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ACCOUNTING ALERT

OCTOBER 2016

COMMON ERRORS IN ACCOUNTING FOR IMPAIRMENT – PART 2B

FMA STANDARD LICENCE CONDITONS FOR CROWDFUNDING

THE ROLE OF THE AUDIT COMMITTEE IN RELATION TO AUDIT QUALITY

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COMMON ERRORS IN ACCOUNTING FOR IMPAIRMENT – PART 2B

Continuing on from August's article on common errors in accounting for impairment, the following highlights instances where, despite the accounting standards being very clear on a particular accounting treatment, Tier 1 and Tier 2 preparers regularly ignore the clear instructions in the standard, resulting in their financial statements being potentially materially misstated.

While estimating an asset's recoverable amount requires a great degree of judgement and estimation, in a number of cases there are a set of very clear rules, which are commonly overlooked. These include:

- Not testing for impairment when the standard clearly requires it
- Not testing for impairment at the correct 'unit of account'
- Not including the correct assets in the impairment test
- Basic errors in determining recoverable amount
  - Basic errors in determining 'value in use'
  - Basic errors in determining 'fair value less cost of disposal'

In August's article (Part 2a), we identified 10 common errors preparers make when determining value in use (VIU) for recoverable amount calculations under NZ IAS 36 *Impairment of Assets*. This month Part 2b covers more common errors relating to VIU calculation, including:

- Projections of cash outflows required to get an asset ready for use
- Avoid double-counting cash flows
- Cash flows shall only include those for the asset in its current condition
- Not including refurbishment costs (day-to-day servicing)
- Including cash inflows or outflows from financing activities in the VIU model
- Treatment of income tax receipts or payments
- Estimating the net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life
- Foreign currency future cash flows.

Projections of cash outflows required to get an asset ready for use

If an asset is not yet ready for use, cash flows to get that asset ready for use must be included in the VIU model.

> When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, the estimate of future cash outflows includes an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale. For example, this is the case for a building under construction or for a development project that is not yet completed.
>
> **NZ IAS 36, paragraph 42 Example 9**

Example 9

Entity H is testing an intangible not yet ready for use for impairment.

Carrying value is $10,000,000.

VIU calculation is based on the forecast EBITDA. The asset is forecast to start generating revenue in nine months' time.

Entity H determines the VIU using a 10% discount rate as follows:

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
EBITDA	600	1,000	3,000	4,000	6,000
10% discount rate	$545.45	$826.45	$2,253.94	$2,732.05	$3,725.53

The recoverable amount is determined to be $10,083,430 and Entity H concludes that no impairment charge is to be recognised (carrying amount is $10 million).

Entity H forecasts that a further $700,000 development spend is required to complete the asset.

Correct VIU calculation is therefore as follows:

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
EBITDA	600	1,000	3,000	4,000	6,000
Capital spend	(700)				
Cash flows	(100)	1,000	3,000	4,000	6,000
10% discount rate	-$90.91	$826.45	$2,253.94	$2,732.05	$3,725.53

Recoverable amount is $9,447,060 and an impairment charge of $552,940 should have been recognised ($10,000,000-9,447,600).

Common Error 11 – Cash flows to get an asset ready for use

VIU model does not include cash outflows required to get an asset ready for use.

Avoid double-counting cash flows

To avoid double-counting, estimates of future cash flows do not include:

a) cash inflows from assets that generate cash inflows that are largely independent of the cash inflows from the asset under review (for example, financial assets such as receivables); and

b) cash outflows that relate to obligations that have been recognised as liabilities (for example, payables, pensions or provisions).

NZ IAS 36, paragraph 43

Double counting cash flows from working capital - Cash inflows from other assets on the statement of financial position.

When preparing VIU calculations, preparers must be careful not to 'double count' cash flows from assets recognised separately on the entity's statement of financial position, that are independent from the asset being tested for impairment. This particularly relates to the receipts from trade receivables, receipts of refundable GST, and the receipts from the sale of finished inventory.

Example 10

Manufacturer A prepares a VIU cash flow model using its forecast EBITDA budget as its basis. Manufacturer A typically has an inventory turnover of 120 days.

At 31 December 2016, it has 90 days of finished goods on hand and 60 days of work in progress.

