BDO

Backing precision

ACCOUNTING ALERT

AUGUST 2016

COMMON ERRORS IN ACCOUNTING FOR IMPAIRMENT – PART 2A

MBIE CONSULTATION OPEN ON FMA FUNDING

STANDARD LICENCE CONDITIONS ISSUED FOR DIMS LICENCES

BDO PUBLICATIONS

Connect with us

www.bdo.nz

COMMON ERRORS IN ACCOUNTING FOR IMPAIRMENT – PART 2A

Continuing on from last month's article on common errors in accounting for impairment we continue to highlight 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 last month's article, we dealt with errors preparers make by not performing an impairment test when NZ IAS 36 *Impairment of Assets* clearly requires impairment testing to be performed.

While many preparers of financial statements consider the determination of an asset's 'value in use' (VIU) to involve a great deal of professional judgement, they would be wrong to believe that very basic errors cannot be made, i.e. where VIU is not determined using the very clear requirements of NZ IAS 36 *Impairment of Assets*.

Unfortunately, there are just too many errors dealing with VIU calculations to deal with in one article. This month, we deal with 'Part A', and include discussion on the following areas where VIU errors may occur:

- Not addressing the risks associated with cash flows – quantum and timing
- Which method is being used to address the risk of variations with cash flows?
- Basis for estimates of future cash flows
- Are your cash flow projections consistent with past actual outcomes?
- Use of cash flow projections for periods longer than five years
- Including cash flows from post Year 5 to the end of the asset's useful life
- Projections of cash inflows from the continuing use of the asset – inflation
- Cash flow projections must include outflows of servicing the asset and future overheads that can be allocated on a reasonable and consistent basis.

Not addressing risks associated with cash flows – quantum and timing

NZ IAS 36, paragraph 31 clearly sets out the two steps involved in determining VIU:

> Estimating the value in use of an asset involves the following steps:
>
> a) estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and
>
> b) applying the appropriate discount rate to those future cash flows.
>
> **NZ IAS 36, paragraph 31**

This article does not consider complex areas of budgeting cash flows. Rather, it looks at the clear requirements of the standard that should be followed.

> The following elements shall be reflected in the calculation of an asset's value in use:
>
> a) an estimate of the future cash flows the entity expects to derive from the asset;
>
> b) expectations about possible variations in the amount or timing of those future cash flows;
>
> c) the time value of money, represented by the current market risk-free rate of interest;
>
> d) the price for bearing the uncertainty inherent in the asset; and
>
> e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.
>
> **NZ IAS 36, paragraph 30**

NZ IAS 36, paragraph 30 acknowledges that there are uncertainties associated with the possible variations in the amount and timing of forecasted cash flows. Specifically the requirement in '(b) expectations about possible variations in the amount or timing of those future cash flows' to be included in the VIU model in turn leads to the need for the VIU calculation to also include '(d) the price for bearing the uncertainty inherent in the asset'.

NZ IAS 36, paragraph 32 goes onto say that the potential variances in expected cash flows (both amount and timing) can be reflected either as adjustments to the future cash flows, or as adjustments to the discount rate.

Error 1

A fundamental error is not to address the risk associated with forecast net cash flows, both in terms of the quantum of these cash flows, and the timing of these cash flows.

Example 1

Entity A has the following cash flow predictions:

	NET CASH INFLOW $'000	PROBABILITY
Optimum case	7,000	10%
Most likely case	6,000	50%
Conservative budget	5,000	30%
Worst case	4,000	10%
TOTAL		100%

Entity A determines that its pre-tax discount rate based on weighted average cost of capital (WACC) is 7%, and for the purpose of the VIU calculation, it will use the most likely cash forecast of $6,000,000.

Error: Entity A has not applied a weighted average adjustment to its cash flow predictions.

	NET CASH INFLOW $'000	PROBABILITY	WEIGHTED AVERAGE $'000
Optimum case	7,000	10%	700
Most likely case	6,000	50%	3,000
Conservative budget	5,000	30%	1,500
Worst case	4,000	10%	400
TOTAL		100%	5,600

If Entity A intends to use a discount rate of 7% it should use the weighted average cash flow forecast of $5,600,000, or it should adjust the discount rate to reflect the risk of the $6,000,000 forecast cash flow not being achieved.

