

**REQUIREMENTS FOR DEBT SECURITY PROSPECTUSES**

**SECURITIES REGULATIONS 1983**

**ACCOUNTING FOR INVESTMENTS OF THE BORROWING GROUP  
IN NON-GUARANTEERING SUBSIDIARIES**

**A DISCUSSION PAPER**

**SECURITIES COMMISSION  
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## PREFACE

The Securities Commission is considering whether to make recommendations to the Governor-General in Council, pursuant to section 70(1)(b) of the Securities Act 1978, ("the Act") for certain changes to the requirements of the Second Schedule of the Securities Regulations 1983 ("the Regulations") as they relate to information to be included in debt issue prospectuses.

The Commission is publishing this paper to give all persons who might be affected by changes to the Regulations the opportunity to make submissions to assist the Commission in settling its policy.

The changes being considered relate to the accounting information which must be included in the financial statements incorporated in a prospectus for debt securities where the issuer has investments in a subsidiary which does not guarantee the obligations of the issuer (a "non-guaranteeing subsidiary" or "NGS").

The Second Schedule at present requires that the accounts to be included in the prospectus should show the issuer's investments in its non-guaranteeing subsidiaries at cost (less amounts written off) or market value (if ascertainable), whichever is the lesser.

During 1990 attention was drawn to this issue by the decision of the Registrar of Companies not to register the respective debt issue prospectuses of ANZ Banking Group (New Zealand) Limited and UDC Finance Limited on the grounds that the prospectuses did not disclose the investments of the two companies in their non-guaranteeing subsidiaries in the manner prescribed in the Regulations. The companies appealed the Registrar's decisions to the Securities Commission under section 69 of the Act and further appealed to the High Court under section 26 of the Act but both the Commission and the Court upheld the Registrar's decision.

In announcing its decision the Commission undertook to review the Regulations. The Commission is at present undertaking that review. Various alternative presentations of the accounting information related to the investment by borrowers in their non-guaranteeing subsidiaries have been considered. A preliminary view has been reached that the information provided to prospective investors in debt securities can be improved.

The Commission invites all persons who wish to make submissions on the matters covered in this discussion paper to forward their submissions to reach the Commission by 24 April, 1992. If you would like to present the submission in person to a meeting of the Commission please indicate this when you forward the submission.

(ii)

The questions which the Commission would like addressed are:

1. Do you consider there is any need to change the requirements of Clause 24 as they relate to the prescribed valuation bases of investments by borrowing entities in their Non-guaranteeing subsidiaries?
2. If your answer to question 1 is "yes", what do you consider to be the principal deficiencies with the present requirements of Clause 24?
3. If you consider changes to clause 24 are necessary or desirable, which of the Alternatives One to Five set out later in Chapter 5 of this paper do you favour most? Why?
4. If you favour one of the options but have comments to make on how the presentation could be improved your comments would be most welcome.
5. Do you prefer another solution not identified in this paper? If so please provide details and justification.
6. Do you consider it is appropriate that the Securities Regulations should continue to exclude the use of equity accounting in financial statements incorporated in debt issue prospectuses? Any comments would be welcome.

Written submissions should be sent to The Chief Executive, Securities Commission, P.O. Box 1179, Wellington. [Phone (04) 4729 830, Facsimile (04) 4728 076]

P.D. McKenzie,  
Chairman

### DEFINITIONS USED IN THIS PAPER

- The Act** means the Securities Act 1978
- Borrowing Group** means the issuer of the securities and all the guaranteeing subsidiaries of the issuer
- Clause 24** means Clause 24 of the Second Schedule of the Securities Regulations 1983
- Commission** means the Securities Commission established by the Securities Act 1978
- Company** means a company within the meaning of the Companies Act 1955
- Debt security** means any interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person (whether or not the interest is secured by a charge over any property); and includes-
- (a) A debenture, debenture stock, bond, note, certificate of deposit, and convertible note; and
  - (b) Any renewal or variation of the terms or conditions of any existing debt security; and
  - (c) Any security that is declared by the Governor-General, by Order-in-Council, to be a debt security for the purposes of the Securities Act 1978;-
- but does not include an interest in a contributory mortgage where the interest is offered by a contributory mortgage broker.
- Equity method of accounting** means a method of accounting relating to the holding by a body corporate of equity capital in another body corporate whereby, in addition to any dividends declared by the other body, a proportion of the retained profits or losses of the other body is taken to be profits or losses of the first-mentioned body.

<b>Guaranteeing subsidiary</b>	<p>in relation to an offer of debt securities, means a subsidiary of the issuer that-</p> <ul style="list-style-type: none"><li>(a) is unconditionally liable (whether or not jointly or severally with the issuer or any other person) to repay the securities; or</li><li>(b) is liable to repay the securities subject only to the condition that the issuer or any other person had failed to do so.</li></ul>
<b>Holding company</b>	has the same meaning as in section 158 of the Companies Act 1955
<b>Issuer</b>	means, in relation to a debt security, or to a prospectus or registered prospectus that relates to a debt security, or to a trust deed that relates to a debt security, the person on whose behalf any money paid in consideration of the allotment of the security is received.
<b>Issuing Group</b>	means the issuer and all its guaranteeing and non-guaranteeing subsidiaries
<b>Non-guaranteeing subsidiary or NGS</b>	means any subsidiary of an issuer which is not a guaranteeing subsidiary
<b>Prospectus</b>	means a document that contains an offer of securities to the public for subscription, and that is intended to be, or has been, delivered to the Registrar for registration under section 42 of the Act.
<b>Registrar</b>	means the Registrar of Companies appointed in accordance with the Companies Act 1955
<b>The Regulations</b>	means the Securities Regulations 1983
<b>Second Schedule</b>	means the Second Schedule to the Regulations
<b>Subsidiary</b>	has the same meaning as in section 158 of the Companies Act 1955

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## **1.0 INTRODUCTION**

- 1.0.1 The Commission is reviewing the provisions in the Regulations which relate to the valuation basis and method of presentation to be followed by persons preparing debt security prospectuses in respect of the investment by members of the borrowing group in subsidiaries which do not guarantee the obligations of the issuer. The existing provisions are primarily contained in Clause 24.
- 1.0.2 In this discussion paper we set out the background to the Commission's present review (Chapter Two), a restatement of the existing requirements of Clause 24 (Chapter Three), an analysis of the issues arising from the High Court determination of the meaning of Clause 24 (Chapter Four), a review of the requirements of Clause 24 in the light of existing market practice, the legal rights of investors in debt securities and broader market considerations (Chapter Five), an analysis of possible changes to the accounting basis of the Regulations (Chapter Six) and an analysis and presentation of some alternative ways of prescribing accounting information in relation to the valuation of investments by members of a borrowing group in non-guaranteeing subsidiaries (Chapter Seven).

## **2.0 BACKGROUND TO THE PRESENT REVIEW**

- 2.0.1 The requirements in the Regulations as they relate to the valuation and presentation of the investment by members of a borrowing group in non-guaranteeing subsidiaries have been unchanged since the Regulations were first promulgated in 1983. Numerous offers of debt securities have been made to the public on the basis of prospectuses which have been prepared in accordance with the Regulations. The requirements of the Regulations are reasonably familiar to investors, issuers, analysts and commentators.
- 2.0.2 There is no direct evidence of investor dissatisfaction with the prospectuses which have been issued on the basis required by the Regulations, although the Reserve

Bank in a recent paper ("The Disclosure Provisions of Part V of the Reserve Bank of New Zealand Act 1989: Background and Proposals for Implementation", issued in November, 1991) regarded the fact that the Securities Act does not require the issuing group accounts included in debt issue prospectuses to incorporate the assets and liabilities of the NGS as a "gap" in the desirable level of disclosure.

2.0.3 The Commission wishes to be satisfied that the requirements of Clause 24 remain the most appropriate basis for debt issuers to disclose the "value" of their investments in NGS, both from the point of view of indicating the value of assets which might be available to meet any claims the investor may ultimately have on the assets of the borrowing group, and also from the perspective of considering the broader risks being engaged in by the whole issuing group.

## 2.1 The ANZ/UDC Debt Issue Prospectuses

2.1.1 In mid 1990 ANZ, and its wholly-owned subsidiary UDC, each sought to register debt issue prospectuses which disclosed the investments of the respective companies in NGS at "directors valuation" in the accounts (although the "cost" of the investments was disclosed in Notes to the accounts). The Registrar of Companies refused to register the prospectuses on the grounds that they did not comply with the requirements of the Regulations, in particular, Clause 24 of the Second Schedule.

2.1.2 ANZ and UDC appealed the Registrar's decision to the Securities Commission under Section 69 of the Securities Act 1978. The companies rejected the Registrar's interpretation of Clause 24 and claimed that statements complying with Clause 24 as so interpreted would not meet the policy objectives of the Act and would not present a "true and fair view" of the state of affairs of the companies as required by the Companies Act 1955.



- 2.1.3 After hearing submissions and evidence, the Commission confirmed the Registrar's decision. In so doing, however, the Commission acknowledged that the wording of Clause 24 may need to be clarified and its impact examined. (See Appendix A for the text of the Commission's determination.)
- 2.1.4 ANZ and UDC subsequently appealed to the High Court for the opinion of the Court on the interpretation of the wording of Clause 24. The High Court (Chief Justice Eichelbaum) affirmed the decisions of the Registrar and the Commission. (See Appendix B for the text of the judgement.)

### **3.0 EXISTING PROVISIONS OF THE SECURITIES REGULATIONS 1983.**

- 3.0.1 No allotment of a security offered to the public for subscription may be made unless at the time of subscription for the security there was a registered prospectus relating to the security (section 37 of the Act). A debt security prospectus must contain the information specified in the Second Schedule to the Regulations (regulation 3(2)).
- 3.0.2 Clause 16 of the Second Schedule requires with respect to a debt security prospectus:

"16(1) An audited consolidated balance sheet of the [borrowing] group giving a true and fair view of the state of affairs of the group-..."

and

"16(3) Nothing in clauses 17 to 26 of this Schedule limits the matters which may be included-

- (a) In any balance sheet required by this clause;  
or
- (b) In notes to any such balance sheet which are set out in the registered prospectus."

3.0.3 Clause 24 states:

"24. Each balance sheet required by clause 16 of this Schedule, or notes to that balance sheet which are set out in the registered prospectus, shall state-

- "(a) The aggregate amount of investments; and
- "(b) In addition (as separate items), the amounts included within that aggregate amount in respect of:
  - (i) The total of investments in subsidiaries that are not members of the group at cost (less amounts written off) or market value (if ascertainable), whichever is the lesser:
  - (ii) The total of investments in related bodies corporate (other than subsidiaries that are not members of the group) at cost (less amounts written off) or market value (if ascertainable), whichever is the lesser:
  - (iii) The total of investments in associated bodies corporate at cost (less amounts written off) or market value (if ascertainable), whichever is the lesser:
  - (iv) Where material, the total of securities issued by the Crown or a local authority; and, where this amount is not market value, the total market value:
  - (v) Where material, the total of investments in other bodies corporate listed on the New Zealand Stock Exchange and, where this amount is not market value, the total market value."