It tests the long-term assets (goodwill and PPE) for impairment, without adjusting the EBITDA forecasts for working capital associated with inventory on hand.

Commentary - Assuming the entity sells goods on 90 day credit terms, and has at least 90 days finished goods on hand, the entity will not receive any cash from the producing assets for 180 days. The cash flow model must be adjusted for this.

Example 11

Entity I has 90 day credit terms and sells approximately 25% of its annual sales in June each year.

At the year-end, 30 June 2016, Entity I has trade receivables of $10 million, which will be collected as follows:

- $1 million in July 2016
- $2 million in August 2016
- $7 million in September 2016

Entity I uses its 30 June 2017 cash flow forecast as the basis for its VIU at 30 June 2016, without any adjustment for working capital.

Commentary - The cash flow model includes $10 million of cash flows that are not being generated by the assets which are being tested for impairment.

Commor Error 12 – Double counting cash inflows for working capital

Double counting cash inflows for receivables and inventory in VIU impairment testing.

Double counting cash flows from working capital - Inclusion/ exclusion of liabilities

In a similar manner to adjustments required to VIU models in respect of assets recognised separately on the statement of financial position (receivables and inventories), preparers should be aware of adjustments required for working capital adjustments to be made for liabilities on the statement of financial position that represent future obligations to pay out cash. This includes trade payables, accrued wages, provisions for restoration, etc.

An area that can commonly lead to errors is the recognition of deferred revenue liabilities when determining VIU, and incorrectly deducting this liability from the carrying value of the asset to be impaired.

Example 12

Software Co sells software licences.

It receives 100% of the sales proceeds when it sells the licence, and recognises a deferred revenue liability. It then recognises revenue over the life of the licence.

Software Co has assets (goodwill and intangibles) of $10 million and a deferred revenue amount of $2 million. When determining the value of the asset to be tested for impairment, it models out its cash flows, using expected cash inflows and adjusting for working capital in respect of trade receivables and trade payables.

It deducts the deferred revenue amount from the carrying value of the producing assets.

Commentary - By its nature, cash has already been received for the deferred revenue, therefore there should be no adjustmentsin VIU model.

Common Error 13 – Double counting deferred revenue liabilities

Deducting deferred revenue liabilities from CGU assets when determining carrying amount of CGU assets tested for impairment.

Cash flows shall only include those for the asset in its current condition

Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from: a) a future restructuring to which an entity is not yet committed; or b) improving or enhancing the asset's performance.

NZ IAS 36, paragraph 44

Because future cash flows are estimated for the asset in its current condition, value in use does not reflect: a) cash outflows or related cost savings (for example reductions in staff costs) or benefits that are expected to arise from a future restructuring to which an entity is not yet committed; or b) future cash outflows that will improve or enhance the asset's performance or the related cash inflows that are expected to arise from such outflows.

NZ IAS 36, paragraph 45

Factoring restructuring into the VIU

NZ IAS 36, paragraph 12(g) requires an entity to test for impairment when 'evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.' In such cases, it is reasonable to expect the entity to take actions to return the asset to its anticipated economic performance. This can be through reorganisations, cost cuttings, redundancies, etc. Preparers must be careful not to include cost savings from a planned restructuring unless they can demonstrate that they are clearly committed to such a plan.

There would appear to be an alignment with this requirement, and the entity recognising a redundancy provision under NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. NZ IAS 36, paragraphs 44(a) and 45(a) clearly prohibit inclusion of savings from restructuring for which an entity is not committed.

Example 13

Publisher A has two operating segments:

- Print publishing
- Online publishing

In November 2016, it prepares its annual budget for 2017, which shows a significant downturn in the profitability of the print publishing division. This triggers the requirement to test the print publishing assets for impairment (NZ IAS 36, paragraphs 9 and 12 (g)).

Concurrent with modelling the VIU, a plan is derived to restructure the operation and merge the print and online businesses, resulting in savings through reducing head count by 100, mainly through reducing duplication of functions (sales, admin and editorial).

At 31 December 2016 this plan has not been communicated to management, staff or to the market. Publisher A incorrectly includes the anticipated savings and concludes that there is no impairment.

Common Error 14 – Restructuring

Including increased cash inflows from a restructuring to which an asset is not yet committed.