Example 2

Entity A prepares a five year cash flow forecast and determines the weighted average forecast cash flow to be $5,600,000. It predicts that the potential pattern of cash inflows will be as follows:

	YEAR 1	YEAR 2	YEAR 3	NET CASH INFLOW	PROBABLILITY OF TIMING OF CASH FLOWS
	$'000	$'000	$'000	$'000	
Optimum case	2,000	3,000	600	5,600	10%
Most likely case	1,500	2,500	1,600	5,600	50%
Conservative budget	1,000	2,000	2,600	5,600	30%
Worst case	500	1,500	3,600	5,600	10%
					100%

Entity A determines that its pre-tax discount rate based on weighted average cost of capital (WACC) is 7% and intends to use a discount rate of 7% on the most likely forecast timing prediction.

Even though Entity A is using the weighted average cash flow forecast, it cannot simply use the 7% discount rate unless it makes an adjustment for the risk associated with the timing of the forecast cash flows.

Which method is being used to address the risk of variations with cash flows?

The elements identified in paragraph 30(b), (d) and (e) can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows, i.e. the weighted average of all possible outcomes. Appendix A provides additional guidance on the use of present value techniques in measuring an asset's value in use.

NZ IAS 36, paragraph 32

NZ IAS 36, paragraph 32 refers preparers to APPENDIX A of the standard for guidance on how to reflect the potential variances in amounts and timing of forecasted cash flows, and the price associated with this risk.

Appendix A sets out two models that can be used:

- Traditional approach or
- Expected cash flow approach.

Under the **'traditional' approach**, adjustments for NZ IAS 36, paragraph 30 factors, '(b) expectations about possible variations in the amount or timing of those cash flows', '(d) the price for bearing the uncertainty inherent in the asset' and '(e) other, sometimes unidentifiable, factors (such as illiquidity) that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset', are embedded in the discount rate.

Under the **'expected cash flow'** approach, these factors result in adjustments in arriving at risk-adjusted expected cash

Error 2 – Traditional approach

If using the 'traditional' approach to determine VIU (cash flows have not had a weighted average probability applied to them, both in respect of amount and timing), the discount rate has not been appropriately adjusted for the price of the risk of uncertainties around the amount and timing of cash flows.

Error 3 – Expected value approach

If using the 'expected value' approach to determine VIU (discount rate does not reflect the uncertainties around the amount and timing of cash flow), an appropriate weighted probability factor has not been applied to forecast cash flows.

Basis for estimates of future cash flows

Although forecasting cash flows is very much an area of professional judgement, NZ IAS 36, paragraph 33 sets out very clear requirements in respect of estimating future cash flows that can lead to some mistakes, namely:

- Cash flow projections must be based on **reasonable and supportable assumptions**
- Cash flow projections must be based on the **most recent financial budgets/forecasts**
- Projections shall **cover a maximum period of five years**
- Projections beyond five years shall **apply a steady or declining growth rate for subsequent years**

In measuring value in use an entity shall:

a) base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence.

b) base cash flow projections on the most recent financial budgets/forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified.

c) estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified.

NZ IAS 36, paragraph 33

Example 3

Entity B has the following results and forecasts for the performance of its CGU X

	2015 ACTUAL	2016 ACTUAL	2017 BUDGET	2018 FORECAST	2019 FORECAST
	$'000	$'000	$'000	$'000	$'000
Net cash flow generated (consumed)	(100)	(90)	(50)	100	400

It is very common for entities to use 'hockey stick' forecasts, whereby the asset's performance is always forecast to improve towards the end of the forecast horizon. It is unlikely that these types of forecasts will meet the requirements of paragraph 33 for the forecast to be supportable.

Error 4 – Cash flow forecasts

Cash-flow forecasts are not reasonable or supportable.

Are your cash flow projections consistent with past actual outcomes?

NZ IAS 36, paragraph 34 requires that 'Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes…'.

Management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

NZ IAS 36, paragraph 34

Example 4

Entity C has the following results and forecasts for the performance of its CGU X.

