MALTA FINANCIAL SERVICES AUTHORITY

Annual Report and Financial Statements
31 December 2019

Board of Governors' report

The Governors present their report and the audited financial statements for the year ended 31 December 2019.

Principal activities

The Malta Financial Services Authority (the 'MFSA' or 'the Authority') is the single regulator for financial services in Malta, which incorporates credit institutions, financial and electronic money institutions, securities and investment services companies, regulated markets, insurance companies, pension schemes, trustees, VFA agents and VFA service providers. The MFSA also acts as the Resolution Authority and has been appointed as the Listing Authority. The Authority is a fully autonomous public institution and reports to Parliament on an annual basis. Prior to 30 April 2018, the MFSA also managed the Registry of Companies ('the Registry').

Review of the business

The Governors hereby report a surplus of €749,361 for the financial year 2019 (2018: deficit of €7,756,903). Income generated from applications fees, supervision fees and listing fees increased by 0.08% as compared with 2018. As a result of the de-merger of the Registry of Companies with effect from 1 May 2018, no income from Registry operations was recognised in the books during 2019 (2018: €5,047,971), other than residual fees received for services and facilities provided by the MFSA to the Registry during the transitional period leading up to the relocation of the Registry's offices. The increasing level of regulatory activity and participation in European meetings across all areas of supervision, saw an increasing cost base for the operations of the Authority.

Throughout 2019, the MFSA continued to perform a core role in disseminating information to consumers, media and the industry, supporting industry education and training programmes, conducting seminars and meetings on legal, technical and regulatory developments, contributing to the framing of national and EU-wide technical policy development and exchanging views and experiences with other national regulatory and supervisory bodies.

Results and surplus funds

The statement of comprehensive income is set out on page 7. During 2019 and 2018, no surplus funds for the financial year were payable to Government, in terms of the Mata Financial Services Authority Act, 1988..

Governors

The Governors of the Authority who held office during the year were:

Prof John Mamo LLD. BLitt. (Oxol). BA - Chairman
Mr Mario Borg BCom, MA (ISSS), MSc Public Economics (York)
Dr Joseph Brincat B.A. (Lond), B.Sc (Econ) Lond, LL.D
Mr Frans Camilleri DSS (Oxon), Graduate Diploma (UEA), MA (UEA)
Dr John Consiglio Ph.D., M.Phil (Eur Studs)., MBA(Wales)., DipFS., Dip Law & Adm., Dip Bus. Law & Actcy., FCIB.
Dr Lauren Ellul B.Accty (Hons), Executive M.B.A. (Edinburgh & ENPC), Ph.D (Birm), F.I.A., C.P.A.
Mr Andre Psaila BCom (Econ.) (Hons), MSc Banking and Finance
Dr Mario Vella B.A., M.Sc. (LSE), Dr. Sc. Oec (Berlin Humboldt)
Mr Herbert Zammit Laferla AIFS
Mr Joseph Cuschieri FIA, CPA, MBA (Henley UK), CIMA Adv. Dip MA - Chief Executive Officer

Board of Governors' report - continued

Statement of Governors' responsibilities

In preparing the financial statements the Governors are responsible for;

- ensuring that the financial statements have been drawn up in accordance with International Financial Reporting Standards as adopted by the EU and the Malta Financial Services Authority Act, 1988;
- selecting and applying appropriate accounting policies;
- making accounting estimates that are reasonable in the circumstances;
- ensuring that the financial statements are prepared on the going concern basis unless it is inappropriate to presume that the Authority will continue in operation as a going concern.

The Governors are also responsible for designing, implementing and maintaining internal control as the Governors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and that comply with the Malta Financial Services Act, 1988. They are also responsible for safeguarding the assets of the Authority and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The financial statements of the Authority for the year ended 31 December 2019 are included in the Annual Report 2019, which is being made available on the Authority's website. The Governors are responsible for the maintenance and integrity of the Annual Report on the website in view of their responsibility for the controls over, and the security of, the website. Access to information published on the Authority's website is available in other countries and jurisdictions, where legislation governing the preparation and dissemination of financial statements may differ from requirements or practice in Malta.

Auditors

PricewaterhouseCoopers have indicated their willingness to continue in office and a resolution for their re-appointment will be proposed.

On behalf of the board

Prof John Mamo LLD. BLitt. (Oxol). BA
Chairman

Joseph Cuschieri FIA, CPA, MBA (Henley UK), CIMA Adv. Dip MA
Chief Executive Officer

Registered office
Malta Financial Services Authority
Notabile Road
Attard BKR 3000
Malta

16 April 2020

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Independent auditor's report

To the Stakeholders of the Malta Financial Services Authority

Report on the audit of the financial statements

Our opinion

In our opinion:

- The Malta Financial Services Authority's financial statements give a true and fair view of the authority's financial position as at 31 December 2019, and of the authority's financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU; and
- The financial statements have been prepared in accordance with the requirements of the Malta Financial Services Authority Act, 1988.