Factoring in enhancements into a VIU model

Entities may also look to improve the performance of an asset by making technological enhancements to the asset. Again, NZ IAS 36, paragraph 44 assumes that cash flows are estimated for the asset in its current condition, and paragraphs 44(b) and 45(b) prohibit the inclusion of the impacts of enhancements to an asset to which it is not yet contractually committed.

Until an entity incurs cash outflows that improve or enhance the asset's performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from the increase in economic benefits associated with the cash outflow (see Illustrative Example 6).

NZ IAS 36, paragraph 48

Example 14

In October 2016, Manufacturer forecasts operating losses in its manufacturing operation in Auckland.

Manufacturer's factory is over 30 years old, and management recognise that in order to compete with more modern factories operating in Taiwan, approximately $100 million of investment is required.

In accordance with NZ IAS 36, paragraph 9, the manufacturing operation is tested for impairment. The VIU includes the cost of $100 million for the required factory enhancements, together with the adjusted capacity and operating costs, and revenue forecasts from these enhancements.

This shows there is no impairment. The entity is in the process of selecting the supplier for these enhancements (i.e. not yet committed).

These enhancements cannot be included in the VIU model because they do not represent cash flows of the refinery in its current condition.

Common Error 15

Including increased cash inflows from improving or enhancing the asset's performance which do not represent future cash flows of the asset in its current condition.

Not including refurbishment costs (day-to-day servicing)

Estimates of future cash flows include future cash outflows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition. When a cash-generating unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.

NZ IAS 36, paragraph 49

Example 15

A CGU comprises a mine, mining equipment, a processing plant and trucks.

The mine has a forecast useful life of 20 years.

The processing plant will require a midlife overhaul after ten years and trucks will need to be fully replaced after ten years.

The VIU model incorrectly excludes the cost of the mid-life refurbishment of the processing plant and the cost of replacing the trucks in ten years.

Example 16

A hotel owner estimates the useful life of its hotel to be 20 years.

It uses a VIU model showing a steady revenue stream between years six and 20, assuming that it will be able to operate as a five star hotel in that city, and that demand and supply for hotel beds will remain in equilibrium.

In order to maintain its position as a five star hotel, it forecasts that it will have to undertake significant renovations every seven years to both its rooms and food and beverage outlets.

The VIU model incorrectly excludes the cost of these refurbishments.

Common Error 16

Not including future cash flows necessary to maintain the level of economic benefits expected to arise from the asset in its current condition.

Including cash inflows or outflows from financing activities in the VIU model

Estimates of future cash flows shall not include:

- cash inflows or outflows from financing activities; or
- income tax receipts or payments.

NZ IAS 36, paragraph 50

Estimated future cash flows reflect assumptions that are consistent with the way the discount rate is determined. Otherwise, the effect of some assumptions will be counted twice or ignored. Because the time value of money is considered by discounting the estimated future cash flows, these cash flows exclude cash inflows or outflows from financing activities. Similarly, because the discount rate is determined on a pre-tax basis, future cash flows are also estimated on a pre-tax basis.

NZ IAS 36, paragraph 51

Example 17

Entity J borrows $100 million to finance the construction of its new factory.

It incurs cash outflows of $10 million per annum servicing this debt.

It wrongly includes these cash outflows in its VIU model.

Example 18

Entity K forecasts that its operation will generate significant cash surpluses which it intends to place on deposit in high yield fixed rate bonds. It wrongly includes the forecast interest income in its VIU model.

Common Error 17

Including cash inflows or outflows from financing activities in the VIU model.

Treatment of income tax receipts or payments

As the VIU model must use the pre-tax interest rate, it is incorrect to include cash receipts or payments in respect of income tax.

Example 19

Entity L has a CGU with a carrying value of $10 million and determines its VIU to be $4,058,000 by wrongly including a 30% tax charge. It recognises an impairment loss of $2,942,000.

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Profit before tax	600	1,000	3,000	4,000	6,000
Tax @ 30%	(180)	(300)	(900)	(1,200)	(1,800)
Cash flows	420	700	2,100	2,800	4,200
10% discount rate	$381.82	$578.51	$1,577.76	$1,912.44	$2,607.87

The above VIU model should have recorded no impairment charge because without the deductions for tax payments, the recoverable amount would have exceeded $10,000,000 (refer table below).

