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# ACCOUNTING

MAY 2016

## *ALERT*



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# ACCOUNTING ALERT

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## FINANCIAL MARKETS AUTHORITY CONSULTS ON EXEMPTIONS FOR SMALL OFFERS OF CO-OPERATIVE SHARES

**Co-operative companies** and **industrial and provident societies** ("IPSS") currently benefit from class exemption relief from some of the requirements of the Securities Act 1978. However these entities will need to comply with the requirements of the Financial Markets Conduct Act 2013 ("FMC Act") by 30 November 2016 when they offer financial products.

The Financial Markets Authority ("FMA") has issued a Consultation Paper ("Exemptions for small offers of co-operative shares"). The paper (which is available [here](#)) examines whether co-operative companies and IPSSs should be granted any class exemptions from the requirements of the FMC Act (note that this relief would be additional to the relief already available in relation to offers of co-operative shares under the FMC Act). The FMA considers that, in most cases, co-operative companies and IPSSs making offers of equity securities or debt securities will be able to comply with the requirements of the FMC Act. However, the FMA does consider that, in some limited cases, a class exemption may be appropriate.

### Proposed exemptions

The FMA is proposing an FMC Act class exemption that would provide a lighter compliance path for offerors of co-operative shares where a shareholder is only required to pay the offeror a small amount in order to transact or enjoy membership benefits. This exemption would allow co-operative companies and IPSSs to make these small offers without having to prepare disclosure documents or comply with the financial reporting and audit requirements of the FMC Act.

The FMA proposes providing this relief where:

- ▶ There is tight linkage between the shares issued and the shareholder's transacting or member relationship with the offeror (this would mean that the exemption would only be available where co-operative shares were being offered to enable shareholders to transact, or enjoy membership benefits, with the offeror)
- ▶ The total amount a shareholder is required to pay for the shares to transact, or enjoy membership benefits, with the offeror is small.

What constitutes "small" will depend on the specific circumstances under which the entity issues shares. People pay for co-operative shares in order to transact, or enjoy membership benefits, with a co-operative company or an IPS in two ways:

- ▶ A subscription(s) for a fixed number of shares (situation 1)

- ▶ A subscription(s) for shares, where the required number of shares subscribed for is determined based on the volume of business the person transacts with the issuer, or the value of other membership benefits gained (situation 2).

Given that, the FMA is proposing that "small" means meeting one of the following criteria:

- ▶ Where shares are required to be subscribed for in order for the member to transact, or enjoy membership benefits, with the offeror, the maximum total capital investment per shareholder is \$1,000 (this might apply in both situations 1 and 2); or
- ▶ Where the above does not apply, the value paid per co-operative share under the offer is less than 5% of the benefits received by a shareholder for each co-operative share held. This would apply in situation 2 only.

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

A co-operative company, which is incorporated under the Companies Act 1993 and registered under the Co-operative Companies Act 1996, allows its owners to carry on business on a mutual basis. Transacting shareholders must hold at least 60% of the voting rights in a co-operative company. A dairy farmer supplying milk to a co-operative dairy company is a transacting shareholder, as is a plumber buying equipment from a plumbing supply co-operative company.

Industrial and provident societies must be registered under the Industrial and Provident Societies Act 1908. They must be incorporated and registered as a co-operative society or conduct business for charitable purposes. Like co-operative companies, they are structured to group shareholders with similar interests under a single organisation.



# FMA IDENTIFIES REQUIRED IMPROVEMENTS TO FINANCIAL REPORTING BY DERIVATIVE ISSUERS

The Financial Markets Authority ("FMA") has recently released a report, entitled "Improving financial reporting by derivative issuers" ("the Report"), which outlines areas in which the FMA considers derivative issuers could improve their financial reporting.

The Report was prepared following the FMA's review of a sample of six derivative issuers' financial statements with a balance date of 31 March 2015. These were the first financial statements to be registered by derivative issuers under the Financial Markets Conduct Act 2013.

The review focused on disclosures made in relation to the new capital and liquidity requirements that derivative issuers are subject to, on the basis that users of derivative issuers' financial statements are likely to find information about compliance with these requirements useful to their decision making. The FMA identified that improvements are required in relation to:

- ▶ Capital management disclosures
- ▶ Cash and liquid assets disclosures.

