Backing precision

ACCOUNTING ALERT

SEPTEMBER 2016

IFRS 3 & IFRS 11 PROPOSED AMENDMENTS

FINANCIAL INSTRUMENTS FOR PUBLIC BENEFIT ENTITIES

CHANGES TO NZ IFRS 2 SHARE-BASED PAYMENT

FMA STANDARD LICENCE CONDITIONS FOR PEER TO PEER LENDING

NEW BDO PUBLICATIONS

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PROPOSED AMENDMENTS TO THE DEFINITION OF A BUSINESS AND ACCOUNTING FOR PREVIOUSLY HELD INTERESTS

The International Accounting Standards Board ("IASB") has recently released an exposure draft, ED/2016/1 *Definition of a Business and Accounting for Previously Held Interests* (Proposed Amendments to IFRS 3 and IFRS 11) ("the Exposure Draft"), which proposes amendments to clarify:

- The definition of a business; and
- How an acquirer should account for previously held interests in a business if acquiring control, or joint control, of that business.

The proposals in the Exposure Draft are relevant for Tier 1 and Tier 2 for-profit entities (i.e. entities reporting under New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") or NZ IFRS Reduced Disclosure Regime).

Once the IASB issues an amending standard based on the Exposure Draft, the New Zealand Accounting Standards Board ("NZASB") will issue an equivalent amending standard in New Zealand.

The definition of a business

IFRS 3/NZ IFRS 3 *Business Combinations* ("IFRS 3") defines a business as "an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants".

The Exposure Draft proposes amending the guidance on the definition of a business to clarify that, to constitute a business, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together have the ability to contribute to the creation of outputs.

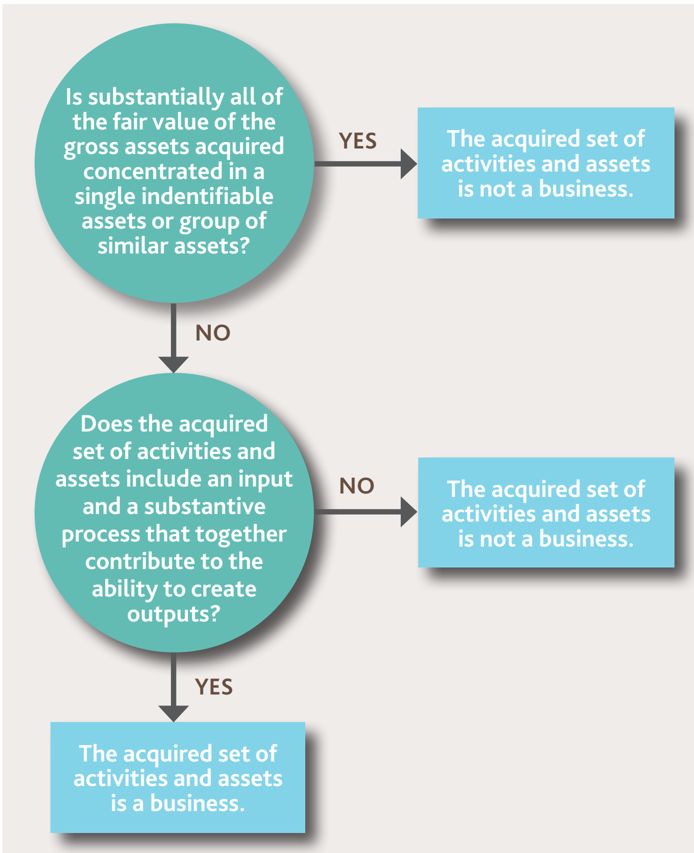
The Exposure Draft also proposes a new two-part test to assess whether a transaction is the acquisition of a business:

- Part 1: An assessment of whether substantially all of the fair value of the gross assets acquired is concentrated in a single asset or group of similar assets (if it is, the transaction is not the acquisition of a business and part 2 of the test is not carried out)
- Part 2: Only if substantially all of the fair value of the gross assets acquired is not concentrated in a single asset or group of similar assets, evaluate whether the acquired set of activities and assets includes a substantive process – if it does, the transaction is a business combination, and if it does not, the acquisition is not a business combination.

