, while three others, owed by a company for a total amount of €19,003, were referred to the legal office. Unfortunately, it was advised that such claims are now time-barred.

Collection Efforts

The Department has specified procedures for all claims. When invoices are issued, a registered notice is then sent. After a statement is sent on a monthly basis, and when six months have elapsed without any payment received, the claim is directly referred to the legal office so that legal proceedings are initiated to avoid prescription.

Transport Malta

Vehicle and Driving Licences

The net closing balance of arrears amounting to €23,662,372, as reported in the 2014 ARR submitted by Transport Malta (TM) consists of dues in respect of motor vehicle road and driving licences, as follows:

	€
a. Vehicle Licences	23,224,427
b. Driving Licences	<u>437,945</u>
Net Closing Balance	23,662,372

An ageing analysis of the amounts due in relation to vehicle licences is as follows:

	€
Amounts outstanding for less than one year (2014)	1,189,297
Amounts outstanding for over one but less than two years (2013)	840,608
Amounts outstanding for over two but less than five years (2010 – 2012)	3,631,570
Amounts outstanding for over five years (– 2009)	<u>17,562,952</u>
Net Closing Balance	23,224,427

Airport Tax

As in the previous year, none of the outstanding dues were written off during 2014, and the same amount of €334,443 which was reported as not collectable for the year 2013 still stands. TM reiterated that the amount considered as not collectable was originally due by two airlines, in terms of the Airport Regulations 1977, with respect to Malta-originating passengers and that it is still awaiting guidance to write off the said amount.

Road Licence Regularisation Scheme

The Road Licence Regularisation Scheme, which gave the possibility to registered owners to regularise any accumulated unpaid licences, as well as benefiting from a reduction in licence and administrative fees, remained applicable during 2014. To this effect, as reported in the 2014 ARR, out of the total arrears collected of €186,150, a balance of €154,303, consisting of licence fees (€100,120) and administration fees (€54,183), were collected.

Ministry for Gozo

The opening balance, at the beginning of 2014 for the Ministry for Gozo (MGOZ) stood at €253,519 and comprised solely amounts payable to the Projects and Development Directorate, namely to the Works, Agriculture and Public Cleansing Departments. This balance was revised upwards to include the amount of €37,619, due to the Ministry by a private company with respect to electrical and mechanical engineering services provided way back to MGOZ. The respective matter was reported upon in the AAR, Public Accounts 2010. The case was then discussed by the Public Accounts Committee in February 2012. Subsequent legal advice sought from AG also confirmed that MGOZ misinterpreted the proper chargeable rates, and thus the amount in question was to be recouped. However, so far the entire amount is still pending. Moreover, no action was taken these last couple of years in an effort to recover the overcharge.

During the year under review, €6,356 of the amount collected, *i.e.* 72%, related to Public Cleansing (Local Councils), with the balance of €2,500, *i.e.* 28%, payable to the Agriculture Department. Newly accrued arrears totalled €11,592, giving a closing balance of €293,874, of which €28,183 due by Local Councils is estimated as not collectable, leaving a net collectable balance of €265,691. Notwithstanding that no movements were recorded in the balances of €39,880 and €149,030 due to the Works Division and the Public Cleansing (Waste Disposal) respectively, which amounts have remained constant for a number of years, they have still not been provided for.

Ageing of debtors can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	11,593
Amounts outstanding for over one but less than two years (2013)	5,397
Amounts outstanding for over two but less than five years (2010 – 2012)	42,022
Amounts outstanding for over five but less than ten years (2005 – 2009)	23,117
Amounts outstanding for over ten but less than fifteen years (2000 – 2004)	<u>183,562</u>
Net Closing Balance	265,691

Gozo Law Courts

The opening balance as at 1 January 2014, reported in ARR submitted by the Gozo Law Courts, stood at €337,802 and €227,528 for fees and fines respectively.

The ageing of the gross outstanding arrears³ can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	134,576
Amounts outstanding for over one but less than two years (2013)	47,430
Amounts outstanding for over two but less than five years (2010 – 2012)	260,213
Amounts outstanding for over five but less than ten years (2005 – 2009)	104,395
Amounts outstanding for over ten but less than fifteen years (2000 – 2004)	36,171
Amounts outstanding for over fifteen but less than twenty years (1995 – 1999)	29,501
Amounts outstanding for over twenty years (1960 – 1994)	<u>20,106</u>
Gross Closing Balance	632,392⁴

Court Fees

As a result of the shortcomings in the Cortex computerised system, the opening balance of €337,802 disclosed in the ARR of the Gozo Law Courts, does not tally with that in the Fees Report, extracted from the Information Technology system, with the latter showing an opening balance of €338,224. The difference comprises a combination of three fees, which varied in the Cortex report for the year under review, from that for the previous year, and two other fees that were excluded from both the 2013 and 2014 reports.

During the year under review, past arrears collected totalled €18,291, and included fees related to 2008 and 2009. Revenue accrued during the year amounted to €72,805, giving a closing balance of €392,316, of which €53,342 is estimated as not collectable. This resulted into a net collectable balance of €338,974, as at end 2014.

Court Fines

Out of the opening balance of €227,528 reported as outstanding fines, the amount of €46,529, *i.e.* 20% (2013: 18%), was collected in 2014. This included fines dating back to 1998. Another €3,118 comprised revisions, mainly relating to revoked fines, thus considered as not due. On the other hand, newly accrued amounts totalled €61,770, ending the year with a net collectable balance of €239,651.

³ Ageing is reported for all outstanding balances since information with respect to amounts estimated as not collectable was not provided.

⁴ The difference between this amount and the closing balance as *per* ARR arises from the variance reported under 'Court Fees' emanating from the shortcomings in the Information Technology system.

The shortcomings reported in previous years were noted once again during the current period. Fines which were settled quite a while ago are again showing as outstanding in the current year's Lecam report. Similarly, the report still includes fines disclosed with a negative balance, amounting collectively to €696, which although not material are affecting the accuracy of outstanding amounts.

All fines to date are deemed revenue attributable to COJ in Malta, with the role of Gozo Courts limited to the monitoring of their respective collection process. Thus, outstanding amounts of the latter are not included with the debtors' list prepared by the Gozo Courts. This has given rise to a discrepancy of €239,651 between the debtors' list and the ARR. Moreover, this revenue was not included in the Debtors' Template prepared by COJ in Malta.

Gozo General Hospital

The opening balance of arrears of revenue for the year under review, which stood at €117,053, was slightly revised upwards to €117,100 by the Gozo General Hospital (GGH), to incorporate a debtor whose respective European Health Card was expired. Past arrears collected during the year totalled only €1,563, *i.e.* less than 2%, while newly accrued revenue amounted to €30,500. Thus, the year ended with a gross outstanding balance of €146,037. Of this amount, €65,631, *i.e.* 45%, relating to arrears for the period 1998 to 2009, is deemed as not collectable, leaving a net collectable balance of €80,406.

Ageing of debtors can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	30,500
Amounts outstanding for over one but less than two years (2013)	10,143
Amounts outstanding for over two but less than five years (2010 – 2012)	<u>39,763</u>
Net Closing Balance	80,406

The collection performance deteriorated when compared to the previous year, given the drop in past arrears collected, as well as an increase in newly accrued revenue. However, as from February 2015, a new billing service was introduced by GGH on a 24/7 basis, and this is already yielding positive results, with the amount collected up to June 2015 exceeding €6,480.

Further to the above, the software linking the Accident and Emergency Department, the Outpatients Section, as well as the Wards and the Health Centre, to the Almoner's Office is currently at testing stage and will be implemented in due course. However, it was decided not to retain the deposit of €100 in the case of those patients who do not present the European Health Card, as proposed by GGH itself last year.

Ministry for Social Dialogue, Consumer Affairs and Civil Liberties

MSDC reported a net collectable balance of €13,917. This amount, which relates solely to newly accrued arrears due from Ministries, represents outstanding salary reimbursements in respect of three employees who were transferred from MSDC.

