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# Guidance and expectations for keeping proper accounting records

Guidance and expectations to help FMC reporting entities to meet their statutory requirement to keep proper accounting records at all times.

FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

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# Introduction

The objective of financial statements is to provide financial information that is useful to investors and other users in making decisions about providing resources to an entity[1]. For many entities, financial statements are the only source of financial information available to investors and other stakeholders.

The Financial Markets Conduct Act 2013 (FMC Act) and other Acts that refer to the requirement to keep appropriate accounting records do not provide any further regulations on the content of these records. As accounting requirements have become more complex over time, accounting records are no longer only bank statements and invoices but include documentation that supports accounting considerations, decision-making and conclusions.

Financial statements must be supported by proper accounting records to provide evidence that they comply with financial reporting requirements, including applicable accounting standards[2].

Entities and their directors need to be able to support the recording and accounting of an event, transaction or circumstance with objective evidence. This includes having and maintaining appropriately detailed documentation that supports accounting considerations, decision making and ultimately application of the applicable accounting standards. These records should be available at all reasonable times for inspection and be easily understood without the need to seek further information. Accounting records should also be kept in a manner that enables financial statements to be readily and properly audited.

Over the years, the FMA has identified an increase in the number of instances where there was a lack of sufficient records to support the accounting treatment. Our reviews of financial statements have identified instances where:

- there is a lack of adequate documentation and accounting records to support recorded transactions, an entity's accounting position and materiality considerations, including level of disclosures in the financial statements[3]
- entities have prepared supporting documentation only at the time of our review
- there is an absence of, or inability to source detailed documentation to support recorded transactions and the accounting approach applied in statements that have been authorised by director(s)
- in absence of their own accounting records, entities have relied on auditors to have documentation and complete analysis of an accounting treatment.

Additionally, in our reviews of financial reporting and audit quality, some entities have been unable to provide us with sufficient evidence on some of the more complex accounting decisions in the financial statements.

This document provides guidance to help entities address these emerging and persistent issues.

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[1] See paragraph 1.2 of NZ Conceptual Framework. This involves decisions about buying, selling, or holding equity and debt instruments; providing or settling loans and other forms of credit; or exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources

[2] Currently applicable accounting standards for the majority of FMC reporting entities in New Zealand are New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) which are based on International Financial Reporting Standards (IFRS). Some FMC reporting entities may be Public Benefit Entities (PBEs), and for these entities the applicable accounting standards are PBE Standards issued by the External Reporting Board (XRB).

[3] See our publication Financial reporting – review findings and guidance for entities

## Why are accounting records important?

Accounting records support the accuracy of financial statements, including providing an explanation of how applicable accounting standards have been applied. As such, they are an integral part of an entity's financial reporting processes and compliance.

Boards of FMC reporting entities are directly responsible for the quality and accuracy of financial statements. Proper accounting records help directors and management to demonstrate compliance with their legislative duties and obligations. Reporting entities and boards should have a rigorous policy to ensure quality and integrity of financial reporting, which includes processes and controls to ensure accounting records that support financial statements are complete, accurate and reliable.

Supporting records include detailed documentation evidencing accounting judgements and other sources of estimation uncertainties applied during financial reporting process. These records are important as they explain the basis and rationale underpinning the accounting approach. They ensure judgements and estimates, as well as underlying inputs and assumptions, that were considered and applied in the financial reporting process are supportable, based on best available information, and well-reasoned.

The failure of keeping proper accounting records could also impact the ability to audit financial statements[4], as the lack of audit evidence may lead to modified audit reports.

## About this document

The purpose of this guidance note is to set out the principles and expectations relating to keeping and maintaining proper accounting records. It is primarily intended for FMC reporting entities and their directors and auditors. However, some principles may be relevant to entities other than FMC reporting entities to help support their financial reporting processes and improve the quality of their accounting records.[5]

## Our expectations

We expect entities to review this document and apply the guidance when fulfilling their statutory requirement to keep proper accounting records, as well as wider financial reporting requirements.

As part of our financial reporting reviews, we will continue to closely monitor whether FMC reporting entities are meeting their obligations to prepare and file[6] audited financial statements that comply with financial reporting requirements, including applicable accounting standards. This includes the obligation to keep proper accounting records that are complete and support the financial statements, including application of applicable accounting standards.

We will continue to provide guidance to help entities focus on common areas of interest and non-compliance, so they can improve internal processes and support their compliance with legislative requirements.