The Exposure Draft proposes providing the following guidance to determine whether a set of activities and assets includes a substantive process:

- If a set of activities and assets does not, at the acquisition date, have outputs (for example, if it is an early-stage entity that has not started generating revenues), the set is a business only if it includes an organised workforce with the necessary skills, knowledge, or experience to perform an acquired substantive process (or group of processes). In addition, that acquired substantive process (or group of processes) must be critical to the ability to develop or convert another acquired input or inputs into outputs. Inputs that the organised workforce could develop (or be developing), or convert into outputs, include intellectual property that could be used to develop a good or service.
- If a set of activities and assets has outputs at the acquisition date (for example, if it generates revenue before the acquisition), the set is a business if either:
  - the acquired set of activities and assets includes a process (or group of processes) that, when applied to an acquired input or inputs, contributes to the ability to continue producing outputs, even without the acquisition of an organised workforce, and that process (or group of processes) is considered unique or scarce, or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs; or
  - the acquired set of activities and assets includes an organised workforce with the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that when applied to an acquired input or inputs, is critical to the ability to continue producing outputs.

The process for determining whether a transaction is the acquisition of a business is thus:



The Exposure Draft provides a number of examples to illustrate the guidance provided. Two of these examples relate to the acquisition of investment properties, which has sometimes been a contentious issue under IFRS 3:

SCENARIO ONE	SCENARIO TWO
BACKGROUND INFORMATION An entity purchases a multi-tenant corporate office park with six 10-storey office buildings that are fully leased. The acquired set of activities and assets includes the land, buildings, leases and contracts for outsourced cleaning and security. No employees, other assets, or other activities are transferred. The contracts for outsourced cleaning and security are ancillary and have a fair value of nil.	BACKGROUND INFORMATION The facts are the same as in scenario one, except that: • The purchased set of activities and assets includes the employees responsible for leasing, tenant management, and managing and supervising all operational processes • The purchase price was significantly higher than in scenario one because of the employees and processes acquired.
ANALYSIS • Each building and the land on which it is located are considered a single asset for the purpose of assessing the concentration of fair value, because, although they are different classes of tangible assets, the buildings are attached to the land and cannot be removed without incurring significant cost • Each building and the leases associated with it are considered a single asset, because they would be recognised and measured as a single identifiable asset in a business combination • The group of six 10-storey office buildings is a group of similar assets • The fair value associated with the acquired contracts for cleaning and security is nil. Based on that analysis, the fair value of the gross assets acquired is concentrated in a group of similar assets.	ANALYSIS The group of six 10-storey office buildings is a group of similar assets. However, there is significant fair value associated with the acquired workforce. Consequently, the fair value of the gross assets purchased is not concentrated in a group of similar identifiable assets. The set of activities and assets has outputs as it generates revenues through the in-place leases. The set of activities and assets includes an organised workforce that performs processes (leasing, tenant management, and supervision of the operational processes) critical to the ability to continue producing outputs when applied to the acquired inputs (the land, buildings, and in-place leases).
CONCLUSION The set of activities and assets acquired is not a business.	CONCLUSION The set of activities and assets acquired is a business.

How an acquirer should account for previously held interests in a business if acquiring control, or joint control, of that business

The Exposure Draft clarifies that:

- Obtaining control of a business that is a joint operation where the acquirer held an interest in its assets and liabilities immediately before the acquisition date (either as a joint operator or as a party to a joint arrangement) is a business combination achieved in stages. This means that the acquirer must re-measure its previously held interests in the joint operation.
- A joint operator or a party that participates in, but does not have joint control of, a joint operation, might increase its interest in a joint operation in which the activity of the joint operation constitutes a business by acquiring an additional interest in the joint operation. In such circumstances, the joint operator may retain joint control, or the party that participates in, but does not have joint control of, the joint operation, may obtain joint control of the joint operation. In such circumstances, previously held interests in the assets and liabilities of the joint operation must not be re-measured.

More information

The Exposure Draft is available **here**.

Making a submission

Information on making a submission to the NZASB is available **here**. Submissions must be made by 30 September 2016.

Information on making a submission to the IASB is available **here**. Submissions must be made 31 October 2016.

