MFSA

MALTA FINANCIAL SERVICES AUTHORITY

14 January 2016

Securities and Markets Supervision Unit

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To: Listed Entities on the Malta Stock Exchange
Attn: Company Secretaries

Dear Sir/Madam

Re: Transparency Directive (Directive 2004/109/EC or the 'TD') – Findings following examination of annual reports of local Listed Entities

1.0 Background

The Transparency Directive (Directive 2004/109/EC or the 'TD') establishes the periodic financial information to be published by issuers whose securities are admitted to trading on a regulated market.

Recital 23 of the TD provides that 'information requirements also require adequate control by the competent authority of the Member State' of the issuer. Regulation 1606/2002/EC paved the way for convergence of the financial reporting standards throughout the Community for issuers whose securities are admitted to trading on a regulated market and who are required to prepare consolidated accounts (see Recital 9 of the TD). The periodic financial information covered by the TD basically relates to the annual report, the half-yearly report and the interim management statements. According to Article 24 of the TD, a single competent authority should be designated in each Member State to assume final responsibility for supervising compliance with the provisions adopted pursuant to the Directive, as well as for international cooperation.

In this regard, ESMA has issued Guidelines on enforcement of financial information under Article 16 of the Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 ('ESMA regulation') in relation to the acts referred to in Article 1(2) of the ESMA Regulation, which includes the Transparency Directive, with a view to establish consistent, efficient and effective supervisory practices in relation to, and ensuring the common, uniform and consistent application of, such acts.

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These guidelines are principles-based and i) define enforcement of financial information and its scope under the Transparency Directive; ii) set out what characteristics enforcers should possess; iii) describe selection techniques that should be followed and other aspects of enforcement methodology; iv) describe the types of enforcement actions that should be made use of by enforcers and explain how enforcement activities are coordinated within ESMA.

The Malta Financial Services Authority is the local independent authority responsible for ensuring compliance by listed companies with the International Financial Reporting Standards ('IFRS'). The Authority's function aims to ensure investor protection and promote market confidence by contributing to improved transparency of accurate and reliable financial information, which is fundamental for investors as well as potential investors, to arrive at an informed investment decision.

2.0 Key Findings

In carrying out its role, the Authority reviews the financial information presented by listed companies in Malta to ensure compliance with the requirements of the IFRSs. The following are the main issues identified and which the MFSA have brought to the attention of the respective issuer.

[A] IAS 7 Statement of Cash Flows

IAS 7 paragraph 6 requires that an entity discloses the policy which it adopts in determining the composition of cash and cash equivalents. In this regard, issuers have been recommended to ensure that the policy disclosed in the financial statements, for cash and cash equivalents, clearly discloses the true nature of the asset, including whether it includes financial assets held in money market funds, as applicable.

[B] IAS 12 Income Taxes

IAS 12 paragraph 4 states that IAS 12 does not deal with the method of accounting for government grants or investment tax credits. However the standard deals with the accounting for temporary differences that may arise from investment tax credits. In this respect, the attention of issuers has been drawn in order to ensure that where investment tax credits have significant impact on the profit or loss for the year, further information is disclosed in the financial statements to allow the user to understand the nature and timing of such credits.

[C] IAS 16 Property, Plant and Equipment ('PPE')

Issuers have been requested to ensure the disclosure in the financial statements of the basis used for determining the gross carrying amount of PPE as required in terms of IAS 16 paragraph 73(a).

[D] IAS 17 Leases

Paragraph 31 of IAS 17 requires that entities that are lessees under a finance lease are to disclose:

a. The net carrying amount of each class of asset, at the end of each reporting period;
b. A reconciliation between total of future minimum lease payments and their present value. In addition, an entity is also required to disclose the total of future minimum lease payments at the end of the reporting period, and their present value;
c. Contingent rents recognised as an expense;
d. Total future minimum sub-lease payments expected to be received;
e. A general description of the lessee's material leasing arrangements.

In this respect, missing disclosures included (b) to (d) above.

Furthermore and in accordance with IAS 17 paragraph 35(c), lessees are required to provide a general description of the lessee's significant arrangements, including the existence and terms of renewal or purchase options and escalation clause. In this regard, missing disclosures included i) the term of lease; ii) a detailed description of the terms of renewal (including the renewal period); and iii) information relating to the change in the annual lease payments.