3.0.4 Clause 27, relating to the requirements for the Profit and Loss Account, states;

"27(1) An audited consolidated profit and loss account of the [borrowing] group giving a true and fair view of the results of the group - ..."

3.0.5 Also of relevance is Clause 32, which states:

"32. The balance sheets, profit and loss accounts, notes, and statements referred to in clauses 16 to 31 of this Schedule shall not include any amounts derived by using the equity method of accounting."

3.0.6 Thus, it can be seen that the primary emphasis in the debt issue prospectus is on the **borrowing group's** accounts and the value of the investment in NGS is to be valued on a "conservative" basis (i.e. lower of cost or market).

3.0.7 The Commission, in its original report recommending the enactment of the Securities Regulations, ("Proposals For The Enactment of Regulations Under The Securities Act 1978" issued by the Commission on 31 March 1980) stated, at para 7.8.1 :

"In other words, we are proposing that in relation to debt securities the consolidated data will exclude the data comprised in the financial statements of the non-guaranteeing subsidiaries. Of course, the interests of the issuer and the guaranteeing subsidiaries in the non-guaranteeing subsidiaries will be included as assets of the issuing group (...at the lesser of cost or market value) and the income therefrom by way of dividends and interest will likewise be included, but to that extent only will the position of the non-guaranteeing subsidiaries be reflected in the summary. Our reason for this is that we think it is important to ensure that the financial statements of the guaranteeing and non-guaranteeing subsidiaries should not be co-mingled in presenting a picture of the group to investors in debt securities. Those investors have recourse upon non-guaranteeing subsidiaries only by way of realisation of the rights of the issuer and the guaranteeing subsidiaries, and we consider that this position should be strictly recognised."

#### **4.0 ISSUES ARISING FROM HIGH COURT DETERMINATION OF THE MEANING OF CLAUSE 24, SECOND SCHEDULE, SECURITIES REGULATIONS 1983**

4.0.1 It is not the purpose of this discussion paper to undertake a comprehensive analysis of the arguments adduced to and the conclusions reached by the High Court in December 1990 in the appeals brought by ANZ and UDC. Nonetheless, reference will be made here to various key points made by the parties.

4.0.2 Note that the issues raised by ANZ and UDC were very similar. Accordingly we will regard them as made for both parties.

4.1 Wording of the Regulations

4.1.1 Considerable debate occurred over the meaning of Clause 24. ANZ/UDC contended that the wording of the clause 24, as it stood, allowed them to use a directors' valuation basis for their investments in NGS in their accounts while disclosing the lower of cost or market (if ascertainable) in the notes to those accounts.

4.1.2 The Registrar did not agree with this view, and his view was endorsed by the Commission in its decision of 2 August, 1990 and upheld by Eichelbaum CJ in his judgment of 7 December, 1990 (AP 137,189/90).

4.2 Policy of the Regulations

4.2.1 The Commission was informed that the requirement to disclose investments in NGS at the lower of cost or market resulted, in the case of ANZ, in the level of shareholders' funds of that company being shown in the financial statements contained in its debt issue prospectus at an amount some \$48 million or 17 per cent lower than the directors considered was appropriate. ANZ contended that the resultant accounts would not show a "true and fair" view of the state of affairs of the company as required by clause 16 of the Second Schedule.

4.2.2 The Commission in its August 1990 decision, addressing this issue, said:

"We recognise the force of that argument [that the value of investments in NGS should not be misleading to investors], but do not consider that it can be sustained having regard to the wording of the regulations. Clause 36 requires the auditor to state 'whether or not in his opinion the financial statements that are required by clauses 16 to 31 of the Schedule and that are required to be audited, comply with these regulations, and in accordance therewith give a true and fair view of the state of affairs of the group as at the date thereof'. The true and fair view is to be given in the context of the requirements of the regulations which expressly include the prescription in regulation 24(b)(i) as the manner in which the value of an investment in non-guaranteeing subsidiaries is to be included in the aggregate amount of investments."

4.2.3 The Chief Justice Sir Thomas Eichelbaum, in his judgment on the appeal by ANZ and UDC against the decisions of the Registrar and Commission, agreed with the Commission's view. His Honour said:

"Broadly, the purpose of the regulation is the protection of the investing public. The interpretation I prefer [i.e. that of the Registrar and the Commission] is consistent with the achievement of that purpose, in that first it compels the adoption of a conservative basis for the valuation of non-guaranteeing subsidiaries, and secondly ensures their valuation on a set and consistent footing on which investors can rely."

4.2.4 The Commission has undertaken its review of the provisions of Clause 24 in conformity with the Court's interpretation of the regulations.

## **5.0 REVIEW OF THE REQUIREMENTS OF CLAUSE 24**

5.0.1 For the purpose of the review the Commission looked at recent market practice in New Zealand by companies raising funds from the public using debt security prospectuses. Comparison was made between accounts which were "true and fair" for the purposes of the Companies Act 1955 and those which were "true and fair" for the purposes of the Securities Act 1978. Note was also made about how issuers coped with the regulatory emphasis on the borrowing group, particularly where significant activities of an issuing group were conducted by non-guaranteeing subsidiaries.

5.0.3 The legal issues leading to the Commission's original recommendations were also re-examined.

5.0.4 Consideration was given to market developments over the last decade. The interdependence of group companies was noted and, in particular, the way in which the market expected support by one company in a group for another to transcend

the pure legal obligations.

## 5.1 Review of Existing Market Practice

- 5.1.1 The Commission looked at the prospectuses of several public issuers, including a registered bank. The companies chosen tended to be significant public issuers but the sample does not purport to be necessarily representative of all market practice.
- 5.1.2 Details of the Commission's analysis is set out in Appendix C to this report.
- 5.1.3 The analysis of these prospectuses has demonstrated that issuers have adopted a variety of approaches to dealing with their regulatory obligations. Three companies (Fletcher Challenge Industries Ltd, Natural Gas Corporation of New Zealand Ltd, and National Australia Bank [N.Z.] Ltd) disclosed both the full consolidated issuing group and the borrowing group accounts, while the other three companies, (Electricity Corporation of New Zealand, Telecom Corporation of New Zealand and Smiths City Market Limited), disclosed only the Borrowing Group accounts.
- 5.1.4 Where the investment in NGS was fairly small relative to group size, the differences in total assets and shareholders funds between the two sets of accounts are likewise fairly small, and the casual investor seeing both sets of accounts may be little more than curious about the differences.
- 5.1.5 If the investor has the full consolidated accounts of both the issuing group and the borrowing group he/she can work out the difference between the cost of the investment in the NGS and the **current book value** of that investment. (That value is equivalent to the equity which the parent holds in the NGS as reflected in the net assets of the NGS.) But, if investors only have the accounts of the borrowing group, then they know the cost of the investment in NGS but they will not know the type or mix of assets that are held by the NGS and they will not know by how much the amount currently invested in the equity of the NGS (i.e. the amount of

the original investment plus additions through retained earnings [or, in many cases, reductions through accumulated losses]) exceeds [or is lower than] the original cost of obtaining that equity. (Losses in subsidiaries are not always immediately recognised by a reduction in the carrying amount of an investment in the subsidiary because it is normal accounting practice to recognise only "permanent" diminutions in the value of subsidiaries.)

5.1.6 Some issuers would appear to recognise that, in some cases, the accounts required by the Second Schedule are inadequate or insufficient to properly inform the investor, and so supplement the prescribed information with additional consolidated accounts of the whole issuing group.

## 5.2 Legal Issues - Creditor Claims on Assets

5.2.1 Where the debt securities of an issuer are guaranteed by another party, the debt security holder will be able to recover an investment in the following ways. With the involvement of the trustee where appropriate, the debt security holder may:

- (1) sue the issuer;
- (2) rank in the winding up of the issuer as a creditor, secured or unsecured according to whether repayment is secured by a charge over any assets;
- (3) sue the guarantor pursuant to the guarantee obligation;
- (4) rank in the winding up of the guarantor as a creditor, secured or unsecured according to whether the guarantor's obligation to pay is secured by a charge over any assets.

5.2.2 Where the debt securities are not guaranteed, the debt security holder will be able to:

- (1) sue the issuer;
- (2) rank in the winding up of the issuer as a creditor, secured or unsecured according to whether repayment is secured by a charge over any assets.

5.2.3 In order to have access to the assets of a NGS, to support the obligation of the issuer to repay the debt securities, the debt security holder will have to rely upon the rights which the issuer has as a shareholder of the subsidiary. The assets could be realised by the shareholder in two ways:

- (1) by sale of the shares in the subsidiary;
- (2) upon the winding up of the subsidiary. Generally speaking the issuer will only be able to force a subsidiary to wind up should it have control of not less than 75% of the voting shares in the subsidiary. Once the subsidiary is wound up, the issuer will only receive its share of the subsidiary's assets after the subsidiary's debts have been paid.

### 5.3 Broader Market Considerations

5.3.1 While the legal rights and relationships should determine what happens in the event that a company is wound up, the position of creditors to the group, whether secured or not, can be considerably affected by the way in which an issuing group conducts its operations.

5.3.2 Because the borrowing company controls its subsidiary companies it may well be able to obtain loans or advances from the NGS which, while often on commercial terms, may nevertheless be made in circumstances where an arms' length lender would not lend. Thus, the borrowing entity may have greater access to the assets of the non-guaranteeing subsidiaries than the legal situation would indicate and the subsidiary may be more vulnerable to the problems of its parent than might be



apparent from the legal situation alone.

- 5.3.3 The reverse can also occur. There are many examples from recent corporate history where a parent company (which may also be an issuer of debt securities) has been badly affected by the misfortunes of a subsidiary whose debts it did not guarantee, even though it had no legal obligation to support the subsidiary.
- 5.3.4 Market expectations are that parents (particularly, but not only, bank parents) will support their subsidiaries even where there is no guarantee commitment obliging them to do so. These expectations are generally reflected in credit ratings and, therefore, lower market interest rates enjoyed by bank-owned financial institutions compared to those not owned by banks.
- 5.3.5 If parents do not support their subsidiaries then experience suggests the parent (and its other subsidiaries) will experience difficulty obtaining funding both domestically and internationally in the future. Where a subsidiary dominates the parent (in size terms) then the problems of a subsidiary can (through "soft" lending given by the parent to support the subsidiary) result in the failure of or severe damage to the parent.
- 5.3.6 The international practices of banking supervisors provide an interesting contrast with the existing Securities Act approach. For example, in the administration of capital adequacy requirements, the minimum capital levels for banks are generally calculated based on the **full consolidated accounts** of the banking entity. A bank must have sufficient capital to support the exposures of its subsidiaries even where it does not guarantee their borrowings.
- 5.3.7 Banking supervisors recognise that the obligations of a subsidiary may effectively become those of the parent even where legally they are not. This might be seen as a "worst case" scenario designed to ensure that banks do not escape their obligations to be adequately capitalised simply by conducting business through subsidiaries.