Industrial and Employment Relations

In its ARR for 2014, the Department for Industrial and Employment Relations reported an outstanding gross closing balance of €306,461. The balance is still due from 75 beneficiaries who benefitted from the 'Self Employed Loan Incentive Scheme', which was introduced by Government in the Budget for 1989, with the aim to assist individuals to start up a business enterprise. The scheme was terminated at the end of 1992.

During the year under review, the Department managed to recoup only €2,020 out of the outstanding balance of €308,481 due at the beginning of the year, *i.e.* less than 1% of the amounts receivable.

As in the preceding year, the Department maintained a provision for bad debts of €195,685, out of which the amount of €4,135 is being contested in Court by one of the beneficiaries. The net collectable figure of €110,776 at year-end can be analysed as follows:

	€
Amounts outstanding for over ten but less than fifteen years (2002)	4,125
Amounts outstanding for over fifteen but less than twenty years (1995 – 1997)	55,026
Amounts outstanding for over twenty years (1993 – 1994)	<u>51,625</u>
Net Closing Balance	110,776

Notwithstanding the fact that legal letters were sent in 2011, as well as in the subsequent year, and reminders were also sent on a regular basis, the Department is still experiencing difficulty to recoup the amounts in question. These are due by individuals that never effected any payments throughout the years, as well as from unemployed and/or retired defaulters and the heirs of deceased beneficiaries. The latter were sent legal letters in line with Article 466 of the Code for Organisation and Civil Procedure, following advice from the legal office, to avoid the possibility that the amounts become time-barred due to prescription.

No further measures have been taken to date to recoup the outstanding amounts. However, the Department is presently analysing the way forward to recoup these outstanding debts in consultation with AG's Office.

Ministry for the Economy, Investment and Small Business

Malta Gaming Authority

The Malta Gaming Authority (MGA) reported a net outstanding arrears balance of €3,058,998 for the year ended 31 December 2014. This amount can be analysed as follows:

	€
a. Duties	2,063,908
b. Licence Fees	<u>995,090</u>
Net Closing Balance	3,058,998

Increase in Net Collectable Arrears

From the gross outstanding balance of €3,937,084 as at 31 December 2014, an amount of €878,086 was reported under 'Estimated as Not Collectable'. During the year under review, a significant increase in the closing net collectable arrears was observed. The Authority stated that this was due to the fact that a new procedure was introduced during 2014, whereas duties and licences were invoiced beforehand and sent to the respective licensee to be paid within one to two months.

Ageing Analysis

An ageing analysis of net outstanding arrears provided by MGA confirmed that the majority of arrears (79%) were outstanding for less than one year. Ageing of arrears is as follows:

	€
Amounts outstanding for less than one year (2014)	2,429,122
Amounts outstanding for over one but less than five years (2010 – 2013)	208,266
Amounts outstanding for over five but less than ten years (2005 – 2009)	<u>421,610</u>
Net Closing Balance	3,058,998

With regards to collectability of arrears, the Authority has set up a Revenue Assurance Unit and a Credit Control Unit to monitor all amounts due and take the necessary action in due course.

An audit on Gaming Taxes collected by MGA is separately reported on page 155.

Malta Communications Authority

The gross outstanding balance as at 31 December 2014 reported by the Malta Communications Authority (MCA) in relation to Radio Communication Licences, amounted to €156,462. This balance can be further analysed as follows:

	€
Amounts outstanding for less than one year (2014)	119,948
Amounts outstanding for over one but less than two years (2013)	5,696
Amounts outstanding for over two but less than five years (2010 – 2012)	26,621
Amounts outstanding for over five but less than ten years (2005 – 2009)	3,731
Amounts outstanding for over ten years (– 2004)	<u>466</u>
Net Closing Balance	156,462

MCA is continuously striving to control the amounts due to Government as at year-end. In fact, the net collectable arrears for the current year were in line with those reported in the 2013 ARR.

Licencees are requested to renew their licence prior to its expiry, upon issuance of invoices. Those who fail to pay their prescribed fee by the expiry date are subject to a penalty fee that is determined from the invoiced amount. Moreover, MCA issues several warnings in cases of non-payment. A judicial letter is issued against defaulters, whilst legal proceedings will be initiated as required.

NAO noted that 54% of the net collectable arrears reported as at 31 December 2014, were received by the Authority in January 2015.

Licensing Software Package

During 2014, a new licensing software package for Radio Communications was implemented, since the previous system was not able to generate specific reports, such as those used for debtor analysis. With the new software package available, MCA is now able to set up an efficient credit control procedure.

Television Licensing Unit

Net arrears due to Government falling under the responsibility of the Television Licensing Unit (TVLU) as at 31 December 2014, were reported as €4,061,983.

MCA licences/fees falling under the responsibility of TVLU, were reported in a separate Return with a balance of €15,230.

Amounts estimated as not collectable

Television Licences

A total of €6,094,033, representing approximately 60% of gross collectable arrears, was reported as not collectable in the 2014 ARR. The percentage of non-collectability registered an increase from its original 40% in 2013. This increase was deemed necessary since the television licence was abolished in 2011 and the Department is expecting that it will be able to collect less of its dues with each passing year.

Radio Communication Licences

An amount of €207,201, pertaining to 146 licences, was also reported as not collectable in relation to MCA licences/fees. The number of defaulting licences increased by 14 since 2013, with a resulting increase in the amount estimated as not collectable of €18,197.

Ageing Analysis

NAO was once again informed that the extraction of an ageing analysis from the system in relation to net collectable balances of €4,061,983 and €15,230, pertaining to television and radio communication licences respectively, was very complicated. Therefore, said information could not be reported upon in this year's Report.

Collection Efforts

Television Licences

The 2013 review revealed that the Unit was in the process of chasing the largest debtor balances by means of legal letters. This process has been completed during 2014, and additional reminders were sent to those debtors who remained unresponsive.

An exercise aiming to write off amounts older than five years has also commenced during 2014, where the relevant amounts were identified. Actual write-offs were carried out during 2015 and will be reported accordingly in the relative ARR.

Radio Communication Licences

Six legal cases, which were pending as *per* last year's review, remained unresolved by the end of 2014. Furthermore, this Office was informed that an exercise to write off arrears, which were either considered to be relatively small, or were prescribed, has commenced in 2015. To the date of writing of this Report, the amount of €6,250 had already been written off.

Trade Services (Commerce)

The following is a sub-classification of the gross closing balance of arrears as reported by the Trade Services Department in the 2014 ARR:

	€
a. Trading Licences	3,606,405
b. Miscellaneous Receipts	14,574
c. Penalties paid by Students	<u>7,549</u>
Gross Closing Balance	3,628,528

Out of the total gross outstanding arrears in relation to trading licences, the amount of €1,600,781 related to active licences, whilst the balance of €2,005,624 consisted of licences in the process of being withdrawn/cancelled or already withdrawn licences.

Amounts considered as not collectable

A significant increase was again noted in the amounts considered as not collectable, which amounted to €837,585 in 2013, and increased to €1,498,824 in 2014. During the year under review, the Department continued using the new procedure adopted during 2013, whereby the older debtors were estimated as having a lesser probability of collection. Different provision rates were applied depending on the year when the amount fell due, with 50% being used for amounts dating back to the period 2002 – 2010, and more recent arrears calculated at 20%, 30% or 40%. On the other hand, a 100% provision, amounting to €7,549, was applied to fees relating to two students who had participated in a student-worker placement in the 1980s but who had resigned before the stipulated time, without ever refunding the relevant amounts.

