

28th March 2019

Enforcement of Financial Information IAS 12: Income Taxes Recognition of Deferred Tax Assets

1. Background

1.1 The Listing Authority

One of the responsibilities of the Listing Authority ('the Authority') is to ensure that financial information published by listed companies on a regulated Market in accordance with the Transparency Directive¹ complies with International Financial Reporting Standards ('IFRS') and other applicable reporting standards.

The Authority aims to ensure investor protection and promote market confidence by contributing to the improved transparency of accurate and reliable financial information. Improved transparency of accurate and reliable financial information is fundamental for investors as well as potential investors, to reach an informed investment decision. In carrying out its role, the Authority examines the financial information published by listed companies in Malta, in terms of the ESMA Guidelines on the Enforcement of Financial Information (ESMA/2014/807).

1.2 Circular rationale

The Transparency Directive establishes the periodic financial information to be provided by Issuers whose securities are admitted to trading on a regulated market. Recital 23 provides that *'information requirements also require adequate control by the competent authority of the Member States'* of the Issuer. European National Enforcers of financial information monitor and review financial statements and consider whether they comply with IFRS and other applicable reporting requirements, including relevant national law.

In its capacity as the National Enforcer of financial information, the Authority is conducting ex-post focused examinations on Issuers' Annual Reports, made available to the public as required in terms of Listing Rule 5.55.

One of the ex-post examinations carried out during Quarter 1 of 2019, is an ex-post examination on compliance with IAS 12 Income Taxes ('IAS 12'), specifically the recognition of deferred tax assets ('DTAs') and the probability of future taxable profits.

¹ DIRECTIVE 2004/109/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 15 December 2004 on the harmonisation of transparency requirements in relation to information about Issuers whose securities are admitted to trading on a regulated market, as amended.

Paragraph 24 of IAS 12 provides that a deferred tax asset shall be recognised for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilised. Moreover, paragraph 34 of IAS 12 outlines that a deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.

Therefore, heightened professional scepticism is exercised when an issuer has a history of recent losses, whilst recognising material DTAs based on the future taxable profits. The Authority's position is that if an issuer has suffered cumulative losses before tax for the past three years², substantive evidence is to be provided to corroborate the appropriateness of the issuer's basis for recognition of the DTA in the financial statements.

The purpose of this circular is to communicate the findings being gathered in relation to the abovementioned ex-post examination regarding IAS 12.

2. Scope

The Authority reviewed all financial statements for the past three years, published by Issuers up until 11th March 2019. In cases where the 2018 financial statements were still not published as at the abovementioned cut-off date, examinations for the preceding three years started from the 2017 financial statements. Within this context, the Authority has carried out checks on all 48 Issuers that had published financial statements by 2018³.

The main considerations in the Authority's examinations involve understanding the profit/loss trend of the Issuers, whilst checking whether a DTA is being recognised in the Statement of Financial Position. In instances of a loss-making trend and a DTA recognition, checks are done on the corresponding supporting evidence. This is enforced through paragraph 35 of IAS 12 which states that, *"...when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity. In such circumstances, paragraph 82 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition."*

The Authority notes that in assessing the probability that future taxable profits will be available, the profit/loss trend of the Issuers is not assessed in isolation as other factors, including the nature of the business and economic conditions, are also taken into consideration. Within this context, evidence, both negative and positive, is considered in order to determine whether the positive evidence outweighs the negative evidence. Positive evidence can include, albeit not

² 'Past three years' is taken to mean 2015, 2016 and 2017 where the 2018 financial statements are not yet published.

³ As at 31st December 2018, the total number of Issuers amounted to 55. Out of these 55 Issuers, 8 Issuers were new in 2018. From these 8 Issuers, only 1 issuer had published an annual report post-listing as at 11th March 2019. This means that the examination is carried out on the whole population of Issuers with published financial statements post-listing.

exhaustively, a loss related to a one-time event or practical tax planning strategies. On the other hand, negative evidence could stem from the following non-exhaustive examples; having a history of operating losses, the entity being a start-up and uncertainty relating to the Issuer's going concern.

In addition, the DTA disclosures, in line with paragraphs 79 to 88 of IAS 12, should be entity specific and directly reflective of the Issuer's facts and circumstances, rather than being boilerplate⁴. Paragraphs 122 to 129 of IAS 1 highlight more disclosure requirements, where the expected disclosures should be comparable to the degree of materiality and the judgements/uncertainties relating to the recognition of DTAs.

3. Findings

It appears that 7 out of the 48 Issuers reported a loss in one or more financial periods in the past three years whilst recognising a DTA at either a group level, a company level, or both. It is to be noted that Issuers that reported a loss but did not recognise a DTA or recognised a DTA but reported a profit, were not subject to further checks in relation to this examination.

The findings were further split depending on whether the figures feature at group or company level; however, some Issuers feature under both levels. Table 1 illustrates the number of Issuers that recognised a DTA and reported a loss. A distinction is drawn between those Issuers that reported a loss as part of a loss-making trend and those that did not have a history of losses⁵.

DTA recognised at Group Level	No. of Issuers
Loss Behaviour	
Reported a loss	4
▪ History of losses	1
▪ No history of losses	3
DTA recognised at Company Level	No. of Issuers
Loss Behaviour	
Reported a loss	6
▪ History of losses	3
▪ No history of losses	3

Table 1 - Loss Behaviour of Issuers that recognised a DTA

From the checks carried out, it appears that in the cases where the Authority noted a trend of losses, the DTA recognised was not significant enough to require additional supporting evidence. Throughout the said examination, the Authority also noted to what extent, if at all, the

⁴ Boilerplate text is taken to imply standard text that has not been adjusted to truly reflect the specific circumstances of the issuer.

⁵ For the purpose of the examination carried out by the Authority, since IAS 12 does not define a 'history of losses', a 'history of losses' is taken to signify a situation where the Issuer reported a trend of pre-tax loss for 2015, 2016 and 2017.

DTAs of the respective Issuer exceeded the corresponding deferred tax liabilities. Having said that, examinations are ongoing and the Authority will continue to do ex-post examinations in terms of the Guidelines on the Enforcement of Financial Information, issued by ESMA, in order to ensure compliance with IFRS and other applicable reporting standards.

The Authority emphasises the importance for Issuers to appropriately recognise DTAs in their financial statements. Moreover, sufficient evidence should be available to support the figures and disclosures communicated in the financial reports.

Contacts

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