## Capital management disclosures

The Report noted that NZ IAS 1 *Presentation of Financial Statements* ("NZ IAS 1") requires issuers to disclose information that enables users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital. Required disclosures include:

- ▶ The nature of externally imposed capital requirements (for example, FMA or NZX requirements)
- ▶ Summary quantitative data about capital (for example, the value of net tangible assets ("NTA") relative to the required level of NTA)
- ▶ Whether the issuer has complied with any externally imposed capital requirements, and the impact of any breaches.

The Report noted significant deficiencies in the provision of the required NZ IAS 1 capital management disclosures, with only one of the six derivative issuers reviewed fully complying with the requirements of NZ IAS 1. Common deficiencies included:

- ▶ Not having a capital management note
- ▶ The lack of a clear statement of compliance with the FMA's requirements in relation to NTA
- ▶ Not providing the actual value of NTA.

The Report noted that, in the future, the FMA expects all derivative issuers to have a capital management note that includes:

- ▶ Details of the specific requirements the derivative issuer is subject to, including the minimum NTA the issuer must hold
- ▶ The actual value of the derivative issuer's NTA as at balance date
- ▶ A clear statement on whether or not the derivative issuer has complied with its NTA conditions, and any consequences for breaches.

## Cash and liquid assets disclosures

The Report noted that derivative issuers are required to hold 50% of the value of their required NTA in cash and cash equivalents (excluding cash held relating to client funds) and the rest in liquid assets and that users of the financial statements are likely to find information about compliance with this requirement useful.

The Report noted a number of areas where derivative issuers could improve the information provided about their cash and liquid assets:

AREA REQUIRING IMPROVEMENT	FMA'S COMMENTS
Balance sheet	The Report noted inconsistency in the treatment of client funds (with some derivative issuers recognising client funds held in trust on the balance sheet and others not recognising them, but disclosing their existence).

AREA REQUIRING IMPROVEMENT	FMA'S COMMENTS
(continued) <b>Balance sheet</b>	As the manner in which such funds are accounted for requires the application of professional judgement, the FMA noted that it expects to see clear accounting policies on the matter.
<b>Cash flow statements</b>	The Report noted that, where client funds held in trust are recognised on the balance sheet, they should not be included in cash and cash equivalents, as doing so creates a false impression of the amount of money that the derivative issuer has available for its own use.
<b>Liquidity risk management</b>	NZ IFRS 7 <i>Financial Instruments: Disclosures</i> ("NZ IFRS") requires the provision of both quantitative and qualitative information about liquidity management. The Report noted that, despite this requirement, some of the reviewed derivative issuers did not state that they are subject to liquidity requirements and none of the reviewed derivative issuers disclosed the value of cash and cash equivalents and liquid assets. The FMA noted that such information would be important to users of derivative issuers' financial statements and should be provided.
<b>Cash pledged as collateral</b>	The Report noted that most derivative issuers have pledged large amounts of cash (up to several million dollars) as collateral for hedging or other facilities and that: <ul style="list-style-type: none"> <li>▶ As this cash is restricted and can't be used in the day-to-day operations of the business, it should be separately disclosed.</li> <li>▶ This cash does not qualify as cash and cash equivalents or liquid assets in meeting a derivative issuer's liquidity requirements and should consequently be excluded from liquidity calculations.</li> </ul>

### Other matters

The Report also noted two additional concerns:

- ▶ That some derivative issuers did not provide information about the parties that they used as hedging counterparties (information that should be provided includes where the counterparty is based, which jurisdiction it is regulated in, and information on its credit rating, if it has one)
- ▶ Where derivative issuers make use of value-at-risk analysis to analyse and manage the risk of derivatives products, information on the analysis undertaken should be included in the financial statements, as permitted by NZ IFRS 7.

### Future action

The Report noted that the FMA is prepared to work collaboratively with derivative issuers as they become familiar with the new requirements with which they must comply, but that derivative issuers that fail to meet the FMA's expectations on an ongoing basis may face regulatory action.

The FMA intends to do a follow-up review of derivative issuers' financial statements for the 2016 financial year to see if disclosures have been improved.