Ageing Analysis

A detailed analysis of net collectable arrears was provided by the Trade Services Department as follows:

	€
Amounts outstanding for less than one year (2014)	314,910
Amounts outstanding for over one but less than two years (2013)	243,041
Amounts outstanding for over two but less than five years (2010 – 2012)	587,631
Amounts outstanding for over five but less than ten years (2005 – 2009)	659,313
Amounts outstanding for over ten but less than fifteen years (2000 – 2004)	<u>317,260</u>
Net Closing Balance	2,122,155

Collectability of Trading Licences

A total of 14,956 renewal notices were issued to all licencees with less than four years of arrears due, followed by 4,021 reminders to those who failed to pay their fees upon receipt of the renewal notice. In addition, several *ad hoc* letters were sent to heirs of deceased licencees, as well as to other active licencees with four or more years due, requesting them to settle their outstanding fees.

Following enhancements on the Licence Management System carried out in March 2014, the Department embarked on an extensive exercise aimed at establishing which fees were actually owed and those fees which were never due, in respect of all the licences which were withdrawn from 2002 to 2013, as a result of amendments to the trade licencing legislation carried out in November 2012.

Ministry for the Family and Social Solidarity

Social Security Benefits

The Department of Social Security (DSS) reported a figure of €21,439,800 as gross/net collectable arrears in the ARR in relation to Social Security Benefits for 2014.

An analysis of the amounts pertaining to each benefit/assistance can be summarised as follows:

	€
a. Social Assistance	11,815,327
b. Retirement Pension	2,057,074
c. Widows Pension	1,829,073
d. Children's Allowance	1,628,610
e. Old Age Benefits	1,554,293
f. Medical Assistance	1,130,302
g. Invalidity Pension	420,845
h. Disability Pension Benefits	317,621
i. Short Term Benefits	256,904
j. Contributory Bonus	<u>156,519</u>
Gross/Net Closing Balance	21,166,568

NAO also noted a discrepancy of €273,232 between the net collectable arrears as *per* ARR 2014 and the figure extracted from the Debtors' Report provided by the Department. Further enquiry established that such difference related to past debtors, which were never included in the Social Assistance and Benefits System (SABS), but were included for reporting purposes in the Debtors' Listing. MFSS confirmed that these amounts will be analysed and further discussed internally in order to determine the best way forward *i.e.* either to be included in SABS or written off.

Past Arrears Collected and Newly Accrued Arrears

No breakdown was available in relation to past arrears collected, amounting to €2,056,762 and newly accrued arrears amounting to €5,114,084, as reported in ARR. DSS stated that, with respect to the former, no information was extracted and historical data could not be extracted from the system. Meanwhile, the newly accrued figure was compiled manually. It was only during 2015 that MITA carried out an adjustment for such data to be extracted from the system. To this effect, NAO could not verify the amounts included in ARR.

Estimated Amounts considered as Not Collectable

Similar to previous year, the ARR did not include a figure in relation to amounts considered as not collectable. From information provided by the Department, the calculation of this information would prove to be difficult and subjective. However, DSS is planning to carry out an exercise to identify overpayments, which were unrealistic and most probably uncollectable in the near future. This would help the Department in determining which overpayments are most likely to be recouped, whilst the residual balances could then be reported as not collectable.

Write-offs

A sample of eight write-offs, totalling €25,788 was selected for testing purposes. This represented 21% of total write-offs of €120,410 as extracted by the Department on 30 December 2014.

NAO noted that in four instances, totalling €14,180 and representing 55% of the sample selected, no formal approval by the Permanent Secretary and/or MFIN was sought by the Department prior to the write-off adjustment. Following communication with DSS, retrospective approval by the Permanent Secretary was obtained in two instances, whilst in the remaining two cases, action was still to be taken.

In its ARR, DSS reported amounts written off as being €124,341. This resulted in a discrepancy of €3,931 from the report showing the individual write-offs extracted in December 2014. DSS confirmed that such reports showed a different balance because some of the write-offs approved from January 2015 onwards could have affected the balance as at the end of 2014.

Revisions

Ten revisions, totalling €33,916 and representing 39% of total reported revisions of €88,013 were also tested.

A particular downward revision of €3,651 was noted in relation to an individual receiving Two-Thirds Pension. Upon assessment, it transpired that an overpayment of €4,267 was created in December 2013, when the claimant was earning income exceeding the National Minimum Wage threshold, whilst still receiving a pension. The downward revision was made following an appeal lodged by the claimant. However, following NAO's remarks and further investigation by the Department, it resulted that the claimant was not entitled to have this overpayment reduced, and therefore the downward revision had to be adjusted during 2015. The amount of €3,651 will be recouped at a rate of 5% of the individual's monthly pension.

Ageing Analysis

Following discussions with MFSS officials, it was decided that, due to system reporting differences, an ageing analysis could not be carried out for the year under review. However, for future periods the system will be adjusted to facilitate retrieval of detailed information.

Collection Efforts

In an effort to recoup the amounts overdue, the Department either withholds part of any benefits or assistances that the beneficiary may still be receiving, or whenever possible, enters into a repayment agreement to collect the amounts in arrears over a stipulated timeframe.

Elderly and Community Care

The Elderly and Community Care Department (ECCD) reported a net collectable balance of €4,227,992, which represents an increase of 35% over the amount of €3,136,595 reported by same for the year ended 31 December 2013.

The ARR submitted by the Department incorporates the following revenue categories:

	€
a. Staff Salaries Reimbursement	4,171,667
b. Revenue Account	54,600
c. Telephone	949
d. Training	<u>776</u>
Net Closing Balance	4,227,992

Whilst no amounts were reported as not collectable in the 2014 ARR, only a balance of €43,545 was recouped during the year, which mostly pertained to the Revenue Account.

Staff Salaries

The amount of €4,171,667, which represents 99% of total arrears as at 31 December 2014, relates to staff salaries due from various Government Departments in relation to seconded ECCD's staff.

Notwithstanding that the Department stated that reminders are sent throughout the year, no amount was collected during 2014 with respect to this category.

Revenue Account

This account receives the amount of 60% collectable from residents in Public Private Partnership homes with respect to other income, consisting of interest, receivable by the residents. DSS identifies any other income earned by the various residents within said homes, and through a shared software, ECCD is able to calculate the total amount due in line with the provisions of Legal Notice 259 of 2004.

As at December 2014, a total of €54,600 was due.

Efforts for Collection

In an effort to collect the balances due, the Accounts Section within ECCD sends monthly reminders, together with a copy of the respective invoice, to those with overdue amounts.

Newly Accrued Arrears

A breakdown of newly accrued arrears for 2014 amounting to €1,134,941 was requested by NAO. Despite numerous reminders sent to ECCD, the latter still failed to submit such breakdown.

Ageing Analysis

The outstanding balances can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	1,133,442
Amounts outstanding for over one but less than two years (2013)	978,154
Amounts outstanding for over two but less than five years (2010 – 2012)	2,112,137
Amounts outstanding for over five but less than ten years (2005 – 2009)	<u>4,259</u>
Net Closing Balance	4,227,992

Ministry for Home Affairs and National Security

Armed Forces of Malta

The Armed Forces of Malta (AFM), reported a gross closing balance of €696,704 as at 31 December 2014, analysed hereunder:

	€
a. Security Duties	607,561
b. Patrol Craft Conveyance and Hire of Vehicles	79,853
c. Helicopter and Other Services	5,141
d. Wages Refund	<u>4,149</u>
Gross Closing Balance	696,704

From this outstanding amount, the sum of €96,889 is considered as not collectable, leaving a net collectable balance of €599,815. The latter includes an amount of €243,216 which is due from Government and Parastatal Entities, whilst €356,599 is owed by individuals and private companies.

	€
Amounts outstanding for less than one year (2014)	544,109
Amounts outstanding for over one but less than two years (2013)	55,691
Amounts outstanding for over two but less than five years (2012)	<u>15</u>
Net Closing Balance	599,815

Collectable Arrears

On 17 June 2015, AFM signed a contractual agreement with a Parastatal Entity that owed €151,940, for security services rendered by AFM for the period from 1 September 2013 to 31 July 2014. The agreement obliges the debtor to settle the outstanding amount over a 24-month repayment term, commencing with effect from when the contract was signed, in monthly instalments of €6,331. The total sum or outstanding balance shall become immediately due together with interest of 8% *per annum* in case of default. As at audit testing stage, *i.e.* end of July 2015, the agreement was still being honoured by the debtor.