5.3.8 The emphasis of the Securities Act seems to be towards ensuring that investors are not misled as to the quantum of assets available to meet their claims for repayment; the emphasis of banking regulation is to regard diminution in the worth of the exposures (assets) of subsidiaries as having the potential to fall back on the capital of the parent when losses occur.

5.3.9 This discussion would suggest that, while the present framework of the regulations carefully avoids including in the accounts of the "borrowing group" assets to which the creditor may have no direct recourse, it also falls short of giving an indication of the full extent of operations the borrowing group's resources may be called upon to support (because the investment in the NGS is recorded at a net figure, and one which does not include assets financed from retained earnings). The accounts required by the regulations, by possibly understating the value of the borrowing group's investment in the NGS, (because of the basis of valuation used) do not indicate to the investor just how significant a commitment the borrowing group is making to the investment in those subsidiaries.

5.3.10 It would seem desirable to try and find a middle ground which does not overstate what the investor may claim on, but also indicates where potential sources of additional risk in an issuing group may exist.

5.3.11 We raise for consideration whether the prospective investor's understanding of the risks of entering into a debt security contract would be enhanced if provided with a comprehensive description of the size and nature of assets and liabilities, and the contribution to profits of the NGS, in addition to those of the borrowing group itself.

## **6.0 POSSIBLE CHANGES TO THE REQUIREMENTS OF THE REGULATIONS**

6.0.1 The regulatory requirements relating to debt security prospectuses are structured

around the differences in the claims the creditor of an issuer has on the assets of a subsidiary company of a borrower as between a subsidiary which guarantees the obligations of its parent (the issuer) and one which does not (a "NGS").

- 6.0.2 The regulations reflect these differing claims by requiring the debt security prospectus to disclose the consolidated accounts of the "borrowing group" (issuer plus guaranteeing subsidiaries) with the investments in NGS in those accounts to be shown as a single-line item "Investments in NGS".
- 6.0.3 The regulations require that the investments in NGS be valued at the lower of cost or, if ascertainable, market value. The reasoning behind this requirement, which effectively prevents the inclusion in the accounts of the borrowing group of any post-acquisition profits remaining in the books of the NGS, is to avoid any "padding" or overstatement of the value of resources available in the NGS to meet the claims of the creditors on the resources of the borrowing group.
- 6.0.4 However use of "cost" as a valuation basis also increases the likelihood that post-acquisition losses will not be recognised quickly because investments are generally only written down where a diminution in value is considered to be "permanent".
- 6.0.5 While valuation of the investments of the borrowing group in its NGS at cost may be regarded as objective and conservative, use of the alternative valuation basis of net book value (assets of the NGS at book values less liabilities of the NGS at book values) would be based on figures which are subject to normal audit scrutiny and may provide a more relevant current measure.
- 6.0.6 Use of market valuation for the investment in NGS would seem less appropriate. Although in theory the market valuation is one which might be both current and relevant, in practice it may be almost impossible to establish a true market value for the controlling interest in a company. Even where the company has shares traded on the Stock Exchange the market price of such shares may not be indicative of the value of a controlling interest.

- 6.0.7 By not providing any details of the composition of a group's assets and liabilities reposed in its NGS, investors are not being made aware of some of the potential risks, to which the entity in which they are considering investing, may become exposed. Could a presentation be devised which would make clear those assets on which the investor has the most direct claims while at the same time providing an analysis of an issuing group's assets and liabilities held by the NGS?
- 6.0.8 The Regulations currently require the accounts presented in a prospectus to disclose a "true and fair view" of the state of affairs of the group. It has been determined that this is to be in accordance with the requirements of the Act and Regulations, and audit certificates are qualified to this effect. It seems most appropriate for this requirement to remain in the Regulations. The need for accounts to show a "true and fair" view should not prevent the Regulations specifying particular disclosure requirements for various items in a borrowing group's financial statements, even if these vary to some degree from normal accounting requirements.
- 6.0.9 The Commission would be interested in comment on the continued exclusion (in financial statements included with debt issue prospectuses) of accounts prepared on an equity accounting basis. Under this method of accounting companies are permitted to take into their accounts post-acquisition increases in the retained earnings of **associated companies**, i.e., those in which the company has an equity interest of around 20 - 49%. It would seem appropriate to continue to exclude equity accounting in debt issue prospectuses because the owning company does not, by definition, have control over associated companies (although it will have influence). Creditor access to the assets of an associate of the borrowing company will be less direct than to those of a subsidiary of such a company.
- 6.0.10 The Commission has considered a number of alternative solutions to the difficulties identified with the present construction of the Regulations. None of these alternatives have been prepared using equity accounting. **Comments are now sought on these various alternatives.** To assist interested parties we have included some comments and analysis of each alternative.

**7.0 ALTERNATIVES ON WHICH COMMENTS ARE NOW SOUGHT**

**7.1 Alternative One - Make No Change to the Regulations**

**7.1.1** The Commission could, after review, affirm the present wording of the regulations.

**7.1.2 Advantages:**

- (i) Maintains status quo, thus removing any difficulties adjusting to changed requirements;
- (ii) Retains use of "objective" valuation of purchase price (cost) or ascertainable market value for the investment in NGS;
- (iii) Is traditionally regarded as the most conservative approach to asset valuation.
- (iv) Has the authority of the High Court.

**7.1.3 Disadvantages:**

- (i) Retains problem of having different valuations for shareholders equity in accounts of borrowing group compared to full consolidated accounts;
- (ii) Although objective, cost price has decreasing relevance over time as a measure of the value of the borrowing group's investments in NGS;
- (iii) Gives the investor no idea of the type or mix of assets and liabilities represented by the single line "Investments in NGS" figure;

- (iv) Could materially understate the potential risks (in "real" if not legal terms) to the borrowing group by having a large quantity of resources committed in NGS (particularly where the investment has been held for a significant period);
- (v) If major activities of issuing group are conducted by NGS regulatory presentation may omit significant sources of revenue and costs of group;
- (vi) There is a risk that losses incurred by subsidiaries will not be recognised quickly in the stated value of the "investment in NGS" because those losses may not be considered to cause a "permanent diminution" in the value of the investment in the NGS.

## 7.2 Alternative Two - Change Bases of Valuation in Clause 24

7.2.1 The basis of valuation of the investment in NGS could be changed to that of the **book value** of the equity investment (with no other presentational changes). The value of the investment in the non-guaranteeing subsidiary is the equivalent of the net assets of the NGS.

### 7.2.2 Advantages

- (i) Would result in the same value for shareholders funds appearing in the borrowing group and the issuing group accounts (unless there are equity accounted associates as well);
- (ii) Would give a more relevant measure (than cost) of the level of investment by the borrowing group in the NGS;

- (iii) Minimal presentational change from the present requirements;
- (iv) Avoids risk that losses in NGS will not (in the short run) be captured in accounting statements.

## 7.2.2 Disadvantages

- (i) Might create impression that creditors of the borrowing group could have access to the stated value of the NGS to meet their claims on the group;
- (ii) Potential creditors have little idea of what assets the investment in NGS represents or how it has been funded;
- (iii) If major activities of issuing group are conducted by the NGS this presentation would not adequately capture information about group sources of revenue and cost.

## 7.3 Alternative Three - Expand the Presentation - Accounts of Issuing Group and Borrowing Group

7.3.1 The prospectus to include the accounts of the whole **issuing group** and also those of the **borrowing group**. The value of the investment in the NGS in the borrowing group balance sheet to be **at book value** which, in effect, is the net asset value of the NGS. (Cost could be included in the Notes.) A reconciliation of the earnings of the borrowing group with that of the NGS would be included.

7.3.2 This presentation has already been used by a number of debt issuers (National Australia Bank (NZ), Fletcher Challenge Industries, Natural Gas Corporation) **except that**, in those prospectuses, the accounts of the borrowing group show the

investment in NGS at cost (sometimes written down) not book value. (See Appendix C.)

### 7.3.3 Advantages

- (i) Potential investors are given comprehensive information both of the assets and resources of the full issuing group and of the borrowing group. The investor can work out by deduction the significance to earnings and resources of the NGS;
- (ii) By valuing investment in NGS at book value the shareholders funds of the borrowing group should in most cases be equal to the shareholders funds of the issuing group.

### 7.3.4 Disadvantages

- (i) Means an increase in regulatory requirements which might increase costs to issuers;
- (ii) Two sets of accounts might lead to confusion as to which is the most relevant for the investor (although explanatory notes and other presentational aids [layout, shading] can help in this regard).
- (iii) Investor does not get a clear explanation of the resources of the group located in the NGS.

## 7.4 Alternative Four - Expand the Presentation - Accounts of Issuing Group and Non-Guaranteeing Subsidiaries

- 7.4.1 Require the prospectus to show the accounts of the issuing group with a complementary statement showing the composition of group investment in the



NGS. This procedure adopts the book values of the assets and liabilities of the NGS. (Again, cost could be included in the Notes.) The user could derive, by deduction, the assets and liabilities of the borrowing group.

#### 7.4.2 Advantages

- (i) Gives investor a comprehensive picture of the group;
- (ii) Balances disclosure of full group results with that of the component of resources and earnings situated/earned outside the borrowing group;
- (iii) Investor gets a comprehensive presentation of group resources held outside the borrowing group.

#### 7.4.3 Disadvantages

- (i) Proposes a presentation investors and analysts are not accustomed to;
- (ii) Does not explicitly display resources and earnings of the borrowing group i.e the components of the group on which the creditor has the most direct claim;
- (iii) Being an expansion of regulatory requirements could involve extra costs for issuers (but note that many already produce two sets of accounts).

#### 7.5 Alternative Five - Expand the Presentation - Accounts of the Borrowing Group and of the Non-Guaranteeing Subsidiaries

7.5.1 Under this alternative the regulations would require the accounts of the borrowing group, with investments in NGS appearing at book value, the equivalent of the net

assets of the NGS. (Consistent with alternatives 3 and 4, cost could be included in the Notes.) Also disclosed would be details of the assets, liabilities and earnings of the NGS. The excess of assets over liabilities in the NGS is reconciled with the amount of the investment in the NGS in the issuing group balance sheet.

#### 7.5.2 Advantages

- (i) Supplements the existing familiar presentation of borrowing group accounts with a statement explicitly reconciling "Investment in NGS" figure with the assets, liabilities and earnings located in the NGS;
- (ii) Investors get an overall picture of both the group on whose assets they have closest claims together with the additional group activities the borrowing group may be called on to support;
- (iii) Investors get an indication of the assets supporting the "investment in NGS" figure included in the borrowing group accounts.
- (iv) By valuing investment in NGS at book value the shareholders' funds of the borrowing group should in most cases be equal to the shareholders' funds of the issuing group.