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



# STANDARD LICENCE CONDITIONS ISSUED FOR DERIVATIVES ISSUERS

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 derivatives issuers. 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:

<b>Condition 1:</b> <b>Prohibition on dealing with unregulated financial services providers</b>	An issuer must take reasonable steps to ensure that any broker, introducing broker, or white-label derivatives business who does business using the derivatives issued by the issuer has the required authorisations, licences or registrations for the jurisdictions it operates in.
<b>Condition 2:</b> <b>Outsourcing</b>	An issuer that outsources a process/system necessary to the effective and proper running of its derivatives issuer service (or any other market services licensee obligation) must: <ul style="list-style-type: none"> <li>▶ Be satisfied that the provider is capable of performing the service to the standard required to enable the issuer to meet its market services licensee obligations</li> <li>▶ Have a legally binding agreement with the provider</li> <li>▶ Ensure that records pertaining to the derivatives issuer service are available for inspection when requested by the FMA.</li> </ul>
<b>Condition 3:</b> <b>Records</b>	An issuer must: <ul style="list-style-type: none"> <li>▶ Have systems and procedures to maintain relevant records pertaining to its market service</li> <li>▶ Provide the FMA with the records it needs to monitor the issuer's on-going capability to effectively perform as a derivatives issuer in accordance with the applicable eligibility criteria in the Financial Markets Conduct Act 2013 ("FMC Act").</li> </ul>
<b>Condition 4:</b> <b>Regulatory returns</b>	An issuer must provide the FMA with the information it needs to monitor the issuer's on-going capability to effectively perform the derivatives issuer 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 issuer's derivative issuer service. Information must be provided in accordance with any requirements issued under the FMC Act.
<b>Condition 5:</b> <b>Compliance</b>	An issuer 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.

<b>Condition 6:</b> <b>Governance arrangements:</b>	<p>An issuer'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 issuer applied for its licence (or any subsequent change advised to the FMA).</p> <p>The issuer 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).</p>
<b>Condition 7:</b> <b>Financial resources – Solvency</b>	<p>The issuer must be solvent at all times, which means that it must meet both limbs of the solvency test in the Companies Act 1993 (i.e. it must be able to pay its debts as they become due in the normal course of business and the value of its assets must be greater than the value of its liabilities, including contingent liabilities).</p>
<b>Condition 8:</b> <b>Financial resources – Cash flow</b>	<p>The issuer must:</p> <ul style="list-style-type: none"> <li>▶ Prepare within one month prior to balance date and the date six months after balance date, a rolling forecast of cash flows over the next 12 months based on the issuer's reasonable estimates of revenue, expenses and other cash flow items over the term – the forecast should be broken down into intervals of no longer than a month</li> <li>▶ Document the calculations and assumptions used in preparing the cash flow forecasts, and explain in writing why the assumptions are appropriate</li> <li>▶ Have the cash flow forecast approved by its board of directors or governing body as being reasonable estimates of receipts and payments over the period</li> <li>▶ Review its actual cash flows against the cash flow forecast promptly following the end of each calendar month, and document the reasons for any significant variations</li> <li>▶ Update its cash flow forecast if there is a reason to suspect an updated projection would show it is not meeting, or will not continue to meet, the applicable financial resource requirements</li> <li>▶ Demonstrate, based on the cash flow projection, that it will have access, when needed, to enough financial resources to meet its liabilities over the projected term, including any additional liabilities it projects may be incurred during that term and any reasonably foreseeable contingencies</li> <li>▶ Demonstrate, based on the cash flow projection, that it will have in cash or cash equivalents, at all times to which the projection relates, an amount equal to or greater than the amount that it is required to have in cash or cash equivalents under the net tangible assets ("NTA") requirement (see below)</li> <li>▶ Make the cash flow projection available to the FMA upon request</li> <li>▶ Provide a report to the FMA within three working days if it knows or suspects that it has ceased (or is likely to cease) to be solvent, or its cash flow forecast shows that its forecast cash expenditure exceeds its cash on hand and forecast cash receipts.</li> </ul>
<b>Condition 9:</b> <b>Financial resources – Net tangible assets</b>	<p>An issuer's NTA must always be at least the greater of \$1,000,000 or 10% of its average revenue (note that the manner in which NTA must be calculated is explained in an appendix to the standard licence conditions). At least 50% of the required NTA must be in cash or cash equivalents (excluding any cash or cash equivalents that are held in respect of any liability or obligation to clients) and any remaining balance must be held in either additional cash or cash equivalents, or other liquid assets.</p> <p>NTA must be calculated:</p> <ul style="list-style-type: none"> <li>▶ As at the last date of each month or, if the issuer's balance date is not the last day of a month, as at the same date as the balance date each month</li> <li>▶ As at any other date on which there is a reason to suspect that NTA has decreased from the amount shown in the last calculation to a level that is less than 110% of the issuer's required NTA.</li> </ul> <p>An issuer must provide specified information to the FMA if either of the following occur:</p> <ul style="list-style-type: none"> <li>▶ The issuer has less than 110% of the required NTA</li> <li>▶ The issuer has less than 100% of the required NTA.</li> </ul> <p>Except with the express written approval of the FMA, an issuer that has 90% or less of its required NTA, or less than 100% of its required NTA for 20 or more</p>