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

FINANCIAL INSTRUMENTS FOR PUBLIC BENEFIT ENTITIES

When accounting for financial instruments, for-profit entities currently apply NZ IAS 39 *Financial Instruments: Recognition and Measurement* ("NZ IAS 39"), while public benefit entities ("PBEs") apply the PBE Standard PBE IPSAS 29 *Financial Instruments: Recognition and Measurement* ("PBE IPSAS 29").

PBE IPSAS 29 requirements are essentially identical to those of NZ IAS 39, which means that for-profit entities and PBEs currently classify financial assets and liabilities into essentially identical categories and account for them in the same manner. In addition, hedge accounting requirements under PBE IPSAS 29 mirror those under NZ IAS 39. The essentially identical nature of the two standards means that entities within mixed groups (groups that consist of both for-profit entities and PBEs) all account for the recognition and measurement of financial instruments in the same manner.

For annual reporting periods beginning on or after 1 January 2018, for-profit entities will apply NZ IFRS 9 *Financial Instruments* ("NZ IFRS 9") to the recognition and measurement of their financial instruments. NZ IFRS 9 differs significantly from NZ IAS 39 and PBE IPSAS 29 in a number of areas, by introducing:

- A new model for the classification and measurement of financial assets
- A single, forward-looking, expected loss, impairment model
- A substantially reformed approach to hedge accounting.

Once for-profit entities have adopted NZ IFRS 9, the preparation of group financial statements for mixed groups will become more difficult, due to the differences in the way in which financial instruments will be accounted for.

PBE Standards are based on International Public Sector Accounting Standards ("IPSAS"). The International Public Sector Accounting Standards Board ("IPSASB") intends to develop an IPSAS based on IFRS 9 (which is the international version of NZ IFRS 9). Ordinarily, the New Zealand Accounting Standards Board ("NZASB") would wait for the completion of an IPSASB project before updating PBE Standards. However, the expected completion date of the IPSASB's financial instruments project is after the effective date of NZ IFRS 9 in the for-profit sector.

The NZASB has decided that there would be advantages to allowing PBEs to report under the requirements of NZ IFRS 9 at the same time as for-profit entities are required to adopt NZ IFRS 9. As a result of that decision, the NZASB has released an exposure draft, ED NZASB 2016-7 PBE IFRS 9 *Financial Instruments* ("the Exposure Draft"). The Exposure Draft is essentially identical to NZ IFRS 9, with some minor amendments:

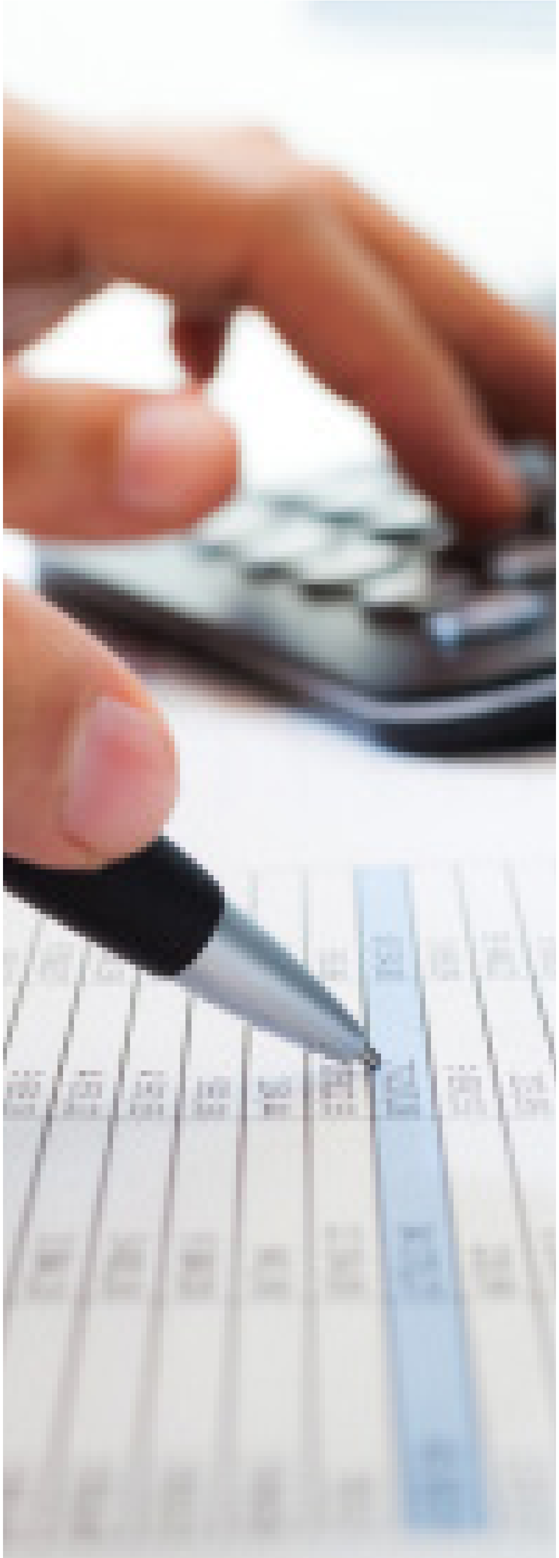
- To mirror the modifications that the IPSASB made to IAS 39 (which is the international version of NZ IAS 39) when it developed IPSAS 29 (which is the IPSASB standard on which PBE IPSAS 29 is based)
- To ensure the coherence of the suite of PBE Standards.