#### 7.5.3 Disadvantages

- (i) Introduces a new statement not familiar to investors or analysts;
- (ii) Could be compliance cost implications because additional statement required;
- (iii) Investors do not get presented with single overall picture of assets and liabilities of the issuing group (although they can get this by adding the two statements together).

7.6 Securities Commission's View

7.6.1 The Commission has reached a preliminary view that some changes to the structure of the Clause may be desirable. The Commission recognises that including the investments of a borrowing group in NGS at the lower of cost or market value can result in the real significance of a group's investment in its NGS being materially understated. The existing presentation can also result in the investor not being made fully aware of some potential risks to which the group he/she is investing in may be exposed.

7.6.3 The Commission is attracted to **Alternative Five** described above because it provides the investor with the accounts of the group on which he/she has the most direct claims, but also specifically highlights the extent of the group's resources and income-generation which comes from the NGS. This presentation also avoids any co-mingling of the assets of the borrowing group with those of the non-guaranteeing subsidiaries. **The Commission welcomes comment on ALL the options discussed in this paper, not just Alternative Five.**

APPENDIX A

BEFORE THE SECURITIES COMMISSION  
AT WELLINGTON

UNDER the Securities Act  
1978

IN THE MATTER of appeals under  
Section 69 of the  
Securities Act 1978.

BETWEEN UDC FINANCE LIMITED  
Appellant

AND THE REGISTRAR OF  
COMPANIES  
Respondent

BETWEEN ANZ BANKING GROUP  
(NZ) LIMITED  
Appellant

AND THE REGISTRAR OF  
COMPANIES  
Respondent

DECISION OF THE SECURITIES COMMISSION DATED 2 AUGUST 1990

Members of the Commission:

Mr P.D. McKenzie (Chairman)  
Mr G.C. Edgar  
Mr B.H. Smith

Date of Hearing: 24 July 1990

Counsel for the ANZ Banking Group (NZ) Ltd: Mr W. Wilson

Counsel for UDC Finance Ltd: Mr P.E. Ratner

Counsel for the Bank of New Zealand: Mr R.R. McLean

Counsel for the National Bank of New Zealand Ltd:  
Mr P.E. Ratner

Counsel for the Registrar of Companies: Mr H.B. Rennie.

1. The Appeals

1.1 Two appeals under s.69 of the Securities Act 1978 from decisions of the Registrar of Companies were heard by the Commission on 24 July 1990. By agreement between the parties, the two appeals were heard together. The appeals raised similar issues.

1.2 The appeal brought by the ANZ Banking Group (NZ) Ltd ("ANZ") is brought against the refusal of the Registrar to register a prospectus in which the value of investments in non-guaranteeing subsidiaries is shown as one value in the financial statements in the prospectus. In the notes to the prospectus the value of this investment is divided into two items, namely the figure for the investments at cost, and a figure for directors' valuation. The total of those two figures is then shown as the total investment in subsidiary companies. The relevant pages 4 and 9 from the financial statements in the prospectus are annexed marked A1 and A2. It was explained on behalf of the bank during the course of argument that the figure of \$48,368,000 in the notes showing these investments at "directors' valuation" is the figure for the additional value which the directors have attributed to the same investments which are shown in the preceding figure of \$226,018,000 as being investments at cost. The bank agreed that there was a need to re-word this note in order to make it clear

that the figure relating to the directors' valuation was supplemental to the figure which shows the investments at cost.

1.3 It was pointed out to us by the ANZ Bank that the Bank has registered four previous prospectuses which are all in the same form, in relation to the matters under appeal, as the prospectus which the Registrar has now declined to register. We recognise that if the Bank is to now present its balance sheet in the prospectus in the form required by the Registrar it would show a reduction in shareholders' funds of \$48,368,000. This may place the Bank in presentation difficulties, but is not a matter to which we can have regard in interpreting the requirements of the Schedule.

1.4 The appeal brought by UDC Finance Ltd ("UDC") is an appeal against the refusal of the Registrar to register a prospectus in which the value of investments in non-guaranteeing subsidiaries is shown in the balance sheet as two values, one at cost and one being the difference between cost and directors' valuation. Both these items are included in the figure which is stated for total investments in the balance sheet. The form of balance sheet which is the subject of UDC's appeal is annexed marked "B".

2. Questions for determination

2.1 Both appeals involve an interpretation of the provisions of the Second Schedule to the Securities Regulations 1983, and in particular the meaning to be given to clause 24 of that Schedule. The relevant part of that clause provides:

"Each balance sheet required by Clause 16 of this Schedule, or notes to that balance sheet which are set out in the registered prospectus, shall state -

- (a) The aggregate amount of investments; and
- (b) In addition (as separate items), the amounts included within that aggregate amount in respect of:
  - (i) The total of investments in subsidiaries that are not members of the group at cost (less amounts written off) or market value (if ascertainable), whichever is the lesser:"

The primary question for the Commission's consideration was helpfully put by Professor Trow as follows when he gave evidence on behalf of the ANZ Bank:

"The question concerns the amount which can be recorded in the balance sheet for the value of investments and subsidiaries that are not members of the charging group. If there is disclosure in the notes to the balance sheet in accordance with clause 24(b) (i), does that mean that the same valuation approach should be employed when presenting the item in the balance sheet itself?"

The Registrar has ruled that neither prospectus meets the requirements of clause 24(b) (i) as the Second Schedule and, in particular, clause 24, does not permit the balance sheet

to include the total of investments in subsidiaries that are not members of the group other than at cost (less amounts written off) or market value (if ascertainable), whichever is the lesser. The Registrar considers that clause 24 does not permit the balance sheet or notes to include as part of the aggregate amount of investments an item representing the directors' valuation of investments above cost. Accordingly, the prospectus lodged by the ANZ Bank and the form of prospectus which UDC proposed to register were unacceptable.

3. Representation on behalf of the Bank of New Zealand and the National Bank

3.1 The Bank of New Zealand and the National Bank asked to be heard in support of the ANZ Bank at the hearing of the ANZ Bank's appeal. The Commission has power under s.19(1)(e) to grant leave to appear or be represented to any person who in the opinion of the Commission is a person who ought to be heard or a person whose appearance or representation will assist the Commission in its consideration of the matter before it. Counsel for the Registrar informed the Commission that the Registrar had no objection to the Bank of New Zealand ("BNZ") and the National Bank of New Zealand Ltd ("National Bank") being heard. The Commission considered that their representation would



assist the Commission in its consideration of the matter before it, and accordingly made an order granting leave to these two banks to appear and be represented on the hearing of the appeal.

4. The Commission's decision

4.1 Full and helpful argument was presented to the Commission on behalf of both appellants and the Registrar, and evidence was given on behalf of the ANZ Bank by Mr D.R. Jeffrey, General Manager Finance, Treasury, of the ANZ Bank, Mr D.B. Scott of Messrs KPMG Peat Marwick (the Bank's auditors) and Professor D.G. Trow, Professor of Accountancy at Victoria University. Submissions were also presented on behalf of the Bank of New Zealand and the National Bank, and Mr Meehan of Messrs Price Waterhouse, auditors to the National Bank, gave evidence in support of that Bank's submission. Mr Rennie, on behalf of the Registrar, informed the Commission that he had not been able to secure any expert accounting evidence on behalf of the Registrar in view of there being a conflict of interest on the part of each of seven chartered accountants whom he had approached in the matter. In the absence of independent expert evidence, Mr Rennie called Mr W.O. Ferguson, a senior investigating accountant with the Commercial Affairs Division at Auckland.

4.2 The Commission does not propose in this written decision to review all of the arguments presented to us. We shall set out the reasons for our decision and then comment briefly on certain of the matters which were put to us and which we have either not accepted or have put aside.

4.3 The question which we are required to determine turns on the meaning to be given to the Second Schedule to the Securities Regulations 1983, and in particular to clause 24 of that Schedule. The central requirement of that clause is that -

"Each balance sheet required by clause 16 of this Schedule, or notes to that balance sheet which are set out in the registered prospectus, shall state -

(a) the aggregate amount of investments; ..."

We accept the submission made on behalf of the banks that the word "or" when used in the opening line of the clause provides the issuer with an alternative. The aggregate amount of investments may be stated either in the balance sheet or in notes to that balance sheet. However, if the balance sheet is to be a meaningful document it will need to include an entry relating to investments.

4.4 If the balance sheet does include an entry relating to investments, the figure entered in the balance

sheet as the aggregate amount of investments must comply with the following paragraph (b) of the clause.

4.5 Paragraph (b), when read together with the opening words of the clause, requires that each balance sheet or notes to that balance sheet shall state in addition (as separate items), the amounts included within that aggregate amount in respect of certain matters including sub-paragraph (i) relating to the total of investments in non-guaranteeing subsidiaries. The paragraph expressly requires that the items set out under sub-paragraphs (i) to (v) must each be "included within that aggregate amount". In relation to non-guaranteeing subsidiaries, sub-paragraph (i) requires that the total of investments in such subsidiaries is to be stated at cost (less amounts written off) or market value (if ascertainable), whichever is the lesser. It is that figure, ascertained in accordance with sub-paragraph (i), which is to be included in the aggregate amount of investments insofar as non-guaranteeing subsidiaries are concerned.

4.6 Accordingly, if the aggregate amount of investments is stated in the balance sheet, that figure can only include, in relation to investments in non-guaranteeing subsidiaries, the amount prescribed by sub-paragraph (i). We read this clause as being prescriptive, and this is indicated by the words

"shall state", which govern both paragraph (a) and paragraph (b).

4.7 We recognise that sub-paragraphs (i) to (v) are not exhaustive of all the matters which may form the "aggregate amount of investments" of the issuer concerned. For example, these sub-paragraphs do not refer to an investment in other bodies corporate which are not listed on the New Zealand Stock Exchange, e.g. investments in companies listed on an overseas exchange and not listed in New Zealand, or investments in a private company or unlisted public company. An investment in a participatory security such as a horticultural partnership is also not included.

4.8 In relation to such other forms of investment we consider that clause 16(3) applies and permits such matters to be included in such aggregate amount of investments detailed in any balance sheet or in notes to the balance sheet. That clause states that "nothing in clauses 17 to 26 of this Schedule limits the matters that may be included in any balance sheet or in notes to any such balance sheet".

4.9 We also consider that clause 16(3) permits reference to be made in the notes or in the balance sheet to other matters referable to investments made by the issuer, including matters of explanation. For

example, the BNZ states in notes to the balance sheet a separate figure for market value of investments in non-guaranteeing subsidiaries. We do not consider, however, that clause 16(3) permits an issuer to include within the "aggregate amount of investments" a figure with respect to any of the particular items required in sub-paragraphs (i) to (v) of clause 26(b) in a manner not permitted by those particular sub-paragraphs. In relation to sub-paragraph (i), for example, investments in non-guaranteeing subsidiaries are to be included in the aggregate only at cost or market value, whichever is the lesser. That express requirement as to the way in which the value of such investments is to be included in the aggregate figure is not affected by the general permission to deviate given by clause 16(3). The express requirements of clause 24(b)(i) ought not to be limited by the general provisions of clause 16(3).