	2015 ACTUAL	2016 ACTUAL	2017 BUDGET	2018 FORECAST	2019 FORECAST
	$'000	$'000	$'000	$'000	$'000
Net cash flow generated (consumed)	(100)	(90)	(50)	100	400
VIU forecast 2014	(10)	100	400	500	550
VIU forecast 2015		(10)	100	400	500

The above table demonstrates that Entity C has a history of being overoptimistic when determining its VIU, with the forecast constantly being pushed out to future years, despite actual results showing poorer results than original forecasts. Again, it is unlikely that Company C will be able to meet the requirements of paragraph 33 for the forecast to be supportable.

Errors 5 – Cash flow forecasts

Assumptions on which its current cash flow projections are based are not consistent with past actual outcomes

Use of cash flow projections for periods longer than five years

NZ IAS 36, paragraph 35 clearly expresses concerns over management being able to predict over periods greater than five years. It states:

- Detailed, explicit and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available
- Management should base their estimates of future cash flows on the most recent budgets/forecasts for a maximum of five years
- Forecasts longer than five years can be used if management are both confident that these projections are reliable and can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

	2017 Forecast	2018 Forecast	2019 Forecast	2020 Forecast	2021 Forecast	2022 Forecast	2023 Forecast
	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Net cash flow generated (consumed)	(10)	10	15	20	30	100	200

Entity D determines its VIU model using the above seven year forecast. The cash flow forecast shows significant growth in years 6 and 7. This is not in line with the requirements of NZ IAS 36, paragraph 35.

Error 6 – Using cash flows beyond five years

Management uses cash flow projections over a period greater than five years and cannot demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

Including cash flows from post Year 5 to the end of the asset's useful life

The restrictions on forecasting cash flows beyond Year 5 does not mean that cash flow forecasts cannot include the period post year 5 to the end of an asset's useful life. For example, if a ship is purchased with an expected commercial life of 15 years, the VIU impairment model would include cash flows from year 6 to 15, however, the revenue generated from the asset in the forecast period would be based on extrapolating forecasts made in the short term, using a steady or declining growth rate.

Example 6

Entity E operates a facility that is forecast to have a 10 year useful life, supplying electricity to the local grid. The CGU has a carrying value of $6,000,000. Entity E has a risk-adjusted discount rate of 10% and forecast net cash flows are as follows:

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Gross cash flows	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Discounted cash flows	$909	$826	$751	$683	$621	$564	$513	$466	$424	$385.54

Entity E only uses the first five year's cash flows and determines the VIU to be $3,791,000 and records an impairment loss of $2,209,000 ($6,000,000-3,791,000).

Entity E is wrong to exclude the forecast cash flows from years 6 to 10, which are based on a steady revenue forecast. The recoverable amount of the asset should be $6,144,570, and no impairment charge should have been recorded.

Error 7 – Not using cash flows beyond five years

Projections wrongly exclude cash flows for the asset after Year 5.

Projections of cash inflows from the continuing use of the asset – inflation

NZ IAS 36, paragraph 40 sets out a number of requirements when determining the projected cash flows.

Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation. Therefore, if the discount rate includes the effect of price increases attributable to general inflation, future cash flows are estimated in nominal terms. If the discount rate excludes the effect of price increases attributable to general inflation, future cash flows are estimated in real terms (but include future specific price increases or decreases).

NZ IAS 36, paragraph 40

Error 8

Inflation assumptions in the discount rate are not consistent with the inflation rate used in the cash flows used in the VIU calculation.

Cash flow projections must include outflows of servicing the asset and future overheads that can be allocated on a reasonable and consistent basis

Projections of cash outflows include those for the day-to-day servicing of the asset as well as future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.

NZ IAS 36, paragraph 41

Example 7

Entity F operates a manufacturing CGU.

Carrying value is $17,000,000, all support functions (sales, marketing, etc.) are performed by head office.

Cost of sales represents all direct factory costs, e.g. material, labour, direct overhead, indirect factory overhead, etc.