[E] IAS 24 Related Party Disclosures

In view of the requirements under paragraph 9 of IAS 24 which provides that non-monetary benefits are a measure of compensation, the Authority has requested that disclosures in the financial statements should also include the value of non-monetary benefits provided to key management personnel ('KMP').

[F] IAS 33 Earnings per Share

IAS 33 paragraph 66 requires earnings per share to be presented for every period for which a statement of comprehensive income is presented. If diluted earnings per share are reported for at least one period, it shall be reported for all periods presented, even if it equals basic earnings per share. If basic and diluted earnings per share are equal, dual presentation can be accomplished in one line in the statement of comprehensive income. IAS 33 paragraph 69 states that an entity shall present basic and diluted earnings per share even if the amounts are negative (loss per share). Issuers have been recommended to ensure the disclosure of diluted EPS, which may be disclosed within the same line on the Statement of Comprehensive Income. In this regard, issuers may also explicitly state that no dilutive instrument has been issued in the past.

[G] IAS 36 Impairment of Assets

IAS 36 paragraph 13(e) specifies that for each material impairment loss recognised or reversed during the period for an individual asset, including goodwill, or a cash-generating unit, the entity shall disclose whether the recoverable amount of the asset (cash-generating unit) is its fair value less costs to sell or its value in use. In this regard, issuers have been requested to revise the level of disclosure and ensure compliance with the requirements of paragraph 13(e).

Additional missing disclosures include the requirements of paragraph 129 which requires that entities that report segment information in accordance with IFRS 8 are to disclose for each reporting segment:

a. The amount of impairment losses recognised in profit or loss and in other comprehensive income during the period;

b. The amount of reversals of impairment losses recognised in profit or loss and in other comprehensive income during the period.

IAS 36, paragraph 134 requires that an entity discloses the information (required by paragraph 134(a) – (f) for each cash generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives.

In this regard, missing disclosures included i) the carrying amount of goodwill allocated to each unit (36.134 (a)) and ii) the methodology and key assumptions used in determining the value in use, the period over which cash flows have been projected, the growth rate and discount rates applied (36.134(d)).

[H] IAS 37 Provisions, Contingent Liabilities and Contingent Assets

IAS 37 paragraph 85(a) requires, for each class of provision, a brief description of the nature of the obligation and the expected timing of related outflows of economic benefits. Paragraph 85(b) specifies that for each class of provisions, entities shall disclose an indication of the uncertainties about the amount or timing of those outflows. In this regard, the Authority has recommended issuers to improve and disclose additional details on the expected timing of the outflows of economic benefits and on the uncertainties and major assumptions in relation to provisions.

[I] IAS 38 Intangible Assets

In terms of the requirements of IAS 38 paragraph 118(a), issuers have been requested to disclose whether the useful life of each intangible asset is finite or indefinite and if finite, the useful life or the amortisation rate used. In addition, paragraph 118(d) requires that an entity discloses the line item(s) of the statement of comprehensive income in which any amortisation of intangible assets is included.

In addition and in terms of the requirements of paragraph 126 of IAS 38, the Authority has drawn the attention of issuers to ensure that development costs that meet the recognition criteria of an intangible asset are accounted for directly as an intangible asset rather than included as an expense and reversed as income in the Statement of Comprehensive Income. Expensed development costs incurred prior to the satisfaction of the recognition criteria cannot be capitalised.

[J] IAS 40 Investment Property

Paragraph 75 of IAS 40 states that an entity shall disclose amongst other requirements:

i. the methods and significant assumptions applied in determining the fair value of investment property, including a statement whether the determination of fair value was supported by market evidence or was more heavily based on other factors (which the entity shall disclose) because of the nature of the property and lack of comparable market data.

ii. the extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.

iii. when classification is difficult, the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business.

Issuers have been requested to clearly indicate the basis used for the valuation of investment property in addition to disclosing the criteria used to distinguish investment property from owner-occupied property and for property held for sale in the ordinary course of business.

Furthermore, and in view of the requirements emanating from paragraph 75(h) of IAS 40 requires, issuers have taken remedial action in order to disclose the contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements of such investment property.

[K] IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

IFRS 5 paragraph 41 (c) specifies that an entity shall disclose the gain or loss recognised in accordance with paragraphs 20-22 and, if not separately presented in the statement of comprehensive income, the caption in the statement of comprehensive income that includes that gain or loss in the period in which a non-current asset (or disposal group) has been either classified or held for sale or sold.

