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Commentary, opinion and intelligence for the New Zealand business community

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How to minimise the coronavirus impact on your business

Coronavirus is bringing the global economy to the brink of chaos. This is a 'black swan' event: a rare, severe issue that comes out of nowhere and wreaks havoc.

Although we know that black swan events will definitely occur, each individual event is unpredictable; but that doesn't mean you can't make your business better prepared, and more able to handle the impact of this global pandemic.

Our small position in a giant economic sea means that any major economic wave sends ripples through our financial systems and businesses.

Two areas of concern for Kiwi companies are supply chain and business continuity. Business owners should be asking some vital questions about both these aspects of their operations.

Do you know what your contracts say about unexpected events?

Your supplier and customer contracts may well include clauses about force majeure events. You and your leadership team need to understand what you can and can't do if one of these events occurs – what are your obligations, rights and responsibilities? If you think your contracts have incorrect or out of date clauses, this might also be a good time to review future contracts, speak to your lawyer, and potentially change the wording.

A big event like this can be an improvement lesson that helps strengthen your systems.

Do you have a diversified supply chain?

Global supply chains were thrown into disarray by coronavirus when the Chinese government, followed by the US and various governments in Europe put containment measures in place after the COVID-19 outbreak. As China - an important source for New Zealand - reduces the labour constraints that restricted manufacturing and logistics, we are seeing supply restarting. This will be experienced differently depending on how closely your supply sources were to an epicenter. The supply chains of particular concern for New Zealand and other nations include electronics and pharmaceuticals. Medical supplies such as PPE are a great example of the backlog created when the world suddenly ups its orders before the plants are fully back on-line. We also need to be mindful that secondary effects might occur if infection rates start to re-emerge, and the Chinese authorities clamp down again. Even if all goes well, it is likely to take some time to clear bottlenecks.

New Zealand businesses can expect shortages of components of products, so if you've been sourcing items purely from one place in China, this could be a sharp reminder about the importance of expanding your sources. After the Fukushima earthquake, once the initial shock to some of the supply chains had occurred, savvy suppliers were able to source from their diversified manufacturers and to work with their competitors to a certain extent to balance allocations; this was a major factor in re-establishing supply volumes quite quickly.

You should be having conversations with your vendors about their supply line and monitor that regularly. You can also talk to people in your industry and share information. Beware of customers' tendency to over order. Identify your critical items and optimise production and sales to these constraints. Refresh your demand and supply matching more frequently.

At times like this, it's about keeping the whole economy stable. You and your suppliers should be working together to make sure everyone gets just enough to keep going.

What do you need to do and how will you communicate?

When a black swan event occurs, you need to know: Are you prepared? Do you know what to do? Can you communicate with your people, your suppliers and your customers?

Your senior leaders need to know their responsibilities and what processes they need to follow. Your business continuity plan should set this out, along with how managers will get hold of people (including back-up plans; what if the internet or the phone network is down?) and what they should be communicating to their teams. The responsibility to your teams doesn't end with everyone being able to work from home; it is just as important to monitor your team's wellbeing and ensure they are coping. You want your business and your people to be in the best shape possible when the event ends.

Your team should also know how to prioritise their work if they have limited hours to operate – when they only have time to do a few jobs, they need to know what to choose and why.

When the end of a black swan event is in sight, you need to think about how to mobilise the business and get your teams engaged in the process; involving them in the planning now can make them feel empowered. Understanding all of the projects that have been put on hold that will need to be reactivated is essential, so create your checklists of these tasks and who should be working on them so the business can hit the ground running.

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Finally, take confidence in New Zealand's position

We can see from other black swan events that it's possible for the economy to bounce back surprisingly quickly. Our Government has provided a substantial economic stimulus package for Kiwi businesses and our Reserve Bank, unlike many others, still has the potential to provide some economic stimulus. While some nations reacted slowly to the threat, New Zealand seems to have reacted as quickly as possible. There's plenty of cause for optimism.

Compared to many other nations our economy is in good shape, we have a strong health and welfare system, stable government and given our geographic isolation, a controllable border. We do not need to panic but do need to recognise that as an island nation, dependent upon export and import, our ability to continue business as usual will be disrupted.