- 4.10 Those findings are sufficient to dispose of these two appeals. The ANZ Bank has included in the figure for the aggregate amount of investments stated in the balance sheet a component representing an additional value above cost placed on some of those investments by the directors. That, in our view, is not permitted by clause 24. UDC, in the proposed prospectus which is the subject of its appeal, has endeavoured to meet this difficulty by stating as a separate item in the balance sheet the additional

directors' valuation put on investments in non-guaranteeing subsidiaries. However, as that figure is aggregated into the total amount of investments, the balance sheet fails to comply with clause 24, as it includes within the aggregate amount of investments a figure for non-guaranteeing subsidiaries which is not permitted by clause 24(b)(i).

5. Supplementary Issues

5.1 In the course of argument, further issues were put before the Commission which, for the assistance of the parties, we feel it proper that we address.

(i) Ascertainable market value. It was submitted by Mr Rennie that the words in clause 24(b)(i) "if ascertainable" indicate that if a figure for market value is to be considered for use, it must be an ascertainable figure. It was submitted that this means a figure established to the usual standard of proof in civil law matters, and cannot include a director's valuation. We accept that submission. The market value attributed to the investment under this sub-clause must be one that is "ascertainable". In order to be ascertained, the market must be tested in a manner which is

appropriate to the particular type of investment. A director's opinion would not be sufficient. We were informed that the practice adopted by auditors was to treat non-guaranteeing subsidiaries in the parent balance sheet in the same way as guaranteeing subsidiaries and bring in the value of the investment on the basis of the net tangible assets of the subsidiary for balance sheet purposes. We consider that the sub-clause does not permit an investment in a non-guaranteeing subsidiary to be valued on that basis.

- (ii) True and Fair View. It was strongly submitted by the banks that if the financial statements included in the prospectus are to present a true and fair view of the state of affairs of the group, as required by clause 36 of the Second Schedule, the aggregate amount of investments as shown in the balance sheet must not be stated at a figure which would be misleading to a prospective investor. Where the investment in non-guaranteeing subsidiaries has a market value significantly above cost, then that figure should be included in the aggregate amount of investments. We recognise the force of that argument, but do not consider that it can be

sustained having regard to the wording of the regulations. Clause 36 requires the auditor to state "whether or not in his opinion the financial statements that are required by clauses 16 to 31 of the Schedule and that are required to be audited, comply with these regulations, and in accordance therewith give a true and fair view of the state of affairs of the group as at the date thereof". The true and fair view is to be given in the context of the requirements of the regulations which expressly include the prescription in regulation 24(b)(i) as to the manner in which the value of an investment in non-guaranteeing subsidiaries is to be included in the aggregate amount of investments. It is having regard to that regulation and in accordance therewith that the financial statements are to give a true and fair view. We are not able to agree with Mr Scott at page 2 of his statement that the figures disclosed in the prospectus must be capable of reconciliation with the company's own audited statutory accounts which have been prepared in accordance with the requirements of the Companies Act 1955. The financial statements to be included in the prospectus are a separate set of financial statements prepared for the purposes of the Securities Act and Regulations, and



consistency with separate financial statements required by the Companies Act, although no doubt desirable, is not required. When considering what matters are to be included in financial statements for the purposes of a prospectus, the governing provisions are those of the Securities Act and Regulations, and it is in the context of those regulations that a true and fair view is required.

- (iii) The impact of equity accounting. It was submitted to us by Mr Ferguson on behalf of the Registrar that the prohibition in clause 32 of the Second Schedule of the equity method of accounting indicated a policy on the part of the regulations with respect to a prospectus relating to debt securities to restrict values to cost or a lower ascertainable market value in order to avoid any additional value above cost price being credited in the parent company's accounts. Although we agree that the prohibition of the equity method of accounting in the case of financial statements in debt prospectuses is indicative of the conservative approach which the regulations take to statements in a debt prospectus, we view this argument as providing limited assistance in interpreting the clause. We note that similar language to that

in clause 26 is used in clause 31 of the First Schedule dealing with the matters required in the prospectus for equity securities where the method of equity accounting is not excluded. We also agree with Professor Trow that the prohibition on equity accounting is directed rather to the bringing in of a notional profit into the profit and loss account than to the way in which investments are valued in the balance sheet and thereby brought into shareholders' funds.

- (iv) The use of similar language in clauses 17, 18, 19, 20, 21, 22 and 23 of the Second Schedule.

Mr Ratner drew our attention in the course of argument to the use in each of the above clauses of the same words as appear in clause 24, namely the words "each balance sheet required by clause 16 of this Schedule or notes to the balance sheet which are set out in the registered prospectus shall state". It was argued that the meaning given to those words for the purposes of clause 24 must be consistent with the use of those words in these other clauses. We accept that there is a need for such consistency, but do not regard the interpretation which we have placed on clause 24 as contradicting this approach. In each case there is a prescription in relation


to matters to be stated in the financial statements, and the issuer is presented with an alternative as to whether the matters prescribed or any of them are to be stated in the balance sheet or in notes to the balance sheet. Where, however, as in clause 24(b)(i) the prescription states the way in which a particular item is to be included in an aggregate figure (whether appearing in the balance sheet or the notes) the issuer is not permitted to include that item, in whichever place stated, in some other form.

6. Summary of Commission's Decision

The Commission accordingly declines to allow either appeal, and holds that the Registrar has correctly interpreted the relevant provisions of the Schedule. The Commission recognises, however, in arriving at this decision that the wording of the regulation needs to be clarified and its over-all impact examined. We propose to address this issue on a review of the regulations.

The Common Seal of the )  
SECURITIES COMMISSION )  
was hereunto affixed )  
in the presence of: )



  
\_\_\_\_\_  
Chairman

## PROFIT AND LOSS ACCOUNT

	Note	Unaudited 6 months to 31/3/90 \$000	Audited 12 months to 30/9/89 \$000	Audited 12 months to 30/9/88 \$000
Gross income	2	555,418	1,099,429	1,113,003
Expenses	2	505,139	1,025,543	967,004
Operating profit before tax		50,279	73,886	145,999
Tax expense	3	14,083	11,055	47,206
Operating profit after tax		36,196	62,831	98,793
Extraordinary items	4	(51)	(27,175)	(1,254)
Operating profit after tax and extraordinary items		36,145	35,656	97,539
Retained earnings at beginning of period		165,510	130,030	89,007
Total available for appropriation		201,655	165,686	186,546
Appropriations				
Interim dividend		-	-	56,455
Transfer to reserves	17	20	176	61
Retained earnings at end of period		201,635	165,510	130,030

The notes on pages 7 to 12 form part of and should be read in conjunction with these financial statements.

## BALANCE SHEET

	Note	Unaudited as at 31/3/90 \$000	Audited as at 30/9/89 \$000	Audited as at 30/9/88 \$000
<b>ASSETS</b>				
Liquid assets	5	1,106,819	1,085,650	572,073
Loans and advances	6,7	4,913,891	4,416,088	3,790,973
Customers' liabilities for acceptances		1,153,519	624,151	1,009,695
Trading securities	8	276,056	710,720	-
Investment securities	9	312,514	798,529	784,803
Loans to associated companies		5,952	4,752	2,286
Investment in associated companies	10	1,191	1,191	1,191
Due from subsidiary companies		151,730	111,219	129,011
Investment in subsidiary companies	11	274,386	272,587	272,587
Fixed assets	13	62,856	56,402	46,862
Deferred tax		20,333	32,899	(18,036)
Current tax		672	6,135	(47,606)
Total assets		8,281,919	8,122,323	6,543,839
<b>LIABILITIES</b>				
Deposits		5,851,206	6,228,385	4,540,708
Bill acceptances		1,153,519	624,151	1,009,695
Due to subsidiary companies		136,083	123,767	278,775
Due to other banks	14	545,063	549,767	218,590
Bills payable and other liabilities		140,148	175,313	113,886
Provisions	15	22,198	25,383	22,284
Total liabilities		7,850,217	7,726,766	6,183,938
Net assets		431,702	395,557	359,901
<b>SHAREHOLDERS' FUNDS</b>				
Issued and paid-up capital	16	117,287	117,287	117,287
Reserves	17	112,780	112,760	112,584
Retained earnings		201,635	165,510	130,030
Total shareholders' funds		431,702	395,557	359,901

The notes on pages 7 to 12 form part of and should be read in conjunction with these financial statements.

## 7. PROVISIONS FOR DOUBTFUL DEBTS

	Unaudited 31/3/90 \$000	Audited 30/9/89 \$000	Audited 30/9/88 \$000
Specific provision			
Balance at beginning of period	107,799	35,776	8,043
Bad debts written off	(50,494)	(53,800)	(13,911)
Recoveries	818	970	481
Charge to profit and loss account	17,826	104,853	41,163
Balance at end of period	75,949	107,799	35,776
General provision			
Balance at beginning of period	23,948	23,948	19,822
Transfer/charge to profit and loss account	(698)	-	4,126
Balance at end of period	23,250	23,948	23,948
Total provisions for doubtful debts	99,199	131,747	59,724

## 8. TRADING SECURITIES

New Zealand Government securities and local authority securities	10,377	30,569	-
Other	265,679	680,151	-
Total trading securities	276,056	710,720	-
Income			
New Zealand Government securities and local authority securities	2,562	1,080	-

## 9. INVESTMENT SECURITIES

New Zealand Government securities and local authority securities	264,232	570,290	322,020
Other	48,282	228,239	462,753
Total investment securities	312,514	798,529	784,803
Market value			
New Zealand Government securities and local authority securities	264,658	572,833	331,311
Income			
New Zealand Government securities and local authority securities	37,343	43,914	73,215
Commitments			
In the course of its normal business activities, the Company has a commitment to repurchase money market securities of \$25,106,000 (1989 Nil) during the next six months.			