What we have audited

The Malta Financial Services Authority's financial statements, set out on pages 6 to 32, comprise:

- the statement of financial position as at 31 December 2019;
- the statement of comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Authority in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements of the Accountancy Profession (Code of Ethics for Warrant Holders) Directive issued in terms of the Accountancy Profession Act (Cap. 281) that are relevant to our audit of the financial statements in Malta. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

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Independent auditor's report - continued

To the Stakeholders of the Malta Financial Services Authority

Other information

The board members are responsible for the other information. The other information comprises the board of governors' report, which we obtained prior to the date of this auditor's report.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the board members for the financial statements

The board members are responsible for the preparation of financial statements that give a true and fair view in accordance with IFRSs as adopted by the EU and the requirements of the Malta Financial Services Authority Act, and for such internal control as the board members determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the board members are responsible for assessing the Authority's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the board members either intend to liquidate the Authority or to cease operations, or has no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

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Independent auditor's report *- continued*

To the Stakeholders of the Malta Financial Services Authority

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the authority's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the board members.
- Conclude on the appropriateness of the board members' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the authority's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Authority's ability to continue as a going concern. In particular, it is difficult to evaluate all of the potential implications that COVID-19 will have on the Authority's trade, customers, suppliers and the disruption to its business and the overall economy
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We have nothing to report to you in respect of these responsibilities.

PricewaterhouseCoopers
78, Mill Street
Qormi
Malta

Stephen Mamo
Partner

16 April 2020

Statement of financial position

	Notes	As at 31 December 2019 €	2018 €
ASSETS			
Non-current assets			
Property, plant and equipment	5	**17,034,074**	16,354,199
Right-of-use assets	13	**410,670**	-
Intangible assets	6	**91,544**	-
Financial assets at amortised cost	7	**1,667,454**	2,169,418
Total non-current assets		**19,203,742**	18,523,617
Current assets			
Financial assets at amortised cost	7	**500,039**	-
Trade and other receivables	9	**1,616,398**	1,134,635
Amounts due from Government	10	**4,944,000**	-
Cash and cash equivalents	11	**7,460,724**	5,050,862
Total current assets		**14,521,161**	6,185,497
Total assets		**33,724,903**	24,709,114
EQUITY AND LIABILITIES			
Capital and reserves			
Capital fund	14	**1,164,687**	1,164,687
Revaluation reserve	15	**5,220,690**	5,220,690
Employee pension fund reserve	16	**1,075,002**	1,000,002
Reserve fund		**8,025,948**	7,351,587
Total equity		**15,486,327**	14,736,966
Non-current liabilities			
Lease liabilities	13	**205,864**	-
Current liabilities			
Trade and other payables	12	**17,819,133**	9,972,148
Lease liabilities	13	**213,579**	-
Total current liabilities		**18,032,712**	9,972,148
Total liabilities		**18,238,576**	9,972,148
Total equity and liabilities		**33,724,903**	24,709,114

The notes on pages 11 to 32 are an integral part of these financial statements.

The financial statements on pages 6 to 32 were authorised for issue by the Board of Governors on 16 April 2020 and were signed on its behalf by:

Prof John Mamo LLD. BLitt. (Oxol). BA
Chairman

Joseph Cuschieri FIA, CPA, MBA (Henley UK), CIMA
Adv. Dip MA
Chief Executive Officer

Statement of comprehensive income

	Notes	Year ended 31 December 2019 €	2018 €
Income	20	**11,169,046**	16,207,671
Government subvention	21	**24,764,770**	-
Operating expenses	17	**(35,260,234)**	(24,107,483)
Operating surplus/(deficit) for the year		**673,582**	(7,899,812)
Loss on sale of investment in subsidiary	8	**(17,230)**	-
Finance income	19	**81,680**	124,457
Other income	22	**11,329**	18,452
Surplus/(deficit) for the year – total comprehensive income		**749,361**	(7,756,903)

The notes on pages 11 to 32 are an integral part of these financial statements.

Statement of changes in equity

	Notes	Capital fund €	Revaluation reserve €	Employee pension fund reserve €	Reserve Fund €	Total €
Balance at 1 January 2018		**1,164,687**	**5,220,690**	**925,002**	**15,183,490**	**22,493,869**
Comprehensive income						
Appropriation from income statement		-	-	-	(7,756,903)	(7,756,903)
Transfer to pension fund reserve	16	-	-	75,000	(75,000)	-
Total comprehensive income for the year		-	-	75,000	(7,831,903)	(7,756,903)
As at 31 December 2018		**1,164,687**	**5,220,690**	**1,000,002**	**7,351,587**	**14,736,966**

Statement of changes in equity - continued

	Notes	Capital fund €	Revaluation reserve €	Employee pension fund reserve €	Reserve Fund €	Total €
Balance at 1 January 2019		**1,164,687**	**5,220,690**	**1,000,002**	**7,351,587**	**14,736,966**
Comprehensive income						
Appropriation from income statement					749,361	749,361
Transfer to pension fund reserve	16			75,000	(75,000)	-
Total comprehensive income for the year		-	-	75,000	674,361	749,361
As at 31 December 2019		**1,164,687**	**5,220,690**	**1,075,002**	**8,025,948**	**15,486,327**

The notes on pages 11 to 32 are an integral part of these financial statements.