Michael Worth
Partner, Operational Advisory
Grant Thornton New Zealand
T +64 9 922 1351
E michael.worth@nz.gt.com

Ken Gibb
Partner, Operational Advisory
Grant Thornton New Zealand
T +64 9 922 1350
E ken.gibb@nz.gt.com

The coronavirus cashflow crisis facing Kiwi businesses

The economic symptoms of COVID-19 are widespread – and they may be just as tough to recover from. This pandemic has highlighted just how dependent our economy is on the rest of the world, both in terms of our export market and how much of our product is sourced from and manufactured offshore.

The level 4 shutdown has also put a freeze on the majority of the domestic economy which has significant ripple effects for all.

For companies that run on tight margins, especially in the worst-affected industries, this is going to be an extremely challenging year. There are imminent complications for large, small, international and domestic businesses.

Being squeezed in three directions

Cashflow is the lifeblood of every business, but keeping it flowing could become a lot tougher in the months ahead. As the economy slows down, businesses will feel pressure in three key areas:

1. Buying supplies is soaking up cash

Businesses are concerned they will run out of essential products, so they've been buying-up large at full price or even at inflated prices. Some exporters sent goods overseas weeks ago, but the products haven't yet 'landed' or been cleared due to various restrictions and quarantines happening in those countries. Stock levels are also becoming dangerously low as factories are shutdown or operating at a reduced capacity. They are looking for alternative suppliers, but this takes time and normally an increased cost. Often payment is required up front with these new relationships as well. The impact on their working capital is considerable.

2. Sales are down

Unless you are an essential service, or a service industry where you have the ability to continue working remotely, everything has come to a grinding halt during the enforced lockdown. No cash coming in means it's tougher to pay staff and suppliers.

3. Clients will be slower to pay

This can become a chain reaction: your clients are late paying you, so you don't have the money to pay your suppliers on time, and so on. It is incredibly important to stay on top of your work in progress and debtor situation.

All this is happening at the worst time of year for many businesses – coming off the holiday period with reduced trading days and right before the year's biggest tax burden is due.

What help is available?

Talk to your bank

The Reserve Bank has implemented a regulatory initiative to defer new bank capital rules by a year. This will reduce the burden on financial institutions at this time of uncertainty, but also give banks the headroom to lend around $47 billion more than expected during a global incident like this.

The banks themselves are saying they will look for ways to support cash-strapped businesses, including temporary interest-only repayments, restructuring or increasing business loans and loan consolidation. It is important that these options are explored sooner rather than later to increase the cash "headroom" for your business.

Government support

The Government's stimulus package for New Zealand businesses is significant, and it's expected that if required, more economic stimulus will be implemented to maintain the country's workforce capability.

Wage subsidies

A large wage subsidy scheme has been put in place; $350 per week per part time worker, and $585.80 per week per full time worker. To qualify for this subsidy, your business will need to confirm:

- a significant impact of COVID-19, being a 30% decline in actual or expected revenue in any month from January to June 2020
- you have tried alternative means to manage the effects of the decline, for example, reaching out to your bank
- a best endeavours commitment to paying employees 80% of their normal income during the subsidy period, or if they cannot do so that at a minimum, the grant is paid to the employee in full.

Leave grants

The leave grant was put in place to support self-isolation measures to prevent the spread of COVID-19. It was available for employers, contractors, sole traders and the self-employed where there was a requirement for them or their staff or a dependent to self-isolate, and they could not work from home.

The leave payment was $585.80 per week per full time employee (works more than 20 hours a week) or $350 per week for each part time employee (works less than 20 hours a week).

Recently, it was announced that this grant has now been folded into the wage subsidy as it was put in place before the lockdown commenced for people who had to self-isolate, and now that everyone has to self-isolate, the Government wants to ensure people are not 'double dipping' on the grants.

Business Finance Guarantee Scheme

The Government has also announced a scheme that will provide short-term credit to cushion the financial distress on solvent small and medium-sized firms affected by the COVID-19 crisis. The Government will carry 80 per cent of the credit risk, the other 20 per cent will be carried by the banks. The loans still need to be repaid, but the Government carrying 80 per cent of the credit risk is intended to make it easier for the bank to make the loan under normal criteria.