The NZASB is proposing that a final standard based on the Exposure Draft would be effective for periods beginning on or after 1 January 2021. This would allow PBEs to continue applying PBE IPSAS 29 if they wanted to, but would allow PBEs that want to do so to early adopt a standard that is essentially identical to NZ IFRS 9.

The NZASB will continue to monitor the IPSASB's financial instruments project, with a view to adopting any final standard that it develops.

The NZASB is seeking comments on the Exposure Draft by 30 September 2016. Information on making a submission is available here.

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



CHANGES TO NZ IFRS 2 SHARE-BASED PAYMENT – CLASSIFICATION AND MEASUREMENT OF SHARE-BASED PAYMENT TRANSACTIONS

The New Zealand Accounting Standards Board ("NZASB") has approved narrow scope amendments to NZ IFRS 2 *Share-based Payment* to clarify the accounting for:

- The impact of vesting and non-vesting conditions when measuring cash-settled share-based payments.
- Share-based payment transactions with a net settlement feature for withholding tax obligations; and
- Share-based payments where the classification of the transaction changes from cash-settled to equity-settled.

The changes apply to Tier 1 and Tier 2 for-profit entities for annual periods beginning on or after 1 January 2018 and can be early adopted. There are specific transitional provisions for each of these amendments (refer to discussion below).

Impact of vesting and non-vesting conditions when measuring cash-settled share-based payments

> The liability shall be measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered service to date.
>
> **NZ IFRS 2, paragraph 33**

Although NZ IFRS 2, paragraph 33 requires cash-settled share-based payment transactions to be measured at fair value using an option pricing model, it does not give guidance on if, and how, vesting and non-vesting conditions should be taken into account when measuring fair value of the cash-settled liability.

These changes clarify that market and non-market vesting conditions and non-vesting conditions should be taken into account when determining fair value of the cash-settled share-based liability in the same way as they would be for equity-settled share-based payment transactions.

CONDITIONS	EXAMPLE	HOW ACCOUNTED FOR IN CASH-SETTLED LIABILITY?
Vesting – non-market	Target sales/ profit	No impact on fair value. Adjust number of awards expected to vest.
Vesting – market	Target share price	Adjust fair value at each reporting date until settlement.
Non-vesting	Future commodity price	Adjust fair value at each reporting date until settlement.

This means that for all types of conditions, the cumulative amount recognised for goods and services as consideration for cash-settled share-based payment transactions will equal the cash paid.

Cumulative expense = cash paid

Transition
These amendments only apply to share-based payment transactions:

- Unvested at the date that the entity first applies the amendments, and
- Those granted on or after the date that the entity first applies the amendments.

The entity first applies these amendments on 1 January 2018 for entities with 31 December 2018 year ends, and 1 July 2018 for entities with 30 June 2019 year ends.