<p>(Continued from previous page)</p> <p><b>Condition 9:</b></p> <p><b>Financial resources – Net tangible assets</b></p>	<p>consecutive working days, must not under any circumstances enter into any transactions with clients that could give rise to any further liabilities, contingent liabilities or other financial obligations.</p>
<p><b>Condition 10:</b></p> <p><b>Financial resources – Risk management</b></p>	<p>An issuer must adequately manage the risks of having insufficient financial resources to meet its financial resource requirements.</p>
<p><b>Condition 11:</b></p> <p><b>Financial resources – Audit requirements</b></p>	<p>Each year, an issuer must engage a qualified auditor to provide the following reports to its board of directors/governing body and the FMA:</p> <ul style="list-style-type: none"> <li>▶ An assurance report on the design and operating effectiveness of its financial resources controls throughout its most recently completed accounting period ("the Assurance Report")</li> <li>▶ A report of factual findings in respect of the NTA calculation as at the end of the most recently completed accounting period on the basis of the audited annual financial statements ("the NTA Report").</li> </ul> <p>The objectives of the Assurance Report are:</p> <ol style="list-style-type: none"> <li>a. To obtain reasonable assurance about whether, in all material respects (1) the controls within the scope of the engagement were suitably designed to achieve compliance with standard conditions 7 to 10 and (2) the controls operated effectively as designed throughout the period</li> <li>b. To express in a written report a reasonable assurance opinion on the matters in (a) above and describe the basis for the opinion.</li> </ol> <p>The qualified auditor must comply with SAE 3150 <i>Assurance Engagements on Controls</i> in forming the reasonable assurance opinion.</p> <p>In order to provide the NTA Report, the qualified auditor must perform an agreed upon procedures engagement. In order to provide the NTA Report based on the issuer's audited annual financial statements, the agreed upon procedures must include the following (or procedures to achieve the same outcome):</p> <ul style="list-style-type: none"> <li>▶ Re-perform the issuer's NTA calculation and report any differences</li> <li>▶ Check that each component of the NTA calculation agrees with the relevant information in the issuer'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)</li> <li>▶ If the issuer has intangible assets or related-party receivables in its audited annual financial statements, recalculate the adjustment required by the NTA calculation and report any differences</li> <li>▶ For any adjustment for subordinated debt made when calculating adjusted liabilities, confirm that an executed deed of subordination exists and confirm whether the amount that has been classified as subordinated debt is not repayable within one year from the date of the NTA calculation</li> <li>▶ Enquire of the issuer whether it has provided any guarantees during the accounting period and note any that have not been included in the NTA calculation.</li> </ul> <p>These reports, and a copy of the issuer's NTA calculation as at its balance date based on the audited financial statements, must be sent to the FMA by the earlier of five working days after the audit report on the annual financial statements is signed, or four months and five working days after the end of the accounting period.</p>
<p><b>Condition 12:</b></p> <p><b>Suitability of products for clients</b></p>	<ul style="list-style-type: none"> <li>▶ Before entering into a derivative with a retail investor, unless the issuer already has the information, it must ask the retail investor to provide information about his/her knowledge, experience and level of understanding of the relevant type of derivative, to enable the issuer to assess whether the derivative is suitable for the individual.</li> <li>▶ When assessing suitability, the issuer must take all reasonable steps to determine whether the retail investor has the ability to understand the particular type of derivative and the risks involved.</li> <li>▶ If, based on the information that it has concerning the retail investor, the issuer considers that the investor does not have the ability to understand the particular type of derivative and the risks involved, the issuer must not enter into that derivative with the investor.</li> <li>▶ If the retail investor does not provide sufficient information for the issuer to assess suitability, the issuer must warn the investor that the issuer is required to request information from the investor in order to assess whether the derivative is suitable for the individual. The warning must note that without such information there is a strong risk that the issuer will not be able to assess whether the investor has the necessary ability to understand the derivative and the risks involved. This warning must also be in writing and prominently displayed. The issuer must strongly advise the investor to provide it with the requested information.</li> </ul>