The five year budget is as follows:

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Gross sales	10,000	10,000	10,000	10,000	10,000
Cost of sales	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
Gross Profit	**5,000**	**5,000**	**5,000**	**5,000**	**5,000**
Support Costs					
Sales team	1,000	1,000	1,000	1,000	1,000
HR team	100	100	100	100	100
Marketing team	100	100	100	100	100
Support team	200	200	200	200	200
Total Overhead	**1,400**	**1,400**	**1,400**	**1,400**	**1,400**

In determining the CGU's recoverable amount, Entity F uses the profit forecast from the factory and a discount rate of 10%

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Gross sales	10,000	10,000	10,000	10,000	10,00
Cost of sales	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
Gross Profit	**5,000**	**5,000**	**5,000**	**5,000**	**5,000**
10%	$4,545.45	$4,132.23	$3,756.57	$3,415.07	$3,104.61

Entity F determines that the recoverable amount is $18,953,930 and there is no impairment charge (carrying value is $17 million).

However, Entity F should have included the cash outflows in respect of the indirect costs associated with running the operation (support costs) as follows:

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Gross sales	10,000	10,000	10,000	10,000	10,00
Cost of sales	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)
Gross Profit	**5,000**	**5,000**	**5,000**	**5,000**	**5,000**
Indirect Overheads	(1,400)	(1,400)	(1,400)	(1,400)	(1,400)
Net Profit	3,600	3,600	3,600	3,600	3,600
10%	$3,272.73	$2,975.21	$2,704.73	$2,458.85	$2,235.32

The above calculation shows that the recoverable amount is actually $13,646,830, and an impairment charge of $3,353,170 should have been recognised ($17,000,000- $13,646,830).

Error 9 – Omitting cash outflows for overheads that can be allocated on a reasonable and consistent basis

Cash outflows exclude cash outflows from future overheads that can be allocated on a reasonable and consistent basis, e.g. head office and other support function overheads that are necessary to service the asset.

Example 8

Entity G operates a manufacturing CGU.

Carrying value is $13,000,000. Entity G bases its VIU calculation on its EBITDA forecast using a 10% discount rate.

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Net Profit	3,600	3,600	3,600	3,600	3,600
10%	$3,272.73	$2,975.21	$2,704.73	$2,458.85	$2,235.32

Based on the above calculation, Entity G determines the recoverable amount of the CGU to be $13,646,830 and that no impairment charge should be recognised (carrying value is $13 million).

Entity G has an accounting policy of capitalising all capital expenditure on items over $10,000, including tooling, etc. Some of these capital items are depreciated (and replaced) over two years.

Cash outflows associated with these short-lived capital items is forecast as follows:

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
Short-lived capital spend	600	500	500	200	100

The correct VIU calculation should be:

	2017	2018	2019	2020	2021
	$'000	$'000	$'000	$'000	$'000
EBITDA	3,600	3,600	3,600	3,600	3,600
Short-lived capital spend	(600)	(500)	(500)	(200)	(100)
Net Cash Flow	3,000	3,100	3,100	3,400	3,500
10%	$2,727.27	$2,561.98	$2,329.08	$2,322,25	$2,173.22

The recoverable amount, correctly including the cost of short-lived assets, is $12,113,800, Entity G should therefore have recognised an impairment charge of $886,200 ($13,000,000-12,113,800).

Error 10 – Omitting cash outflows for servicing the asset

Cash outflows exclude the cash outflows from day-to-day servicing of the asset because EBITDA forecasts are used for the basis of a VIU cash flow forecasts. In these situations, relatively short-lived fixed assets can be erroneously excluded from the effective maintenance cash outflows because their cost (as depreciation/amortisation) is excluded from cash outflow projections.

Next month we will discuss more errors when determining value in use (Part 2B).

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

MBIE CONSULTATION OPEN ON FMA FUNDING, THE FMA LEVY, THE XRB LEVY AND COMPANIES OFFICE FEES

The Financial Markets Authority ("FMA") has been working with the Ministry of Business, Innovation and Employment ("MBIE") to review the funding model for the FMA, the External Reporting Board ("XRB") and Companies Office.

MBIE has published a consultation paper on the reviewed funding model for the above entities. The consultation paper sets out three potential funding options, and indicates the level of funding that is believed to be appropriate and would enable these entities to support good conduct, good customer outcomes and growth and integrity in our capital markets.

Submissions must be made to MBIE by Monday, 22 August 2016. The consultation paper is available here.