Estimated as not Collectable

AFM confirmed that during the year under review none of the debts considered as not collectable, amounting to €96,889, and which have been outstanding from between 1993 to 2012, were referred to AG. This provision includes, amongst others:

- a. dues from a Government Department, amounting to €75,244, for patrol craft conveyance services provided during 2008. Approval to write off the foregoing amount has not been given, despite a request made to OPM, on 3 July 2011;
- b. an amount of €10,345, representing three claims issued during the years 1997 and 2005, for security services rendered. Although, it is unlikely that this revenue will be collected, AFM has not sought write-off approval yet; and
- c. three claims for refund of wages, outstanding for over 20 years, in aggregate amounting to €4,149. As at date of audit verification, court proceedings were still in progress.

Police

The Malta Police Force reported a gross closing balance, amounting to €396,409, for the year ended 31 December 2014, comprising:

	€
a. Weapons (Sporting) Licences	326,599
b. Miscellaneous Fines (issued to Airlines and Shipping Companies)	45,233
c. Services to Third Parties (Extra Duty)	14,013
d. Other Miscellaneous Revenue	<u>10,564</u>
Gross Closing Balance	396,409

Write-offs

During the year under review, the amount of €15,549 was written off from the Miscellaneous Fines opening balance of €53,650. This included an amount of €13,685, being 50% of a claim totalling €27,370, in respect of charges imposed on a shipping company since passengers on board did not have the necessary travel documents. Following an Appeal Board's decision, the amount was accordingly reduced by the Commissioner of Police.

Estimated as not Collectable

Arrears amounting to €32,111, relating to Weapons (Sporting) Licences, were reported in ARR as 'Estimated Amount considered as not collectable', given that all efforts to trace the licensee proved futile, and/or heirs of deceased licensees were not aware of the firearms and provided an affidavit to this effect. The amount in question also includes cases whereby the system was not updated with records relating to weapons confiscated by the Court or seized in connection with investigations.

Ageing Analysis

A new computer system is now in place, however it was still not possible to generate an ageing analysis of Weapons (Sporting) Licences, since the system is expected to become fully functional in 2016. In line with previous years, an ageing of debtors relating to Services to Third Parties (Extra Duty) is still unavailable, since there is no computerised system to record such revenue falling in arrears.

Hereafter is an ageing analysis of the remaining debtors (Miscellaneous Fines and Other Miscellaneous Revenue):

	€
Amounts outstanding for less than one year (2014)	32,214
Amounts outstanding for over one but less than two years (2013)	466
Amounts outstanding for over two but less than five years (2010 – 2012)	20,515
Amounts outstanding for over five but less than ten years (2007 – 2009)	<u>2,602</u>
Net Closing Balance	55,797

Civil Protection Department

The Civil Protection Department reported a gross closing balance of €16,001. This includes a provision for bad debts, amounting to €6,251, leaving a net collectable balance of €9,750 as shown below:

	€
Amounts outstanding for less than one year (2014)	8,548
Amounts outstanding for over one but less than two years (2013)	<u>1,202</u>
Net Closing Balance	9,750

Estimated as not Collectable

The provision comprises amounts pending from 13 claims for firefighting personnel and fire engines requested onsite during various events, held between the years 2008 and 2010.

Collection Efforts

The Department has endeavoured to collect dues by requesting applicants to settle any arrears prior to submitting a new application for service. Furthermore, applicants requesting a service will in future be required to pay the full amount beforehand.

Land and Public Registry

The arrears of revenue reported by the Land Registry relate to outstanding fees from official searches on individuals and entities, requested by notaries and other third parties, in connection with transfers, liabilities and wills.

On 10 September 2013, by virtue of Legal Notice 269 of 2013, Identity Malta Agency was established in order to execute the functions and responsibilities of the public administration, amongst which those of the Land and Public Registry.

Consequently, due to the transition, NAO could not carry out testing in order to verify the reported gross closing balance of arrears as at 31 December 2014, amounting to €50,988.

Ministry for Finance

The gross/net closing balance as at 31 December 2014, as provided by MFIN, consists of:

	€
a. Quality Assurance Unit	7,140
b. Training	3,600
c. Miscellaneous Reimbursement	967
d. Guarantee Fees	<u>2,135,800</u>
Gross/Net Closing Balance	2,147,507

The Department has yet to recover a prepayment of €3,600, made towards training courses which did not materialise during 2012, as well as €967 which has been outstanding for over 10 years.

Two new balances due from two companies, amounting to €1,899,000 and €236,800 respectively, were reported in the 2014 Return. These consisted of guarantee fees charged by Government in respect of a total of five new Letters of Guarantee and renewals of two existing ones, which secure loan/overdraft facilities granted to same.

An ageing analysis of the collectable arrears is as follows:

	€
Amounts outstanding for less than one year (2014)	2,137,523
Amounts outstanding for over one but less than two years (2013)	3,509
Amounts outstanding for over two but less than five years (2010 – 2012)	5,206
Amounts outstanding for over five but less than ten years (2005 – 2009)	302
Amounts outstanding for over ten years (– 2004)	<u>967</u>
Gross/Net Closing Balance	2,147,507

Treasury Department, Salaries and Pensions Section

The gross arrears closing balance as at 31 December 2014, as provided by the Treasury Department, Salaries and Pensions Section, consists of:

	€
a. Pension Claims from Public Entities	29,122,508
b. Refunds of Deceased Pensioners	17,170
c. Overpayments to Pensioners	12,924
d. Special Cases	<u>7,689</u>
Gross Closing Balance	29,160,291

During the year, the sum of €530,139 was collected, representing 2.28% of the opening arrears balance as at 1 January 2014. This represents a considerable increase over the equivalent amount collected in 2013, which amounted to €19,549 and represented 0.08% of the then opening balance.

As in previous years, the Department forwarded a number of explanations in relation to each of the categories of arrears.

Pension Claims from Public Entities

The amounts due from public entities include arrears from those entities that employed officers who on the date of retirement had the right for a Treasury Pension.

During 2013, there had been no movement in this category of arrears, since no notification letters were sent to the respective entities during the year. However, notification letters in relation to both 2013 and 2014 were sent during the year under review. In fact, newly accrued arrears of €6,414,941, of which €3,120,830 pertained to 2013 and €3,294,111 to 2014, were reported in the 2014 ARR.

The Department confirmed that at the beginning of 2015, a thorough exercise was undertaken to update and send notification letters to all entities. The majority of these entities responded to the Department's communication and payments are being received.

NAO also noted that one of the entities paid more than the amount actually due, resulting in an overpaid balance amounting to €38,740. This balance was erroneously listed in the net collectable arrears as at 31 December 2014, instead of reported separately as accrued income.

Refunds of Deceased Pensioners

These dues consist of payments issued by the Department to individuals who pass away during the period to which the pension relates.

The Department has confirmed that two officers are in charge to check and confirm each of the instances pertaining to refunds of Deceased Pensioners. When these cases arise, the amounts that are to be refunded are computed and his/her heirs are requested to settle the amounts due.

Overpayments to Pensioners

These overpayments arise when pensioners who decide to resume work, exceed the permitted earnings threshold. This would result in overpayments in pension that have to be refunded to the Department.

Efforts to collect these amounts are similar to those explained under the previous category.

Special Cases

As explained in previous years, different cases relating to overpayments fall under this category. Particularly, part of the balance of €7,689 related to retired police officers who were reinstated within the Malta Police Force, after serving their 25-year term.

There have also been no changes to the collection procedure of these amounts. If the overpayment is up to 60% of the pension rate, it can be deducted entirely from the following pension payment. Otherwise, repayment has to be made in three instalments, unless the pensioner claims financial hardship and a different repayment method is agreed upon.

