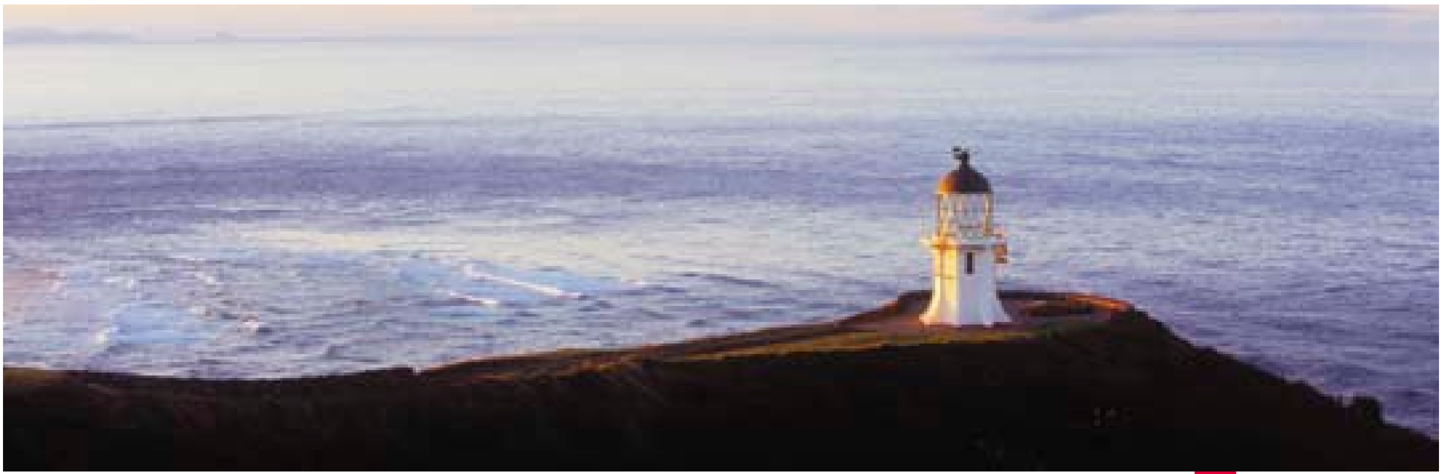
ASSURANCE ALERT



ACCOUNTING FOR THE CHANGE IN COMPANY TAX RATE FROM 30% TO 28%

THE GOVERNMENT'S 2010 BUDGET ANNOUNCED A CHANGE IN THE COMPANY TAX RATE FROM 30% TO 28% FOR THE 2011/12 INCOME TAX YEAR ONWARDS. THIS CHANGE IN THE TAX RATE WILL HAVE AN IMPACT ON THE CALCULATION OF DEFERRED TAX UNDER NZ IAS 12 - INCOME TAXES (NZ IAS 12).

NZ IAS 12 requires that deferred tax assets and liabilities be measured at the rate that is expected to apply when the asset is realised or the liability settled using the tax rates enacted or substantively enacted by the reporting date.

We believe the "substantively enacted test" set out in NZ IAS 12 has been met through the required legislation having been passed through parliament in respect of the new tax rate.

Any deferred tax assets and liabilities that reverse in periods to which the new tax rate applies (i.e., accounting periods ending on or after 20 May 2010 – i.e. 31 May 2010 and 30 June 2010 year ends onwards) will need to be remeasured to reflect the 28% tax rate. Depending on the nature of the underlying item that gives rise to the deferred tax, any such adjustment will be recognised in profit or loss or other comprehensive income as appropriate.

For accounting periods ending before 20 May 2010 (i.e. 31 March 2010 year ends) where the financial statements have not yet been finalised, no accounting adjustments are required be made to the financial statements. The impact of the 28% tax rate is, however, required to be disclosed in the notes to the financial statements as a non-adjusting event under NZ IAS 10 – *Events After the Reporting Period.*

▶ For assistance or guidance on the above, please contact your local BDO representative.

CONTENTS

THE EFFECT OF THE CHANGES IN THE TAX DEPRECIATION RULES ON BUILDINGS

THE GOVERNMENT'S 2010 BUDGET HAS INTRODUCED A SIGNIFICANT CHANGE TO THE TAX DEPRECIATION RULES ON BUILDINGS CHANGING THE DEPRECIATION RATE TO 0% FROM THE 2012 INCOME TAX YEAR FOR BUILDINGS WITH AN ESTIMATED USEFUL LIFE OF 50 YEARS OR MORE.