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[4] Section 461D of the FMC Act requires financial statements to be audited

[5] Section 194 of the Companies Act 1993

[6] Additional information about filing of financial statements can be found in our report Filing of financial statements: review findings and guidance

# Key principles and considerations for keeping proper accounting records

This section provides an overview of the key principles and considerations that underpin the legislative requirement for keeping proper accounting records.

We encourage reporting entities to not only follow these principles and considerations (as applicable to them), but also to consider how quality accounting records support their financial reporting processes, the objective of financial statements and ultimately compliance with legislative requirements.

### 1. Sufficient, supportable, and reliable

Every entity must keep and maintain accounting records that support the existence, completeness, and accuracy of its financial reporting. Accounting records should include enough detail to support the recorded transactions, events, or circumstances.

Accounting records need to include sufficient detail to support the accounting approach and how it demonstrates compliance with applicable accounting standards. This should include details of considered alternatives and why they are not applicable[7]. For example, when an entity applies significant estimates and judgements, the entity should document how it has considered and complied with the accounting requirements, why it has used the approach, details of the inputs and assumptions, and rationale for why it is reasonable.[8] This includes details of any material considerations taken along the way to support a complete, well-reasoned and researched approach.

The same expectations apply if an entity engages an external expert for accounting purposes.[9]

Records should include a record of discussions between management and the Board, and/or any other person, where that discussion is of relevance to financial reporting decision-making that has an impact on the content of the financial statements.

Materiality assessment, including decisions underpinning the material level of disclosures, should be well documented and supported (see Principle 4).

### 2. Reasonable format

Accounting records should be kept and maintained in a reasonable format. Entities should think about:

- the type of accounting record (for example, invoice, agreement, spreadsheet, work paper, technical paper, supporting data, minutes of the meeting); and

[7] See *Appendix: Examples of accounting records* for working and accounting papers content
[8] See *Areas of significant judgement and critical accounting estimates* on page 9
[9] Also see *Areas of significant judgements and critical accounting estimates* on page 9

- whether it is in a format that can be effectively shared, including making it available for inspection.[10] Entities should consider the auditor's needs as part of this.

Reporting entities should consider how accounting records are kept: paper (hard copy) or electronic file (saved on a computer, drive or any other media). When keeping any accounting records in paper form (hard copy), entities should consider creating a permanent file in an electronic form for safety and back-up purposes.

If an accounting record is a work document (for example a spreadsheet), ensure any formulas, references and hyperlinks (to information either within or outside of the document) remain unbroken and always work.

### 3. Easy to access, use and understand

Accounting records should be easy to access, regardless of how and when and by whom the record was created.

This includes records being written in a way that is easy to understand and interpret without previous knowledge, by anyone who is required to inspect those records, and extends to any considerations, inputs and assumptions used as part of the financial reporting process (for example, forward-looking information), regardless of when these records were prepared.

To support easy and timely access, entities should consider maintaining a repository for accounting records, as part of their control system. This will minimise risk and support consistency and continuity.

In case of changes to key financial reporting staff or Board members, accessibility and understandability of the accounting records needs to be maintained and remain uncompromised.

### 4. Supportable materiality assessment

Consideration of materiality is fundamental for the preparation of financial statements. In accordance with generally accepted accounting practice in New Zealand (NZ GAAP), information should be disclosed only when it is assessed to be material to users' decision-making processes. Materiality is an entity-specific aspect of relevance based on the nature or magnitude (or both) of the items to which the information relates.

Complete consideration and documentation of materiality assessment, including a material level of disclosures, forms part of an entity's accounting records – in particular, ensuring its financial statements comply with NZ GAAP. Documenting the materiality assessment also ensures the basis of the assessment can be evidenced, should the FMA require it.

Entities need to make decisions, based on professional judgement, about what information is material and should be disclosed for financial reporting purposes. In doing so, they should document their materiality assessment and rationale to support these decisions. This includes documenting the rationale for omitted disclosures that the entity and its directors determined were not material for financial reporting purposes.

[10] Section 459 of the FMC Act

Assessments should be complete and consider entity-specific facts and circumstances as well as both qualitative and quantitative factors.[11] A materiality assessment should be completed and documented for each reporting date.

We have seen that entities often assess materiality exclusively on quantitative factors, based on the impact on specific aspects of the primary financial statements, such as net assets or net profit after tax, without any consideration of qualitative factors[12], or any other relevant entity-specific factors and circumstances. In our view, this can result in an incomplete materiality assessment when it comes to disclosures in supplementary notes to the financial statements, as materiality depends on the nature and/or magnitude of information.