## 10. INVESTMENT IN ASSOCIATED COMPANIES

At cost - unquoted	1,191	1,191	1,191
Total investment in associated companies	1,191	1,191	1,191

## 11. INVESTMENT IN SUBSIDIARY COMPANIES

Unquoted			
—at cost	226,018	224,219	224,219
—at Directors' valuation	48,368	48,368	48,368
Total investment in subsidiary companies	274,386	272,587	272,587

## 12. AGGREGATE OF INVESTMENTS

Investment in			
—securities	312,514	798,529	784,803
—associated companies	1,191	1,191	1,191
—subsidiary companies	274,386	272,587	272,587
Total aggregate of investments	588,091	1,072,307	1,058,581

## 13. FIXED ASSETS

	Cost or valuation \$000	Accumulated depreciation \$000	Book value \$000
Unaudited			
As at 31/3/90			
Freehold land	295	-	295
Freehold buildings	1,155	24	1,131
Leasehold improvements	5,114	1,138	3,976
Motor vehicles, equipment and plant	104,359	49,162	55,197
Work in progress	2,257	-	2,257
Total fixed assets as at 31/3/90	113,180	50,324	62,856
Audited			
As at 30/9/89			
Freehold land	355	-	355
Freehold buildings	2,110	36	2,074
Leasehold improvements	4,695	549	4,146
Motor vehicles, equipment and plant	91,729	42,833	48,896
Work in progress	931	-	931
Total fixed assets as at 30/9/89	99,820	43,418	56,402

		Unaudited 31 March 1990 \$000's	30 Sept 1989 \$000's	30 Sept 1988 \$000's
<b>ASSETS</b>				
<b>Fixed Assets</b>				
Land & Buildings	(Note 1)	8,511	545	295
Motor Vehicles, Equipment and Leasehold Improvements	(Note 2)	6,563	7,420	8,315
<b>Total Fixed Assets</b>		<u>15,074</u>	<u>7,965</u>	<u>8,610</u>
<b>Investments</b>				
Investment in non-guaranteeing subsidiary (Directors Valuation \$14,000,000)		10,000	14,000	10,000
New Zealand Government Stock	(Note 13)	35,721	38,909	49,362
Negotiable/Transferable Certificates of Deposits	(Note 13)	11,867	27,350	49,342
Local Authority Stock				1,058
Loan to non-guaranteeing subsidiary		2,300	1,720	
Investments in associate companies at cost		40	40	40
Listed Company Shares (at Market Value)		89	108	1,335
Other Investments		38	38	37
<b>Total Investments</b>		<u>60,055</u>	<u>82,165</u>	<u>111,174</u>
<b>Trading Assets</b>				
Accounts Receivable		1,072,757	1,038,979	960,265
Deduct Deferred Income		213,308	208,784	193,713
Deduct Provision for Doubtful Debts		18,346	20,522	16,753
		<u>841,103</u>	<u>809,673</u>	<u>749,799</u>
Bills Receivable	(Note 13)	106,344	69,446	119,063
Other Trading Assets	(Note 4)	21,940	29,884	17,043
<b>Total Trading Assets</b>	(Note 3)	<u>969,387</u>	<u>909,003</u>	<u>885,905</u>
<b>TOTAL ASSETS</b>		<u>1,044,516</u>	<u>999,133</u>	<u>1,005,689</u>

The notes and accounting policies on pages 17 to 23 form part of these financial statements.

IN THE HIGH COURT OF NEW ZEALAND  
WELLINGTON REGISTRY

IN THE MATTER of appeals under  
Section 26 of  
the Securities  
Act 1978

AP 137/90

BETWEEN UDC FINANCE  
LIMITED a duly  
incorporated  
company having  
its registered  
office at  
Wellington

Appellant

A N D THE REGISTRAR OF  
COMPANIES  
appointed in  
accordance with  
the Companies  
Act 1955

Respondent

AP 189/90

BETWEEN ANZ BANKING  
GROUP (NEW  
ZEALAND) LIMITED

Appellant

A N D THE REGISTRAR OF  
COMPANIES

Respondent

Hearing: 4 December 1990

Counsel: W M Wilson & J B B Steel for appellants  
H B Rennie for respondent

Judgment: 7 December 1990

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JUDGMENT OF EICHELBAUM CJ

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Before the Court are appeals against two decisions of the Securities Commission, brought by way of case stated under S 26 of the Securities Act 1978. They turn on the same issue of interpretation relating to the Securities Regulations 1983, arising in the context of a prospectus offering debt securities, and can be dealt with in a single judgment. Subject to an exception for the "short form" prospectus, the Regulations require that every prospectus relating to an offer of debt securities shall contain all of the information, statements, certificates, and other matters specified in the second schedule to the Regulations that are applicable. Clause 16 of the second schedule requires inclusion of "an audited consolidated balance sheet of the group giving a true and fair view of the state of affairs of the group" as at a specified date. In relation to an offer of debt securities, "group" means the issuer and all guaranteeing subsidiaries in respect of the periods since they became such subsidiaries.

Clause 24 needs to be set out in full. It states:

"24. Investments - Each balance sheet required by clause 16 of this Schedule, or notes to that balance sheet which are set out in the registered prospectus, shall state -

- (a) The aggregate amount of investments; and
- (b) In addition (as separate items), the amounts included within that aggregate amount in respect of:
  - (i) The total of investments in subsidiaries that are not members of the group at cost (less amounts written off) or market value (if ascertainable), whichever is the lesser:



- (ii) The total of investments in related bodies corporate (other than subsidiaries that are not members of the group) at cost (less amounts written off) or market value (if ascertainable), whichever is the lesser:
- (iii) The total of investments in associated bodies corporate at cost (less amounts written off) or market value (if ascertainable), whichever is the lesser:
- (iv) Where material, the total of securities issued by the Crown or a local authority; and, where this amount is not market value, the total market value:
- (v) Where material, the total of investments in other bodies corporate listed on a trading exchange and, where this amount is not market value, the total market value."

The issue is as to the amount which can be recorded in the balance sheet for the value of investments in subsidiaries that are not members of the group (the non-guaranteeing subsidiaries), "investment" being defined as meaning any security owned by the person concerned that is not a current asset. In the case of UDC Finance Ltd the Registrar of Companies (respondent in both appeals) declined to register a prospectus in which the value of investments in non-guaranteeing subsidiaries was shown as two amounts, one at cost, the other a higher figure, apparently a valuation by the directors. The higher value was brought to account in the figure shown for total investments, in the financial statements included in the prospectus. In the case of ANZ Banking Group (NZ) Ltd the Registrar declined to register a prospectus in which a note to the financial statements showed the value of investments in non-guaranteeing subsidiaries as comprising the cost of such investments plus an additional value described as "at

directors' valuation". I was informed from the bar that the intent was to describe an increment to cost, determined by a valuation by the directors. The sum of the two items coincided with the figure shown in the balance sheet under the heading "total investment in subsidiary companies".

The Registrar of Companies took the view that the requirements of the second schedule did not permit a balance sheet to include the total of the investment in non-guaranteeing subsidiaries other than at cost (less amounts written off) or market value (if ascertainable) whichever is the lesser. Contrary to the appellants' contentions the Registrar considered that Clause 24 did not permit the balance sheet, or the notes accompanying it, to include as part of the aggregate amount of investment an item representing the directors' assessment of investments above cost. For these reasons he declined to register the prospectuses tendered on behalf of the appellants. After a full hearing, at which expert evidence was given, the Securities Commission in a considered decision upheld the Registrar's opinion. It is a matter of substance, not one of mere presentation, since in the ANZ case the opposing methods of calculation make a difference of some 13% in shareholders' funds for the year ended 30 September 1988, while in the UDC case the difference is some 5%. Further there is a wider significance in that the answer will be applicable to prospectuses generally.

Both sides were agreed that Clause 24 gave the issuer an option whether to include the required information in the balance sheets, or in notes to it, or a combination of the two.

The required information is (a) the aggregate amount of investments, and additionally, as a separate item, (b) the amount included within such aggregate of total investments in non-charging subsidiaries, the latter figure to be calculated at the lesser of cost (less amounts written off) or market value (if ascertainable).

The critical issue in my opinion is the meaning of the expression in Clause 24(b) "the amounts included within that aggregate amount" in respect of the matters set out in paras (i) to (v). "That aggregate amount" is the aggregate amount of investments. For the appellants it was submitted that the expression "included within" should be interpreted as conveying that the particular item, in this case the total of investments in non-guaranteeing subsidiaries, was contained in the aggregate, but that the issuer was not limited to the figure thus included. The respondent's contention on the other hand was that the expression referred to the same amounts as had been used in the calculation of the aggregate. In other words, it referred to the very same components and in each case that component was to be calculated in the way set out in para (i) of Clause 24(b). In my opinion the respondent's construction is correct.

Broadly, the purpose of the regulation is the protection of the investing public. The interpretation I prefer is consistent with the achievement of that purpose, in that first it compels the adoption of a conservative basis for the valuation of non-guaranteeing subsidiaries, and secondly ensures their valuation on a set and consistent footing on which investors can rely.

The appellants' prospectuses would comply with (b) above but they wish to be free to calculate the "aggregate amount of investment" under (a) on a different basis. To my mind that contradicts the language and purpose of the clause. The particularisation required under (b) is of "the amounts included within that aggregate", that is, the requirement is for specification under (b) of an actual component of (a). To permit (a) to be calculated on a different basis would make no sense, and would defeat the object of achieving a balance sheet giving a true and fair view of the state of affairs of the group.

The appellants' submission focussed critically on two successive sentences in the Commission's decision:

"...if the balance sheet is to be a meaningful document it will need to include an entry relating to investments.

If the balance sheet does include an entry relating to investments, the figure entered in the balance sheet as the aggregate amount of investments must comply with the following paragraph (b) of the clause." (pp 7-8)

It was submitted that these contradicted the earlier acceptance by the Commission of the proposition that the opening words of Clause 24 provided the issuer with an alternative. While the passage may be elliptic, what I take the Commission to be saying is that it was inconceivable that a balance sheet could present a "true and fair view" of the state of affairs of the group (see Clause 16(1)) without including reference to investments. Such statement need not necessarily be in aggregate form, but if it is not, in order to comply with Clause 24(a) the issuer then must include such an aggregate in a note. In either event, for the reasons given in the following passages of the Commission's decision, the portion of the aggregate attributable to investments in non-guaranteeing subsidiaries must be calculated in accordance with the formula set out in para (i) of Clause 24(b).

As the Commission pointed out, the prescriptions contained in paras (i) to (v) of Clause 24 are not all embracing. In relation to forms of investment not covered, Clause 16(3) applies, and permits such items to be included in the aggregate amount of investments, either in the balance sheet or notes to it. The manner in which such items are presented is of course subject to the general reservation under Clause 16(1) that the balance sheet must give a true and fair view of the state of affairs of the group at the specified date. Where however paras (i) to (v)

of Clause 24 require specific information, or a calculation made in a particular way, the general provisions of Clause 16(3) must give way to the express mandate of Clause 24.

In each instance the formal questions posed in the Case are as follows:

- (a) Whether Clause 24 of the Second Schedule permits the Appellant in calculating the "aggregate amount of investments" (as required by Clause 24(a)) to bring the total value of investments in subsidiaries that are not members of the Group to account at a value determined other than on the basis of Clause 24(b)(i) provided that:
  - (i) that value gives a true and fair view of the state of affairs of the Group; and
  - (ii) there is separately disclosed either on the face of the balance sheet or in the notes to the balance sheet the total value of such investments included in the aggregate amount of investments determined in accordance with Clause 24(b)(i);
- (b) Whether the Second Schedule permits the Appellant in calculating the total assets of the Group to bring the total value of investments in subsidiaries that are not members of the Group to account at a value determined other than on the basis of Clause 24(b)(i) provided that:
  - (i) that value gives a true and fair view of the state of affairs of the Group; and
  - (ii) there is separately disclosed either on the face of the balance sheet or in the notes to the balance sheet the total value of such investments determined in accordance with Clause 24(b)(i);
- (c) Whether the total of investments in subsidiaries that are not members of the Group can only be brought to account in the balance sheet and be included in the aggregate amount of investments (clause 24(a)) on the basis of a value calculated in accordance with Clause 24(b)(i).