Transition – granted before date amendment first applies
For unvested share-based payment transactions granted before the date that the entity first applies these amendments, the cash-settled liability must be remeasured on the date the amendments are first applied (e.g. 1 January or 1 July 2018), and the effects of remeasurement recognised in opening retained earnings on that date.

Net settlement feature for withholding tax obligations

Tax laws in some countries require an entity to withhold an amount to settle an employee's tax obligation for a share-based payment transaction, and to pay that amount over to the tax authorities on the employee's behalf, usually in cash.

To fulfil these obligations, share-based payment transactions may allow/ require entities to withhold a number of equity instruments, equal to the monetary value of the employee's tax obligation, from the total number of equity instruments that otherwise would have been issued. The obligation to settle in cash would usually result in such transactions being classified as cash-settled. The changes in paragraphs 33E to 33H clarify that such transactions with the net settlement feature will be accounted for as follows:

- Classify the transaction as equity-settled in its entirety if, without the net settlement feature, it would have been so classified, and
- Debit payments made by the entity for withholding tax as a deduction from equity.

However, paragraph 33H clarifies that this treatment will not apply where:

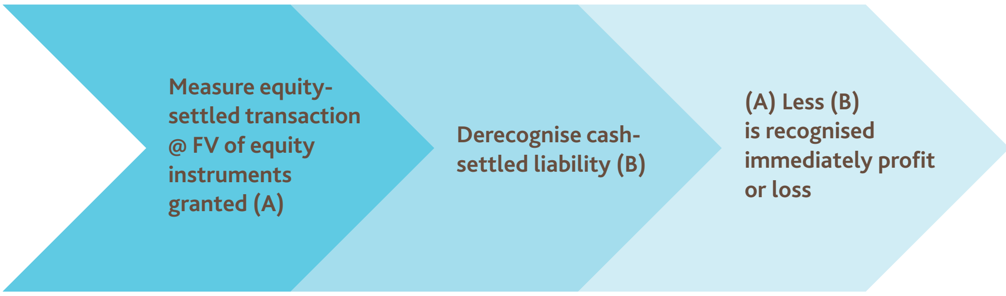
- There is no obligation on the entity under tax law to withhold amounts to cover the employee's tax obligations from the share-based payment arrangement, or
- The entity withholds equity instruments in excess of the employee's tax obligation under the share-based payment arrangement. In such cases the excess equity instruments withheld are accounted for as a cash-settled share-based payment if this amount is paid in cash.

Transition – granted on or after date amendment first applies
These amendments only apply to unvested (or vested but unexercised) share-based payment transactions that are granted on or after the date that the entity first applies the amendments, i.e. 1 January 2018 for entities with 31 December 2018 year ends and 1 July 2018 for entities with 30 June 2019 year ends.

Transition – granted before date amendment first applies
For unvested (or vested but unexercised) share-based payment transactions that were previously accounted for as 'cash-settled' because of the net settlement feature, but are now classified as 'equity-settled', the carrying amount of the cash-settled liability must be reclassified as equity on the date these amendments are first applied.

Changing classification from cash-settled to equity-settled

Guidance paragraphs B44A to B44C have been added to clarify the accounting if the terms of a share-based payment are modified such that a cash-settled transaction becomes an equity-settled transaction. The steps to follow on modification date are:



Transition

These amendments only apply to modifications that occur on or after the date that the entity first applies the amendments, i.e. 1 January 2018 for entities with 31 December 2018 year ends and 1 July 2018 for entities with 30 June 2019 year ends.

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

STANDARD CONDITIONS ISSUED FOR PEER-TO-PEER LENDING SERVICE LICENCES

Late in 2015 the Financial Markets Authority ("FMA") consulted on proposed variations to standard conditions for market service licences. The FMA has now completed the consultation process and issued updated information on standard licence conditions for peer-to-peer lending services ("P2P lending services"). The new conditions are effective from 31 March 2016, which means that the new audit procedures and financial resource requirements apply to licensees for accounting periods ending on or after 31 March 2016.