Statement of cash flows

	Notes	Year ended 31 December 2019 €	2018 €
Cash flows from operating activities			
Cash generated from/(used in) operations	24	**4,694,822**	(1,035,007)
Interest received	19	**107,825**	124,457
Other income	22	**11,329**	18,452
Net cash generated from/(used in) operating activities		**4,813,976**	(892,098)
Cash flows from investing activities			
Purchase of property, plant and equipment	5	**(1,791,490)**	(1,207,691)
Purchase of intangible assets	6	**(122,059)**	-
Net movement in loans and receivables		**-**	6,000,000
Net cash (used in)/generated from investing activities		**(1,913,549)**	4,792,309
Cash flows from financing activities			
Capital repayments of lease liabilities		**(490,565)**	-
Net cash used in financing activities		**(490,565)**	-
Net movement in cash and cash equivalents		**2,409,862**	3,900,211
Cash and cash equivalents at beginning of year		**5,050,862**	1,150,651
Cash and cash equivalents at end of year	9	**7,460,724**	5,050,862

The notes on pages 11 to 32 are an integral part of these financial statements.

Notes to the financial statements

1. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

1.1 Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and the requirements of the Malta Financial Service Authority Act, 1988. They have been prepared under the historical cost convention as modified by the fair valuation of the land and buildings class of property. The preparation of financial statements in conformity with IFRSs as adopted by the EU requires the use of certain accounting estimates. It also requires the Governors to exercise judgement in the process of applying the Authority's accounting policies (see Note 3 – Critical accounting estimates and judgements).

During 2019, the Authority reported a surplus of €749,361 and a net current liability position of €3,511,551. The Governors have taken cognisance of the overall performance and cash flow position of the Authority and to that effect, a system of pre-approval of the annual subvention as approved by the House of Representatives has been agreed and established. This will be based on annual and five-year forecasts of revenues and expenditure. On this understanding, the board of Governors have determined that there is a reasonable expectation that the Authority will have adequate resources to continue its operations for the foreseeable future. For this reason, these accounts have been prepared on a going concern basis.

Standards, interpretations and amendments to published standards effective in 2019

In 2019, the Authority adopted new standards, amendments and interpretations to existing standards that are mandatory for the Authority's accounting period beginning on 1 January 2019. The adoption of these revisions to the requirements of IFRSs as adopted by the EU did not result in substantial changes to the Authority's accounting policies impacting the financial performance and position, except for IFRS 16 'Leases' explained further below.

New and amended standards adopted

The Authority had to change its accounting policies as a result of adopting IFRS 16 'Leases'. The Authority elected to adopt the new rules retrospectively but recognised the cumulative effect of initially applying the new standard on 1 January 2019. The impact of the adoption of this standard and the new accounting policies are disclosed in Note 2 below. The other standards did not have any impact on the Authority's accounting policies and did not require any adjustments to the Authority's financial performance and position.

New standards and interpretations not yet adopted

Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2019 reporting periods and have not been early adopted by the Authority. These standards are not expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions.

1. **Summary of significant accounting policies** - continued

1.2 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements are presented in Euro, which is the Authority's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss.

All foreign exchange gains or losses are presented in the income statement.

1.3 Property, plant and equipment

All property, plant and equipment is initially recorded at historical cost. Land and buildings, comprising mainly the Authority's offices, are shown at fair value based on periodic valuation, less subsequent depreciation of buildings. Valuations are carried out on a regular basis such that the carrying amount of property does not differ materially from that which would be determined using fair values at the end of the reporting period. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset, and the net amount is restated to the revalued amount of the asset. All other property, plant and equipment is stated at historical cost less depreciation and impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Authority and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

Increases in the carrying amount arising on revaluation of land and buildings are credited to other comprehensive income and shown as a revaluation reserve in equity. Decreases that offset previous increases of the same asset are charged in other comprehensive income and debited against the revaluation reserve directly in equity; all other decreases are charged to profit or loss.

Items of property plant and equipment comprise land and buildings, furniture, fixtures and fittings and equipment and are initially recognised at acquisition cost. Subsequently they are carried at acquisition cost less subsequent depreciation and impairment losses.

1. **Summary of significant accounting policies** - continued

1.3 Property, plant and equipment - continued

Land is not depreciated as it is deemed to have an indefinite life. Depreciation on other assets is calculated using the straight-line method to allocate their cost or revalued amount to their residual values over their estimated useful lives, as follows:

	%
Furniture, fixtures and fittings	20
Equipment	20

Buildings are depreciated over an estimated useful life of 75 years whilst improvements carried out on leased property are depreciated over the lease period, which is 3 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the proceeds with carrying amount and are recognised in the income statement. When re-valued assets are sold, the amounts included in the revaluation reserve relating to the assets are transferred to retained earnings.

1.4 Intangible assets

Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives of four years. Costs associated with maintaining computer software programmes are recognised as an expense as incurred.