Ageing of Debtors

The ageing of debtors analysis could not be conducted by this Office since the requested information was not made available, in spite of numerous reminders.

Inland Revenue Department

The Inland Revenue Department (IRD) reported a gross arrears balance of €910,537,249 in its ARR for the year ended 31 December 2014. This balance represents an increase of 7% over the gross arrears of €849,743,003 reported last year.

The following is a sub-classification of the gross closing balance of arrears as reported by the Department in its ARR:

	€
a. Pre '99 System (Up to Year of Assessment 1998)	161,540,198
b. Self-Assessment System (Post Year of Assessment 1998)	447,701,642
c. Final Settlement System (FSS) (Employers)	81,012,206
d. Social Security Contributions (SSC) Class 1 (Employers)	146,538,332
e. SSC Class 2 (Self-Employed/Occupied)	<u>73,744,871</u>
Gross Closing Balance	910,537,249

Out of this balance, the amount of €671,356,963 was considered as not collectable, thus resulting in net collectable arrears of €239,180,286. Similar to previous years, an arbitrary flat percentage rate was used to derive the uncollectable amounts, which in the case of Pre '99 balances amounted to 80%, and in the case of Self-Assessment balances, amounted to 78.4%. With regards to the FSS and SSC (Class 1), the non-collectability rate stood at 70% and 49.3% respectively. On the other hand, all balances owed in relation to Class 2 Contributions that are older than five years, were considered as not collectable.

Ageing Analysis

The ageing of the net collectable arrears can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	31,774,511
Amounts outstanding for over one but less than two years (2013)	28,108,193
Amounts outstanding for over two but less than five years (2010 – 2012)	61,810,308
Amounts outstanding for over five but less than ten years (2005 – 2009)	45,872,168
Amounts outstanding for over ten but less than twenty years (1995 – 2004)	53,815,935
Amounts outstanding for over twenty years (– 1994)	<u>18,127,915</u>
Net Closing Balance	239,509,030

The total of the ageing analysis differs from the net collectable arrears in the ARR by €328,744. This amount relates to payments collected by IRD in connection with the Pre '99 system collection schemes, which amount could not be set off against the balance due in any particular year, therefore it was omitted from the ageing analysis.

Efforts to Collect

The Department commented that the efforts made to collect the amounts overdue are part of an ongoing process. In fact, planned action in 2015 includes sending of FSS Demand Notices for amounts over €100,000, as well as the issuing of statements of pending balances to individuals, Corporate Entities and employers.

Furthermore, the Collection Section committed itself to keep sending notices with respect to agreements in default, preparing for and attending Court sittings as well as remitting interest agreements and other instalment plan agreements. The remission of interest agreements is also reviewed by an internal Board to ascertain consistency and equity.

Capital Transfer Duty Department

The gross closing balance as reported by the Capital Transfer Duty Department in its ARR ending 31 December 2014 consists of:

	€
a. Duty on Documents	24,801,055
b. Death and Donation	<u>4,623,516</u>
Gross Closing Balance	29,424,571

Out of the €29,424,571 gross closing balance, of which €13,312,103 were reported as being under contestation, the amount of €22,143,037 was considered as not collectable, thus resulting in net collectable arrears pertaining to Duty on Documents and Death and Donation of €6,838,106 and €443,428 respectively.

Ageing Analysis

The outstanding balances can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	2,144,761
Amounts outstanding for over one but less than two years (2013)	117,980
Amounts outstanding for over two but less than five years (2010 – 2012)	319,447
Amounts outstanding for over five but less than ten years (2005 – 2009)	853,967
Amounts outstanding for over ten but less than fifteen years (2000 – 2004)	2,977,144
Amounts outstanding for over fifteen but less than twenty years (1995 – 1999)	<u>868,235</u>
Net Closing Balance	7,281,534

Amounts under Contestation

Amounts under contestation amounting to €13,312,103, relate to objections made by the taxpayers. This figure is made up of 1,439 cases, 1,355 of which are statute-barred. On the other hand, 84 cases concerning Duty on Documents and Transfers are still under objection, and are currently awaiting action or a Court hearing.

Amounts considered as not collectable

The dues estimated as not collectable amounted to €22,143,037 in 2014. This figure includes the amounts under contestation mentioned above, as well as other claims, which, although never contested, the Department failed to collect, due to legal and/or technical reasons. These also include amounts upon which legal action was taken and Garnishee Orders were issued, but the respective taxpayers do not hold the necessary funds to settle. A provision of approximately 10% was taken for those newly accrued arrears that remained unpaid by the end of the year 2014.

Collection Efforts

The Collection and Legal Sections within the Department are constantly monitoring the outstanding balances and taking necessary action. During 2014, a number of reminders, including letters from the Legal Unit were sent to various debtors. Furthermore, the Department proceeded with 97 Garnishee Orders and 240 legal action warnings.

Value Added Tax Department

The following is a sub-classification of the gross closing balance of arrears as reported by the VAT Department in its ARR for the year ending 2014:

	€
a. VAT (1998)	1,106,361,362
b. VAT (1995)	14,422,586
c. Customs and Excise Tax	6,462,781
d. Eco-Contribution	8,985,146
e. Refund to Government on stocks – 1997	<u>620,381</u>
Gross Closing Balance	1,136,852,256

The amount of €620,381 represents debts due to the Department, accruing from stock on which VAT was due following the changeover to Customs and Excise Tax in 1997. However, no breakdown of such amount was available, as was reported in last year's AAR.

Net collectable arrears amounted to €70,145,048 after deducting a balance of €1,066,707,209, which is estimated as not collectable by the Department.

Whereas write-offs during the year amounted to €527, a total balance of €113,356,120 was reported as not due in the VAT Department's ARR, representing cancellations of assessments, penalties, estimations and interest, following the submission of declarations by taxpayers.

A lower figure of past arrears collected was noted for 2014, which was due to changes in legislation on appropriation, whereby payments received are no longer automatically allocated against old balances. Instead, payments intended to cover a VAT Return, are allocated to the period pertaining to that Return and not against older balances, leading to a more realistic account of the amounts being paid.

As reported in previous years, no ageing analysis of net collectable arrears could be provided.

Customs Department

The 2014 net closing balance of arrears, amounting to €37,074,216, as provided by the Customs Department, is analysed as follows:

	€
a. Import and Export Duties	36,344,261
b. Licences, Taxes and Fines	82,747
c. Fees of Office	2,407
d. Reimbursements	<u>644,801</u>
Net Closing Balance	37,074,216

Newly Accrued Arrears

Newly accrued arrears amounted to €34,718,895, out of which an amount of €29,194,177 pertained to excise duties on petroleum products which a company purchased but failed to pay during 2014. Furthermore, another amount of €2,329,373 is still due from said company as from February 2012.

Estimated Amounts considered as not collectable

The Customs Department reported an aggregate amount of €6,893,815 for a number of cases whereby the related amounts were undergoing Court proceedings.

Since the majority of the amounts due relate to Court cases, including appeals on the original decision, the Department stated that it is very difficult to assess the collectability of such dues, particularly the ones involving material amounts. Even when judgement is passed in favour of the Department, the latter would still need to institute recovery proceedings, thereby extending the collection process further.

Collection Efforts

When the arrears are not being contested in Courts, the Department sends a number of reminders. If debtors fail to settle their invoices, Customs proceeds to block the Economic Operator Registration Identification number in the electronic system, so as not to allow further importation or exportation of consignments. In the event that even this measure fails, judicial action is then taken. Members of the Enforcement Unit call at the individual/company premises in those cases where amounts are relatively small and judicial action is not cost-effective.