## 5. Preparing accounting records in a timely manner and regularly maintaining them

Entities should prepare accounting records in a timely manner and, where applicable, keep them maintained throughout the year. Where records are updated, entities should maintain an audit trail.

Where relevant, processes relating to preparing and keeping accounting records should be pre-determined to help ensure effective and timely completion of compliant financial statements. These processes should factor in information and other dependencies (for example, input required from finance and legal teams, key operational management, auditors, external experts) as well as any other relevant aspects.

Technical accounting papers, including relevant reviews and approvals, should be prepared in a timely manner following a specific event or a circumstance, particularly where they relate to a complex technical accounting issue, or complex or new accounting standards and requirements, including standards that have been issued but not yet effective. For example, in case of:

- an acquisition of a business, technical accounting papers, together with support for material assumptions and inputs used, should be prepared following the acquisition and maintained as required;
- a standard that has been issued but not yet effective, entities should assess and document the possible impact of this standard following its issuance.

As part of this process, entities should consider engaging with their technical experts and auditors.

Entities should regularly update any registers they keep. For example, a register with details of all related party relationships and transactions should be maintained in a timely basis as relevant activity occurs.

## 6. Reconcile with financial statements

Accounting records and supporting documentation should be kept in a way that supports financial statements authorised by director(s). This means documentation and work papers should fully support and reconcile with balances, and with any disclosures in supplementary notes to the audited financial statements.

[11] The International Accounting Standards Board (IASB) issued a practice statement Making Materiality Judgements. We encourage entities to consider this guidance when deciding and documenting what information is material, including considering the qualitative and quantitative factors

[12] Qualitative factors are characteristics of a transaction, or other events or conditions (or the context of these) that, if present, make information more likely to influence the decision of a user. See IASB's practice statement Making Materiality Judgements (see previous footnote) for further guidance

For example, where an entity makes a late adjustment to an impairment assessment after finalising supporting work papers and that adjustment is included in the audited financial statements, the entity should have documentation to support this adjustment and any differences between supporting work papers and financial statements.

## 7. Protection and safeguards

Entities should have adequate safeguards and contingency plans in place for keeping and maintaining accounting records, including back-up copies. As part of this, entities should include authorisation policies on altering accounting records. These plans should be regularly reviewed and updated.

Entities should also consider having a strategy and governance structure to manage cyber risk and its impact on record keeping. The FMA has issued a thematic review report on Cyber resilience in FMA-regulated financial services as well as an information sheet on cyber security and operational systems resilience information sheet for market services licensees (excluding benchmark administrators), which may be a useful reference when considering cyber security.

## 8. Controls over the accounting records

Reporting entities and boards should maintain an effective system of internal controls for producing reliable financial reporting and accounting records. Control processes should support the integrity, accuracy and timeliness of accounting records as well as financial reporting systems. Internal controls include evaluating and testing, oversight and governance. Control processes for accounting records should be documented.

Entities should regularly evaluate and monitor control processes for accounting records. This includes boards regularly receiving and reviewing reports about internal control processes, including any deficiencies, risks and steps being taken to manage them.

## 9. Length of time

The FMC Act requires entities to keep accounting records or copies for *at least* 7 years.

Entities need to consider on a case-by-case basis if specific records should be kept for longer. Records that are of relevance to numerous reporting periods and financial statements should be kept until no longer relevant.

For example, if an entity acquires a business and records this transaction as business combination including the goodwill, if any, the entity should keep documentation supporting the acquisition and the goodwill that forms part of the entity’s assets until no longer relevant.

## 10. Records kept in a location outside entity’s registered office

Where an entity keeps its accounting records in a location outside its registered office (for example, with an outsourced accounting services provider or other cloud service provider in New Zealand), it needs to ensure the records are kept following all these key principles and considerations and are accessible for the required period of time. The reporting entity and its directors remain responsible for the records.

Although original accounting records can be stored overseas, the entity must send, and keep documents in New Zealand that enable the preparation of financial statements in accordance with the FMC Act. This includes any other documents annexed to the financial statements that give information required by any enactment.[13]

[13] See section 456(2) of the FMC Act

# Areas of significant judgements and critical accounting estimates

Reporting entities and their directors are required to make many judgements and estimates in preparing financial statements. Each estimate or judgement can materially impact the entity's financial statements, and each estimate has a range of possible outcomes. Estimates involve a level of subjectivity around assumptions relating to forward-looking information and other sources of estimation uncertainty. As such, the inputs and assumptions used require the most difficult, subjective, and complex judgements. As information is often forward looking, it is important that entities provide sufficient support at the time of making these assumptions to avoid the use of hindsight.

