

# Consultation paper: Determining whether you are acquiring a business or assets

## About this consultation

Under the Financial Markets Conduct Regulations 2014 (the Regulations) issuers making regulated offers of debt and equity securities are required to provide investors with a Product Disclosure Statement (PDS) that contains selected financial information for recent or proposed business acquisitions. It is not always clear what constitutes a 'business' for these purposes, particularly in the context of property investments. Previously the FMA has interpreted 'business' by referring to guidance issued on the equivalent requirements under the Securities Regulations 1983. We now consider a better approach is available. We are seeking your feedback on our proposed guidance that issuers should:

- refer to generally accepted accounting practice (GAAP) and its guidance to determine whether a business or asset has been acquired
- consider disclosing certain additional information where an asset has been acquired.

Submissions close on Thursday, 30 August 2018.

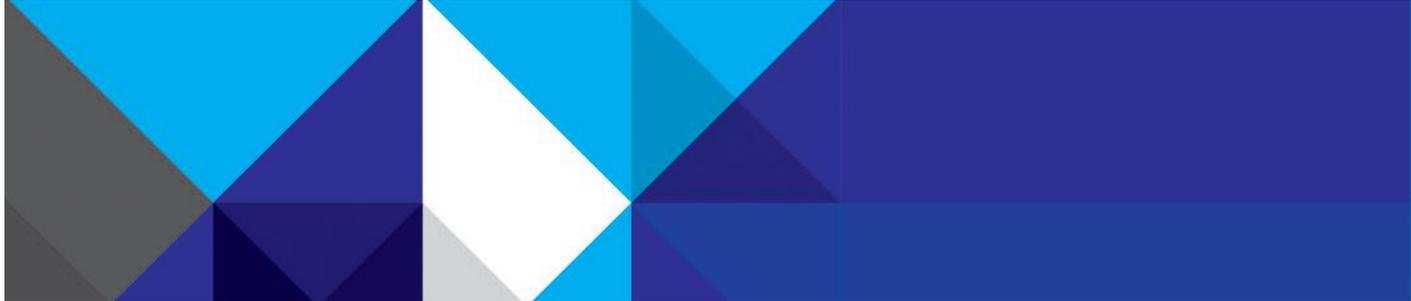
## Next steps

After we consider all submissions, we intend to finalise this guidance and publish it on our website.

### About this guidance note:

This guidance note is for issuers, their advisers, investors and other interested parties.

We are seeking feedback on our proposed guidance and interpretation of the Regulations.



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[Document history](#)

This version was issued in July 2018 and is based on legislation and regulations as at the date of issue.

FMA document reference code 4179303

# Background

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From time to time we receive questions on what constitutes a business, as opposed to an asset, for the purpose of disclosing prescribed financial information in a PDS for an offer of equity or debt securities.<sup>1</sup> This is usually in the context of property investments that are being offered as equity. It's important that issuers have clarity on what is a business, as the prescribed financial information may be costly to prepare.

## Our existing interpretation — continuity of operations

Historically the Securities Commission and the FMA have interpreted 'business' by reference to the Securities Commission's 2004 paper *Definition of a Business for the Purpose of the Securities Regulations 1983* (the 2004 paper). We have continued to refer to the 2004 paper because the Securities Regulations 1983 and 2009 contained disclosure requirements for business acquisitions that are analogous to those in the FMC Regulations.

The 2004 paper's approach to determining whether a business had been acquired was to focus on whether there was sufficient continuity in the acquired operations so that disclosure of the prior financial information is material to a potential investor's understanding of future operations of the issuing group.

In practice, this approach complicated the offer process, particularly for property investments. For example, if an issuer acquired a property from a vendor who used the property to generate rental income and the issuer intended to continue to use it this way, then we considered the issuer had acquired a business and was required to disclose the prescribed financial information. We held this view regardless of whether or not the issuer acquired the employees, management contracts or other processes to generate rental income. However, issuers frequently either did not have access to financial information, or the information would be costly to prepare. Moreover, the cost of obtaining or preparing that information was not justified when alternative information was more relevant to investors, and was available, for example, an independent valuation. As a result, the Securities Commission and the FMA granted a number of exemptions so that, subject to disclosing the alternative information, the issuer did not have to disclose the prescribed information.