Tax changes and options

A range of tax changes have been implemented by Inland Revenue to support Kiwi businesses during this time of unprecedented uncertainty including:

- Depreciation for new and existing non-residential buildings including hotels and motels, as well as any capital improvements to the property including seismic strengthening. The ability to apply for a special depreciation rate for non-residential buildings has also been reintroduced
- The low value asset threshold write-off has increased from $500 to $5,000 for assets acquired between 17 March 2020 and 16 March 2021; this will revert to $1,000 from 17 March 2021
- The threshold for becoming a provisional taxpayer has increased from $2,500 to $5,000 from the 2021 income year
- Inland Revenue has been given discretion to remit use of money interest for payments due on or after 14 February 2020 in situations where the taxpayer's ability to pay has been affected by COVID-19. This applies to all types of tax payments. Inland Revenue have also signaled that they will look to remit late payment penalties
- Improved refundability of the R&D tax credits originally intended to take effect from 2021 has been brought forward to take effect from the 2020 year. The cap of $255,000 per year has been replaced with the total employment related taxes paid (PAYE, ESCT and FBT) in the year. Non-corporate entities can now access the refund (previously only available to companies). The R&D tax credit regime is available to taxpayers with over $50,000 in R&D expenditure and grant up to a 15% tax credit on eligible expenditure.

Inland Revenue is also offering tax relief and income assistance to those affected by the COVID-19 downturn, including re-estimating provisional tax, early refunds where provisional tax has been overpaid and payment in instalments. It's possible that businesses could also get an extension to filing dates for income tax returns (but not PAYE and GST returns), and penalties on late filings for PAYE and GST may be remitted.

The provisional tax threshold increase is a significant change for smaller taxpayers (residual income tax under $5,000) that would have otherwise been paying provisional tax in the 2020-21 tax year; they will benefit from immediate cashflow as they can now defer the payment of their tax to 7 February 2022 (or 7 April 2022 with a tax agent extension of time).

Visit grantthornton.co.nz for more details about funding criteria, how to apply for grants, and to keep up to date with the latest COVID-19 Government announcements and tax updates.

Outlasting the outbreak

Our Government is well-positioned to support the economy, with surpluses and more ability to borrow than many of our trading partners. The spending will probably start with infrastructure, which generates jobs and improves our quality of life in the long run.

As unexpected as COVID-19 has been, downturns are an inevitable feature of the economic cycle – and we will get through it. This outbreak will eventually come to an end. And if your business outlasts the virus, you should be stronger for the experience.

Dan Lowe
Partner, Business Advisory Services
Grant Thornton New Zealand
T +64 9 922 1201
E dan.lowe@nz.gt.com

Could a tax loss carry back be next on the Government's COVID-19 agenda?

At the end of 2019, we were seeing a lot of businesses forecasting significant growth in their profits. Now that we've entered into a national lockdown – which is unquestionably the right thing to do – the impact on businesses is unprecedented.

The Government's series of new tax changes to help business in these difficult times are obviously welcome. They include measures to decrease the number of provisional taxpayers, the ability to write off use of money interest, allowing fixed assets of up to $5,000 to be written off when purchased rather than depreciated over time, bringing forward the improved rules for refundability of R&D tax credit incentives, and the reintroduction of depreciation on non-residential buildings.

The asset write offs and depreciation allowances will give taxpayers more deductions from the 2021 income year. But as COVID-19 grinds a lot of businesses to a halt, they may not need them as they could already be in losses. This may mean that these businesses won't see a cash benefit from Inland Revenue's initiatives for a number of years.

Tax losses may be carried forward indefinitely and set off against future profits. There is an additional requirement for companies that 49% of the shareholders stay the same. But for the tax losses to be useful, there has to be a future profit.

The COVID-19 tax measures should help businesses when they are hurting now. So why not allow businesses to carry their losses back instead of forward?

It would deliver immediate relief if businesses could carry tax losses back to prior years. If companies made a profit in the prior year and paid tax, this would give them a tax refund to help with their cashflow sooner.

A number of countries in the OECD including Canada, France, Germany, Ireland, the Netherlands, the United Kingdom and the United States already allow some form of tax loss carry back to prior years. The ability to carry losses back is generally limited to one year and can be limited to certain types of businesses. The United States allows up to two years, and Canada three years.

A tax working group in Australia considered introducing a loss carry back regime in 2012 and recommended that this should proceed, however, it is yet to be implemented.

In New Zealand, the tax working group recommended changes to the loss carry forward rules in 2018. Before this global pandemic reared its ugly head, Inland Revenue was due to release proposals on the loss carry forward rules – so the time is right to prioritise this.

