



Backing precision

ACCOUNTING

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GUIDE FOR DIRECTORS RELEASED

In the [October 2015](#) edition of *Accounting Alert*, we examined the Financial Markets Authority's ("the FMA's") handbook, *Corporate Governance in New Zealand: Principles and Guidelines*, which provided an overview of the principles of good corporate governance and guidelines on how to apply those principles.

The corporate governance information provided by the FMA has now been supplemented by the release of *A Director's Guide* ("the Guide"), which the FMA released in conjunction with the Institute of Directors in New Zealand. The Guide outlines some of the essential behaviours that directors should demonstrate to meet legal, regulatory and ethical standards. These standards apply to all directors, no matter how large the company is. The Guide is available [here](#).

The Guide states that the essential duties and responsibilities of a director are to:

- ▶ Be honest
- ▶ Act with integrity
- ▶ Act in the best interests of the company at all times
- ▶ Have the right mix of skills and experience
- ▶ Understand risk and be responsive to risks and conflicts
- ▶ Ask the hard questions until satisfied that a decision can be made.

The Guide also outlines a number of circumstances that directors commonly face and provides guidance on the actions that directors should take in each of those circumstances:

Circumstance	The Guide's recommendations
Before taking up a directorship	<p>If you're thinking of becoming a company director, before you accept the appointment you should:</p> <ul style="list-style-type: none"> ▶ Make sure that you have the time for both regular board meetings and unexpected demands that might arise ▶ Get to know the company and its markets (find out how it makes money and how it manages risks; find out who the board members and the management team are and what skills they have; review financial statements, forecasts and constitutional documents) ▶ Understand the responsibilities a directorship involves (ask the board what skills they expect you to bring; become familiar with legislation relevant to the company and any personal responsibilities imposed on directors by that legislation; ask about the insurance that the company has for directors)
When working with other board members and management	<p>Directors have a legal duty to act in good faith and in the best interests of the company. If you're a director you should:</p> <ul style="list-style-type: none"> ▶ Remember the big picture (understand the long-term strategy) ▶ Do more than tick the boxes (think, question and challenge) ▶ Look for the bad news and ensure that management is supplying the board with the information that it needs to spot developing problems ▶ Ensure that the board minutes are an accurate record of the matters considered ▶ Participate in, and learn from, regular (preferably annual) reviews of board performance
When making decisions	<p>Directors can rely on information and professional or expert advice, but only if they act in good faith, make proper inquiry or have no knowledge such reliance is unwarranted. If you're a director you should:</p> <ul style="list-style-type: none"> ▶ Apply your understanding of the company and the environment it works in (including the legislation that it must comply with) ▶ Prepare for board meetings, ask questions and get advice (but also test that advice for reasonableness) ▶ Assess how the company's plans fit with its own policies (such as those related to lending, credit and liquidity) ▶ Exercise your own independent, objective judgement (don't rely on others to make decisions for you; don't get railroaded by others; seek independent advice where required, but still make up your own mind) ▶ Be aware of potential conflicts of interest and make sure that any interests you personally have are officially recorded ▶ Ensure that any related party transactions are identified, entered into in accordance with the company's rules and appropriately disclosed to investors ▶ Apply the solvency test when it is required (such as when making distributions to shareholders)