1.5 Financial assets

1.5.1 Classification

From 1 January 2018, the Authority classifies its financial assets in the following measurement categories;

- those to be measured subsequently at fair value (either through OCI or through profit or loss), and
- those to be measured at amortised cost.

The classification depends on the entity's business model for managing the financial assets and the contractual terms of the cash flows. The Authority's financial assets are classified at amortised cost.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or OCI. For investments in equity instruments that are not held-for-trading, this will depend on whether the Authority has made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income (FVOCI). The Authority reclassifies debt instruments when and only when its business model for managing those assets changes.

1. **Summary of significant accounting policies** - continued

1.5 Financial assets - continued

1.5.2 Recognition and derecognition

Regular way purchases and sales of financial assets are recognised on trade-date, the date on which the Authority commits to purchase or sell the asset. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Authority has transferred substantially all the risks and rewards of ownership.

1.5.3 Measurement

Subsequent measurement of debt instruments depends on the Authority's business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which the Authority classifies its debt instruments:

- Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Interest income from these financial assets is included in finance income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss and presented in other gains/(losses) together with foreign exchange gains and losses. Impairment losses are presented as separate line item in the statement of profit or loss.

- FVOCI: Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in other gains/(losses). Interest income from these financial assets is included in finance income using the effective interest rate method. Foreign exchange gains and losses are presented in other gains/(losses) and impairment expenses are presented as separate line item in the statement of profit or loss.

- FVPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL. A gain or loss on a debt investment that is subsequently measured at FVPL is recognised in profit or loss and presented net within other gains/(losses) in the period in which it arises.

From 1 January 2018, the Authority assesses on a forward looking basis the expected credit losses associated with its debt instruments carried at amortised cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

For trade receivables, the company applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables, see note 1.6 for further details.

1. Summary of significant accounting policies - continued

1.6 Trade and other receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets. Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method less loss allowance.

IFRS 9 Financial Instruments – impairment of financial assets

IFRS 9 replaces the provisions of IAS 39 that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting.

The adoption of IFRS 9 Financial Instruments from 1 January 2018 resulted in changes in accounting policies and adjustments to the amounts recognised in the financial statements.

Impairment

From 1 January 2018, the Authority assesses on a forward looking basis the expected credit losses associated with its debt instruments carried at amortised cost and FVOCI. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade receivables, the Authority applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

1.7 Cash and cash equivalents

Cash and cash equivalents are carried in the statement of financial position at face value. In the statement of cash flows, cash and cash equivalents include cash in hand, deposits held at call together with short-term, highly liquid investments that are readily convertible into known amounts of cash, and which are subject to an insignificant risk of changes in value.

1.8 Trade and other payables

Trade payables comprise obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities. Trade and other payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

1.9 Provisions

Provisions for legal claims are recognised when the Authority has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

1. **Summary of significant accounting policies** - continued

1.10 Revenue recognition

The Authority recognises revenue when the amount of revenue can be reliably measured, when it is probable that future economic benefits will flow to the entity, and when specific criteria for each of the Authority's activities have been met, as described below:

(i) Income from application fees is recognised upon receipt of the application.
(ii) Income from annual supervisory fees is recognised by reference to the stage of completion of the transaction, which equates to a systematic recognition of revenue as it accrues over time.
(iii) Interest income from investments is reported on an accrual basis using the effective interest method.

1.11 Leases

As explained in Note 1.1 above, the Authority has changed its accounting policy for leases where the company is the lessee. The new policy is described below and the impact of the change is described Note 2.

Accounting policy as from 1 January 2019

The Authority leases various vehicles and office spaces. Rental contracts are typically made for fixed periods ranging from 2 to 3 years. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.

From 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Authority.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities comprise the net present value of the fixed lease payments (including in-substance fixed payments), less any lease incentives receivable.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be readily determined, which is generally the case for leases in the company, the lessee's incremental borrowing rate is used, being the rate that the individual lessee would have to pay to borrow the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment with similar terms, security and conditions.

To determine the incremental borrowing rate, the Authority where possible, uses recent third-party financing received by the individual lessee as a starting point, adjusted to reflect changes in financing conditions since third party financing was received.

Lease payments are allocated between principal and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. Lease payments due within twelve months are classified as current, if not they are presented as non-current liabilities.

Right-of-use assets are measured at cost comprising the amount of the initial measurement of lease liability.

Right-of-use assets are generally depreciated over the lease term on a straight-line basis.

1. **Summary of significant accounting policies** - continued

1.11 Leases - continued

Payments associated with short-term leases of vehicles and land are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less.

Accounting policy as at 31 December 2018

Until 31 December 2018, leases in which a significant portion of the risks and rewards of ownership were not transferred to the Authority as lessee were classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) were charged to profit or loss on a straight-line basis over the period of the lease.

1.12 Government subvention and EU grants

Grants from the Government, including national Government and EU, are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Authority will comply with all attached conditions.

Government grants relating to costs are deferred and recognised in the income statement over the period necessary to match them with the costs that they are intended to compensate.

Government grants relating to property, plant and equipment are included in non-current liabilities as deferred government grants and are credited to profit or loss on a straight-line basis over the expected lives of the related assets.