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Profit before tax	600	1,000	3,000	4,000	6,000
Cash flows	600	1,000	3,000	4,000	6,000
10% discount rate	$545.45	$826.45	$2,253.94	$2,732.05	$3,725.53

Common Error 18

Including income tax receipts or payments in the VIU model.

Estimating the net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life

The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life shall be the amount that an entity expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the estimated costs of disposal.

NZ IAS 36, paragraph 52

Example 20

Entity M prepares the following VIU model for a CGU with a carrying amount of $10 million.

It determines the recoverable amount to be $9,773,000 and recognises an impairment loss of $227,000.

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Profit before tax	600	1,000	3,000	4,000	5,500
Cash flows	600	1,000	3,000	4,000	5,500
10% discount rate	$545.45	$826.45	$2,253.94	$2,732.05	$3,415.07

The VIU model incorrectly excluded the forecast scrap value ($500,000) of disposing of all of the assets that should have been included in the VIU model. This resulted in a VIU of $10,083,000 with no impairment write-down.

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Profit before tax	600	1,000	3,000	4,000	5,500
Sale proceeds					500
Cash flows	600	1,000	3,000	4,000	6,000
10% discount rate	$545.45	$826.45	$2,253.94	$2,732.05	$3,725.53

Common Error 19

Not including the net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life in the VIU model.

Estimating the fair value

The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life is determined in a similar way to an asset's fair value less costs of disposal, except that, in estimating those net cash flows: a) an entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and have operated under conditions similar to those in which the asset will be used. b) the entity adjusts those prices for the effect of both future price increases due to general inflation and specific future price increases or decreases. However, if estimates of future cash flows from the asset's continuing use and the discount rate exclude the effect of general inflation, the entity also excludes this effect from the estimate of net cash flows on disposal.

NZ IAS 36, paragraph 53

Example 21

Entity N prepares the following VIU model for a CGU with a carrying amount of $10 million.

It determines the recoverable amount to be $10,083,000 assuming that the scrap value of the equipment, including the impact of inflation, over the next five years of 5% per annum is $500,000.

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Profit before tax	600	1,000	3,000	4,000	5,500
Sale proceeds					500
Cash flows	600	1,000	3,000	4,000	6,000
10% discount rate	$545.45	$826.45	$2,253.94	$2,732.05	$3,725.53

The discount rate of 10% excludes inflation. Therefore the estimated fair value of the sale value of the asset should not have been adjusted for inflation and should instead have been recorded at $300,000 with an impairment loss of $41,000 (refer table below).

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Profit before tax	600	1,000	3,000	4,000	5,500
Sale proceeds					300
Cash flows	600	1,000	3,000	4,000	5,800
10% discount rate	$545.45	$826.45	$2,253.94	$2,732.05	$3,601.34

Common Error 20

Incorrectly estimating the net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life in the VIU model.

Foreign currency future cash flows

Future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency. An entity translates the present value using the spot exchange rate at the date of the value in use calculation.

NZ IAS 36, paragraph 54

Example 22

Entity O has an asset with a carrying value of $10 million.

It has cash inflows in USD and translates the forecasted cash flows at the forward rates available for the next two year period, then takes a consensus view with a steady weakening of the New Zealand dollar. The VIU recoverable amount is calculated as $11,892,000 and Entity O records no impairment loss.

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Sales proceeds USD	2,700	2,700	2,700	2,700	2,700
Exchange rate	0.70	0.65	0.60	0.58	0.57
Sales proceeds NZD	3,857	4,154	4,500	4,655	4,737
Costs in NZD	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)
Net cash flows	2,657	2,954	3,300	3,455	3,537
10% discount rate	$2,415.58	$2,441.20	$2,479.34	$2,359.93	$2,196.10

The spot rate was 0.74 and the VIU impairment model should have been as follows:

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Sales proceeds USD	2,700	2,700	2,700	2,700	2,700
Exchange rate	0.74	0.74	0.74	0.74	0.74
Sales proceeds NZD	3,649	3,649	3,649	3,649	3,649
Costs in NZD	(1,200)	(1,200)	(1,200)	(1,200)	(1,200)
Net cash flows	2,449	2,449	2,449	2,449	2,449
10% discount rate	$2,226.04	$2,023.68	$1,839.71	$1,672.46	$1,520.42