## Our proposed interpretation — GAAP

We are now proposing to change our view such that issuers should use the definition of business and guidance in GAAP.<sup>2</sup> This would mean issuers should interpret the definition of business using the guidance set out in [Appendix B of NZ IFRS 3: Business Combinations](#) (or any replacement guidance).

At a conceptual level, we consider this interpretation to be consistent with the approach taken in Schedules 2 and 3 of the Regulations, which refer to GAAP when defining financial terms and concepts.<sup>3</sup> Using the GAAP definition of a 'business' appears appropriate when it comes to providing financial information that is based on GAAP requirements.<sup>4</sup>

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<sup>1</sup> See Schedule 2 (Debt Securities) [Clause 37\(4\)-\(5\)](#); Schedule 3 (Equity Securities) [Clause 35\(2\)-\(3\)](#).

<sup>2</sup> GAAP for for-profit entities is the New Zealand equivalents to International Financial Reporting Standards. Public benefit entities should refer to the guidance under PBE IFRS 3: Business Combinations.

<sup>3</sup> See Schedule 3 (Equity Securities), [Clause 35\(1\)](#); Schedule 2 (Debt Securities), [Clause 37](#).

At a practical level, NZ IFRS 3 explains that a business consists of *inputs* and *processes* applied to those inputs that have the ability to create *outputs*. While this definition has had its own practical difficulties, the International Accounting Standards Board is working towards changes to IFRS 3, including a screening test, to help issuers distinguish between acquisitions of a business and of assets when applying IFRS 3.<sup>5</sup> Therefore, we think using the GAAP definition will provide issuers with sufficient clarity on whether they need to disclose the prescribed financial information.

With specific reference to property investments, IFRS 3 is narrower in its application than the Securities Commission's continuity of use test. That is, when an issuer acquires a property with leases (i.e. inputs) but *not* the substantive processes to manage the property and collect rental income (the outputs), it will not be considered a business acquisition. This will reduce both the uncertainty and the need for exemptions.

#### Additional information for asset acquisitions

If an issuer has acquired assets (rather than a business) then it is not required to disclose the prescribed financial information. However, there is no guidance on the information issuers should disclose. We think it would be helpful to set out our expectations about the additional information that issuers should disclose where they have acquired an asset(s). In particular, we expect issuers to consider the disclosure requirements in [Schedule 5: Managed Investment Products in Other Schemes](#) on the acquisition of key property.

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<sup>4</sup> This overall approach of deferring to GAAP is consistent with the Australian Securities and Investment Commission's guidance for disclosure in prospectuses when determining whether a business has been acquired. See ASIC [Regulatory Guide 228 Prospectuses: Effective disclosure for retail investors](#) (Nov, 2016) at paragraphs RG228.96-98.

<sup>5</sup> See the IASB project *Definition of a business* <https://www.ifrs.org/projects/work-plan/definition-of-a-business/#current-stage>. The External Reporting Board will consider any amendments in line with their normal procedures. Based on the final position of the International Accounting Standards Board and the External Reporting Board we will consider whether any changes to our guidance are needed.

# Proposed guidance

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Under the Financial Markets Conduct Regulations 2014 (the Regulations) issuers making regulated offers of debt and equity securities are required to provide investors with a Product Disclosure Statement (PDS) that contains prescribed financial information for recent or proposed business acquisitions. This guidance sets out our view of what constitutes a 'business' for these purposes as opposed to an asset. It also sets out additional information issuers should consider disclosing for asset acquisitions.

## Requirements<sup>6</sup>

If you intend to issue debt or equity securities, you must disclose prescribed financial information if:

- (a) either or both of the following apply:
  - I. a member of the issuing group acquired a *business*, or became your subsidiary, at any time in a relevant period
  - II. the PDS contains a statement to the effect that a member of the issuing group intends to acquire a business or to acquire equity securities that will result in a body corporate becoming your subsidiary and
- (b) the information required [...] in relation to the *business*, subsidiary, or body corporate is material information.

