Australian Government

Financial Reporting Panel

19 October 2010

The Directors
BBX Property Investment Fund Limited
916 Pacific Highway
GORDON NSW 2072

Attention: Mr Tim Creasy
Company Secretary

Dear Directors

FINANCIAL REPORTING PANEL REPORT: BBX PROPERTY INVESTMENT FUND LIMITED A.C.N. 118 847 108

On 4 August 2010 the Financial Reporting Panel (the Panel) received a referral from the Australian Securities and Investments Commission (ASIC) concerning its dispute with BBX Property Investment Fund Limited A.C.N. 118 847 108 (BBX) over its accounting treatment in the financial report for the half-year ended 31 December 2009.

The Panel's decision in this matter is attached.

As required under Section 323EK(5) of the *Corporations Act 2001*, a copy of this report will also be given to ASIC and to the National Stock Exchange of Australia.

The contact officer on this matter is the Panel's Secretary, Mr Marcus McKillop, who may be contacted on 02 6263 2877.

David Boymal

Professor David Boymal
Chair of the Panel Convened

Ken McKenzie

Mr Ken McKenzie
FRP Chairman

REPORT OF THE FINANCIAL REPORTING PANEL – BBX PROPERTY INVESTMENT FUND LIMITED

Executive summary

The Australian Securities and Investments Commission (ASIC) referred to the Financial Reporting Panel (the Panel) the financial report of BBX Property Investment Fund Limited A.C.N. 118 847 108 (BBX) with the claim that the company's financial statements for the half-year ended 31 December 2009 were not in compliance with the following standards:

- AASB 134 *Interim Financial Reporting*
- AASB 132 *Financial Instruments: Presentation*
- AASB 136 *Impairment of Assets*
- AASB 138 *Intangible Assets*

The 31 December 2009 the half-year financial statements of BBX included a current asset titled 'Trade Dollar account' on the face of the Statement of Financial Position. These same assets were presented as non-current 'Other Financial Assets' in the financial statements for the year ended 30 June 2009. The half-year financial statements do not include an explanation as to why the change in presentation occurred. However, note 2 to the half-year financial statements still indicate that these Trade Dollars are classified as 'Non-current Other Financial Assets', and accounted for on that basis.

ASIC claims that the trade dollars should be classified and accounted for as intangible assets, and therefore subject to the impairment approach of AASB 136 *Impairment of Assets,* (and therefore subject to further impairment than was booked in the December 2009 half-year financial statements).

The Panel considered four questions in its evaluation of the claim by ASIC:

1. What is the nature of the Trade Dollars?
2. What was the correct measurement principle on initial recognition of the Trade Dollars?
3. What is the appropriate basis to approach the impairment test?
4. If there is need for a correction how should it be accounted for?

Based on the documents provided to the Panel and after hearing evidence from both ASIC and BBX, the Panel concluded that:

1. The Trade Dollars in the hands of BBX meet the definition of an intangible asset, not a financial asset.
2. Trade Dollars issued in return for shares should have been recognised at their fair value at the date of issue, which is likely to be different to AUD$1 dollar (AUD1).
3. Trade Dollars received as consideration for providing rental services should have been recognised in accordance with the rental contracts.
4. Determining the fair value of the Trade Dollars at initial recognition needs to take into account the apparent 'discounting' due to the trades being based on the list price and take account of other market participant assumptions.
5. AASB 136 *Impairment of Assets* is the appropriate standard to apply to assess impairment. This requires the determination of the higher of the fair value less costs to sell and its value in use. The evidence indicates that the fair value of the Trade Dollars can be assessed, and

hence value in use is not the only approach that BBX should apply. For this purpose, the assessment of the fair value would need to reflect the significant holding that BBX had of Trade Dollars and reflect a discount for the time period over which they could be utilised.

6. Accounting corrections relating to prior period errors should be accounted for retrospectively in accordance with AASB 108.42 as discussed in section 4 below.

The reasons for this conclusion are set out in section 3 below.

1. Background

BBX is a member of the BBX Trading Program. This Program enables members to exchange goods and services for Trade Dollars rather than paying cash. Throughout the periods 1 July 2006 to 31 December 2009 BBX issued shares in return for Trade Dollars and recognised these at an amount of $15,389,081 (ascribing AUD1 per Trade Dollar). During the same period, $2,726,402 have been utilised in purchasing sundry services and being paid as deposits on land purchases.

As at 30 June 2009, the Trade Dollar Account had a value of $12,673,571, based on each Trade Dollar having a value of AUD1.

BBX has in the past used Trade Dollars as a deposit amounting to approx 30% on land purchases with payment of the remaining balance in cash.

2. Process

The Panel received written submissions from both ASIC and BBX with supporting evidence for their views. Both parties also appeared in a hearing before the panel to discuss their written submissions, provide any additional evidence and to answer questions from the panel.

In forming its conclusion, the panel have taken account of all of the evidence provided via this process and considered the requirements of the relevant Australian Accounting Standards.

3. Reasons for conclusions

3.1 What is the nature of the Trade Dollar asset?

The Framework defines an asset as:

> 'A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.'