Don MacKenzie
Partner, Tax
Grant Thornton New Zealand
T +64 21 221 3275
E don.mackenzie@nz.gt.com

Are your systems fully connected – or barely on speaking terms?

General ledger, payroll, e-commerce, banking, CRM, inventory: this is your business ecosystem. Do your systems talk to each other? Or are they only distantly acquainted?

Imagine your data as water: it should be flowing smoothly from one place to the next, not collecting in a barrel so you have to scoop it up in buckets and pour it into the next pipe. When your systems talk to each other, the water flows along without interruption. When you're bucketing data from one system to the next, it causes leakages every time the water gets moved around and it's an unnecessary use of time and money.

But we've been doing it this way for years!

Unfortunately, many Kiwi business still operate on systems that aren't properly connected and are often underutilised. Take timesheets for example; these are often filled out in a spreadsheet, emailed to a manager to be approved (yes, each individual spreadsheet), then entered into the payroll system by an administrator, before being processed by accounts so payments can be made manually. Despite being painfully clunky, this process doesn't actively cause problems – after all there are businesses out there who have been using spreadsheets for decades – so it often doesn't get any attention. I hear it often: "We've been doing it this way for years and it works fine!" Which is another way of saying, "Why should I spend money on something that nobody's complaining about?"

It does cost a chunk of money to upgrade an organisation's systems. But the right technology can enable staff members enter their timesheets directly into a system where the manager can see them all in one place for approval. Then the system pushes the approved timesheets into an automated process that calculates the taxes owed, automatically generating direct debits to pay the staff members and Inland Revenue. This saves hours of work across admin, management and accounts – and it prevents the kinds of errors and leaks that inevitably crop up when we transfer data manually.

Starting from Xero, all the way through to fully customised systems

It's amazing how many companies have systems in place, but the systems don't communicate and are often massively underutilised. I wish I could say this is unusual, but it's not. When I help people to create a business ecosystem, we start with Xero. It's being used by more than a million Kiwi companies, yet many don't understand how to get full value from all of its features.

If you're a small business owner, you should be talking to your accountant about whether you're doing everything you can with your cloud accounting platform. Xero's basic inventory system, for instance, can be a great way for small businesses to have a beautifully connected micro-ecosystem. For mid-sized business owners, you'll need more – there are so many well-priced off-the-shelf solutions that plug seamlessly into your cloud accounting software. For instance, you might find that you can use WooCommerce, CIN7, ApprovalMax and PaySauce, all of which talk to each other and to Xero. If this makes no sense to you at all, that's what we're here for; talk to us about how to choose the right add-ons and take advantage of all Xero's features.

As your business grows to the $20 million turnover or multi-branch category, you might need a custom-built solution. It's really satisfying to be able to assist in a successful implementation of a system of this size. For example, a retail business can roll out a system that allows customers to place orders online, pick up from any one of its stores nationwide and log into a portal to track their orders and accounts. Without the right technology in place, an organisation could be employing anywhere up to five data entry people – people who could be better utilised in other areas of the business.

I know the phrase 'change management' strikes boredom into the hearts of many. However, introducing a new system needs to be done gently and sympathetically.

Reluctant workers may need their hands held

I know the phrase 'change management' strikes boredom into the hearts of many. However, introducing a new system needs to be done gently and sympathetically. Some of those staff members who love their spreadsheets and don't see anything broken with the old system may be less than enthusiastic about change. Some may even be actively hostile for a variety of reasons.

If you're making a significant investment in new technology and connecting your systems, it's mission critical to leave room in the budget for training your staff.

The next level: your data as another revenue stream

If you do an outstanding job of collecting your data and systematising it, there's a goldmine of information there for you to analyse. It can help you forecast more accurately, improve your pricing and target your marketing. And there's another potential upside: your data may be valuable to other businesses.

For example, you could use your data to map sales trends in your industry. It will be valuable to a nearby business that isn't a competitor but sells a product with a similar target market. You can add a completely new revenue stream to your business by selling trend maps to other businesses – it costs almost nothing, and your new customers will be delighted with the insights. It's important to note that you will need to be explicit about how you will use customers' data in your company's privacy policy.

You might be surprised at how valuable your data could be for you own business and beyond.