In the PDS, you must include the following prescribed financial information for an offer of debt or equity securities:

- (a) in one or more tables, selected financial information for the *business*, subsidiary or body corporate (e.g. revenues, net profit after tax, assets, liabilities and net cash flows from operating activities); and/or
- (b) pro-forma financial information as if the *business*, subsidiary or body corporate was part of the issuing group.

If you are issuing equity securities, you must also disclose financial statements for the business, subsidiary or body corporate, together with any auditor's report on those financial statements on the Disclose Register.

## When acquiring a business

You should use definition and guidance in generally accepted accounting practice to help you determine whether you have acquired a 'business' for the purposes of disclosing the prescribed financial information. If you are a for-profit issuer, you should refer to [Appendix B in NZ IFRS 3: Business Combinations](#) (or any replacement guidance).<sup>7</sup>

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<sup>6</sup> See Schedule 2 (Debt Securities) [Clause 37\(4\)-\(5\)](#); Schedule 3 (Equity Securities) [Clause 35\(2\)-\(3\)](#); [Clause 53\(1\)\(b\)](#)

<sup>7</sup> GAAP for for-profit entities is the New Zealand equivalent to International Financial Reporting Standards. Public benefit entities should refer to the guidance under PBE IFRS 3: Business Combinations.

## When acquiring assets

If you have acquired or intend to acquire assets, and financial information for the assets is material, we expect you to consider what additional information should be disclosed to help investors understand the value of the assets.

In particular, we expect you to refer to what is set out in [Schedule 5: Managed Investment Products in Other Schemes](#) on the acquisitions of key property when considering what additional information you should disclose. Where relevant your PDS should include the following (non-exhaustive examples) information:

- a description of each asset and a brief description of how it will be managed and by whom
- a recent valuation of each asset, including a statement whether or not the valuation was obtained from registered valuers
- key sources of borrowing used, or to be used, to acquire each asset; the gearing and/or interest-cover ratio, if relevant, as well a statement as to whether a security interest exists
- a summary of the independent valuation reports, including their basis, the methodologies used and the material or adverse findings
- a summary of the due diligence done for the acquisition, including any material or adverse findings.

You should disclose additional information in the PDS (for example after section 4 and/or section 9 in a PDS for debt securities, or section 2 and/or section 9 in a PDS for equity securities) provided it does not detract from the prominence of the required information, and still meets length restrictions for a PDS.

You should also consider whether any additional information should be included in the register entry. We expect you to consider the requirements in Schedule 5 for this purpose as well. For example, if the PDS refers to an independent valuation report, you should include a copy of that report in the register entry.

### Are you making a property investment by issuing shares?

If so, you should read the [Financial Markets Conduct \(Shares in Investment Companies\) Designation Notice 2017](#). This notice designates certain shares as managed investment products rather than equity securities. This is because the shares the designation applies to are, in economic substance, managed investment products. The company issuing the shares is designated as a managed investment scheme. If the designation applies, it is appropriate that the requirements of the MIS regime apply, rather than the requirements of the equity regime.

## Questions

1. Where do you agree with our guidance?
2. Where do you disagree with our guidance?
3. Do you think our guidance will result in appropriate information being disclosed to investors?
4. Do you think our guidance should refer to other information that should be disclosed to investors?
5. What other circumstances raise disclosure issues that you think the guidance should cover?

### Feedback form — Consultation paper: Determining whether you are acquiring a business or assets

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at [consultation@fma.govt.nz](mailto:consultation@fma.govt.nz) with 'Determining whether you are acquiring a business or assets: [your organisation's name]' in the subject line. Thank you.

**Submissions close on Thursday 30 August 2018**

Date: \_\_\_\_\_ Number of pages: \_\_\_\_\_

Name of submitter: \_\_\_\_\_

Company or entity: \_\_\_\_\_

Organisation type: \_\_\_\_\_

Contact name (if different): \_\_\_\_\_

Contact email and phone: \_\_\_\_\_

Question number	Response
Q1	
Q2	
Q3	
Q4	
Q5	

**Feedback summary** – *if you wish to highlight anything in particular*

**Please note:** Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

**Thank you for your feedback – we appreciate your time and input.**