What I have said already indicates that my answer to 9(a) is no. As to (b), the regulations do not deal with this explicitly. However, I am satisfied that the intent and meaning must be that the method of calculation of investments is to be consistent throughout the prospectus. To permit the issuer to state the value of investments on one footing in the balance sheet, and then to set out the aggregate of investments in non-guaranteeing subsidiaries on a different basis (whether in the balance sheet itself, or in a note to it) would be confusing if not misleading.

It follows that in all respects I am in agreement with the reasoning and conclusions of the Commission's decision of 2 August 1990. My formal answers to the questions posed in the cases are in each instance (a) no; (b) no; (c) yes.

In the case of each appeal I award costs to the respondent in the sum of \$1,000, together with disbursements if any as approved by the Registrar.

Shoosha Investments Ltd

Solicitors:

Rudd Watts & Stone, Wellington for UDC Finance Ltd  
 Bell Gully Buddle Weir, Wellington for ANZ Banking Group  
 (NZ) Ltd  
 Macalister Mazengarb Perry Castle, Wellington for respondents

## APPENDIX C

### REVIEW OF PRESENT MARKET PRACTICE

#### IMPORTANT NOTE

THE ANALYSIS IN THIS APPENDIX HAS BEEN CARRIED OUT BY THE COMMISSION WITHOUT THE BENEFIT OF DISCUSSION WITH THE COMPANIES CONCERNED. THE RESULTS OF THE ANALYSIS ARE ENTIRELY THE RESPONSIBILITY OF THE COMMISSION. NO ENDORSEMENT OR CRITICISM IS INTENDED BY THE INCLUSION OF THE ACCOUNTS OF ANY PARTICULAR COMPANY.

#### C.1 Smiths City Market Limited : August 1987

- C.1.1 Smiths City raised debenture finance regularly from the market for a number of years.
- C.1.2 The prospectus shows the accounts of the charging group only. It lists the NGS by name but a separate item for "Investments in NGS" does not appear.
- C.1.3 The amount for shareholders' funds in the annual accounts was \$57.105 million while in the prospectus the amount is \$57.083 million. This difference comes primarily from the inclusion of "Share of Associated Company Retained Earnings \$19,000" in the annual accounts. In other words the main difference appears to be the equity accounting in the annual accounts.
- C.1.4 The application of the Second Schedule requirements has resulted in accounts which differ little from those in the company's annual accounts, presumably because at that date the NGS were not very significant. The investor cannot determine either the cost or the market value of the investment in NGS.



**C.2 Electricity Corporation of New Zealand - June 1991**

C.2.1 Electriccorp publishes a prospectus for its ongoing issues of bonds. The prospectus contains the accounts of the Borrowing Group only. Included in the explanatory notes is an item "Shares in NGS at cost \$566 million. Shares in NGS have no ascertainable market value."

C.2.2 The accounts show Net Profit After Tax for the Borrowing Group of \$491.7 million compared to \$508.7 million in the published Annual Accounts of the Corporation. Shareholders Funds are shown as \$3.571 billion for the Borrowing Group and \$3.593 billion for the whole corporation, while Total Assets are \$7.904 billion and \$8.171 billion respectively.

C.2.3 An investor with the prospectus only has no indication of the difference between the cost of the investment in the NGS and the book value of the assets underlying that investment. Nor does he/she know the composition of the assets of the NGS.

**C.3 Telecom Corporation of New Zealand : June 1991**

C.3.1 The accounts in the prospectus are for the Borrowing Group only. The names of guaranteeing and NGS are listed in the prospectus. Shares in NGS are shown in the notes to the accounts at \$312.2 million. Presumably the note "Non-current investments are stated at the lower of cost or, where the directors consider that there has been a permanent diminution in value, at directors' valuation" applies to the investment in NGS although this is not explicitly stated.

C.3.2 Comparing the figures for the Borrowing Group with those in the recent Equity Offering Memorandum shows Net Profit After Tax of \$310.3 million for the Borrowing Group and \$338.5 million for the Consolidated Group,

Shareholders' Funds of \$2.568 billion and \$2.595 billion respectively, and Total Assets of the Borrowing Group at \$4.990 billion compared with a lower \$4.717 billion for the consolidated Group.

C.3.3 The reason for the higher total assets of the borrowing group is that there is a \$405 million long-term loan from one of the NGS to Telecom which is consolidated out in the full accounts.

C.3.4 This situation is similar to that of Electricorp, apart from the inter-group funding. The debt prospectus highlights the inter-group funding arrangement, information which is consolidated out in the equity offering memorandum. Without access to the equity offering memorandum the investor in debt securities does not know the difference between the cost of the investments in the NGS and the value of the assets underlying those investments and nor does he/she know how much income is generated in the NGS compared to the borrowing group.

**C.4 Fletcher Challenge Industries Limited : Capital Notes; May 1990**

C.4.1 Fletcher Challenge Industries Ltd ("FCIL") went to the market in 1990 (and again last year) with an issue of Capital Notes which have a conversion option to Fletcher Challenge Limited ("FCL") shares in 10 years' time. FCIL is the holding company for the FCL group's major industrial activities including construction, mining, the Canadian operations, and many more. (The other major element of the FCL group is the Financial Services Group.) The Notes were not guaranteed by either the parent (FCL), or any of the operating subsidiaries.

C.4.2 The Notes were considered debt securities for the purposes of the Regulations. Financial information was presented in the prospectus in modified form under the authority of a Securities Commission Exemption Notice

- C.4.3 The prospectus contains several sets of accounts. It has a set for FCIL on its own, (the "borrowing group") a set for FCIL and all its subsidiaries, and, because of the possibility of conversion to FCL shares, those of FCL as well.
- C.4.4 The prospectus states that the accounts of FCIL and FCL are required by the Regulations, while those of FCIL and subsidiaries are included on a voluntary basis.
- C.4.5 The different sets of accounts are clearly separated in the prospectus. Those of FCIL are first, then FCIL and subsidiaries, then FCL. Preceding the consolidated accounts of FCIL is a statement, in bold type on its own page, stating:
- "The inclusion of the extracts from the unaudited consolidated financial statements of Fletcher Challenge Industries and Subsidiaries is to provide additional information in respect of the underlying assets, earnings and cash flow of Fletcher Challenge Industries Limited. The subsidiaries of Fletcher Challenge Industries Limited do not guarantee the Capital Notes"**
- C.4.6 The accounts of FCIL included in the prospectus are as at 31.12.89, covering a six month period only.
- C.4.7 The valuation of Investments in Subsidiaries is stated to be arrived at after determining a fair value on acquisition. If the cost is higher than the assessed value the difference is written off to earnings immediately. Investments are then carried at this value until a permanent impairment in value occurs, at which time the value will be written down again.
- C.4.8 The value of Investment in the shares of Subsidiaries is shown as \$6.22 billion in the accounts of FCIL. The net earnings after tax of FCIL are shown as \$38 million (with the principal income being dividends of \$116 million), while the

net earnings after tax and minorities of the Consolidated FCIL is \$289 million.

C.4.9 The Shareholders' Funds of FCIL are shown as \$3.56 billion while those of the consolidated FCIL group are \$4.419 billion. The Total Assets of FCIL are \$6.70 billion whereas those of the consolidated FCIL group are \$15.439 billion.

C.4.10 FCIL has obviously recognised that showing only the required set of FCIL accounts would not give the prospective investor the information he/she needs to make an informed investment decision and therefore has included a set of consolidated accounts with a very clear disclaimer.

C.4.11 Since FCIL is a holding company any investor in the Capital Notes would have to look at the underlying assets of the subsidiaries because that is the source of the earnings and cash flow to service the Notes over time. On the other hand, since the Notes are issued by FCIL and servicing is not guaranteed by any other party it is important that the investor be aware of the nature and resources of that entity. The level of disclosure may have been assisted still further by a reconciliation of the financial results of FCIL with the full consolidated FCIL group.

**C.5 Natural Gas Corporation Limited - Natural Gas Notes - March 1991**

C.5.1 The issues raised by the prospectus for Natural Gas Notes are very similar to those in the FCIL prospectus. Natural Gas Corporation Limited ("NGC") is a holding company formed on 17 December, 1990 to acquire all the shares of Natural Gas Corporation of New Zealand Limited ("NGCNZ") which is the principal operating subsidiary for all the natural gas activities (although there are two other major subsidiaries as well). NGS is a wholly owned subsidiary of its ultimate parent, Fletcher Challenge Limited ("FCL").

C.5.2 The Notes are issued by NGC and are not guaranteed by NGCNZ or any of the other subsidiaries or by the ultimate parent FCL. The Notes are fully subordinated.

C.5.3 The prospectus contains financial statements as follows:

- (1) Income Statement for NGC for the period 17-12-90 to 31-12-90. This contains all the headings required in the Second Schedule but is completely blank.
- (2) Balance Sheet of NGC as at 31.12.90. This shows authorised capital of \$0.1 thousand and no other entry.
- (3) Cash Flow Statement. Again blank.
- (4) A balance sheet of NGC as at the date of the prospectus (8-3-91). Because the shares of NGCNZ were acquired in February 1991 and various other transactions took place in February/March 1991 this is a substantive balance sheet which shows Investments in NGCNZ at cost of \$380 m and advances to subsidiaries of \$494 m.

C.5.4 There are then a substantial number of statements of NGC and subsidiaries which are preceded by a page headed "Additional Information" which includes the following:

"The information ...is additional information, does not form part of the Financial Statements of NGC ... and constitutes, in the view of the Directors, material matters requiring disclosure to investors"

"Use of the word 'Group' in the additional information ... should not be taken to indicate that any company other than NGC is liable for payment of principal or interest under the Notes. None of the subsidiaries of NGC guarantees the repayment of the Notes or the interest thereon."

C.5.6 These statements include:

- (1) Forecasted Income Statement, Balance Sheet and Statement of Cash flows (to 30-6-91 and 30-6-92) for the consolidated NGC group even though the Notes are issued by NGC and the subsidiaries do not guarantee them. There are no forecasts for NGC alone even though that company is the issuer.
- (2) A summary of the consolidated financial statements of NGCNZ for the last 5 years.
- (3) A special summary of NGC and subsidiaries as at 31.12.90 as if Natural Gas Contracts Limited (one of the major operating companies of the group) had been acquired before that date.
- (4) Consolidated Income Statements and Balance Sheets for NGCNZ as at 31-12-90, 30-6-90, and 30-6-89 (and the respective financial periods ending on those dates).