AREA REQUIRING IMPROVEMENT	FMA'S COMMENTS
<p><i>(Continued from previous page)</i></p> <p><b>Condition 12:</b></p> <p><b>Suitability of products for clients</b></p>	<p>► If a retail investor asks an issuer to go ahead with entering into a derivative in circumstances where the issuer does not have sufficient information to assess whether the derivative is suitable for the individual, despite having given the above warning, the issuer may choose whether or not to go ahead with the transaction having regard to all the circumstances.</p>

Note that the financial resources conditions outlined above (conditions 7 to 11) do not apply to a derivatives issuer that is a registered bank, a non-bank deposit taker (as defined in the FMC Act), or a licensed insurer.

The full standard licence conditions for derivatives issuers are available [here](#).

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

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





# ACCOUNTING ALERT

MAY 2016

## COMMON ERRORS IN CASH FLOW STATEMENTS

The cash flow statement is one of the four primary financial statements and provides extremely valuable (material) information to users, particularly in respect of an entity's liquidity, going concern and general financial health. Together with the basis of preparation note and the auditor's report, when trying to analyse the risk of an entity failing, the cash flow statement is the key statement users should read.

In this article we look at common errors that result in the cash flow statement, prepared under NZ IAS 7 *Statement of Cash Flows*, being misstated. These fall into the following areas:

- ▶ Overstating operating cash inflows
  - Treating operating cash outflows as investing cash flows
  - Treating operating cash outflows as financing cash flows
  - Treating investing cash inflows as operating cash flows
  - Treating financing cash inflows as operating cash flows
- ▶ Grossing up non-cash settlements
- ▶ Netting off transactions
- ▶ Errors with foreign currency
- ▶ Errors in determining what is 'cash' or a 'cash equivalent'.

### Overstating operating cash inflows

#### Treating operating cash outflows as investing cash flows

Showing negative cash outflows from operating activities, or declining cash inflows, is a potential indicator of potential failure, insolvency, etc. Therefore there are incentives for preparers to classify as many items as they can as part of investing activities.

#### NZ IAS 7 definition of 'operating activities'

'Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.'

#### NZ IAS 7:16

'..Only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities.'

For this reason, if expenditure does not create a recognised asset, then it cannot be shown as a cash outflow from investing activities. In particular, this definition closely links with what can be capitalised under NZ IAS 38 *Intangible Assets*. Common mistakes include showing the following as investing cash outflows:

- ▶ Advertising
- ▶ Research
- ▶ Training
- ▶ Initial costs of set up
- ▶ Repairs
- ▶ Spend on exploration activities, where the entity's policy is to expense exploration and evaluation costs.

### Treating operating cash outflows as financing cash flows

NZ IAS 7 requires that financing cash flows include cash repayments of amounts borrowed, and cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Common mistakes include:

- ▶ Treating payments to trade creditors as financing cash flows
- ▶ Treating payments of operating leases as financing cash flows
- ▶ Treating contingent payments on business combinations as financing or investing.

### Treating operating cash outflows as financing cash flows

Common mistakes include:

- ▶ Treating sale proceeds from the sale of available for sale investments as operating cash flows
- ▶ Showing sale proceeds from the disposal of property, plant and equipment (PPE) as operating cash flows
- ▶ Showing sale proceeds from the sale of an associate, JV or a subsidiary as operating cash flows
- ▶ Showing cash receipts on advances and loans made as operating cash flows
- ▶ Showing cash receipts from futures contracts and forward contracts (classified as hedging investing cash flows) as operating cash flows (e.g. hedges taken out for PPE).

Another common error is the treatment of proceeds in respect of deferred consideration for the sale of PPE or a business as operating cash flows.

### Treating financing cash inflows as operating cash flows

Common mistakes include:

- ▶ Showing cash proceeds from issuing shares as operating cash flows
- ▶ Showing cash proceeds from issuing loans, notes, bonds, mortgages and other short-term or long-term borrowings as operating cash flows.

### Grossing up non-cash settlements

A correctly prepared cash flow statement is very important for an investor to be able to analyse the performance of loans, and the ability of the entity to raise equity. A common error is incorrectly grossing up transactions in the cash flow statement.

#### Example 1

Entity A's only asset is a \$10,000 loan to Company B. 10% interest is charged per annum on the loan, payable quarterly in arrears.