When signing off financial statements	<p>Directors have a legal duty to exercise their powers and duties with the care, diligence and skill that a reasonable director would exercise. This includes taking steps to ensure that they are properly informed about the financial position of the company and ensuring that they understand their responsibilities on behalf of the company. If you're a director you should:</p> <ul style="list-style-type: none"> ▶ Make sure you're familiar with how to read the key financial statements ▶ Check that the financial statements are consistent with other documents that management has produced ▶ Check the disclosures provided in the financial statements (check whether the most significant areas of judgement and any uncertainties about the on-going viability of the business are clearly disclosed) ▶ Make sure there are no mathematical errors ▶ Don't sign off anything you're not comfortable with (that includes the financial statements and the directors' representation letter to the external auditors) ▶ Be alert to what the external auditors say (and ask for further explanation if required)
If raising capital from the public	<p>There are strict legislative requirements when raising capital from the public. If you're a director you should:</p> <ul style="list-style-type: none"> ▶ Learn the rules in relation to the documents that must be prepared, disclosure requirements that apply and any other requirements that must be met ▶ Seek advice where required, but be satisfied yourself that the company has complied with applicable legal requirements ▶ Make sure that your investors get an accurate picture (examine whether the information provided by the company includes all material information, gives a balanced view and is sufficient to allow a potential investor to make an informed decision)
When things go wrong	<p>Directors have a duty to not cause or allow the business of a company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors. This is in addition to the general duty to act in good faith and in the best interests of the company. If you're a director you should:</p> <ul style="list-style-type: none"> ▶ Keep an eye out for warning signs ▶ Monitor financial forecasts (and examine whether the assumptions on which they are based are realistic) ▶ Find out who to go to if things are going wrong (you may need to seek advice from experts other than those engaged by the company or notify parties such as the FMA or the Serious Fraud Office)
If the company becomes insolvent	<p>Directors can be held liable for reckless trading, incurring an obligation without reasonable grounds to believe the company can perform the obligation and negligent trading. If you're a director and the company becomes insolvent, you should:</p> <ul style="list-style-type: none"> ▶ Stop trading (if the company can't pay its debts when they are due, directors must prevent it from further trading, or they may be liable for civil penalties, compensation proceedings or criminal charges) ▶ If the company can't refinance or obtain funding to recapitalise, appoint the right person to take control (the board, not management, must appoint an insolvency expert; the board should ensure that the person appointed is proficient and competent to advise and does not have any conflicts of interest) ▶ Understand that, if the company is placed in voluntary administration or liquidation, the directors will lose control of the company ▶ Understand that you will still have obligations (such as assisting the insolvency expert by providing financial and other records and attending meetings, or even court, as required).

For more on the above, please contact your local BDO representative.

INCORPORATED SOCIETIES BILL

The Ministry of Business, Innovation and Employment (MBIE) has released for comment the Incorporated Societies Bill ("the Bill") that will update the Incorporated Societies Act 1908.

The Bill follows on from the review carried out by the Law Commission that was aimed at determining what was needed to modernise legislation surrounding incorporated societies ("societies") as well as provide guidance about the obligations of those running societies and about how disputes within societies should be dealt with.

The Bill highlights that it is intended that societies:

- ▶ Should be operated by their own members;
- ▶ Should not distribute profits or financial benefits to members; and
- ▶ Should be free from inappropriate Government interference.

The Bill therefore provides a framework that will allow a society flexibility, through the society's own rules, to operate in furtherance of its particular structure, culture and goals.

Recommendations contained in the Bill

Some of the key recommendations contained in the Bill are:

- ▶ Removing the ability to establish an incorporated society under the Charitable Trusts Act 2005, so they can only be incorporated under the new (proposed) act.
- ▶ Cutting the minimum membership requirement from 15 members to 10 members (at all times).
- ▶ Requiring every society to have a committee of officers to make decisions and run its affairs, including one person to be the society's statutory officer.
 - The Bills contain a list of officers' duties along the lines of directors' duties in the Companies Act 1993 and a set of rules governing the disclosure and management of conflicts of interest.
- ▶ Requiring minimum detailed rules in all constitutions dealing with meetings, quorums, procedures for committee member appointments, etc.; and introducing a model constitution containing all of those rules required by the new (proposed) act
- ▶ Requiring detailed annual reporting to the Registrar including membership numbers, annual financial statements and contact information for the new role of a "statutory officer" of the society.
- ▶ Requiring that annual financial statements be prepared in the same manner that is currently required for registered charities; i.e. in accordance with generally accepted accounting practice (GAAP) (except for societies with operating expenditure of less than \$125,000 p.a. which can choose to report under the applicable non-GAAP standard).

- ▶ Requiring that every society must have rules in its constitution to provide procedures for the resolution of complaints about misconduct and discipline of members and about grievances brought by members concerning their rights or interests as members and grievances between members, the committee and the society itself.
- ▶ Introducing a range of criminal offences (with fines up to a maximum of \$200,000 or five years' imprisonment) for offences such as using a position of responsibility to obtain an advantage, as well as infringement offences (punishable by \$5,000 fine) for non-compliance with filing and other obligations under the act
- ▶ Allowing members to resolve to liquidate a society at a single meeting, rather than the current double meeting requirement, but requiring that 30 days' notice of a motion to liquidate be provided. The Bill also clarifies the prohibition on distributing surplus assets to members on dissolution.
- ▶ Introducing provisions to enable amalgamations and mergers of societies to be easier.
- ▶ Granting powers to the Registrar to investigate and intervene in a society if it is in the public interest to do so.

In addition to the above MBIE intend to also make recommendations on what auditing or review requirements will be required for societies. It is anticipated that the threshold will be set quite high for the requirement to have an audit or a review carried out and that the majority of societies will be able to decide for themselves whether they want an audit or review to be carried out.