2. **Change in accounting policies**

This note explains the impact of the adoption of IFRS 16 *Leases* on the Authority's financial statements.

As indicated in Note 1.1 above, the Authority has adopted IFRS 16 *Leases* retrospectively from 1 January 2019, but has not restated comparatives for the 2018 reporting period, as permitted under the specific transition provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognised in the opening balance sheet on 1 January 2019. The new accounting policies are disclosed in Note 1.11.

On adoption of IFRS 16, the Authority recognised lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of IAS 17 *Leases*. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of 1 January 2019. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on 1 January 2019 was 4%.

2. Change in accounting policies - continued

(i) Practical expedients applied

In applying IFRS 16 for the first time, the Authority has used the following practical expedients permitted by the standard:

- applying a single discount rate to a portfolio of leases with reasonably similar characteristics
- relying on previous assessments on whether leases are onerous as an alternative to performing an impairment review – there were no onerous contracts as at 1 January 2019; and
- accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases

The Authority has also elected not to reassess whether a contract is, or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date, the company relied on its assessment made applying IAS 17 and Interpretation 4 *Determining whether an Arrangement contains a Lease.*

(ii) Measurement of liabilities

	2019
	€
Operating lease commitments as at 31 December 2018	1,061,970
Discounted using the lessee's incremental borrowing rate at the date of initial application	(178,107)
Lease liability as at 1 January 2019	**883,863**
Of which are:	
Current lease liabilities	568,558
Non-current lease liabilities	315,305
	883,863

(iii) Measurement of right-of-use assets

The associated right-of-use assets for vehicle leases were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the balance sheet as at 31 December 2018.

(iv) Adjustments recognised in the balance sheet on 1 January 2019

The change in accounting policy affected the following items in the balance sheet on 1 January 2019:

(a) right-of-use assets - increase by €883,863
(b) lease liabilities - increase by €883,863

There is no net impact on retained earnings on 1 January 2019.

3. Financial risk management

3.1 Financial risk factors

The Authority's activities potentially expose it to a variety of financial risks namely market risk, credit risk and liquidity risk. The Authority's risk management is coordinated by the Board of Governors and focuses on actively securing the Authority's short to medium term cash flows by minimising the exposure to financial markets. Long-term financial investments are managed to generate lasting returns.

The Authority does not actively engage in trading of financial assets for speculative purposes nor does it write options. The most significant financial risks that the Authority is exposed to are described below.

(a) Market risk

In view that the investments in Malta Government bonds (see Note 7) are accounted for at amortised cost, the Governors do not consider that the Authority is exposed to significant market risk.

(a) Credit risk

The Authority's exposure to credit risk is limited to the carrying amount of financial assets recognised at the reporting date, as summarised below. The Authority's exposures to credit risk as at the end of the reporting periods are analysed as follows:

	Notes	**2019**	2018
		€	€
Financial assets at amortised cost	7	**2,167,493**	2,169,418
Trade and other receivables	9	**686,924**	713,080
Amounts due from government	10	**4,944,000**	-
Cash and cash equivalents	11	**7,460,724**	5,050,862
		15,259,141	7,933,360

The Authority assesses the credit quality of its customers taking into account financial position, past experience and other factors. It has policies in place to ensure that sales of services are affected to customers with an appropriate credit history. The Authority monitors the performance of its receivables on a regular basis to identify incurred collection losses, which are inherent in the Authority's receivables, taking into account historical experience.

The Authority's receivables, which are not impaired financial assets, are principally in respect of transactions with customers for whom there is no recent history of default. Management does not expect any losses from non-performance by these customers. None of the Authority's financial assets are secured by collateral.

As at 31 December 2019, trade receivables of €990,537 (2018: €1,108,000) were impaired, and the amount of the provisions in this respect are equivalent to these amounts. Reversal of provisions for impairment arises in those situations where customers recover from unfavourable circumstances and accordingly start meeting repayment obligations. The Authority does not hold any collateral as security in respect of the impaired assets.

3. **Financial risk management** - continued

3.1 Financial risk factors - continued

(b) Credit risk - continued

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

	2019	2018
	€	€
Balance at beginning of year	**1,108,000**	612,474
(Decrease)/increase in loss allowance on trade receivables	**(117,463)**	495,526
Balance at end of year	**990,537**	1,108,000

Credit risk in relation to cash and cash equivalents and held-to-maturity investments is considered to be limited, since the counterparts and issuer are reputable banks, and the Government of Malta respectively.

(c) Liquidity risk

The Authority is exposed to liquidity risk in relation to meeting future obligations associated with its financial liabilities, which comprise trade and other payables (Note 12). Prudent liquidity risk management includes maintaining sufficient cash and committed credit lines to ensure the availability of an adequate amount of funding to meet the Authority's obligations.

The Authority monitors liquidity risk by reviewing expected cash flows and ensures that no additional financing facilities are expected to be required over the coming year. The Authority's liquidity risk is not deemed material in view of the matching of cash inflows and outflows arising from expected maturities of financial instruments.