The standard licence conditions are:

Condition 1: Skills and expertise	A P2P lending service, or any authorised body covered by its licence, must inform the FMA whenever there is a change in its key people and managers (these are the people responsible for the main activities required for the P2P lending service to deliver the licensed service; the FMA would have been told about these people during the licence application process and this requirement means that the relevant information is kept up to date).
Condition 2: Outsourcing	A P2P lending service that outsources a process/system necessary to the effective and proper running of the P2P lending service (or any other market services licensee obligation) must: ▶ Be satisfied that the provider is capable of performing the service to the standard required to enable the P2P lending service to meet its market services licensee obligations ▶ Have a legally binding agreement with the provider ▶ Ensure that records pertaining to the P2P lending service are available for inspection when requested by the FMA.
Condition 3: Records	A P2P lending service must: ▶ Have systems and procedures to maintain relevant records pertaining to its market service ▶ Provide the FMA with the records it needs to monitor the P2P lending service's on-going capability to effectively perform the P2P lending service in accordance with the applicable eligibility criteria in the Financial Markets Conduct Act 2013 ("FMC Act").
Condition 4: Regulatory returns	A P2P lending service must provide the FMA with the information it needs to monitor the P2P lending service's on-going capability to effectively perform the P2P lending service in accordance with the applicable eligibility criteria in the FMC Act. Information that will be required will include updated information on the nature, size and complexity of the P2P lending service. Information must be provided in accordance with any requirements issued under the FMC Act.
Condition 5: Compliance	A P2P lending service must, at all times, have adequate and effective systems, policies, processes and controls that are likely to ensure that it will meet its market services licensee obligations in an effective manner.
Condition 6: Governance arrangements	A P2P lending service's governance and compliance arrangements must be substantially the same as, or better than, those in place, or which the FMA was advised of, at the time the P2P lending service applied for its licence (or any subsequent change advised to the FMA). A P2P lending service must notify the FMA of material changes to its governance and compliance arrangements (including material changes to its outsourcing arrangements) as soon as practicable (which the FMA would ordinarily consider to be within five working days of the change taking effect).

Condition 7: Financial resources	**Calculation of net tangible assets ("NTA")** A P2P lending service must calculate its NTA (note that the manner in which NTA must be calculated is explained in an appendix to the standard licence conditions): ▶ At least monthly, including as at its balance date each year on the basis of its audited financial statements ▶ On any other date on which there is a reason to suspect that its NTA is not positive. If the calculation shows that the P2P lending service did not have positive NTA, the P2P lending service must notify the FMA as soon as practicable and explain: ▶ The circumstances that cause it to have NTA that is not positive, including the nature of any significant intangible assets or related party receivables ▶ Whether the P2P lending service considers that having NTA that is not positive adversely impacts on its ability to carry out the market service effectively on an ongoing basis and why. The P2P lending service is not required to make this notification if: ▶ It has previously notified the FMA that its NTA was not positive and provided an explanation ▶ The FMA has advised in writing that it does not need to provide further notifications in respect of having NTA that is not positive arising from those circumstances ▶ There has been no material change from the position and circumstances described to the FMA in its most recent previous notification. **NTA Report** A P2P lending service must: ▶ Engage a qualified auditor to perform agreed upon procedures ("AUP") and provide the P2P lending service with a report in respect of the calculation of its NTA during its accounting period, including the calculation of its NTA as at its balance date performed on the basis of its audited annual financial statements ▶ Send the FMA a copy of the report, including a copy of the P2P lending service's NTA calculation as at its balance date, by the earlier of (1) five working days after the audit report on its annual financial statements is signed and (2) four months and five working days after the end of its accounting period. As part of the AUP, the qualified auditor must obtain all NTA calculations performed by the P2P lending service during the accounting period and, for each calculation include in the report (1) the date that the calculation relates to, (2) the date the calculation is recorded as having been prepared and (3) the value of the NTA calculated. The AUP must also include the following procedures (or procedures to achieve the same outcome) for the P2P lending service's NTA calculation as at its balance date, based on its audited financial statements: ▶ Re-perform the P2P lending service's NTA calculation ▶ Check that each component of the NTA calculation agrees with the relevant information in the P2P lending service's audited annual financial statements (or, where the information is not included in those financial statements, agree it to appropriate accounting records or other relevant documentation) ▶ If the P2P lending service has intangible assets or related-party receivables in its audited annual financial statements, determine whether an adjustment has been made for those in the NTA calculation ▶ For any adjustment for subordinated debt made when calculating adjusted liabilities, check that (1) an executed deed of subordination exists and (2) the amount that has been classified as subordinated debt is not repayable within one year from the date of the NTA calculation and enquire of the P2P lending service whether it has provided any guarantees during the accounting period and note any that have not been included in the NTA calculation

Note that condition 7 does not apply to a P2P lending service that is a registered bank, a non-bank deposit taker (as defined in the FMC Act), or a licensed insurer.