Ageing Analysis

The ageing of the net collectable arrears can be analysed as follows:

	€
Amounts outstanding for less than one year (2014)	34,324,287
Amounts outstanding for over one but less than two years (2013)	35,362
Amounts outstanding for over two but less than five years (2010 – 2012)	2,370,907
Amounts outstanding for over five but less than ten years (2005 – 2009)	264,586
Amounts outstanding for over ten but less than fifteen years (2000 – 2004)	45,294
Amounts outstanding for over fifteen but less than twenty years (1995 – 1999)	3,769
Amounts outstanding for over twenty years (– 1994)	<u>30,011</u>
Net Closing Balance	37,074,216

Department of Contracts

The outstanding gross closing balance of €294,464, reported by the Department of Contracts as at 31 December 2014, consisted of penalties and damages due by seven contractors.

Total dues of €17,287 were collected during the year from two contractors, one of whom, during 2011, was served with a Garnishee Order, as well as issued a Performance Guarantee in favour of the Department. An amount of €11,236 owed by a contractor who had been served with a Judicial Letter more than five years ago was written off.

Estimated Amounts Considered as Not Collectable

A balance of €168,636 was reported as considered as not collectable, of which €42,261 also featured under this category in 2013. The remaining €126,375 pertained to two contractors, whose dues were reported as being under contestation.

The amount of €59,748 owed by a foreign company, reported as estimated as not collectable as at December 2013, is now considered due since the Court sentence has been reactivated.

Ageing Analysis

The resulting net collectable arrears of €125,828 is analysed as follows:

	€
Amounts outstanding for less than one year (2014)	-
Amounts outstanding for over one but less than two years (2013)	-
Amounts outstanding for over two but less than five years (2010 – 2012)	51,441
Amounts outstanding for over five but less than ten years (2005 – 2009)	-
Amounts outstanding for over ten years (– 2004)	<u>74,387</u>
Net Closing Balance	125,828

Ministry for Health

The gross closing balance of €5,195,627 as at 31 December 2014, is made up of the following:

	€
a. Hospital Tests: Primary Health Care (PHC)	9,899
b. Hospital Fees: Sir Paul Boffa Hospital (SPBH)	112,236
c. Hospital Fees: St. Luke's Hospital	237,984
d. Hospital Fees: Mater Dei Hospital (MDH)	2,567,060
e. Sundry Bills: MDH	1,164,806
f. Resignations and Overpayments: MDH	231,560
g. Licences	30,160
h. Ship Sanitation	10,819
i. Breach of Contract	2,278
j. EU Countries E125 Claims	750,370
k. EU Countries E127 Claims	<u>78,455</u>
Gross Closing Balance	5,195,627

From the gross receivable at year-end of SPBH, a total amount of €68,840 is being estimated as not collectable, since such balance has been due for more than four years and the respective five foreign patients are not traceable. This resulted in a net closing balance of €5,126,787, as analysed below:

	€
Amounts outstanding for less than one year (2014)	2,217,419
Amounts outstanding for over one but less than two years (2013)	902,450
Amounts outstanding for over two but less than five years (2010 – 2012)	1,052,854
Amounts outstanding for over five but less than ten years (2005 – 2009)	711,727
Amounts outstanding for over ten but less than fifteen years (2000 – 2004)	191,047
Amounts outstanding for over fifteen years (– 1999)	<u>51,290</u>
Net Closing Balance	5,126,787

Five Returns were submitted individually by the Units falling under the portfolio of the Ministry for Health, namely that of the Central Procurement and Supplies Unit, SPBH, PHC, MDH and the Ministry. The latter three did not submit the Return by the deadline as required in terms of Treasury Circular No. 4/2015 – ‘End of Year (2014) Statements of Account’, in one case it was submitted more than three months later. Moreover, following testing carried out by NAO, three of the five Returns and the respective Analysis of Debtors were revised, namely that of SPBH, PHC and the Ministry, due to several errors noted. The following shortcomings under the pertinent Unit were also noted:

Mater Dei Hospital

The supporting documentation provided by MDH could not be corroborated with the amounts recorded in the respective Return. Consequently, NAO carried out an intensive exercise, in an attempt to reconcile the ancillary data and to update the amounts quoted in the Return and the Analysis of Debtors accordingly. Although the revised amounts, together with the respective workings, were communicated to the Financial Controller, the Return and the related Analysis of Debtors were not re-submitted, with the consequence that the reported figures are not correct.

The major discrepancies noted were mainly due to:

- a. amounts recorded in the Return not tallying with the supporting documentation provided;
- b. the ageing of debtors does not match with the Return and Analysis of Debtors submitted;
- c. legal fees payable by third parties not taken into consideration, and therefore not included with the amount outstanding;
- d. an amount of €24,430 due since year 2012 with respect to various casualty fees was removed from the debtor’s list, notwithstanding that the relevant approval for write-off was not obtained; and
- e. sundry bills of €541,172, due since year 2013 from MITA, were not included in the closing balance as at 31 December 2013. As a result, the opening balance for the year under review was understated.

According to the Financial Controller, an exercise was commenced to identify debtors who are not traceable, so as to propose the necessary write-off. It was also stated that the long outstanding balances are mostly due from tourists who cannot be traced. However, despite clear indication that the collectability of certain amounts is remote, they still featured in the Return as outstanding, rather than considered to be estimated as not collectable.

Last year it was reported that beginning January 2015, a new system should be running in the Billing and Revenue Section. This has now been installed and efforts are being made to integrate the Clinical Patient Administration System, which is intended to be in place by the first quarter of 2016.

Ministry

The newly appointed Finance Senior Manager was delegated to monitor the balances outstanding from licences and ship sanitation on a monthly basis and to assist as necessary. According to the Financial Controller, works were being carried out to implement an online payment system, in order to ameliorate the collection of these dues.

Although due licences date way back from year 2000 and the balances relating to ship sanitation have been pending since year 2010, NAO was not provided with any evidence that any action was taken during the year under review, to collect these arrears of revenue. Furthermore, no provision has as yet been taken.

Arrears of Revenue 2014 ^a

Ministry/Department		Gross Outstanding on 31/12/2013 ^b	Collected during 2014	Written off 2014	Revisions 2014	Arrears 2014
Office of the Prime Minister	€	7,026	3,998	-	-	11,211
Department of Information	€	77,903	62,274	155	-37	48,983
Government Printing Press	€	662,359	410,336	-	-	195,536
Government Property Department	€	23,227,108	5,254,190	15,991	-270,594	9,677,969
Attorney General ^d	€	26,064	11,584	-	4,346	8,047
Judicial ^d	€	11,483,008	1,307,059	191,426	-1,283,542	2,307,512
Notary to Government ^d	€	1,511	1,497	-	-	17,973
Ministry for Foreign Affairs	€	-	-	-	8,565	52,734
Ministry for Tourism	€	1,679,678	411,291	-	-62,794	514,732
Institute of Tourism Studies ^e	€	223,777	-	4,711	-	51,300
Department of Local Government	€	2,575	2,575	-	-	3,150
Ministry for Education and Employment	€	636,481	48,787	-	-34,082	123,510
Ministry for Sustainable Development, the Environment and Climate Change	€	1,560,008	768,975	5,552	-17,255	802,662
Ministry for Transport and Infrastructure	€	614,707	216,346	13,477	458,727	480,365
Transport Malta ^f	€	20,408,940	186,150	-	46,739	3,727,286
Ministry for Gozo	€	253,519	8,855	-	37,619	11,593
Gozo Judicial Courts	€	565,330	64,820	-	-3,118	134,575
Gozo General Hospital	€	117,053	1,563	-	47	30,500
Ministry for Social Dialogue, Consumer Affairs and Civil Liberties	€	-	-	-	-	13,917
Industrial and Employment Relations	€	308,481	2,020	-	-	-
Ministry for the Economy, Investment and Small Business						
Malta Gaming Authority	€	1,509,162	1,200	-	-	2,429,122
Malta Communications Authority	€	155,281	118,952	-	-	120,133
Television Licensing Unit	€	10,408,726	18,747	-	-11,532	-
Trade Services (Commerce)	€	3,796,073	535,809	2,450	-19,230	389,944
Ministry for the Family and Social Solidarity						
Social Security Benefits	€	18,594,832	2,056,762	124,341	-88,013	5,114,084
Social Welfare Standards	€	-	-	-	-	2,690
Elderly and Community Care (including Welfare Committee)	€	3,136,596	43,545	-	-	1,134,941
Ministry for Home Affairs and National Security						
Armed Forces of Malta ^f	€	728,117	575,522	-	-	544,109
Police	€	396,070	64,292	15,550	-19	80,200
Civil Protection	€	19,124	11,115	238	-318	8,548
Land and Public Registry	€	74,985	10,393	20,190	-	6,586
Ministry for Finance	€	25,422	15,438	-	-	2,137,523
Treasury (Pensions Section)	€	23,256,008	530,139	-	-	6,434,422
Inland Revenue (including Tax Compliance Unit):						
Income Tax	€	578,440,686	106,693,395	-	-286,336,053	423,830,602
Social Security Contributions: Class 1 and Class 2	€	197,706,416	67,955,616	-	-2,555,174	93,087,577
Final Settlement System	€	73,595,901	48,895,044	-	-2,340,132	58,651,481
Capital Transfer Duty:						
Duty on Documents	€	24,692,430	926,642	-	-1,268,093	2,303,360
Death and Donation Duty (including Penalties)	€	4,624,016	500	-	-	-
V.A.T.	€	935,590,276	12,529,022	527	-113,356,120	327,147,650
Customs	€	101,729,014	92,479,878	-	-	34,718,895
Contracts	€	322,987	17,287	11,236	-	-
Economic Policy	€	-	-	-	-	9,564
Ministry for Health	€	5,060,659	2,036,062	-	-53,445	2,224,475
TOTAL ^g	€	2,045,718,309	344,277,680	405,844	-407,143,508	978,589,461