C.6 National Australia Bank (N.Z.) Limited - Prospectus 7  
June, 1991

C.6.1 The National Australia Bank (NZ) Limited ("NABNZ"), in its debt issue prospectus, shows the accounts of the parent (the borrowing entity) alongside those of the full consolidated group. The prospectus includes a statement:

"The accounting information which follows details two sets of figures. The columns headed "PARENT" comprise the unconsolidated accounts of NABNZ. The Five Year Financial Summary also relates to NABNZ as it is the only member of the "borrowing group". The Securities Regulations 1983 require this financial information to be included, and it is these figures which intending investors should study.

"As NABNZ owns a number of wholly owned subsidiaries, and these companies hold a significant portion of the assets and liabilities of the Group, accounting information for this Group is also disclosed. These figures are shown under the columns headed "CONSOLIDATED" and are for information and comparison only. Attention is drawn to the fact that the obligations of NABNZ are not guaranteed by its subsidiaries, and that on a winding-up NABNZ would only be entitled to receive the surplus assets after all liabilities of all subsidiaries had been fully satisfied. None of the subsidiaries guarantees the securities offered under this Prospectus."

C.6.2 In addition, because the accounts of the borrowing group are presented alongside those of the issuing group (with those of the "borrowing group" - the parent in this case - shaded) there is a statement on the pages of the prospectus containing the Statements of Profit and Loss, Balance Sheets, Statement of Cash Flows, and at the conclusion of the Notes, which says:

"The Important Note re Financial Statements on page 5 should also be read in conjunction with these accounts"

C.6.3 The accounts show that the total assets of NABNZ were \$2.521 bn at 31 March, 1991, while those for the group amounted to \$2.543 bn. Shareholders' funds of NABNZ were \$147.6 m, while those of the group were \$150.0 m, indicating that the difference in valuation of the investment in NGS between cost (written down) and book value was \$2.4 m. The Statements of Profit and Loss show that NABNZ made an operating loss of \$186,000 after tax while the consolidated group made a loss of \$6.7 m.

## APPENDIX D

### COMPARISON OF ALTERNATIVE APPROACHES

#### IMPORTANT NOTE

THE PRESENTATIONS IN THIS APPENDIX HAVE BEEN PREPARED BY THE COMMISSION USING INFORMATION PUBLISHED IN THE RELEVANT PROSPECTUS OF FLETCHER CHALLENGE INDUSTRIES LIMITED ("FCIL"). FCIL HAS NOT BEEN INVOLVED IN THE DATA COMPILATIONS NOR HAS IT GIVEN ANY ADVICE ON THE ASSUMPTIONS WHICH WERE MADE IN PREPARING THESE ALTERNATIVE PRESENTATIONS. THESE ACCOUNTS HAVE BEEN USED SOLELY TO DEMONSTRATE THE EFFECT OF THE VARIOUS ALTERNATIVE PRESENTATIONS DISCUSSED IN THE MAIN PAPER. NO ENDORSEMENT OR CRITICISM OF THE ACCOUNTS OF FCIL OR THE STRUCTURE OF ITS OPERATIONS IS INTENDED. FCIL BEARS NO RESPONSIBILITY FOR THE ACCURACY OR OTHERWISE OF THE RESULTS AS PRESENTED IN THIS APPENDIX.

D.1 This paper has nominated five alternative approaches. This appendix sets out examples of three of those methods of presentation, namely Alternatives Three, Four and Five. The first two alternatives, which have little appeal to the Commission, were:

- (1) Alternative One which was to make no change to the Regulations;
- (2) Alternative Two which changed the basis of valuation required in Clause 24 to the **book value** of the equity investment in the non-guaranteeing subsidiaries (but made other presentational changes).

D.2 In providing these examples, we have made use of the case of Fletcher Challenge Industries Limited data as referred to in Appendix C.



**D.3 Revised Presentation - Alternative Three**

D.3.1 This option involves showing the accounts of the **full issuing group** alongside those of the **borrowing group**, with the Investments in NGS in the accounts of the borrowing group shown at net asset value (not cost or market valuation). There is also a reconciliation of the contribution of the borrowing group and the NGS to group profitability.

D.3.2 The illustration of this alternative using the accounts of Fletcher Challenge Industries Limited starts on the next page.

**Fletcher Challenge Industries Limited**      **(Alternative Three)**

<b><u>BALANCE SHEET</u></b>	<b><u>Consolidated Accounts</u></b> \$ bn	<b><u>Borrowing Group</u></b> \$ bn
<b><u>Assets:</u></b>		
Fixed Assets	10.467	-
Investments	0.643	-
Current Assets	4.099	0.282
Investments In Related Companies	0.228	-
Investments In Non-Guaranteeing Subsidiaries:		
Equity		6.636 [1]
Net Advances		<u>(2.482)</u>
	<hr/>	<hr/>
	<b>15.439</b>	<b>4.436</b>
	<hr/>	<hr/>
 <b><u>Liabilities and Shareholders Funds</u></b>		
Shareholders Funds:		
Issued and Paid Up Capital	2.647 [2]	2,201
Reserves	1.772	1.772
Parent Company Debt	<u>0.329</u>	<u>0.329</u>
Overall Parent company investment	4.748	4.302
Minority Interests	1.189	-
Deferred Tax	0.409	-
Convertible Liabilities	0.125	-
Term Liabilities	6.639	0.108
Current Liabilities	2.326	0.026
	<hr/>	<hr/>
	<b>15.439</b>	<b>4.436</b>
	<hr/>	<hr/>

Notes

1. In these accounts the investment of the borrowing group in the non-guaranteeing subsidiaries is valued at the amount of the equity which would be shown in the books of the NGS (after making some simplifying assumptions), **not at lower of cost or market value (if ascertainable)** as required in the Second Schedule. If the amount was shown at "cost", then the Equity Investment in NGS would be shown as \$6.224 bn, and the Shareholders' Funds would be \$0.411 bn lower.
  
2. For an explanation of the reason why the amount of Issued and Paid Up Capital of the "Consolidated Group" is higher than that of the "borrowing group" it is suggested the reader obtain a recent annual report of Fletcher Challenge Limited. It appears to relate to external capital raising by a subsidiary of FCIL.

(If cost was retained as the valuation basis for the investment in NGS then the Borrowing Group Column would show a figure for equity investment in NGS of \$6.224 million, and it would be necessary to show a reconciliation statement to explain the difference between that figure and the amount in the Non-guaranteeing subsidiaries column.)

**D.5 Revised Presentation - Alternative Five**

D.5.1. Under this alternative the regulations would require the accounts of the **borrowing group**, with the investments in NGS appearing at book value, the equivalent of the net assets of the NGS. (Consistent with Alternatives Three and Four, cost could be included in the Notes.) Also disclosed would be details of the assets, liabilities and earnings of the NGS. The excess of assets over liabilities in the NGS is reconciled with the amount of the investment in the NGS in the issuing group balance sheet.

**PROFIT AND LOSS ACCOUNT**

	<u>Consolidated Accounts</u> \$ mn	<u>Borrowing Group</u> \$ mn
<b><u>Turnover</u></b>	<b><u>5,666</u></b>	-
Operating Earnings	606	(19)
Investment Earnings	42	15
Funding Costs	(238)	(7)
Dividends from Operating Subsidiaries	-	116
Interest Paid to Subsidiaries	-	(104)
	—	—
<b>Earnings Before Taxation</b>	<b>410</b>	<b>1</b>
Taxation Charge	(102)	-
Taxation Effect of Dividend	-	37
Minority Interest	(19)	-
Extraordinary Items	(19)	-
	—	—
<b>Net Earnings After Tax</b>	<b>270</b>	<b>38</b>
	—	—
<b><u>Reconciliation</u></b>		
Net Earnings of FCIL and Subsidiaries		270
Share of Group Earnings contributed by the (non-guaranteeing) subsidiaries after payment of dividends to, and receipt of interest from, FCIL		232
		—
<b>Net Earnings of FCIL (the borrowing entity)</b>		<b>38</b>
		—

**D.4 Revised Presentation - (Alternative Four)**

D.4.1 This presentation involves showing the full consolidated accounts of the issuing group together with a reconciliation to the assets, liabilities and earnings of the non-guaranteeing subsidiaries.

**BALANCE SHEET**      **(Alternative Four)**

	<u>Consolidated</u> <u>Accounts</u> \$ bn	In The Accounts of the Non- guaranteeing <u>Subsidiaries</u> \$ bn
<b><u>Assets:</u></b>		
Fixed Assets	10.467	10.467
Investments	0.643	0.643
Current Assets	4.099	3.817
Investments in Related Coys	<u>0.228</u>	<u>0.228</u>
	<b>15.439</b>	<b>15.155</b>
<b><u>Liabilities and Shareholders Funds</u></b>		
Shareholders Funds	4.419	-
Parent Company Debt	<u>0.329</u>	-
Parent Company Investment	4.748	
Minority Interests		1.189
External Capital Investment in subsidiary		0.446
Deferred Tax	0.409	0.409
Convertible Liabilities	0.125	0.125
Term Liabilities	6.639	6.531
Current Liabilities	<u>2.326</u>	<u>2.300</u>
		11.000
Net Equity Investment of FCIL in Operating Subsidiaries		6.636
<u>Plus</u> Debt Owed by Operating Subsidiaries to FCIL		<u>0.195</u>
Gross Investment by FCIL in Operating Subsidiaries		6.831
<u>Less</u> Debt Owing by FCIL to Operating Subsidiaries		<u>(2.677)</u>
Net Investment By FCIL in (Non- guaranteeing) Subsidiaries		<u>4.154</u>
	<b><u>15.439</u></b>	<b><u>15.155</u></b>

(The FCIL accounts in the debt issue prospectus show equity investment in subsidiaries as \$6.224 billion, against \$6.636 billion in the above presentation - the difference is the increased reserves of the subsidiaries.)

**BALANCE SHEET**      **(Alternative Five)**

	Borrowing Group <u>Accounts</u> \$ bn	Non-Gtg <u>Subsidiaries</u> \$ bn
<b><u>Assets</u></b>		
Fixed Assets	-	10.467
Investments	-	0.643
Current Assets	0.282	3.817
Investments in Related Companies	-	0.228
Investments in Non-Guaranteeing Subsidiaries:		
Equity	6.636	
Net Advances	<u>(2.482)</u>	
	4.154	
	<hr/>	<hr/>
	<b>4.436</b>	<b>15.155</b>
	<hr/>	<hr/>
<b><u>Liabilities and Shareholders Funds</u></b>		
Shareholders Funds		
Issued and Paid Up Capital	2.201	-
Reserves	1.772	
Parent Company Debt	<u>0.329</u>	
Parent Company Investment	4.302	
External Capital Investment in Subsidiary		0.446
Minority Interests		1.189
Borrowing Group Investment		
Equity		6.636
Net Advances		<u>(2.482)</u>
		4.154
Deferred Tax	-	0.409
Convertible Liabilities	-	0.125
Term Liabilities	0.108	6.531
Current Liabilities	0.026	2.300
	<hr/>	<hr/>
	<b>4.436</b>	<b>15.155</b>
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