3.2 Capital risk management

The Authority's equity, as disclosed in the statement of financial position, constitutes its capital. The Authority's objectives when managing capital are to safeguard the respective entity's ability to continue as a going concern in order to provide returns and benefits for stakeholders, and to maintain an optimal capital structure to reduce the cost of capital. The Authority's equity is maintained in line with the provisions set within the Malta Financial Services Authority Act, 1988.

In view of the nature of the Authority's activities and its financial position, the capital level as at the end of the reporting period is deemed adequate by the Governors.

3. Financial risk management - continued

3.3 Fair values of financial instruments

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as Level 1 in view of the Quoted prices (unadjusted) in active markets for identical assets or liabilities.

The following table presents the authority's assets and liabilities that are measured at fair value at the respective dates:

	Level 1
	€
31 December 2019	
Financial assets at amortised cost	**2,167,493**
31 December 2018	
Financial assets at amortised cost	2,169,418

At 31 December 2019 and 2018 the carrying amounts of cash at bank, receivables, payables and accrued expenses reflected in the financial statements are reasonable estimates of fair value in view of the nature of these instruments or the relatively short period of time between the origination of the instruments and their expected realisation.

4. Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances.

In the opinion of the Governors, the accounting estimates and judgements made in the course of preparing these financial statements are not difficult, subjective or complex to a degree which would warrant their description as critical in terms of the requirements of IAS 1.

5. Property, plant and equipment

	Land and Buildings	Furniture, fixtures and fittings	Equipment	Total
	€	€	€	€
Year ended 31 December 2018				
Opening net book amount	14,674,960	299,940	1,050,994	16,025,894
Additions	331,959	198,664	677,068	1,207,691
Disposals	-	-	(5,149)	(5,149)
Depreciation charge	(294,655)	(82,240)	(501,998)	(878,893)
Depreciation released on disposal	-	-	4,656	4,656
Closing net book amount	**14,712,264**	**416,364**	**1,225,571**	**16,354,199**
At 31 December 2018				
Cost or valuation	15,559,226	2,432,178	5,960,344	23,951,748
Accumulated depreciation	(846,962)	(2,015,814)	(4,734,773)	(7,597,549)
Net book amount	**14,712,264**	**416,364**	**1,225,571**	**16,354,199**
Year ended 31 December 2019				
Opening net book amount	14,712,264	416,364	1,225,571	16,354,199
Additions	368,405	278,080	1,145,005	1,791,490
Disposals	-	-	(32,853)	(32,853)
Depreciation charge	(310,360)	(131,756)	(653,936)	(1,096,052)
Depreciation released on disposal	-	-	17,290	17,290
Closing net book amount	**14,770,309**	**562,688**	**1,701,077**	**17,034,074**
At 31 December 2019				
Cost or valuation	15,927,631	2,710,258	7,072,496	25,710,385
Accumulated depreciation	(1,157,322)	(2,147,570)	(5,371,419)	(8,676,311)
Net book amount	**14,770,309**	**562,688**	**1,701,077**	**17,034,074**

5. Property, plant and equipment - continued

Fair value of land and buildings

The Authority's office building was revalued on 31 December 2017 by independent professionally qualified valuers. The valuation was conducted by DeMicoli & Associates (a firm of architects). The book value of the property was adjusted to the revaluation and the resultant surplus, was credited to the revaluation reserve (refer to Note 15). The Board of Governors has reviewed the carrying amount of the property as at 31 December 2019 and no adjustments to the carrying amount were deemed necessary as at that date taking cognisance of developments that occurred during the current financial year.

The Authority is required to analyse non-financial assets carried at fair value by level of the fair value hierarchy within which the recurring fair value measurements are categorised in their entirety (Level 1, 2 or 3). The different levels of the fair value hierarchy have been defined as fair value measurements using:

- Quoted prices (unadjusted) in active markets for identical assets (Level 1);
- Inputs other than quoted prices included within Level 1 that are observable for the asset, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2);
- Inputs for the asset that are not based on observable market data (that is, unobservable inputs) (Level 3).

The recurring property fair value measurement at 31 December 2019 uses significant unobservable inputs and is accordingly categorised within Level 3 of the fair valuation hierarchy.

The Authority's policy is to recognise transfers into and out of fair value hierarchy levels as of the beginning of the reporting period. There were no transfers between different levels of the fair value hierarchy during the year ended 31 December 2019.

A reconciliation from the opening balance to the closing balance of non-financial assets for recurring fair value measurements categorised within Level 3 of the value hierarchy, is reflected in the table above.

Valuation processes

The valuation of the property is performed regularly on the basis of valuation reports prepared by independent and qualified valuers. At the end of every reporting period, management assesses whether any significant changes in the major inputs have been experienced since the last external valuation. Management reports to the Board of Governors on the outcome of this assessment.

When an external valuation report is prepared, the information provided by the valuers – and the assumptions and the valuation models used by the valuers – are reviewed by the COO. This includes a review of fair value movements over the period. When the COO considers that the valuation report is appropriate, the valuation report is recommended to the Board of Governors. The Board of Governors considers the valuation report as part of its overall responsibilities.