This has resulted in a significant deferred tax issue under NZ IAS 12, as from the beginning of the 2012 income tax year, no further tax depreciation can be claimed (discussed further below). As the rate has been reduced to 0% the buildings remain depreciable property for tax purposes and if the building is sold in excess of its book value for tax purposes, any depreciation previously claimed will be recouped.

Certain types of buildings such as barns, carparks, chemical and fertiliser works, powder drying buildings and site huts acquired on or before 30 July 2009 (excluding any improvements thereon post 30 July 2009) are given certain 'grandparented' exemption and will still be allowed to be depreciated.

Other assets included within buildings that are treated separately from the building can continue to be depreciated, and buildings with useful lives of less than 50 years will continue to be depreciated.

THE DEFERRED TAX IMPLICATION OF THE REMOVAL OF TAX DEPRECIATION ON BUILDINGS

The removal of the tax depreciation on buildings will result in a significant increase in the deferred tax liability of certain buildings.

Currently held buildings:

NZ IAS 12 requires that the amount of deferred tax to be recognised on the building will depend on the expected manner of recovery (i.e. through use or sale or both) of the building and whether or not the buildings are owner occupied (items of property, plant and equipment) or investment properties for accounting purposes.

For reporting dates after 20 May 2010, deferred tax must be calculated based on the newly legislated rate of 28%. (Refer to "Accounting for the change in Company tax rate" article above).

For buildings that are expected to be recovered through use, the deferred tax liability will increase due to the fact that the tax base will reduce to only be the amount of the tax depreciation that is able to be claimed for periods up to the end of the 2011 income tax year. This will result in a significant increase in the temporary difference between the building's tax base and its carrying amount for accounting purposes. The increase in the deferred tax liability will be recognised through profit of loss.

If the carrying amount of the building is expected to be recovered through sale, then the deferred tax will be the amount of tax on depreciation recovered. This is unlikely to be impacted on by the adoption of the new tax rules. (Please note that for entities that are subject to capital gains taxes, the deferred tax requirements in relation to buildings recovered through sale are different than what is detailed here.)

EXAMPLE – RECOVERY THROUGH USE

Entity A has an existing building with a cost of $1,000; a carrying value of $900 and a tax book value of $700 and expects to recover the carrying amount through use. Tax deprecation for the 2011 year will be $10. Deferred tax pre- and post the change in the tax depreciation rules and rate will be as follows:

	Carrying Value	Tax Base	Temporary Difference	Deferred Tax Liability	Tax Rate
Pre the changes	$900	$700	$200	$60	@ 30%
Post the changes	$900	$10	$890	$249	@ 28%
Movement in deferred tax liability due to change in rate (remember the deferred tax adjustment follows the underlying accounting entry – i.e., either in "profit or loss" or "other comprehensive income".)				$189	

New buildings:

For any building acquired after the change in the tax rules in a transaction that is not a business combination, the initial recognition exemption under NZ IAS 12 applies and no deferred tax arises.

Any subsequent revaluation of the building will result in deferred tax being recognised on the revaluation increase in other comprehensive income for owner occupied properties and in profit or loss for the revaluation of any investment properties held for rental purposes. (No deferred tax is recognised on

▶ CONTINUED ON PAGE 3

▶ CONTINUED FROM PAGE 2

investment properties held only for capital appreciation.)

If a building is acquired in a business combination deferred tax is required to be calculated thereon and this will impact on the amount of goodwill that arises on the business combination, as the initial recognition exemption does not apply.

Special care needs to be taken when analysing the purchases of investment properties. In many instances, these purchases are actually business combinations rather than straight purchases of an asset.

▶ For assistance, please contact your local BDO representative.

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HOW DO YOU TREAT COSTS ASSOCIATED WITH DEBT REFINANCING?

Entity X has renegotiated its bank borrowings to relax its debt covenants to avoid default due to reduced forecast cash inflows for the year ahead... The Bank has increased the rate of interest and has also charged Entity X significant fees in respect of the renegotiation. Can these fees be spread over the life of the bank borrowings in terms of the requirements of NZ IAS 39 – Financial Instruments: Recognition and Measurement (NZ IAS 39)?

It will depend on whether the terms of the revised bank borrowings are significantly different from those of the original bank borrowings.

Where terms are significantly different, the renegotiation is treated as an extinguishment of the original bank borrowings and the issuance of new bank borrowings with all fees incurred being recognised as a part of the gain or loss that is recognised in profit or loss on the derecognition of the original bank borrowings.

If the terms of the new bank borrowings are not significantly different from the original bank borrowings, the renegotiation is treated as a modification of the original bank borrowings, which continue to be recognised. Depending on the types of fee charged by the Bank Entity X will either recognise the fee immediately or make adjustments to the effective interest rate on the bank borrowings.