What this means for current societies

When the proposed changes come into effect, every current society will need to ensure that its constitution complies with the new requirements.

As amending a society's constitution can be a lengthy process, there is likely to be a transition period to allow those societies which require amendments to their constitutions sufficient time to comply.

In the interim, for any members setting up a new incorporated society, it is highly recommended that consideration be given to the recommendations in the Bill when drafting the society's constitution and considering the governance structure.

Deadlines for submissions

Submissions on the draft Bill are due into MBIE by 30 June 2016.

More detail can be found on MBIE website [here](#).

For more on the above, please contact your local BDO representative.

MORE CASH FLOW STATEMENT DISCLOSURES – CHANGES TO NZ IAS 7

In January 2016, the International Accounting Standards Board (IASB) issued amendments to IAS 7 *Statement of Cash Flows* that require additional disclosures about changes in an entity's financing liabilities arising from both cash flow and non-cash flow items.

The changes are a result of investor requests for entities to provide information to improve their understanding of changes in the entity's net debt, and management of financing activities. The changes are part of the IASB's Disclosure Initiative project to improve disclosures in financial statements.

When do the changes apply?

The changes, which can be early adopted once approved by the New Zealand Accounting Standards Board (NZASB), are mandatory for annual periods beginning on or after 1 January 2017. These changes will apply to all Tier 1 and Tier 2 for-profit entities. Comparatives are not required in the first year of adoption.

Which liabilities do the new disclosures apply to?

The new disclosures required by IAS 7, paragraphs 44A to 44E, apply to all liabilities whose cash flow movements are disclosed as part of financing activities in the cash flow statement.

These disclosures also apply to any changes in financial assets (e.g. those used to hedge liabilities arising from financing activities) if cash flows from these financial assets will be included in cash flows from financing activities.

Additional disclosures required

To meet the disclosure objective of these changes, entities will need to disclose the following changes in liabilities arising from financing activities:

- ▶ Changes from financing cash flows
- ▶ Changes from obtaining or losing control of subsidiaries or other businesses
- ▶ Effect of changes in foreign exchange rates
- ▶ Changes in fair values, etc.

What should disclosures look like?

There is no specific requirement to make these additional disclosures appear in a particular way (e.g. tabular format).

Paragraph 44D notes that one way to show these disclosures might be by including a reconciliation between opening and closing balances in the statement of financial position for liabilities that result in financing cash flows. Where this format is used, users should be able to tie back items in the reconciliation to the statements of financial position and cash flows. A good way to do this is by cross-reference.

Example C (reproduced below) has been inserted into IAS 7 to provide an illustrative example of the disclosure. The example does not illustrate the prior year comparatives, which must be included from the second year of adoption onwards.

	1 JANUARY 2017	CASH FLOWS	NON-CASH CHANGES			31 DECEMBER 2017
	\$	\$	ACQUISITION \$	FOREIGN EXCHANGE MOVEMENTS \$	FAIR VALUE CHANGES \$	\$
Long-term borrowings	22,000	(1,000)	–	–	–	21,000
Short-term borrowings	10,000	(500)	–	200	–	9,700
Lease liabilities	4,000	(800)	300	–	–	3,500
Assets held to hedge long-term borrowings	(675)	150	–	–	(25)	(500)
Total	35,325	(2,150)	300	200	(25)	33,650

Because of the requirement in paragraph 44D for users to be able to link items disclosed in the reconciliation with movements in the cash flow statement, we note that this example may be too simplistic for some entities, particularly where:

- ▶ Each of the above categories contain repayments of borrowings and new borrowings raised (i.e. would be shown as separate categories in financing activities), and
- ▶ Interest payments on borrowings and lease liabilities are classified as operating cash flows, and therefore included as operating activity outflows.

In these cases, the reconciliation may need to be expanded, for example, by including separate columns for:

- ▶ Cash inflows and outflows, which reconcile to financing activity cash inflows and outflows in the cash flow statement, and
- ▶ Interest payments included as operating cash flows.

For more on the above, please contact your local BDO representative.



CHANGES TO NZ IAS 12 CLARIFY RECOGNITION OF DTAS ON UNREALISED LOSSES

In January 2016, the International Accounting Standards Board (IASB) issued amendments to IAS 12 *Income Taxes* to clarify the requirements for recognising deferred tax assets (DTAs) for unrealised losses, particularly with respect to fixed rate debt instruments. These amendments will impact all Tier 1 and Tier 2 for-profit entities in New Zealand.