Gross Outstanding on 31/12/2014	Gross Variation	Amounts Est. as not Collectable	Net collectable arrears as at 31/12/2014	Net collectable arrears as at 31/12/2013	Net Variation	Due from Govt. Dept. & Para. Bodies	Due from Individuals & Private Cos.	Amounts coll. during January 2015	Balance as at 31/01/2015
14,239	7,213	-	14,239	7,027	7,212	-	14,239	-	14,239
64,420	-13,483	-	64,420	77,902	-13,482	64,420	-	26,167	38,253
447,559	-214,800	-	447,559	662,359	-214,800	447,372	187	34,768	412,791
27,364,302	4,137,194	-	27,364,302	23,227,108	4,137,194	9,655,552	17,708,750	543,747	26,820,555
26,873	809	569	26,304	25,496	808	-	26,304	749	25,555
11,008,493	-474,515	102,762	10,905,731	11,338,396	-432,665	-	10,905,731	190,251	10,715,480
17,987	16,476	-	17,987	1,511	16,476	17,987	-	6,443	11,544
61,299	61,299	12,959	48,340	-	48,340	22,358	25,982	27,408	20,932
1,720,325	40,647	54,365	1,665,960	1,625,313	40,647	-	1,665,960	-	1,665,960
270,366	46,589	-	270,366	210,857	59,509	53,935	216,431	-	270,366
3,150	575	-	3,150	2,575	575	3,150	-	1,820	1,330
677,122	40,641	140,563	536,559	580,092	-43,533	8,471	528,088	4,633	531,926
1,570,888	10,880	29,762	1,541,126	1,533,617	7,509	22,276	1,518,850	-	1,541,126
1,323,976	709,269	56,478	1,267,498	556,161	711,337	435,824	831,673	3,307	1,264,191
23,996,815	3,587,875	334,443	23,662,372	19,143,662	4,518,710	-	23,662,372	10,992	23,651,380
293,876	40,357	28,183	265,693	225,336	40,357	79,042	186,649	1,127	264,566
631,967	66,637	53,342	578,625	520,218	58,407	-	578,625	-	578,625
146,037	28,984	65,631	80,406	63,934	16,472	-	80,406	1,898	78,508
13,917	13,917	-	13,917	-	13,917	-	13,917	-	13,917
306,461	-2,020	195,685	110,776	112,796	-2,020	-	110,776	125	110,651
3,937,084	2,427,922	878,086	3,058,998	639,576	2,419,422	-	3,058,998	887,339	2,171,659
156,462	1,181	-	156,462	155,281	1,181	43,031	113,431	83,880	72,582
10,378,447	-30,279	6,301,234	4,077,213	6,150,209	-2,072,996	140,000	3,937,213	31,872	4,045,341
3,628,528	-167,545	1,506,373	2,122,155	2,958,488	-836,333	-	2,122,155	36,937	2,085,218
21,439,800	2,844,968	-	21,439,800	18,594,832	2,844,968	-	21,439,800	926,557	20,513,243
2,690	2,690	-	2,690	-	2,690	2,690	-	2,690	-
4,227,992	1,091,396	-	4,227,992	3,136,595	1,091,397	4,172,616	55,376	8,300	4,219,692
696,704	-31,413	96,889	599,815	631,460	-31,645	243,216	356,599	50,845	548,970
396,409	339	32,111	364,298	382,075	-17,777	6,479	357,819	7,119	357,179
16,001	-3,123	6,251	9,750	12,554	-2,804	-	9,750	-	9,750
50,988	-23,997	11,807	39,181	42,988	-3,807	-	39,181	623	38,558
2,147,507	2,122,085	-	2,147,507	25,422	2,122,085	2,135,800	11,707	-	2,147,507
29,160,291	5,904,283	-	29,160,291	23,256,008	5,904,283	29,122,508	37,783	-	29,160,291
609,241,840	30,801,154	480,114,025	129,127,815	128,452,840	674,975	-	129,127,815	1,100,546	128,027,269
220,283,203	22,576,787	134,534,394	85,748,809	83,999,946	1,748,863	-	85,748,809	9,388,796	76,360,013
81,012,206	7,416,305	56,708,544	24,303,662	22,078,824	2,224,838	-	24,303,662	9,278,206	15,025,456
24,801,055	108,625	17,962,949	6,838,106	9,963,895	-3,125,789	-	6,838,106	115,215	6,722,891
4,623,516	-500	4,180,088	443,428	1,865,884	-1,422,456	-	443,428	-	443,428
1,136,852,257	201,261,981	1,066,707,209	70,145,048	49,233,506	20,911,542	-	70,145,048	-	70,145,048
43,968,031	-57,760,983	6,893,815	37,074,216	c	c	31,122,311	5,951,905	2,173,172	34,901,044
294,464	-28,523	168,636	125,828	209,741	-83,913	-	125,828	250	125,578
9,564	9,564	-	9,564	-	9,564	7,761	1,803	1,803	7,761
5,195,627	134,968	68,840	5,126,787	4,991,820	134,967	1,120,549	4,006,238	19,399	5,107,388
2,272,480,738	226,762,429	1,777,245,993	495,234,745	416,696,304	41,464,225	78,927,348	416,307,394	24,966,984	470,267,761

- a) Figures may not add up due to rounding-up.
- b) Opening Balances reported as featuring in last year's AAR, unless otherwise specified.
- c) Did not send Return of Arrears 2013.
- d) Featured in 2013 under the Ministry for Home Affairs and National Security.
- e) Figures were incorrectly compiled and could not be verified by NAO.
- f) Opening Balance 2014 does not tally with Closing Balance 2013 (*vide* comments).
- g) Totals are incomplete in view of c), e) and f) above.

Conservatorio Vincenzo Bugeja

Background

The Conservatorio Vincenzo Bugeja (CVB) was instituted by virtue of the Deed made by the Marquis Vincenzo Bugeja on 4 December 1880. The main objective of the Trustees is to execute the Founder's will, primarily by managing the funds and contributing to the running of the residential homes, which provide therapeutic and education services to female adolescents, between the ages of 12 and 17, encountering behavioural problems.