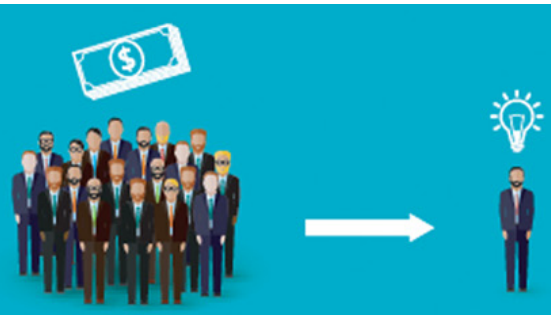
This results in a recoverable amount of $9,282,000 and an impairment loss of $718,000.

Common Error 21

An entity translates foreign currency cash flows at a rate other than the prevailing spot rate.

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

STANDARD CONDITIONS ISSUED FOR CROWDFUNDING 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 crowdfunding 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 crowdfunding 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 crowdfunding 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 crowdfunding service that outsources a process/system necessary to the effective and proper running of the crowdfunding 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 crowdfunding service to meet its market services licensee obligations ▶ Have a legally binding agreement with the provider ▶ Ensure that records pertaining to the crowdfunding service are available for inspection when requested by the FMA.
Condition 3: Records	A crowdfunding 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 crowdfunding service's on-going capability to effectively perform the crowdfunding service in accordance with the applicable eligibility criteria in the Financial Markets Conduct Act 2013 ("FMC Act").
Condition 4: Regulatory returns	A crowdfunding service must provide the FMA with the information it needs to monitor the crowdfunding service's on-going capability to effectively perform the crowdfunding 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 crowdfunding service. Information must be provided in accordance with any requirements issued under the FMC Act.
Condition 5: Compliance	A crowdfunding 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 crowdfunding 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 crowdfunding service applied for its licence (or any subsequent change advised to the FMA). A crowdfunding 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 crowdfunding 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 crowdfunding service did not have positive NTA, the crowdfunding 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 crowdfunding 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 crowdfunding 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 crowdfunding service must: ▶ Engage a qualified auditor to perform agreed upon procedures ("AUP") and provide the crowdfunding 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 crowdfunding 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 crowdfunding 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 crowdfunding service's NTA calculation as at its balance date, based on its audited financial statements: ▶ Re-perform the crowdfunding service's NTA calculation ▶ Check that each component of the NTA calculation agrees with the relevant information in the crowdfunding 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 crowdfunding 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 crowdfunding service whether it has provided any guarantees during the accounting period and note any that have not been included in the NTA calculation.
Condition 8: Restriction on offers by nominee companies	A crowdfunding service must not, without the prior written consent of the FMA, allow a nominee company (which is defined as a company which is in substance being used as a conduit for investment in a single financial product) to raise capital through its crowdfunding service, unless the financial product in which the nominee company invests is itself a financial product that is able to be offered through a crowdfunding service. A crowdfunding service must not make, or allow any company using its crowdfunding service to make, any statement to the effect that the FMA endorses the company, or the structure of the company, raising capital through its crowdfunding service.

Note that condition 7 does not apply to a crowdfunding 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 crowdfunding service that is a market participant requiring capital under the NZX Participant Rules ("NZX Rules"), provided that the crowdfunding 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 crowdfunding services are available here.

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

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

THE ROLE OF THE AUDIT COMMITTEE IN RELATION TO AUDIT QUALITY

Under the Auditor Regulation Act 2011, the Financial Markets Authority ("FMA") is required to ensure that a quality review of the systems, policies and procedures of licensed auditors and registered audit firms (i.e. those auditors and audit firms licensed to audit FMC reporting entities) is carried out at least once every four years. The FMA releases an annual report summarising the quality reviews that have been undertaken in the preceding year.

In December 2015 the FMA released its audit quality report for the year to 30 June 2015. This was the third annual report prepared by the FMA. During those three years, the FMA carried out at least one review of every registered audit firm.