Four changes

The changes clarify four issues as follows:

- ▶ If all other recognition criteria are met, DTAs must be recognised for the deductible temporary difference between the fair value and tax base on fixed rate debt instruments that are not deemed to be impaired (see example below).
- ▶ Deductible temporary differences must be compared to taxable profits of the same type (e.g. capital or revenue profits) to determine whether there is sufficient taxable profit against which the deductible temporary differences can be utilised.
- ▶ To avoid 'double dipping', when comparing deductible temporary differences against the amount of future taxable profits, the calculation of future taxable profits must exclude tax deductions resulting from the reversal of those deductible temporary differences.
- ▶ The estimate of future taxable profits can include recovery of certain assets at amounts more than their carrying amount if there is enough evidence that it is probable that the entity will recover the asset for more than its carrying amount. Examples would include:
 - Property measured using cost model for which an external valuation has been conducted.
 - Fixed rate debt instruments held to maturity.

Example (based on facts included in illustrative example to paragraph 26(d))

Entity A purchases a debt instrument on 1 January 2017 with the following terms:

- ▶ Face value \$1,000
- ▶ Repayable in five years' time
- ▶ Interest rate is two per cent payable annually in arrears
- ▶ Effective interest rate is two per cent
- ▶ Instrument is measured at fair value in the financial statements
- ▶ Tax base = cost = \$1,000 because it will result in a tax deduction of \$1,000 when determining taxable profit, irrespective of whether the instrument is sold or used.

On 31 December 2018, the fair value has decreased to \$918 because market interest rates have increased to five per cent.

It is probable that Entity A will collect all cash flows if it holds the instrument to maturity. This means that there is no impairment loss on the debt instrument, which will be recovered on maturity for \$1,000.

The illustrative example clarifies that on 31 December 2018, when the fair value of the debt instrument falls below cost, there is a deductible temporary difference of \$82, being the difference between the carrying amount of the instrument (\$918) and the tax base (\$1,000).

When do the changes apply?

The changes, which can be early adopted once approved by the New Zealand Accounting Standards Board (NZASB), are mandatory for annual periods beginning on or after 1 January 2017.

The amendments apply retrospectively so generally restatement of prior year comparatives will be required. However, in the first year of application, adjustments to opening equity (usually at the opening balance sheet date of 1 January or 1 July 2016, depending on the year-end) can be recognised in opening retained earnings without allocating the change between retained earnings and other components of equity. If this relief is applied, the entity must disclose this fact.

For more on the above, please contact your local BDO representative.

GUIDANCE FOR CHARITIES ISSUING DEBT

The Financial Markets Authority ("FMA") has released an Information Sheet entitled "Raising money from investors – a guide for community and voluntary organisations" ("the Information Sheet"), which outlines the options for community and voluntary organisations wanting to borrow money from investors.

Background

Until recently, an entity that wanted to raise money from investors by offering debt securities (such as bonds or debentures) had to have a trustee, a registered prospectus and an investment statement. Registered charities were exempt from those requirements, but from 30 November 2016 the exemption will end and charities will be required to follow the same new rules as all entities issuing debt securities. Those new rules have been introduced by the Financial Markets Conduct Act 2013 ("the FMC Act").

FMC Act requirements

The FMC Act requires offerors of regulated offers to provide information about the financial products being offered in a product disclosure statement. Additional information must also appear on the Disclose Register, which is run by the Companies Office. Together, this information must include all information about the offer and be up-to-date, accurate and understandable. There must be also a trust deed, and a licensed supervisor to act as the trustee under that trust deed.

However, the FMC Act excludes several types of offers and types of investors from being classified as regulated offers (and consequently from meeting the requirements that apply to regulated offers). These types of offers therefore cost less to make than regulated offers.

The main exclusions that may be appropriate for voluntary or community organisations looking for a lower-cost option for raising money by issuing debt are:

- ▶ Making offers to wholesale investors
- ▶ Raising a maximum of \$2 million in a 12-month period from retail investors by making small personal offers, or making offers through peer-to-peer lending platforms (or a combination of both)

Making offers to wholesale investors

Offers of financial products to wholesale investors are not regulated offers and are consequently excluded from the standard rules for disclosure, governance and financial reporting.

There are two types of wholesale investors – wholesale investors for all offers of financial products and investors who are wholesale investors on a case-by-case basis for particular offers.