How to get started

At Grant Thornton we map our clients' ecosystems, then we build or strengthen the connections between each system and help businesses to plan to better use each platform. We talk about what they'll need in the future, change management, and where they can build value and reduce inefficiency and leakage.

This is an area of business where your advisor can provide you with outstanding value if they know what they're doing. You don't need to go it alone – we can help.

Krystle Brough
Partner, Business Advisory Services
Grant Thornton New Zealand
T +64 9 922 1262
E krystle.brough@nz.gt.com

Technical guidance for CFOs: How can you report COVID-19's impact on your business?

As the impact of COVID-19 continues to unfold in New Zealand and around the world, Directors and those preparing financial statements need to be cognisant of not only what's happening now, but what is likely to happen next.

Here's our 10 ten questions organisations need to ask to ensure that financial statements yet to be issued are presented fairly.

1. COVID-19 – the big picture: what should be included in financial statements that have not yet been authorised and approved for issue?

An organisation's stakeholders will use financial statements to evaluate the magnitude of potential disruptions to their businesses and if any estimates are included, they will want insight into how these were calculated.

2. Will the outbreak of COVID-19 result in more disclosures?

Almost certainly yes. In many situations, the outbreak will result in "new" obligations or uncertainties that an entity may not have previously recognised or disclosed in its financial statements. The additional disclosures will not only relate to the revenues, expenses, assets and liabilities they have already recognised, but also what might end up recognised in subsequent reporting periods.

3. There has recently been a significant drop in the value of equities so if you have a 31 December balance date, can your financial statements be adjusted for this?

No. In many circumstances the relevant accounting standards will not permit this because the fall in value was not a result of fact and circumstances that existed at the balance date. However, what the accounting standards actively encourage is commentary and assessment of the impact of events after the balance date, provided what is disclosed can be reasonably estimated.

4. If there is estimation uncertainty, what should be reported in financial statements?

In 31 March 2020 financial statements, for example, businesses will need to pinpoint where accounting estimates have been made and what assumptions were used to determine the amounts that are reflected in the financial statements. For example, a company may have perishable goods that due to market circumstances brought about by COVID-19, will have to be sold for less than it cost to produce them. Having never faced this situation, a range of selling prices exists which means the loss arising from having to write down the value of its inventory will also change. In many instances there will be a range of possible outcomes. Accounting standard setters encourage those preparing financial statements to indicate the sensitivity of any carrying amounts reflected in their financial statements to changes in the assumptions that impact on those carrying amounts. Lastly, if there have been any methodology changes in arriving at those estimated amounts, full disclosure of this should be made.

5. How much hindsight can be reflected in financial statements?

Very little. Entities are required to determine amounts based on their knowledge of events at the balance date, not after it. This is particularly important when considering whether assets are impaired or not. The only situation where changes can be made is when additional evidence of conditions that existed at the end of the reporting period are uncovered. So, the determination of the recoverable amounts of an asset can only consider the information obtained after the reporting date if such conditions existed as of the reporting period end. So if your organisation has been severely affected by COVID 19 and plans to restructure its operations in 2020 as a consequence of this, you cannot take this post balance date decision and its economic consequences into account when determining the carrying amount of any assets that you are looking to impair if you have a 31 December 2019 balance date.

6. Is it reasonable to take the view "the more uncertain the environment, then more detailed disclosures of the assumptions and assessments used to prepare the financial statements should be made?"