Company B is in financial difficulty and is unable to pay interest on the loan. Interest is therefore being capitalised.

	INCORRECTLY GROSSING UP	CORRECTLY TREATED	NOTES	
INCOME STATEMENT				
Interest income	1,000	1,000		
BALANCE SHEET				
Loan receivable	11,000	10,000		
Accrued interest receivable		1,000		
CASH FLOW STATEMENT				
Operating cash inflow				
Interest income	1,000	Nil	Incorrect gross up gives the misleading impression that Company B is actually servicing its debt.	
Investing cash outflow				
Loans to borrowers	(1,000)	Nil		

**Example 2**

Company A issued a convertible note in 2008 containing a 'ratchet' feature.

In 2015, the note was converted into equity by issuing significantly more shares than were originally intended when the note was issued.

The main reason for conversion was the inability of Company A to repay the amount owing on the note.

		INCORRECTLY GROSSING UP	CORRECTLY TREATED	NOTES
<b>CASH FLOW STATEMENT</b>				
<i>Financing cash flows</i>				
Cash raised from equity raise	1,000		Nil	Incorrect gross up creates impression of liquidity (being able to repay borrowings and being able to raise equity)
Repayment of borrowings	(1,000)		Nil	

**Netting off transactions**

Given the specific financing arrangements of an entity, the stability or otherwise of an entity's financing arrangements can be significant to a user. That is, the entity having to repay loans, raise new financing, etc. A common error is to net off loan repayments and new financing.

**Example 3**

Company A reported long-term borrowings of \$10,000 with Big Bank at 30 June 2014. During the year it breached various loan covenants and was forced to refinance with a variety of promissory notes and convertible notes.

		INCORRECTLY NETTING OFF	CORRECTLY TREATED	NOTES
<b>CASH FLOW STATEMENT</b>				
<i>Financing cash flows</i>				
Cash raised from new borrowings	Nil		10,000	Incorrect netting creates impression of stable financing arrangements
Repayment of borrowings	Nil		(10,000)	

**Errors with foreign currency**

The preparation of a cash flow statement is significantly complicated when the group has subsidiaries with a different functional currency to that of the group's presentation currency. Again, errors can occur that lead to the overstatement of operating cash flows. These errors include:

- ▶ Foreign exchange (FX) movements in cash held in the subsidiary's functional currency that is different from presentation currency
- ▶ FX gains and losses on foreign currency loans
- ▶ Incorrectly translating cash receipts from financing activities
- ▶ Incorrectly translating cash payments for investing or financing activities.

**Example 4 - FX movements in cash held in the subsidiary's functional currency that is different from presentation currency**

Exchange rate USD to NZD as at 30 June 2014 was 1: 1.

Exchange rate USD to NZD as at 30 June 2015 was 1: 0.7.

Group's presentation currency is NZD but Subsidiary B has a USD functional currency.

At both 30 June 2014 and 2015, Company B has cash at hand of \$10,000 USD.

This amount translates to \$10,000 NZD as at 30 June 2014 and \$14,286 as at 30 June 2015.

Recognising that there is no profit impact on this translation, there is an amount of \$4,286 when reconciling the opening and closing cash positions. This amount should not be included in operating cash inflows, but is shown as a separate line on the cash flow statement.



**Example 5 - FX movements in cash held in the subsidiary's functional currency that is different from presentation currency**

Exchange rate USD to NZD as at 30 June 2014 was 1: 1.

Exchange rate USD to NZD as at 30 June 2015 was 1: 0.7.

Company A has a USD functional currency. It has long term borrowings of \$10,000 NZD.

This amount translates to \$10,000 USD as at 30 June 2014 and \$7,000 as at 30 June 2015.

This retranslation represents an FX gain in Company A's income statement, but it does not represent an operating inflow.

**Example 6 - Incorrectly translating cash receipts from financing**

The group's presentation currency is NZD but Subsidiary B has a USD functional currency.

The subsidiary borrows \$10,000 (USD) on 31 May 2015. This amount remains unspent at 30 June 2015.

Exchange rate USD to NZD as at 30 June 2014 was 1: 1.

Exchange rate USD to NZD as at 30 June 2015 was 1: 0.7.

Exchange rate USD to NZD at 31 May 2015 was 1: 0.75.

The average USD to NZD exchange rate for the year was 1: 0.90.

The group incorrectly translates the cash receipt at the average annual exchange rate, rather than the exchange rate as at 31 May 2015 (being the receipt of the cash).

