FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

JULY 2022

Approach to oversight of financial statements

The main statutory objective of the Financial Markets Authority – Te Mana Tātai Hokohoko is to promote and facilitate the development of fair, efficient and transparent financial markets.

Audited financial statements are an important resource for investors when making investment decisions. Investor confidence in an entity is largely dependent on the quality of the financial statements it prepares and provides to the market.

In this document we provide a summary of our main work in monitoring compliance with financial reporting obligations by FMC reporting entities and registered schemes (regulated entities) from 2022-2025.

How we monitor compliance with financial reporting obligations

To achieve the objective that regulated entities file their financial statements in a timely manner, and in a way that complies with the accounting standards in New Zealand, we:

- monitor that regulated entities file financial statements in a timely matter
- review financial reports to ensure compliance with applicable accounting standards
- inform and educate stakeholders.

Financial statements filing reviews

Regulated entities are required to lodge audited financial statements with the Registrar[1] within four months of their balance date. It is critical for investors and stakeholders to have timely access to these financial statements.

There can be various reasons for failure to lodge within the legislative timeframe, from minor matters that get financial statements rejected, to more significant governance or compliance issues.

[1] The Companies Office administers NZ's statutory registers, which include the Disclose Register for offers of financial products and managed investment schemes under the FMC Act.

The types of reasons for non-compliance that we would be most concerned about include entities not being able to operate as a going concern, not keeping proper accounting records, and other conduct and governance issues. These instances often warrant consideration of an appropriate regulatory approach.

We work closely with the Registrar to identify whether regulated entities are complying within the legislative timeframe. Where there is non-compliance, the FMA considers the most appropriate next steps including assessment of the appropriate regulatory action, if relevant.

In 2021 we published a report titled 'Filing of financial statements: review findings and guidance', which provides details on our key findings and insights from our financial statements filing reviews. It also provides guidance and sets our expectations in this area.

In relation to the timely filing of financial statements our focus continues to be on:

- monitoring regulated entities' financial reporting obligations[2] on an ongoing basis, to ensure compliant financial statements are filed on time; and
- taking the appropriate regulatory response where entities do not comply with filing requirements.

Financial reporting reviews

To verify if entities are complying with their reporting requirements we review their financial statements as well as relevant market announcements, management commentary, investor presentations and other communications to shareholders and market participants. This includes financial information disclosed in the entity's annual report.

Our financial reporting reviews can either be:

- proactive (based on our internal selection model or thematic areas of interest); or
- reactive (based on a specific event, such as a qualified audit report, media coverage, complaints and enquiries, referrals from other regulatory agencies).

Selected areas of interest for proactive reviews for 2022-2025 reporting cycles are detailed further below.

Education and stakeholder engagements

Our regulatory reviews help identify areas for improvement and determine the key messages that let us set expectations, provide guidance, and educate and engage with our stakeholders.

We will continue to engage with stakeholders and overseas regulators, and to share our findings in order to meet our objectives, including by:

- issuing publications such as information sheets, thematic reports, monitoring reports and guidance notes that summarise our findings and set expectations and principles, where relevant
- communicating with FMC reporting entities and their boards about our reviews of financial statements including any supporting documentation and accounting records

[2] Part 7 of the Financial Markets Conduct Act (FMC Act) requires regulated entities to file audited financial statements with the Registrar within four months of the entity's balance date

- collaborating with the External Reporting Board (XRB) on mutual areas of interest, our findings and any areas for improvement, which XRB can use in its standard-setting efforts, including to influence international accounting standards
- participating in and presenting at various local and international professional forums
- working with local regulatory bodies and government agencies such as the Companies Office, Reserve Bank of New Zealand (RBNZ), Inland Revenue Department (IRD), Ministry of Business Innovation and Employment (MBIE)
- liaising with international regulatory bodies and organisations such as the Australian Securities and Investments Commission (ASIC) and International Organization of Securities Commissions (IOSCO)
- speaking with statutory supervisors on financial reporting matters including expectations and education.

2022-2025 reporting cycle: areas of interest

When performing our proactive and reactive financial reporting reviews we take a risk-based approach and focus on the areas that are material and based on the facts and circumstances relevant to each entity.

Below we set out some of the areas of attention for the 2022-2025 reporting cycles.

NB: Our areas of interest are subject to change based on market conditions, new legislation and any other relevant developments.

Significant accounting judgements and sources of estimation uncertainty

Reporting entities and their directors are required to make many judgements, estimates and assumptions in preparing financial statements in accordance with applicable accounting standards. This relates to recognition, derecognition and measurement, as well as the level of disclosures relevant to the areas of significant judgements and accounting estimates.

Our focus in this area continues to be on:

- **the accounting approach** taken by an entity in relation to recognition, derecognition and measurement, including supporting these with well-reasoned documentation outlining the entity's methodologies and considerations
- **material assumptions and inputs** including accounting papers that support their reasonableness and appropriateness
- **sensitivity analysis** of the carrying amounts to the methods, inputs and assumptions
- **sufficient level of disclosures** in the financial statements relating to areas of significant estimates and judgements, including sensitivity disclosures. This includes materiality assessment of the level of disclosures included in the financial statements, to help ensure users receive the necessary information.