Paragraph 41 (d) also requires the disclosure, if applicable of the reportable segment in which the non-current asset (or disposal group) is presented in accordance with IFRS 8 Operating Segments.

In this regard, the Authority has drawn the attention of issuers in order to ensure that in the annual financial statements the disclosure clearly indicates the gain or losses recognised on disposal of assets held for sale as required by paragraph 41 of IFRS 5.

[L] IFRS 7 Financial Instruments: Disclosures

In view of the requirements emanating from paragraph 25 of IFRS 7 issuers have been requested to ensure the disclosure of the fair value of each class of financial asset and liability in a way that permits it to be compared with its carrying amount.

Issuers have also been requested to ensure compliance with IFRS 7 paragraph 37(a) which requires entities to disclose an analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired.

[M] IFRS 8 Operating Segments

IFRS 8 paragraph 22 (a) requires disclosure of the factors used in identifying reportable segments. The Authority has recommended issuers to improve and disclose more information in order for the users of financial statements to understand the factors used in identifying reportable segments.

In view of the requirements emanating from IFRS 8 paragraph 23, the Authority is requesting issuers to ensure that they disclose a measure of total assets and liabilities for each reportable segment where these amounts are regularly provided to the chief operating decision maker.

IFRS 8 paragraph 23(c) requires interest revenue to be reported separately from interest expense for each reportable segment unless the major part of revenue is derived from interest and the chief operating decision maker relies primarily on net interest revenue to assess the performance of the segment. In this case, the entity is allowed to report interest revenue net of interest expenses but such detail must be disclosed. Issuers have been recommended to ensure that when disclosing interest revenue net of interest expenses such detail is also disclosed.

IFRS 8 paragraph 23(h) requires disclosure of income tax expense or income for each reportable segment. Paragraph 25 states that the amount of each segment item reported shall be the measure reported to the chief operating decision maker for the purposes of making decisions about allocating resources to the segment and assessing its performance.

In this regard missing disclosures included i) the allocation of the tax expense by segment and ii) reference that segment reporting is based on information as reviewed by the chief operating decision maker.

IFRS 8 paragraph 24(b) requires that entities disclose the amounts of additions to non-current assets if the specified amounts are included in the measure of segment assets reviewed by the chief operating decision maker, or are otherwise regularly provided to the chief operating decision maker, even if not included in that measure of segment assets. In this regard, issuers have been requested to also consider that the allocation of assets against segments automatically implies that additions may be allocated to segments.

In terms of the requirements of IFRS 8 paragraph 28(c), the Authority has requested issuers to include a reconciliation of the total of the reportable segments' assets to the entity's assets in order to explain the reason for the difference between the two balances.

IFRS 8 paragraph 34 requires that an entity provides information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10 per cent or more of an entity's revenues, the entity shall disclose:

i. that fact;
ii. the total amount of revenues from each customer; and
iii. the identity of the segment or segments reporting the revenues.

In this regard, missing disclosures included i) the identity of the major customers; and ii) the amount of revenues that each segment reports from major customers.

[N] IFRS 13 Fair Value Measurement

Paragraph 97 of IFRS 13 requires that for each class of assets and liabilities not measured at fair value in the statement of financial position but not which the fair value is disclosed, an entity shall disclose the information required by paragraph 93(b), (d) and (i). Paragraphs 93(b), (d) and (i) require that entities disclose the level of the fair value hierarchy, the valuation techniques used (for level 2 & 3) and information about the highest and best use. Where the fair value disclosed is based on a level 2 approach, the Authority is requesting issuers to disclose the valuation techniques and inputs used in arriving at the fair value measurement as required by paragraph 93(d) of IFRS 13.

3.0 Conclusion

We trust that the findings outlined above will assist local Listed Entities who have still not been selected by the Authority for examination of the published accounts to ensure that applicable disclosures are included in their annual financial statements.

Should you have any queries regarding the above, please do not hesitate to contact Ms Lorraine Vella, Senior Manager (lvella@mfsa.com.mt) or Ms Stephanie Buhagiar Camilleri (scamilleri@mfsa.com.mt).

Sincerely,

Dr Christopher P. Buttigieg
Director
Securities and Markets Supervision Unit