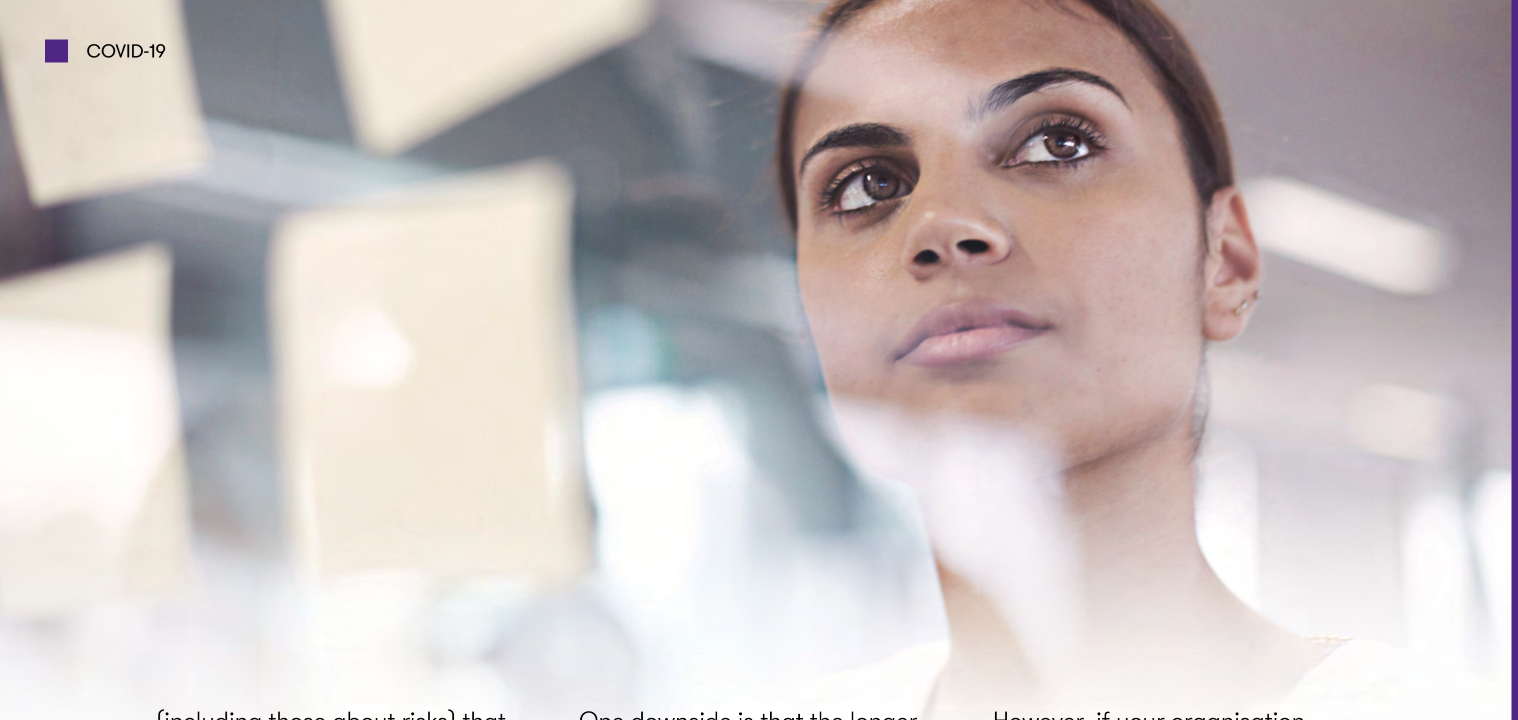
Yes. Those preparing financial statements should always be mindful of who will be reading them and how they might be used. If they anticipate that readers may not agree with their assessments and their assumptions, they should provide enough information to allow them to make their own judgments of what the carrying amounts should be.

7. When assessing estimated credit losses (ECL), what should be taken into consideration?

Again, any assessment being made should only be based on information that existed at the reporting date. The expectation set out in accounting standards is that past events, current conditions and the forecast of future economic conditions for any financial asset that is not measured at fair value is clearly communicated in financial statements. ECL is a probability weighted amount that should be determined by evaluating a range of possible outcomes, and this is often overlooked. To make this assessment often takes a considerable amount of time and professional judgment.

8. What should be taken into consideration when determining fair values at a reporting date?

The relevant accounting standard is NZ IFRS 13 Fair Value and it states the fair value of an asset or a liability at a measurement date is a specific exit price estimate that is based on assumptions



(including those about risks) that market participants would make under current market conditions. Put another way: at the reporting date, what assumptions would market participants have made using all available information, including information that may be obtained through due diligence efforts that are usual and customary? Unobservable inputs will often have to be included to measure fair value to the extent that relevant observable inputs are not available. However, the key point to recognise is that the fair value measurement objective remains the same, i.e., an exit price at the measurement date from the perspective of a market participant.

9. How much attention needs to be given to going concern for COVID-19?

A considerable amount. In assessing whether the going concern assumption is appropriate, the accounting profession requires that all available information about the future, which is at least, but not limited to, twelve months from the date of authorising the financial statements for issue, be considered.

