FMA, 2018c

July 2018

Disclosure of significant accounting estimates

Introduction

Recent reviews of a number of financial statements revealed a lack of disclosure in significant accounting estimates and assumptions, particularly those containing high levels of uncertainty.

We confirmed material information had been omitted from the financial statements leading us to engage in often lengthy enquiries to be able to understand these matters and work with the entities to improve future disclosure.

Without sufficient disclosure there is a lack of transparency between the entity and those who read its financial statements. The financial values most at risk of being materially misstated are those that are critical to decisions that existing or potential investors may make.

Determining the carrying amount of some assets and liabilities requires estimating the effects of uncertain future events and this may require difficult judgements. As the number of variables increase, those judgements become more subjective and complex and the potential for a material error more likely.

We have seen instances where entities have disclosed the area(s) requiring significant estimates and judgements but they did not always disclose:

- all of the key assumptions underpinning those estimates and judgements;
- future assumptions or other major sources of estimation uncertainty with a risk of a material adjustment in the next financial year; and/or
- how sensitive to change the estimate is.

Common areas of concern

Preparers of financial statements must understand the complexities and uncertainties within estimates and assumptions to be able to determine the appropriate level of disclosure. Without appropriate disclosure, it is unclear whether the entity has sufficiently reviewed, assessed, and understood the significant judgements in its financial statements. Recent mistakes in material accounting estimates suggests this has been the case.

For a reader to understand a significant judgement they must be provided with enough detail. In many cases this will require disclosure of more than just the nature of those underlying key assumptions and estimates. To further understand the risk of a material adjustment, a reader also needs to be aware of those assumptions or estimates with the higher degrees of uncertainty and therefore how susceptible to change they may be. The following are examples that often need more transparency:

- potential liabilities subject to the outcome of litigation;
- recognition and measurement of revenues of long term contracts;
- recognition and measurement of any expected contract losses;
- unobservable inputs used in assessments of the fair value or recoverable amount of an asset or liability;
- recognition and measurement of a group of insurance contracts; and
- the cost of a business combination when consideration is contingent on future performance or events.

Materiality

Materiality is not just a number in isolation, or a value relative to the rest of the balance sheet or profit or loss items. Entities should consider materiality in the context of the accounting framework and consider items on a qualitative and quantitative basis.

Information is material if omitting it or misstating it could influence decisions that investors make based on that financial information. Materiality is entity specific and should be considered by nature as well as magnitude.

In June 2018 we released a report Improving financial statements that provides further guidance and expectations on disclosure of material information.

Engagement with the FMA

We expect entities to review their disclosures relating to significant judgements, assumptions and estimates in response to our comments above. Entities must also prepare and maintain appropriately detailed accounting records in support of both the estimate and corresponding disclosures.

Constructive engagement is vital between regulators and participants. Entities should take regulator enquiries as a valuable check on their own internal processes. In most cases the regulator is asking questions that should have been answered internally already.

We promote the streamlining of financial statements to improve the overall quality of information being disclosed. This process should be focused on presenting material and relevant information to readers. We are not advocating voluminous disclosure. However, in determining the appropriate level of disclosure we remind entities that the effectiveness of their communication is lost if material matters such as this are not disclosed in sufficient detail.

We continue to monitor this area and will provide further, more detailed, guidance if necessary.

The Capital Markets Disclosure Team is responsible for the risk assessment and reviews of disclosure information for issuers' primary and on-going disclosure relating to offers of debt, equity, managed investment products and derivatives, both listed and unlisted. The Capital Markets Disclosure Team does not risk assess or review every piece of disclosure information and is also not responsible for approving any disclosure information.

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180703 Disclosure of significant accounting estimates
This information sheet explains our expectations on disclosure of significant accounting estimates. It is part of our work on improving the overall quality of information being disclosed in financial statements.

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