5. **Property, plant and equipment** - continued

Valuation techniques

The Level 3 fair valuation of the Authority's land and buildings was determined by using a comparative approach whereby the current selling prices and rental values of similar developments were compared in order to obtain an equitable rental value of the property. The significant unobservable inputs in the valuation include:

Equivalent rental values — based on the actual location, type and quality of property supported by current market rents for similar properties.

Capitalisation rates — based on actual location, size and quality of the property and taking into account market data at the valuation date.

Information about fair value measurements using significant unobservable inputs (level 3)

			Significant unobservable inputs	
Description	**Fair value at 31 December 2019 and 2018**	**Valuation technique**	**Equivalent rental value**	**Capitalisation Rate**
	€		**€**	**%**
Office building	14.375m	Comparative and Investment method	0.89m	6.25

The higher the rental yield and the lower the capitalisation rate, the higher the fair value. Conversely, the lower the rental value and the higher the capitalisation rate, the lower the fair value.

Historical cost of land and buildings

If the land and buildings were stated on the historical cost basis, the amounts would be as follows:

	2019	2018
	€	€
Cost	**10,706,941**	10,338,536
Accumulated depreciation	**(907,492)**	(620,312)
Net book amount	**9,799,449**	9,718,224

6. Intangible assets

	Computer Software €
Year ended 31 December 2019	
Additions	122,059
Depreciation charge	(30,515)
Closing net book amount	**91,544**
At 31 December 2019	
Cost	122,059
Accumulated depreciation	(30,515)
Net book amount	**91,544**

7. Financial assets at amortised cost

Financial assets include the following investments:

	2019 €	2018 €
Non-current		
Financial assets at amortised cost	**1,667,454**	2,169,418
Current		
Financial assets at amortised cost	**500,039**	-
As at 31 December	**2,167,493**	2,169,418

The movements during the year in financial assets at amortised cost, which comprise Malta Government Bonds, were as follows;

	2019 €	2018 €
Opening net book amount	**2,169,418**	2,171,342
Amortisation	**(1,925)**	(1,924)
Closing net book amount	**2,167,493**	2,169,418

8. Investment in subsidiary

	2019 €	2018 €
As at 31 December		
Cost	-	2,329
Fair value loss	-	(2,329)
Carrying amount	-	-

The Authority's investment in Malta International Training Centre Limited, in which it owned 99.9% of the company's shares, was sold on 1 April 2019 on a going concern basis.

9. Trade and other receivables

	2019 €	2018 €
Current		
Trade receivables – gross	**1,677,461**	1,698,830
Less: Loss allowance on trade receivables	**(990,537)**	(1,108,000)
Trade receivables – net	**686,924**	590,830
Amounts due by subsidiary	-	69,272
Prepayments	**870,733**	421,555
Accrued income	**58,741**	52,978
	1,616,398	1,134,635

10. Amounts due from Government

	2019 €	2018 €
Funds committed by Government	**4,944,000**	-

11. Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise the following:

	2019 €	2018 €
Cash and cash equivalents	**5,289,134**	2,905,828
Technical account held at the Central Bank of Malta (Note 12)	**2,171,590**	2,145,034
	7,460,724	5,050,862

12. Trade and other payables

	2019 €	2018 €
Current		
Trade payables	**1,406,303**	2,429,583
Amount due to Malta Business Registry	**1,406,479**	2,656,178
Other creditors	**2,171,590**	2,212,152
Indirect taxation	**371,177**	515,748
Accruals	**8,163,628**	1,117,181
Deferred government subvention	**3,119,223**	-
Deferred income	**1,180,733**	1,041,306
	17,819,133	9,972,148

The Authority provisionally holds on deposit with the Central Bank of Malta an amount of €2,171,590 (2018: €2,145,034), included within other creditors, as part of its duty as a regulatory body.

13. Lease liabilities

This note provides information for leases where the company is a lessee.

(i) Amounts recognised in the balance sheet

The balance sheet shows the following amounts relating to leases:

	2019 €
Right-of-use assets	
Vehicles	153,943
Offices	256,727
	410,670
Lease liabilities	
Current	213,579
Non-current	205,864
	419,443

13. **Lease liabilities** - continued

(ii) Amounts recognised in the income statement.

The statement of profit or loss shows the following amounts relating to leases:

	2019
	€
Depreciation charge of right of-use of assets	
Vehicles	**93,271**
Offices	**379,922**
	473,193
Interest expense (included in finance income/cost)	**26,145**

14. Capital fund

The capital fund of €1,164,687 represents the initial contribution by the Government to the Authority in 1994 upon its establishment.

15. Revaluation reserve

	2019	2018
	€	€
As at 31 December	**5,220,690**	5,220,690

The revaluation reserve is not distributable and represents the accumulated fair value movements on the Authority's land and buildings.

16. Employee pension fund

	2019	2018
	€	€
Balance as at 1 January	**1,000,002**	925,002
Transfer for the year	**75,000**	75,000
As at 31 December	**1,075,002**	1,000,002

The employee pension fund reserve has been created to set aside reserves to prepare for the potential employee pension fund that may be set up for the benefit of the employees at the opportune time.

