

# FMA, 2014b

## QUALITY FINANCIAL REPORTING

### HOW TO IMPROVE FINANCIAL STATEMENTS

The FMA's response to themes raised at its  
September 2014 quality financial reporting event



# Beyond IFRS: Quality Financial Reporting Event Summary



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Chairman of the FMA Audit Committee

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# Introduction

In September 2014, the FMA hosted a half-day discussion forum in Auckland titled 'Beyond International Financial Reporting Standards (IFRS): Quality Financial Reporting'. This forum aimed to facilitate a clearer understanding of disclosure challenges within the New Zealand environment, and identify ways to improve financial statements so they are a clear and effective reporting and communication tool.

The forum comprised keynote presentations from invited speakers and a panel discussion. Attendees came from a range of backgrounds, including financial reporting preparers, users, standard setters, auditors, law firms and FMA representatives.

From the discussion at the forum it is clear to us that disclosure challenges exist. But there is no single step or solution to overcome it.





It was also evident that all stakeholders contribute to one or more of the perceived problems about the extent and complexity of disclosures in financial statements.

These challenges provide an opportunity for stakeholders to reassess their approach and focus on moving forward, and improving financial reporting disclosure.

This report outlines the FMA's response to the main questions raised at the forum.

It also outlines some ideas that may help address disclosure in financial statements, and ultimately make financial statements a more effective communication tool.

Existing and potential investors, lenders and other creditors are the primary consumers of financial statements. In this document we refer to these groups collectively as 'users', and the organisations preparing financial statements as 'entities'.



## What information do users need?

Over the years, it has become evident that annual financial statements are not meeting users' needs as a tool to support their investment and other business decisions.

Financial statements that are not clear, concise and effective have an adverse impact on the effective communication channel between entities and their users.

Many commentators agree that disclosure overload in financial statements can obstruct the more useful information contained in financial statements. There is a clear need for disclosures contained within the financial statements to be refocused on their primary purpose. That is, to provide investors with useful information that will help them make decisions about providing resources to the business, and assess management's stewardship of the resources entrusted to it.

Disclosures in financial statements need to provide sufficient information that helps users to assess the prospects for providing future net cash inflows to an entity.<sup>1</sup> This requires a shift away from the current prevailing approach to disclosure, which satisfies the requirements of all accounting standards without considering material relevance of that disclosure to the entity.

The desired approach is to focus on identifying material information and communicating this in a clear, concise and effective manner. To be of real help to users, financial statements should tell the entity's story.

In our view, this material information should include:

- information for understanding the entity's financial position, performance, cash flows and prospects
- a disaggregation of the individual balances at a level of detail that enables the key components of primary financial statements to be understood
- information about significant business developments
- matters of importance to the business
- the specific financial risks to which the business is exposed, together with their context and management's approach to those risks
- an explanation of the basis for recognition and measurement of line items in the primary financial statements, in particular when management exercised its judgement
- information relating to items not recognised in the statement of financial position that, if or when recognised, will have a significant effect on future cash flows.

### **Financial statements are one of many sources of financial information**

When thinking about the information financial statements can provide, users should keep in mind that they are just one of many sources of financial information. Financial statements are only part of the story, and users should not expect that they include everything they need to know.

The *New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting 2010* (NZ Framework) highlights that financial statements do not and cannot provide all of the information that primary users need<sup>2</sup>. If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. Relevant information is capable of making a difference in decisions made by users<sup>3</sup>.

For example, financial statements form part of the annual report, which contains a wider range of useful information such as management commentary, corporate governance statements (for NZX listed entities) and information required by the *Companies Act 1993*. In addition to the annual report, users should also consider relevant information from other sources, for example the general economic conditions and expectations, industry and company outlooks<sup>4</sup>.

We also strongly encourage entities to improve the transparency and consistency of information disclosed in the annual report. We believe entities should focus on disclosing only relevant, quality information in all their documents and avoid including information that is not material, or not useful to the end user.

### **Non-GAAP financial information can be useful for investors**

We understand that results presented in accordance with New Zealand generally accepted accounting principles (NZ GAAP) may not adequately portray the performance of an entity in certain circumstances. No single income line can capture everything about a company's performance that a user will need, due to, for example, the multi-faceted nature of company performance.

For this reason, we accept that non-GAAP financial information may be useful for investors if it is built on the cornerstones of NZ GAAP. Non-GAAP financial information is normally presented outside of the financial statements, for example within the management commentary, market announcements, and entity's market presentations.

The FMA issued guidance on non-GAAP financial information in September 2012, which includes detailed guidance to help reduce the risk of non-GAAP financial information being misleading. We continue to encourage all entities to use this guidance when presenting non-GAAP financial information.

#### **Key points**

- Financial statements should tell a story about the entity in the most clear and effective manner.
- Financial statements' primary purpose is to provide investors with useful information that will help them make decisions about providing resources to the entity and assessing management's stewardship of the resources entrusted to it.
- Financial statements do not and cannot provide all of the information that primary users need.
- Financial statements are one of many sources of financial information.
- Non-GAAP financial information can be useful for investors in specific circumstances, and we encourage the use of the FMA guidance note when presenting this information.

<sup>2</sup> Paragraph OB6, NZ Framework

<sup>3</sup> Paragraph QC6, NZ Framework

<sup>4</sup> Paragraph OB6, NZ Framework