Assume the group had no cash as at 1 July 2014.

	INCORRECT TRANSLATION	CORRECTLY TREATED	NOTES
<b>CASH FLOW STATEMENT</b>			
Cash flows from operating activities	\$3,175	Nil	
<b>Financing cash flows</b>			
Cash from financing activities	\$11,111	\$13,333	Incorrectly translated using average FX rates for the year. Should be translated at FX rate on loan date (1:0.75)
Net cash inflows	\$14,286	\$13,333	
Impact of FX on foreign cash balances	Nil	\$953	
Cash at 1 July 2014	Nil	Nil	
Cash at 30 June 2015	\$14,286	\$14,286	

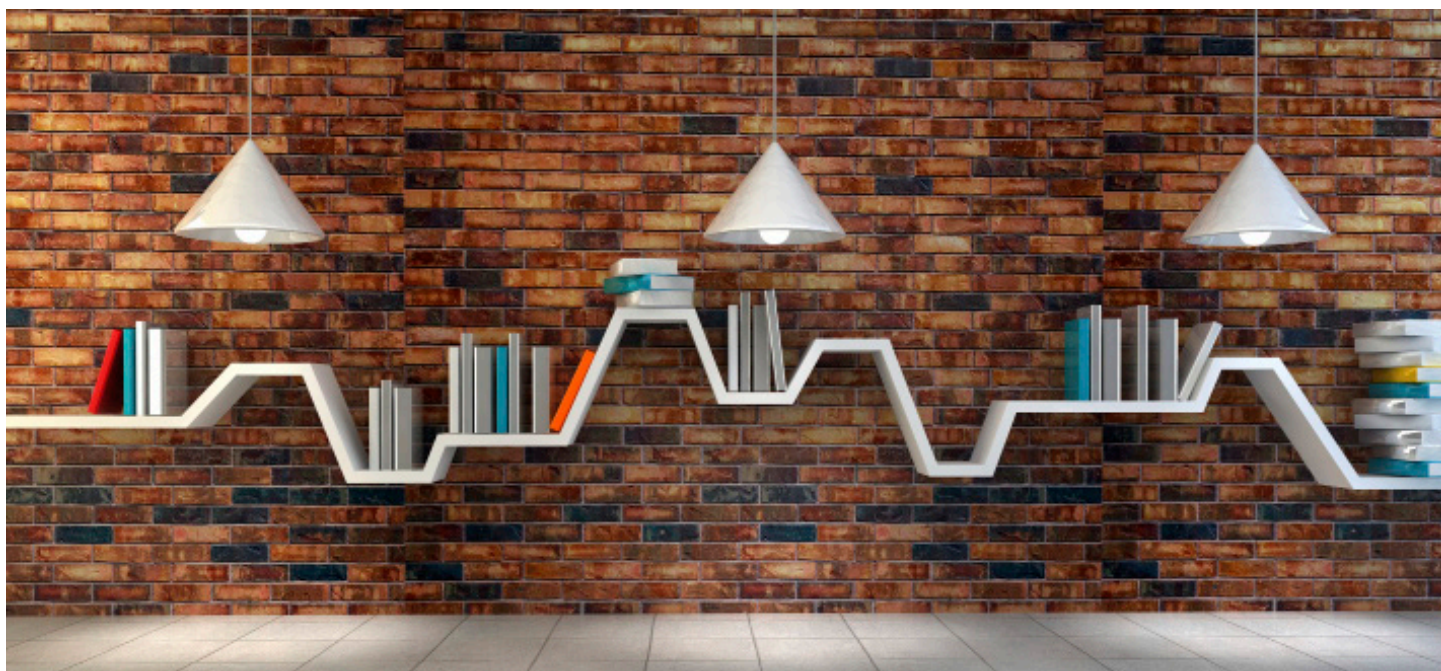
**Errors in determining what is 'cash' or a 'cash equivalent'****NZ IAS 7.7**

'Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition.'

**Common errors in classification**

- ▶ Treating term deposits as cash
- ▶ Treating long-term term deposits with less than three months to maturity as cash
- ▶ Treating investments in equity instruments as cash.

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## BDO PUBLICATIONS

The [Audit](http://www.bdo.nz/en-nz/services/audit-assurance) section of our website ([www.bdo.nz/en-nz/services/audit-assurance](http://www.bdo.nz/en-nz/services/audit-assurance)) 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 2015-08 *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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