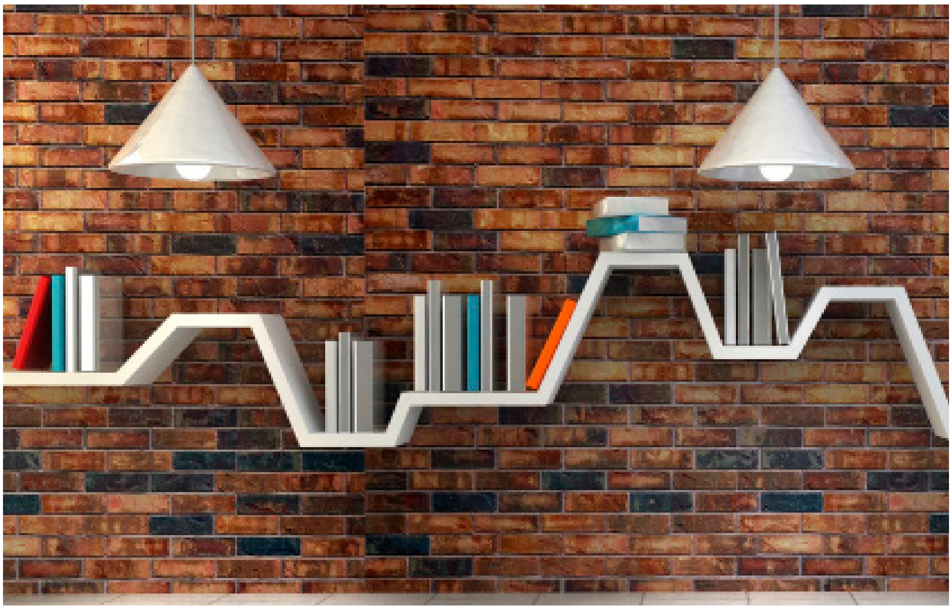
Condition 7 also does not apply to a P2P lending service that is a market participant requiring capital under the NZX Participant Rules ("NZX Rules"), provided that the P2P lending service:

- Is not exempt from the capital adequacy requirements in the NZX Rules
- Complies with the capital adequacy requirements in the NZX Rules
- Provides the FMA with copies of any notification given by it to the NZX if its net tangible current assets (as defined in the NZX Rules) is at any time less than 120% of its prescribed minimum capital adequacy (this information must be provided at the same time as it is provided to the NZX)
- Provides the FMA with copies of the final version of any reports from the NZX relating to its compliance or non-compliance with the capital adequacy requirements in the NZX Rules
- Notifies the FMA if it ceases to be subject to regulation by the NZX as soon as reasonably practicable.

The full standard licence conditions for P2P lending services are available **here**.

In addition to these standard licence conditions, the FMA may impose additional specific licence conditions on individual P2P lending services on a case by case basis.

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



BDO PUBLICATIONS

The **Audit** section of our website includes a range of publications on accounting standards issues. For example:

- **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.

The **BDO Global** site 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 16 *Leases* (July 2016), IFRS 9 (2014) *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), and *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 15 *Revenue from Contracts with Customers - Transition* (July 2016), IFRS 15 *Revenue from Contracts with Customers* (July 2016), IFRS 11 *Joint Arrangements* (Feb 2016), IFRS 9 *Financial Instruments* (Oct 2015), 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 *The implementation of IFRS 9 requirements by banks*, IASB ED 2015-08 *IFRS Practice Statement: Application of Materiality to Financial Statements*, IASB ED 2015-11 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – Proposed amendments to IFRS 4*, 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* and Basel Committee on Banking Supervision – Guidance on accounting for expected credit losses.

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