Audit Scope

The audit was conducted in accordance with generally accepted auditing standards. These standards require planning and performing audit procedures in order to obtain reasonable assurance as to whether the internal control structure at the entity concerned is adequate. It was also ascertained whether the Foundation Deed, together with the policies set by the Accounting Policy Document, approved by the Board of Trustees (BOT) of CVB on 20 June 2011, have been followed.

The Management Letter for the year ended 31 December 2013, drawn up by the National Audit Office (NAO) contained comments and recommendations to provide constructive advice to the Board.

Observations

Negligible Funds used for Welfare Assistance

The main objective of BOT is to execute the Founder's will, primarily by managing the funds and contributing to the running of *Fejda* Programme and Jeanne Antide Home.

During the audits of the previous three years, it was observed that minimal funds were shown under Welfare Assistance in the Financial Statements, compared to earlier years. The aggregate expenditure to this effect amounted only to €3,470 in 2013, which is even less than the amounts paid in recent years.

NAO was verbally informed that extensive works for new residences are being paid for by CVB. These premises will accommodate those girls who reach the age of 18 and are not catered for by the present programmes. According to the Chief Executive Officer (CEO), apprenticeship schemes have also been

sought from a private enterprise so that the girls are given the opportunity to have specialised training and eventually find suitable jobs.

However, both the donation in kind and the apprenticeship schemes were not disclosed in the Financial Statements.

Lack of Transparency in Procurement

Further to last year's comments where NAO noted lack of transparency in procurement, it was again observed that in a number of instances, the approval for appointment of particular contractors or service providers, as well as the amount involved for the respective procurement, is not mentioned in the Board minutes. Furthermore, though CEO claimed that it is standard practice to issue a call for quotations, no such evidence was provided.

Presentation of Accounts not in line with International Accounting Standards

Fixed Assets

CVB has maintained its policy of giving a notional value of €233 for each of its 48 properties, with the exception of two premises which are recognised at cost, as one was purchased and has been developed since recent years, whilst the other, which is on a short-term rental agreement, has been valued on the basis of costs for improvement. This valuation approach is not in compliance with the International Accounting Standards (IASs) which require more disclosure on the actual valuation of the properties.

Financial Assets

The Conservatorio has also maintained its policy to recognise at cost, equity investments which do not have a maturity date. This is not in line with IAS 39 which states that “... *the best evidence of fair value is quoted prices in an active market*”.

Presentation of Accounts

The same presentation of accounts as per previous years has been retained. This is not in accordance to the format required as per IASs and does not include the Cash Flow Statement and the Statement of Changes in Equity.

Management Comments

Negligible Funds used for Welfare Assistance

The Board agreed to NAO's recommendation to include further information within the Financial Statements on the work done by BOT in relation to Welfare Assistance and Contributions to the Homes.

Lack of Transparency in Procurement

The recommendation, to ensure that the acquisition of goods and services is officially approved by BOT and duly documented in the minutes of the respective Board meetings, will be taken on board to ensure transparency and accountability.

Presentation of Accounts not in line with International Accounting Standards

Management reiterated that it is not obliged to present accounts in line with IASs, but in accordance to the Accounting Policy Document, approved by BOT on 20 June 2011.

Co-operatives Board

Audit for Financial Year 2014

Background

The Co-operatives Board was established by virtue of Article 3 of the Co-operative Societies Act, Chapter 442 of the Laws of Malta, as a statutory body having distinct legal personality. This Board consists of a Chairman and a number of members, appointed by the Minister responsible for Co-operative Societies, whose functions are to:

- a. register, monitor and exercise supervision over Co-operative Societies and to ensure compliance with the provisions of the Co-operative Societies Act;
- b. support and assist the establishment of Co-operative Societies in all sections of the economy and society; and
- c. furnish information regarding co-operative principles, practices and management.

Article 9(2) of the aforementioned Act, requires the Co-operatives Board to submit to the Minister and the Minister responsible for Finance, a statement of accounts duly audited by the Auditor General, and a report of its activities, by not later than three months after the end of each financial year.

The allocated budget of the Co-operatives Board for the financial year 2014 totalled €100,000, an increase of €6,500 over the preceding year's approved estimate.

Audit Scope

The scope of the audit was to ensure that the Financial Statements for the year ended 31 December 2014 show a true and fair view of the financial position of the Co-operatives Board as at that date, and of its financial performance and cash flows for the year then ended. Compliance with the Co-operative Societies Act, 2001, as well as the existence of adequate internal controls, was also ascertained.

Control Issues

Shortcomings in the Engagement of a Service Provider

No Expression of Interest was issued by the Co-operatives Board prior to appointing a service provider on a retainer basis for the period April 2014 to March 2015. The annual fee for these services was of €4,000, payable every three months in equal instalments. An officer of the Co-operatives Board stated that the renewal of this contract was based on satisfactory service in prior years.

Furthermore, the above-mentioned agreement included a clause which stated that the contracting parties may unanimously agree to extend the agreement, subject to the Board's approval. Although the Board committed itself to issue an Expression of Interest once this agreement expired, the inclusion of this clause in the contract allows for the possibility that such service is again procured through Direct Order in the future.

The Board's approval for appointing this service provider on a retainer basis for the period April 2014 to March 2015, was granted on 6 June 2014, while the agreement was dated 17 June 2014. Therefore, the agreement entered into force prior to it being formally approved and endorsed.

Overpayment of Mobile Phone Allowance

The Contract of Employment with a former Manager, stated that the officer was entitled to a mobile phone allowance of up to a maximum of €600 *per* year, upon presentation of appropriate fiscal receipts. The officer was employed with the Co-operatives Board until early October 2014 and thus, the *pro-rata* entitlement of this allowance amounted to €460. However, the officer was paid a total of €552 during the year, hence resulting in an overpayment.

Recommendations

Control Issues

Shortcomings in the Engagement of a Service Provider

The engagement of service providers is to be as transparent as possible, in order to ensure fair competition, besides obtaining the most cost-effective fees. Furthermore, the Co-operatives Board is to ensure that no agreements are to be entered into unless the procurement of the respective services is duly approved beforehand. Agreements are also to be timely endorsed by all parties involved.

Overpayment of Mobile Phone Allowance

The Board is to ascertain that the overpaid mobile phone allowance is recouped.

Management Comments

As regards the engagement of the above-mentioned service provider, Management stated that an Expression of Interest was published one month prior to the expiry of the contract in force, on 1 March 2015.

Furthermore, Management claimed that it will be communicating with the former Manager to recover the overpaid mobile phone allowance.



Recent NAO Publications

NAO Audit Reports

December 2014	Annual Audit Report of the Auditor General - Public Accounts 2013
December 2014	Annual Audit Report of the Auditor General - Local Government 2013
January 2015	Information Technology Audit: Commerce Department
February 2015	An Analysis of Types of Errors in Public Procurement within the Structural Funds Programmes
February 2015	An Investigation of Government's Acquisition of the Café Premier
March 2015	An Analysis of Enemalta Corporation's Hedging Activity during 2014
April 2015	Performance Audit: Provision of Residential Long-term Care (LTC) for the Elderly through Contractual Arrangements with the Private Sector
May 2015	Audit of Gozo Channel Company Limited: Public Service Obligation Bid Feasibility and Operational Considerations
June 2015	Performance Audit: Class Size in State Primary Schools
July 2015	A Comparison of Crude Oil Prices and Electricity Tariff Band Structures
July 2015	Performance Audit: Tackling Domestic Violence
July 2015	Information Technology Audit: Housing Authority
October 2015	An Investigation of matters relating to the Emphyteutical Contract between Government and the General Workers Union
November 2015	An Investigation into the Issuance of Encroachment Permits between December 2012 and March 2013

NAO Work and Activities Report

May 2015	Work and Activities of the National Audit Office 2014
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