The following people are wholesale investors for all offers of financial products:

- ▶ Local authorities and Crown entities
- ▶ Investment businesses (those who habitually invest money as the main part of their business)

- ▶ Large investors (those with net assets or consolidated turnover of more than \$5 million in each of the past two years)
- ▶ Active investors (those with financial portfolios worth at least \$1 million over the past two years).

The following people are wholesale investors on a case-by-case basis for particular offers:

- ▶ Eligible investors (those who certify themselves as knowledgeable and experienced investors)
- ▶ Investors who plan to invest at least \$750,000 in the offer (or whose combined investments with the offeror for the same class of financial products add up to at least \$750,000).

Although offers of financial products to wholesale investors are not regulated offers, there are still some rules that apply. Charities planning to issue debt to wholesale investors must familiarise themselves with these requirements before issuing the debt.

Raising a maximum of \$2 million in a 12-month period from retail investors

Retail investors are investors who are not wholesale investors. There are two main lower-cost ways that charities can use to raise money from retail investors – small personal offers and using peer-to-peer lending platforms. Charities can raise up to \$2 million over a 12-month period using one of these methods, or both methods combined.

Small personal offers

A small personal offer can be accepted by up to 20 investors over a 12-month period. It must be a personal offer to someone who is likely to be interested in the offer, and

- ▶ Someone with whom you have a professional or other connection, or
- ▶ Someone with whom you have had previous contact, or
- ▶ Someone who has indicated they are interested in such offers.

Small personal offers can also be made to someone with a gross annual income of at least \$200,000 in each of the past two years.

Although small personal offers of financial products to retail investors are not regulated offers, there are still some rules that apply. Charities planning to issue debt in this manner must familiarise themselves with these requirements before issuing the debt.

Offers through peer-to-peer lending platforms

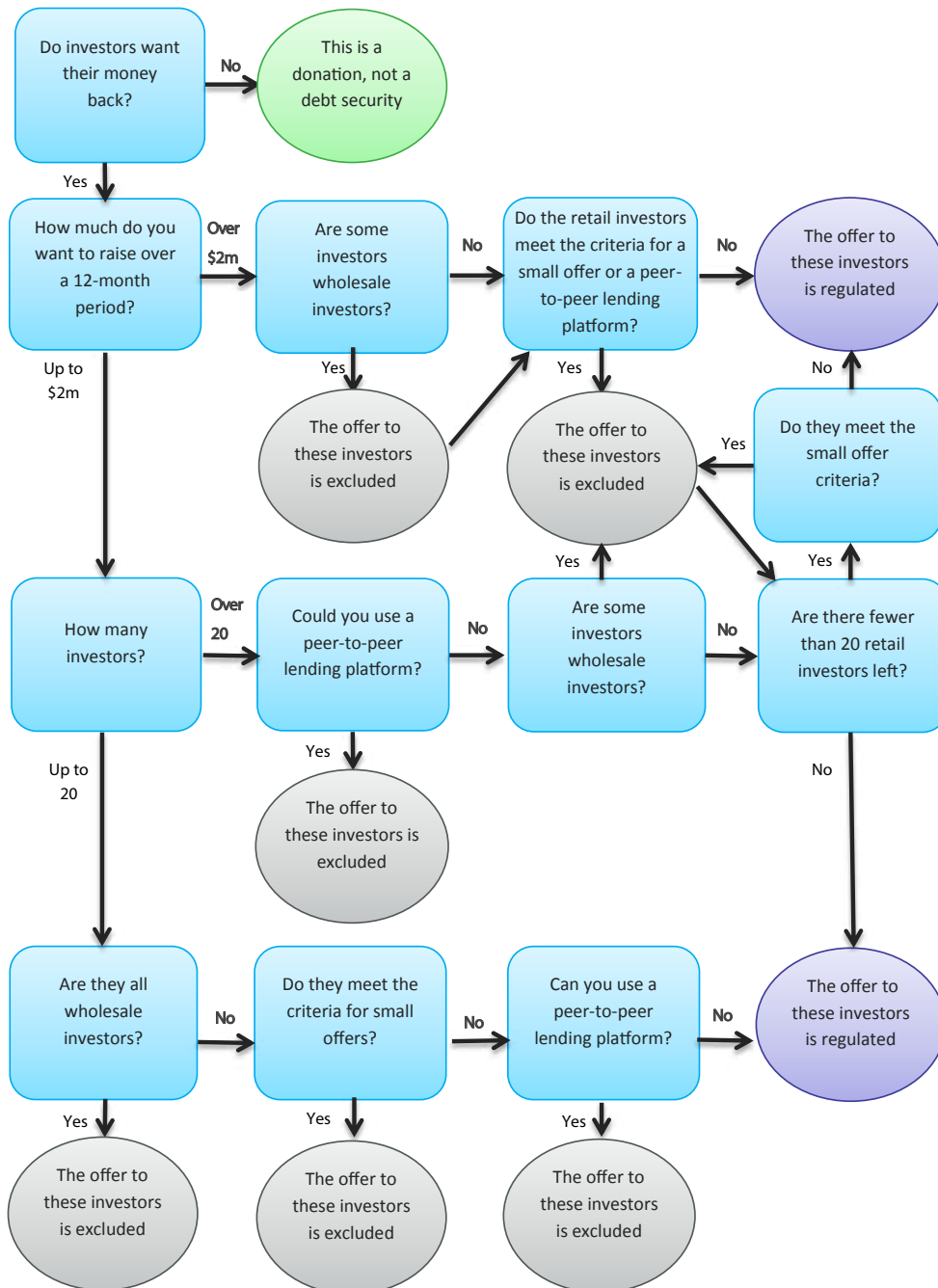
Peer-to-peer lending services match investors with people or organisations needing loans. These services are typically based online.