It is the responsibility of management to develop entity-specific, well-reasoned and supportable estimates and judgements, including those relating to forward-looking information.

Without proper supporting documentation, it can be unclear whether an entity and its directors have sufficiently considered, understood and reviewed the areas of significant judgement and critical accounting estimates, and whether these are based on reasonable and well-considered inputs and assumptions.

Accounting treatments that lack support in subjective and complex accounting areas can materially impact the financial statements, both quantitatively and qualitatively. They can also impact the audit process and opinion. The FMA's publication *Audit quality- a director's guide* provides further guidance for how directors of FMC reporting entities can improve the audit process.

To support their accounting position and approach in the areas of significant judgements and critical accounting estimates, entities should maintain proper records and documentation that outline and support in detail the:

a) **accounting approach** taken by the entity in relation to recognition, derecognition, measurement and disclosure (*i.e.* compliance with applicable accounting standards). This includes documenting the rationale for the accounting approach taken, including accounting policies, methodologies and models considered and used.

b) **material assumptions and inputs,** including documenting background, source, considerations and rationale supporting reasonableness and appropriateness of material inputs and assumptions, and detailing material considerations of any alternatives to support a well-reasoned and objective position. Observable market inputs and conditions, including any deviations and adjustments, should also be well documented. Unobservable inputs should be supported by records evidencing that they are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

c) **sensitivity analysis** of the carrying amounts to the methods, inputs and assumptions underlying their determination. This includes rationale for selected material input variable(s) used in sensitivity scenarios as well as applied change/range. Documents should allow easy analysis of the impact of applied changes to selected material input variable(s).

d) **level of disclosures** in the financial statements relating to the areas of significant estimates and judgements, including sensitivity analysis. Accounting records should support the level of disclosures, materiality and relevance. This includes consideration of an appropriate level of disclosure beyond the minimum disclosures prescribed in the applicable accounting standards, to meet investors' information needs.

e) **discussions** involving the board and/or Audit Committee relating to areas of significant judgements and critical accounting estimates. This includes:

- consideration and discussion of the areas of significant judgements and complex accounting estimates, including reasonableness of the information used by management
- understanding the inputs and assumptions used, including alternatives considered and the drivers of difference
- considering if inputs and assumptions are reasonable and in line with directors' knowledge and understanding (for example, their awareness of the business and the entity's future plans, prospects and environment)
- challenging management on the validity of the accounting approach, including applied judgements such as reasonableness of key inputs and assumptions, where necessary
- consideration of the underpinning narratives and level of disclosures in the notes to the financial statements
- discussions with the entity's auditors and any other relevant person
- anything else pertaining to the directors' consideration of the areas of significant judgements and critical accounting estimates.

**Example: Engagement of external valuer**

Methods and underlying inputs and assumptions used in valuations need to be well explained, supported, and documented, regardless of whether the valuation is conducted internally or externally. Management and the board remain responsible for valuations of the entity's assets and liabilities, including ensuring they are reasonable and supportable.

When an entity engages an external valuer for accounting purposes, it should retain evidence of the instructions given to the valuer. Instructions should contain enough detail of the scope of the work (for example, asset to be valued, methods to be applied) to ensure the valuation is conducted in accordance with the methodologies outlined in the accounting standards, is entity- and asset-specific, and is suitable for financial reporting purposes.

Entities should understand and validate the basis and rationale for methods, material inputs and assumptions used by an external valuer. This includes information supporting the reasonableness of all material inputs and assumptions (e.g. forecasted cash flows, discount rate) used. Entities should also understand and have details of all observable market inputs and benchmarks used and/or considered by the external valuer, including their assessment of entity-specific facts and circumstances. Analysis and rationale for any material variances and deviation should be understood and supported. Key discussions with external valuer relevant to methods, material inputs and assumptions as well as the accounting treatment needs to be documented and kept.

Entities should have records supporting the selected valuation method (in case of multiple methods applied and value options provided by the external expert), as well as the representative value chosen from the range of possible values.

Entities should also maintain records evidencing their evaluation of any limitations and disclaimers highlighted by the external valuer, and the impact on the proposed valuation range and representative value used for financial reporting purposes.

Entities need to have proper records that support and allow sensitivity analysis to the material variable input(s) of the value, or a valuation range, determined by an external party.

Entities should also keep records supporting any labelling and description of external valuation as "independent", taking into account the limitations, disclaimers, source of used inputs and assumptions, independent testing of those and similar.