- For example, if the covenants have been changed for an upfront fee and no other terms have changed (i.e., interest, settlement dates and payments do not change) the fee can be spread over the life of the bank borrowings by adjusting the effective interest rate (NZ IAS 39.AG62)
- If instead the renegotiation consists of adjustments being made to the future payments due on the bank borrowings, Entity X is required to recalculate the carrying value of the bank borrowings by computing the present value of the revised payments using the original effective interest on the bank borrowings. Any adjustment between existing carrying value and recalculated carrying value is recognised as income or expense in profit or loss on the renegotiation date. (NZ IAS 39.AG8)

▶ For help in ensuring compliance with NZ IAS 39 requirements, please contact your local BDO represenative.

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ARE YOU ACTING AS AN AGENT OR A PRINCIPAL IN A REVENUE TRANSACTION?

NEW ZEALAND EQUIVALENT TO INTERNATIONAL FINANCIAL REPORTING STANDARD (NZ IFRS) NZ IAS 18 – REVENUE (NZ IAS 18) REQUIRES THAT IN AN AGENCY RELATIONSHIP, THE ENTITY ACTING AS AGENT ONLY RECOGNISES THE AMOUNT OF COMMISSION AS REVENUE.

The amounts collected on behalf of the principal are not revenue, as these amounts do not result in increases in equity for the entity acting as agent.

In 2009 an amendment was made to NZ IAS 18, effective for annual periods commencing on or after 1 January 2010, to provide for the first time explicit guidance on whether an entity is acting as an agent or a principal. The amendment is included in paragraph 21 of the Appendixto NZ IAS 18 and is available for early adoption.

The guidance states that an entity acts as a principal only where it is exposed to the significant risks and rewards associated with the sale of goods. In all other circumstances the entity is acting as an agent.

Risks and rewards that need to be considered include: customer credit risk; inventory risk; responsibility for fulfilling the order; responsibility for providing the goods or services to the customer and ability to set the selling price.

If the amount that the entity earns is predetermined (fixed fee per transaction or stated fixed percentage of the customer's bill) this is an indication that the entity is acting as agent.

We do not anticipate that this amendment will impact significantly in practice as it is merely a clarification of the principles in NZ IAS 18.

WHEN CAN YOU USE THE TERM "GROUP" IN FINANCIAL STATEMENTS?

NZ IFRS DEFINES *A GROUP* AS BEING 'A PARENT AND ALL ITS SUBSIDIARIES'. THEREFORE IF YOU ARE A PARENT ENTITY WITH ONLY AN INVESTMENT IN A JOINT VENTURE OR AN ASSOCIATE, YOU *MAY NOT* REFER TO THE FINANCIAL STATEMENTS THAT CONTAIN THE EQUITY ACCOUNTED INTERESTS OF THE PARENT IN AN ASSOCIATE OR JOINT VENTURE OR THE PROPORTIONATELY CONSOLIDATED RESULTS OF THE JOINT VENTURE AS 'GROUP' FINANCIAL STATEMENTS.

As a parent entity is prohibited from equity accounting associates and joint ventures or proportionately accounting for joint ventures in its separate financial statements, what do you do when you have investments in associates and/or joint ventures with no investments in subsidiaries and equity accounting or proportionate consolidation is required?

(In the parent entity's separate financial statements the investments in associates and joint ventures are carried either at cost less impairment losses or at fair value in accordance with NZ IAS 39 – Financial Instruments: Recognition and Measurement, unless they are classified as held for sale).

If the parent entity is required to present separate financial statements for reporting purposes it will, in addition to those separate financial statements, also have to prepare individual financial statements. I.e., the parent will still end up presenting four column financial statements for its financial reporting period.

The individual financial statements include the parent's equity accounted interests in an associate or joint venture or the proportionately consolidated results of the joint venture.

If the parent entity is not required to prepare separate financial statements, we believe that it will be sufficient for the parent entity to merely present individual financial statements, as long as they are clearly marked as being such and the notes to the financial statements clearly explain the basis of preparation.

In summary, if the parent entity has investments in subsidiaries that are being consolidated; joint ventures that are being proportionately consolidated or equity accounted; and/or associates that are being equity accounted, the following terminology should be used:

Financial statements should be referred to as:	**Group financial statements**	**Individual financial statements**
Investments in subsidiaries only	●	
Investments in subsidiaries, associates and/or joint ventures	●	
Investments in associates and joint ventures only		●
Investments in associates only		●
Investments in joint ventures only		●

▶ Please contact your local BDO representative for information or assistance on any of these topics.

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