These services are required to be licensed by the FMA. Borrowers have to abide by certain rules, such as being honest about the information provided and their ability to pay it back. There is no limit on investor numbers, and no requirement for a personal connection with investors. More information about peer-to-peer lending is available from the FMA [here](#).

Summary of charities' options when issuing debt

The FMA has provided a diagram that summarises the guidance provided in the Information Sheet:

Your guide to making an offer to investors



The Information Sheet (which includes the diagram above) is available [here](#).

For more on the above, please contact your local BDO representative.

NEW BDO PUBLICATIONS

The **Audit** section of our website (www.bdo.co.nz/audit) includes a range of publications on accounting standards issues. For example:

- ▶ **NZ IFRS Industry Issues** contains a high level overview of the impact of new standards on particular industries. Recent NZ IFRS Industry Issues include overviews of the impact of NZ IFRS 15 *Revenue from Contracts with Customers* on the manufacturing; retail; telecommunications, software; media, construction-real estate and professional services industries.
- ▶ **Summaries on a Page (SOAPs)** contain summaries of NZ IFRS Standards for for-profit entities and PBE Standards for public sector and not-for profit entities currently in effect in New Zealand.

Also look for the '**BDO International IFRS**' link which includes resources such as:

- ▶ **IFRS at a glance** – 'one page' and short summaries of all IFRS standards.
- ▶ **IFRS News at a glance** – provides high-level headlines of newly released documents by the IASB and IFRS related announcements by securities regulators.
- ▶ **Need to Knows** – updates on major IASB projects and highlights practical implications of forthcoming changes to accounting standards. Recent Need to Knows include IFRS 9 *Financial Instruments – Classification and Measurement* (April 2015), IFRS 9 *Financial Instruments - Impairment of Financial Assets* (Dec 2014), IFRS 15 *Revenue from Contracts with Customers* (Aug 2014), IFRS 9 *Financial Instruments* (May 2014), *Hedge Accounting* (IFRS 9 *Financial Instruments*) (Jan 2014).
- ▶ **IFRS in Practice** – practical information about the application of key aspects of IFRS, including industry specific guidance. Recent IFRS in Practice include IFRS 11 *Joint Arrangements* (Feb 2016), IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers – Transition*; IFRS 15 *Revenue from Contracts with Customers* (Oct 2014), IAS 7 *Statement of Cash Flows, Distinguishing between a business combination and an asset purchase in the extractives industry* (March 2014), IAS 36 *Impairment of Assets* (Dec 2013) and *Common Errors in Financial Statements – Share-based Payment* (Dec 2013).
- ▶ **Comment letters on IFRS standard setting** – includes BDO comments on various projects of international standard setters, including Exposure Drafts and other Discussion Papers, when it is considered that the issue is significant to the BDO network and its clients. Latest comment letters include IASB ED 2015-3 *Conceptual Framework for Financial Reporting*, ED *Proposed amendments to IAS 19* and IFRIC 14, IASB 2015-6 *Clarifications to IFRS 15*, IASB ED 2015-1 *Classification of Liabilities*, Basel Committee on Banking Supervision – Guidance on accounting for expected credit losses, and IASB ED 2014-04 *Measuring Quoted Investments in Subsidiaries, Joint Ventures and Associates at Fair Value*.

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