Finally, documentation needs to be of a suitable standard for independent audit.

**Example: Impairment testing – reasonable and supportable cash flows**

Forecasting cash flows needs to be reasonable and supportable. To achieve this, entities need to have adequate documentation underpinning future cash flows, which details all relevant considerations, facts and circumstances.

For example, documentation supporting future cash flows should include:

- support for predicted growth, including consideration and analysis of the past growth, to support achievability and sustainability
- the basis for any significant increase in cash flows forecasted for after the year end. This includes analysis of results versus forecasts for the period between the balance date and when the financial statements were authorised
- consideration of whether cash flow forecasts were met in the past, and the impact of this on reliability of forecasting and producing reasonable forecasts used in impairment testing
- justification and support for cash flow forecasts beyond five years that exceed the long-term average growth rate for the products, industries, or countries in which the entity is operating, or for the market in which the asset is used
- consideration of the impact of material risks on cash flow projections associated with matters such as climate change, market changes and technological changes.

# Appendix: Examples of accounting records

The following are examples of what may be covered as part of the accounting records:

- Invoices, including documents of invoices being paid, and documents supporting receipts of money or payment. This includes any correspondence, salary records and similar
- Cash records including records of bank deposits, cash receipts, petty cash book and similar
- Bank statements and loan documents
- Taxation returns
- Agreements and contracts including documentation supporting accounting considerations and, where relevant, financial reporting treatments of provisions contained in those agreements and contracts
- Documents supporting inter-company and other related party relationships and transactions. This includes documentation supporting the existence and completeness of related party relationships and transactions, based on respective definitions in applicable accounting standards
- Resolutions, including those of directors and committees together with supporting documents (such as board/committee papers)
- Registers such as shareholders/members register, debt securities register, asset registers including depreciation schedules
- Detailed minutes of meetings, such as board of directors, audit committee and senior management meetings relevant to financial reporting matters including supporting documents (such as, for example board/committee papers)
- Detailed working and accounting papers explaining:
    - the background and nature of transactions, events or circumstances
    - details of the accounting requirements that are applicable, and why
    - details of considered accounting alternatives and why they are not applicable
    - how the entity has approached the assessment and the analysis of a transaction, event or circumstance against the requirements of applicable accounting standards
    - material decisions, inputs and assumptions
    - conclusions of the assessment and analysis including how the transaction/event has been recorded and disclosed in the financial statements
- Detailed working papers supporting materiality considerations and assessments, including the level of material disclosures in the notes to the financial statements. This includes a completed disclosure checklist and records supporting omitted disclosures determined not to be material (including rationale)
- Any other document relevant to supporting the application of applicable accounting standards including accurate recording, disclosure and financial reporting treatment of a particular event, transaction and/or circumstance, as well as the adjustments made to the financial statements

# Appendix: Legislative requirement to keep proper accounting records

This section provides a summary of the main legislative requirements relating to accounting records under the Financial Markets Conduct Act 2013 (FMC Act) as background for this guidance note.

Part 7 of the FMC Act requires FMC reporting entities to keep proper accounting records at all times that:

- correctly record the transactions of the entity; and
- in the case of a manager of a registered scheme, correctly record the transactions of the scheme; and
- enable the entity to prepare financial statements that comply with generally accepted accounting practice and any prescribed requirements[14]; and
- enable the entity to have those statements readily and properly audited.[15]

In addition, reporting entities must establish and maintain a satisfactory system of control over the accounting records.[16]

These records must be kept in a written form and in English, or in a form which is easily accessible and convertible in a written form in English.[17]

Accounting records or their copies are required to be kept for at least 7 years after the later of:

a) the date the records are made; and
b) the date of completion of the transaction to which these records relate.[18]

These accounting records need to be available for inspection at all reasonable times to:

a) directors of the reporting entity; and
b) the supervisor, if any; and
c) the Financial Markets Authority (the FMA); and
d) any person authorised or permitted by an enactment to inspect the accounting records of the FMC reporting entity.[19]

Accounting records are required to be kept at the registered office of a reporting entity or any other place that the directors of a reporting entity think fit.[20]

The accounting records will generally be required to be kept in New Zealand unless certain conditions are met.[21]

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14 If exemption notice is applied, generally accepted accounting practice is defined in that notice
15 Section 455 (1) of the FMC Act
16 Section 455 (2) of the FMC Act
17 Section 457 of the FMC Act
18 Section 458 of the FMC Act
19 Section 459 of the FMC Act
20 Section 456 (1) of the FMC Act
21 Section 456 (2) of the FMC Act

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