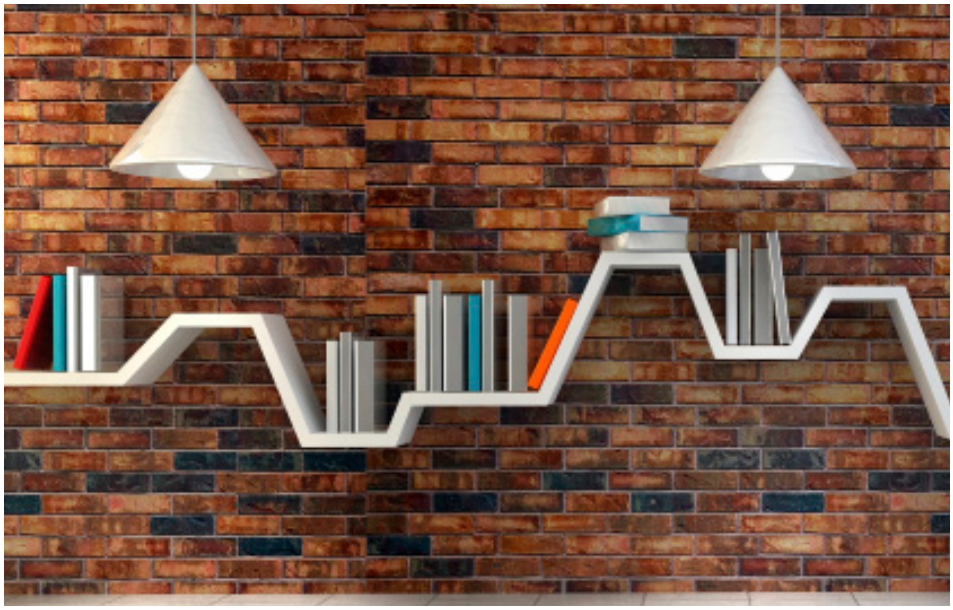
Although the report principally provides information of relevance to auditors, the FMA considers that audit committees/directors of FMC reporting entities have an important role to play in ensuring high audit quality. Consequently, the FMA's report includes a number of suggested improvements for audit committees. These suggestions are summarised in the table below:

AREA FOR IMPROVEMENT	FMA COMMENTS
Auditor independence	Audit committees and directors of FMC reporting entities should: ▶ Emphasise the need for high standards of reporting of independence threats by their auditors ▶ Challenge auditors on the safeguards they have in place to protect their independence, particularly when non-audit fees are high relative to the audit fee ▶ Consider engaging other audit firms for non-audit services.
Monitoring of audit quality	Audit committees and directors of FMC reporting entities should: ▶ Look to contribute to a high quality audit, by ensuring that the business has appropriate policies and procedures to address complex accounting issues or business transactions, and not solely rely on their auditor to address such issues ▶ Require active involvement from management to ensure appropriate audit evidence is provided to the auditors ▶ Discuss with audit firms their policies and procedures for reviewing their internal quality.
Professional scepticism	Audit committees and directors of FMC reporting entities should: ▶ Encourage professional scepticism from their auditors ▶ Discuss the work performed and the concerns auditors have regarding management's key judgements ▶ Provide high quality audit evidence to support assumptions made in the key judgement areas of the financial statements.
Using a management or auditor's expert	Audit committees and directors of FMC reporting entities could improve the quality of experts' reporting by: ▶ Ensuring that the scope of an expert's work for material valuations is discussed between the directors, management, the expert and the auditor ▶ Where experts disclaim items regarding the reliability of data or assumptions used, ensuring that the effect of these disclaimers and the level of uncertainty is clearly documented in the expert's report.
Responsibilities relating to fraud	Audit committees and directors of FMC reporting entities could improve their oversight of fraud risks in the audit process by discussing with their auditor: ▶ Fraud risk factors ▶ The controls the business has in place to mitigate the risk of material misstatement in the financial statements due to fraud ▶ How the auditor has concluded on the audit procedures to respond to the risks of material misstatement due to fraud.
Materiality	Audit committees and directors of FMC reporting entities should understand: ▶ The basis for the materiality levels set ▶ How these materiality levels reflect the needs and expectations of those who use the financial statements ▶ How materiality levels affect the extent of audit work undertaken in significant areas.

Although the FMA's suggestions specifically relate to the audit committees of FMC reporting entities, they are also relevant to the directors of any entity that is audited.

The full report is available here.

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



BDO PUBLICATIONS

The **Audit** section of our website (**https://www.bdo.nz/en-nz/services/audit-assurance**) 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 **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.

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

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