While areas of significant accounting estimates and sources of estimation uncertainty are entity-specific, the following are some of the relevant common areas of focus for the upcoming reporting cycles in this area:

- ➢ Impairment of non-financial assets
- ➢ Valuation, including fair value determination
- ➢ Expected credit losses on loans and receivables

- Going concern assumptions
- Revenue recognition
- Accounting for Leases

Related party disclosures

Adequate disclosure of related party transactions is critical for investors to understand the relationships the entity has and the impact these relationships and transactions have on the business.

Although related party transactions may occur in the course of normal business, because the entities are not entirely independent of each other, the transactions may carry a higher risk of material misstatement.

Due to the importance of these transactions, entities are required to disclose related party relationships, transactions and outstanding balances, including commitments in their financial statements, to draw attention to the possibility that the financial position and performance of the entity may have been affected by the existence of related parties[3].

Our reviews will focus on:

- **adequacy and completeness of related party disclosures**
- **completeness and existence** of related party relationships and related party transactions including supporting records and documentation
- **related internal controls, systems and processes** including those relating to accounting records supporting related party relationships, transactions and the level of disclosures that meet the requirements of the applicable accounting standards
- **materiality assessment** including the completeness of materiality considerations taking into account qualitative, quantitative and entity-specific factors.

Non-GAAP financial information

Non-GAAP financial information is financial information outside of the financial statements,[4] where that information is not prepared and presented in accordance with generally accepted accounting practice (GAAP) or is presented as an alternative to statutory profit.

Management should carefully consider if non-GAAP financial information needs to be used and presented. In cases where management believes using an alternative to statutory profit is appropriate and useful to investors, non-GAAP financial information should be presented in a way that is not false or misleading.

[3] NZ IAS 24 Related Party Disclosures paragraphs 1 and 3

[4] Non- GAAP financial information is commonly presented in market announcements, management commentary, investor presentations, disclosure documents filed with the Registrar and licensed market operators, and other communications to shareholders and market participants

Our focus continues to be on the consideration and application of our 2017 guidance note 'Disclosing non-GAAP financial information', including the general principles set out in it. This includes the rationale for the use of the measure, and the reasonableness of the adjustments including supporting documentation.

Climate-related matters

Climate change is receiving increased attention from governments, investors and other stakeholders, as the effects of climate change become more visible.

Climate change may impact business models, cash flows, financial positions and the performance of many regulated entities. Consequently, regulated entities should not only consider climate change when applying accounting standards, but also its likely effect in the context of the financial statements (taken as a whole) including the level of disclosures relevant for investors to understand the impact of climate-related matters on the reporting entity, if that impact is assessed to be material.

Our financial reporting reviews will focus on:

- entities' assessment of climate change and its effect on their financial statements; and, where relevant, entities' consideration of climate-related matters when applying accounting standards including level of disclosures; and
- consistency between the information presented outside of the financial statements relating to climate change and the financial statements.

In addition, in 2021 the New Zealand Government introduced the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill, which will require approximately 200 FMC reporting entities to provide separate disclosures on their climate risk and emissions. This will be a requirement from financial years commencing in 2023. For those entities that will be required to prepare separate disclosures on climate risk and emissions, it is important that there is consistency between climate-related disclosures and financial statements.

In November 2020, the International Accounting Standards Board (IASB) issued a publication called 'Effects of climate-related matters on financial statements'. This gives examples illustrating when accounting standards may require companies to consider the effects of climate-related matters in applying the principles of accounting standards. We encourage entities to consider this publication when assessing the impact of climate-related matters while preparing financial statements.

Accounting records

FMC reporting entities and their directors are required to prepare and maintain appropriately detailed documentation that supports accounting considerations, decision-making and conclusions, and ultimately the application of generally accepted accounting practice in New Zealand.[5] In addition, complete and accurate accounting records help ensure that regulators, supervisors and auditors can perform their work effectively. This includes records being kept in such a way that they are readily available for inspection.

[5] Section 455 of the FMC Act

It also involves documenting relevant assessments and rationale, taking into account all relevant facts and circumstances, including detailing analyses and evaluating the alternatives to arrive at well-reasoned professional judgements on application of the accounting standards. Without proper supporting documentation it is unclear whether an entity, including its directors, could have sufficiently reviewed, considered, challenged and understood the areas of significant judgement and critical accounting estimates.

Accounting records also include: technical papers for areas of significant accounting estimates and judgements; board papers where material accounting positions were discussed, challenged and agreed; documentation supporting materiality assessments and the appropriate level of disclosures in the financial statements.

As part of our financial reporting reviews, we continue to focus on the proper documentation and other accounting records as required under the legislation. This includes monitoring application and consideration of any guidance issued by the FMA relating to keeping and maintaining proper accounting records.

Our expectations

The FMA will continue to monitor FMC reporting entities to ensure that they:

- **comply with the legislative requirement** to file their financial statements in a timely manner
- **prepare reliable, supportable financial statements** that comply with the requirements of applicable accounting standards
- **keep proper accounting records** supporting application of applicable accounting standards including accounting considerations and position.

When we make enquiries about entities' financial statements, we expect entities to engage constructively and with the aim of providing accurate and complete information to their stakeholders. We expect entities to have accounting records readily available on request that support accounting considerations, decisions and assumptions made to support compliance with generally accepted accounting practice in New Zealand. This includes materiality assessment and consideration given to the appropriate level of disclosure in the financial statements.

Where entities expect to run into issues or face delays, they should engage with the FMA and the Registrar on a timely and proactive basis.