One downside is that the longer it takes an entity to complete their financial statements after its balance date, the more information they need to take into consideration. So if the business is being audited, it should work very closely with its auditor to agree the level of analysis and evidence that is appropriate to support whatever going concern is made.

10. Ultimately, what impacts of COVID-19 will the users of the financial statements be most interested in?

For many organisations, it will be how have they coped with the outbreak so far. Their focus should be on disclosing in their financial statements, what steps have been taken to contain and minimise the impact of this global event on their operations. Almost every entity with a 31 December 2019 balance date is likely to conclude that this outbreak is a non-adjusting event – but that does not absolve it from fully disclosing the post balance date consequences on the organisation and its future operations and activities.

However, if your organisation has a later balance date, say 31 March 2020, then adjustments to the carrying amounts included in your financial statements will almost certainly be required if the organisation is in a position to quantify then. If not, then this should be disclosed as well because the objective of preparing any set of financial statements should be to provide readers with insight not only on the entity's past activity, but also its current operating situation and its future viability.

Mark Hucklesby
National Technical Director, Audit
Grant Thornton New Zealand
T +64 9 922 1381
E mark.hucklesby@nz.gt.com

COVID-19: hidden gems for some businesses in Government's economic rescue package

Ten years ago, Rt Hon Bill English removed the ability for some businesses to claim depreciation deductions on buildings in his May 2010 Budget. Fast forward to 2020 and the world is in a very different place.

The impacts of the economic response package on accounting standards and annual accounts will be the last thing that businesses are thinking about at the moment. But these impacts could be significant and hugely positive.

In the mysterious world of accounting standards, entities have to account not only for their current tax obligations, but also for something that is known as deferred tax.

Deferred tax can either be an asset or a liability. When depreciation was removed from buildings, for some it resulted in large deferred tax liabilities on the balance sheets of businesses that owned buildings. It also created a large one-off increase in tax expense which reduced accounting profit.

As this was just an accounting entry no actual tax was paid – but increased tax would be paid over the life of the building as the tax deduction for depreciation had been removed. The large accounting adjustment takes into account that more tax would have to be paid in one go all upfront.

As part of the Government's COVID-19 economic response package, deductions for depreciation on industrial and commercial buildings have been reintroduced from the 2021 income year onwards. This will mean from 1 April 2020 most businesses that own buildings, will be able to once again deduct depreciation. Some businesses may already now be able to deduct depreciation, depending on their balance date.

This is good news for Kiwi businesses that own commercial buildings; they will be able to claim depreciation when calculating their income tax, and will therefore pay less tax which will ease some of the pressure from the COVID-19 pandemic.

And for some there's a second hidden gem in those mysterious accounting standards.

Ten years ago, businesses took a large one-off hit to accounting profit and a reduction to their net assets. Now that the Government has announced it's business continuity package, they have the opposite. There will likely be a one-off increase to their accounting profit and an increase in net assets due to the reversal of the deferred tax liability that has been recognised on buildings that have an economic life of 50 years or more.

Even though this change is spread over future years, the benefit is recognised in one go upfront. And this could even be the case for accounting periods that have finished but have not been signed off - for example, 31 December 2019 - as the accounting standards impose a disclosure requirement where the effect of applying changes that have been announced but not yet substantively enacted is expected to be significant.

It may mean for instance that some companies will stay solvent. That's because the test of solvency is that assets exceed liabilities and liabilities have been decreased as a result of the Government announcement. This increases the ability for company directors to do certain things like pay dividends, consolidate entities and the like.

It may also mean that some businesses will continue to meet their banking covenants for longer.

Don MacKenzie
Partner, Tax
Grant Thornton New Zealand
T +64 21 221 3275
E don.mackenzie@nz.gt.com

If you require further information about any of these topics or would like details on other accounting or advisory matters, contact your local Grant Thornton office:

Auckland
L4, Grant Thornton House
152 Fanshawe Street
Auckland 1140
T +64 9 308 2570
F +64 9 309 4892
E enquiries@nz.gt.com

Wellington
L15, Grant Thornton House
215 Lambton Quay
Wellington 6143
T +64 4 474 8500
F +64 4 474 8509
E enquiries@nz.gt.com

Christchurch
L3, Grant Thornton House
134 Oxford Terrace
Christchurch 8140
T +64 3 379 9580
F +64 3 366 3720
E enquiries@nz.gt.com

www.grantthornton.co.nz

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