17. Expenses by nature

	2019	2018
	€	€
Depreciation of property, plant and equipment (Note 5)	**1,096,052**	878,893
Depreciation of intangible assets (Note 6)	**30,515**	-
Employee costs (Note 18)	**15,486,700**	12,532,762
Professional fees	**2,462,280**	1,304,884
Regulatory support fees	**2,306,761**	1,114,453
Enforcement and compliance fees	**8,879,278**	3,567,189
(Decrease)/Increase in provision for bad debts	**(117,463)**	495,526
Communications and events	**659,788**	646,457
Governors' emoluments	**151,233**	140,940
Other administrative expenses	**4,305,090**	3,426,379
Total operating expenses	**35,260,234**	24,107,483

Auditor's fees
Fees charged by the auditor for the statutory audit amount to €7,000 (2018: €7,000).

18. Employee costs

	2019	2018
	€	€
Wages and salaries	**12,738,216**	10,721,379
Social security costs	**766,484**	659,344
Other staff costs	**1,982,000**	1,152,039
	15,486,700	12,532,762

Average number of persons employed by the Authority during the year:

	2019	2018
Managerial	**281**	235
Administration	**41**	51
	322	286

During 2018 and 2019, the Authority offered its employees a Voluntary Severance Scheme for which the current year's expense, included within other staff costs, amounted to €681,585 (2018: €540,417).

19. Finance income

	2019	2018
	€	€
Interest income from demand deposits	**834**	17,481
Interest income from Government bonds	**106,991**	106,976
Interest charges for lease liabilities	**(26,145)**	-
	81,680	124,457

20. Income

	2019	2018
	€	€
Authorisations	**770,262**	979,763
Securities and markets supervision	**2,614,104**	2,576,515
Insurance and pensions supervision	**2,216,164**	2,359,425
Conduct	**564,467**	620,116
Banking supervision	**4,291,149**	4,246,631
Listing authority income	**559,150**	377,250
Registry of Companies	**-**	5,047,971
Fintech	**153,750**	-
Total income	**11,169,046**	16,207,671

21. Government subvention

The government subvention represents a contribution by Government towards the Authority to ensure that it has adequate resources to continue its operations and meet its obligations as the single regulator for financial services in Malta.

22. Other income

	2019	2018
	€	€
EU grants designated for specific purposes	**7,428**	18,452
Other	**3,901**	-
	11,329	18,452

EU funds designated for specific purposes amounting to €7,428 at 31 December 2019 (2018: €18,452) are amortised to profit or loss over the term of the service concession.

23. Tax expense

Section 30 of the Malta Financial Services Authority Act, Cap 330 exempts the Authority from any liability to pay income taxes.

24. Cash generated from/(used in) operations

Reconciliation of operating surplus/(deficit) generated from operations:

	2019 €	2018 €
Operating surplus/(deficit) for the year	**673,582**	(7,899,812)
Adjustments for:		
Depreciation of property, plant and equipment (Note 5)	**1,096,052**	878,893
Depreciation of intangible assets (Note 6)	**30,515**	-
Depreciation of right-of-use assets (Note 13)	**473,193**	-
Loss on sale of property, plant and equipment (Note 5)	**15,563**	493
Amortisation of investment (Note 7)	**1,925**	1,924
(Decrease)/increase in loss allowance on trade receivables (Note 9)	**(117,463)**	495,526
Bad debts written off	**-**	5,200
Changes in working capital:		
Trade and other receivables	**(381,530)**	458,764
Amounts due from government	**(4,944,000)**	-
Trade and other payables	**7,846,985**	5,024,005
Cash generated from/(used in) operations	**4,694,822**	(1,035,007)

25. Commitments

	2019 €	2018 €
Capital expenditure		
Capital expenditure that has been contracted for but not yet accounted for in the Financial Statements	**961,381**	-
Capital expenditure that has been authorised by the Board of Governors but has not yet been contracted for	**5,990,002**	2,568,965

26. Contingencies

The Authority has not provided for claims instituted against it by a number of persons on the basis that the proceedings are still at an early stage and the potential financial impact and probable outcome of these claims has as yet not been quantified.

27. Related party transactions

Except for transactions disclosed or referred to previously, the following significant transactions, which were carried out principally with related entities, have a material effect on the operating results and financial position of the Authority:

	2019	2018
	€	€
Funds committed by Government (Note 10)	**4,944,000**	-
Amounts due to Malta Business Registry (Note 12)	**1,406,779**	2,656,178

Key management personnel compensation, consisting of Governors' remuneration is disclosed in Note 18.

28. Statutory information

The Malta Financial Services Authority (MFSA) ('the Authority') is the single regulator for financial services in Malta enacted by virtue of the Malta Financial Services Act, 1988 and reports to the Maltese Parliament.

On 20 March 2018, by virtue of Act No. VI of 2018, Articles 2(2) and 6, it had been established that the Register of Companies shall no longer form part of the Malta Financial Services Authority.