STANDARD CONDITIONS ISSUED FOR DISCRETIONARY INVESTMENT MANAGEMENT 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 a discretionary investment management service ("DIMS"). 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 DIMS, 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 DIMS 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: Incidental financial advice	A DIMS must maintain procedures for providing incidental financial advice to retail investors. These procedures must ensure that clients have a similar standard of consumer protection to that provided by advisers under the Code of Professional Conduct for Authorised Financial Advisers.
Condition 3: Outsourcing	A DIMS that outsources a process/system necessary to the effective and proper running of the DIMS (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 DIMS to meet its market services licensee obligations ▶ Have a legally binding agreement with the provider ▶ Ensure that records pertaining to the market service are available for inspection when requested by the FMA.
Condition 4: Records	A DIMS must: ▶ Have systems and procedures to maintain relevant records pertaining to its market service ▶ Provide the FMA with the records its needs to monitor the on-going capability of the DIMS to effectively perform the DIMS in accordance with the applicable eligibility criteria in the Financial Markets Conduct Act 2013 ("FMC Act").
Condition 5: Regulatory returns	A DIMS must provide the FMA with the information it needs to monitor the on-going capability of the DIMS to effectively perform the DIMS 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 DIMS. Information must be provided in accordance with any requirements issued under the FMC Act.
Condition 6: Compliance	A DIMS 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 7: Governance arrangements	The governance and compliance arrangements of a DIMS must be substantially the same as, or better than, those in place, or which the FMA was advised of, at the time the DIMS applied for its licence (or any subsequent change advised to the FMA). A DIMS 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 8: Financial resources	**Calculation of net tangible assets ("NTA")** A DIMS 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 DIMS did not have positive NTA, the DIMS 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 DIMS 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 DIMS 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.

Continued on next page.

NTA Report

A DIMS that is not eligible to rely on the Financial Markets Conduct (Financial Reporting – DIMS Licensees) Exemption Notice 2015, or is requested to do so by the FMA, must:

- Engage a qualified auditor to perform agreed upon procedures ("AUP") and provide the DIMS 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 NTA calculation for the DIMS 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 DIMS 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.

For the calculation of the NTA of the DIMS as at its balance date on the basis of its audited financial statements, the AUP must also include the following procedures (or procedures to achieve the same outcome):

- Re-perform the NTA calculation of the DIMS
- Check that each component of the NTA calculation agrees with the relevant information in the audited annual financial statements of the DIMS (or, where the information is not included in those financial statements, agree it to appropriate accounting records or other relevant documentation)
- If the DIMS 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
- Enquire of the DIMS 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 8 does not apply to a DIMS that is a registered bank, a non-bank deposit taker (as defined in the FMC Act), or a licensed insurer.

Condition 8 also does not apply to a DIMS that is a market participant requiring capital under the NZX Participant Rules ("NZX Rules"), provided that the DIMS:

- 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 a DIMS are available here.

In addition to these standard licence conditions, the FMA may impose additional specific licence conditions on an individual DIMS 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 (**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 **BDO International** 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 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.

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

KEY CONTACTS

NORTHLAND
Angela Edwards
T: +64 9 407 7250
Adelle Allbon
T: +64 9 430 0471

AUCKLAND
David O'Connor
Andrew Sloman
Chris Neves
Graeme Lynch
Wayne Monteith
Blair Stanley
Richard Croucher
T: +64 9 379 2950

WAIKATO
Bernard Lamusse
T: +64 7 839 2106

TAURANGA
Fraser Lellman
T: +64 7 571-6280

ROTORUA
Stephen Graham
T: +64 7 347 9087

GISBORNE
Chris Torrie
Daryl Keast
T: +64 6 869 1400

TARANAKI
Steve Waite
T: +64 6 759 9034

CENTRAL NORTH ISLAND
Glenn Fan-Robertson
T: +64 6 835 3364
Matt Coulter
T: +64 6 872 9817

WELLINGTON
Henry McClintock
Mark Bewley
Geoff Potter
T: +64 4 472 5850

CHRISTCHURCH
Michael Rondel
Warren Johnstone
T: +64 3 379 5155

INVERCARGILL
Greg Thomas
T: +64 3 218 2959