The Panel believes the Trade Dollars meet the definition of an asset in the *Framework*. The Trade Dollars once received are under the control of BBX to use for future purchases of goods or services. The receipt of the Trade Dollars has arisen from past events – issuing goods or services. Future economic benefits are expected to arise, as the Dollars can be used to acquire a range of goods and services.

AASB 139.11 defines a financial asset as:

'A financial asset is any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity;'[1]

The Trade Dollars give BBX the right to enter into barter trade transactions with other members of the Program. They do not provide BBX with a right to receive cash or equity instruments from other parties, nor can they be traded on an exchange. While they have some features of cash, being used by the members to settle obligations, they are not cash.

Cash by its nature is legal tender that is used for exchanges by all citizens in particular jurisdictions. As cash is legal tender there is a government that stands behind the currency, providing a guarantee/support. No such mechanism exists with the Trade Dollars held by BBX. Each holder of the Trade Dollars carries a risk, relying on the other members in the Program to honour them in transactions.

Therefore the Trade Dollars are not cash, they not an equity instrument of another entity, nor do they constitute a right to receive cash or another financial asset. Therefore they are not a financial asset.

AASB 138.8 defines an intangible asset as:

> 'an identifiable non-monetary asset without physical substance.'

A monetary asset is further defined in the Glossary to AASB as:

> 'Money held and assets to be received in fixed or determinable amounts of money.'

The Trade Dollars have no physical substance being a piece of paper granting a right to trade. As noted above, while they have features similar to cash, the rights do not constitute cash or money. They therefore are non-monetary assets.

Therefore the Trade Dollars meet the definition as an intangible asset and should be accounted for as such.

3.2 What was the measurement on initial recognition of the Trade Dollars?

AASB 138.24 states that:

> 'An intangible asset shall be measured initially at cost.'

The Glossary to AASB provides a general definition of cost as:

> 'The amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs eg IFRS 2 *Share based payment transactions*.'

BBX has gained the Trade Dollars via two methods – in exchange for providing rental services and the issue of equity instruments. The majority of the Trade Dollars were received in exchange for the issues of BBX equity instruments.

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[1] AASB132.11 also includes a part (d) relating to a contract to be settled by the entity's own equity instruments, which is not applicable in the current situation, hence has been left out.

3.2.1 Trade Dollars gained from goods or services.

The provision of services in return for an intangible asset is considered an exchange transaction for dissimilar goods. AASB 118 *Revenue* governs the recognition and measurement of revenue. In particular AASB 118.12 establishes a principle for recognising revenue in exchange transactions as follows:

> 'When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.'

Therefore to the extent that the Trade Dollars are received as consideration for goods or services sold, they are recognised at their fair value at that date, as the Trade Dollars are dissimilar to the goods or services that BBX provide.

However, most of the services provided by BBX in exchange for Trade Dollars are rental services generating rental income. The recognition of rental income is governed by AASB 117 *Leases* rather than AASB 118. AASB 117.50 states that:

> 'Lease income from operating leases shall be recognised in income on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.'

Therefore, the measurement of Trade Dollars earned from lease rental services on initial recognition is driven by the calculated lease revenue derived from the lease contract rather than the fair value of the Trade Dollars.

3.2.2 Trade Dollars gained from issuing equity instruments.

AASB 2.Appendix A defines an equity-settled share-based payment transaction as:

> 'A transaction[2] in which the entity:
>
> (a) Receives goods or services as consideration for its own equity instruments, or'[3]

AASB2.5 further states:

> 'Goods includes inventories, consumables, property, plant and equipment, intangible asset and other non-financial assets.'

The Trade Dollars were received in exchange for BBX equity instruments, and are therefore within the scope of AASB 2 as an equity-settled share based payment transaction. Therefore AASB 2 will apply to determine the cost on initial recognition of the intangible assets.

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[2] AASB 2.Appendix A contains a number of interlinked definitions – 'share-based payment transaction' and 'share-based payment arrangement' which essentially require the entity to enter into a transaction that entitles the other party to receive equity instruments of the entity if vesting conditions are met.

[3] The definition in AASB 2. Appendix A also contains a part (b) which encompasses goods or services received with no obligation to settle to the transaction, which is not relevant for this discussion.

AASB2.10 states:

> 'For equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.'

The Trade Dollars should therefore have been recorded on initial recognition at their fair VALUE. If this value could not be determined, the fair value of BBX equity instruments should have been determined and be used as the basis to value the Trade Dollars.

3.3 Determining the fair value of the Trade Dollars on initial recognition

Fair value is defined in AASB2.Appendix A as:

> 'the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.'

The Panel is not able to determine the fair value, but it is able to discuss the principles for determining fair value that can be derived from the definition. These are as follows:

- It reflects market participants' views and assumptions rather than entity specific views and assumptions. Therefore in the case of BBX, it would consider the wider use for which Trade Dollars could be used, not just BBX's ability to use the Trade Dollars by virtue of the business model of BBX.
- Similar transactions are taken into account as much as possible, as these are the best reflection of the amounts parties are willing to pay. In the case of the Trade Dollars this means looking at comparable cash transactions to determine the value ascribed to the Trade Dollars, and not necessarily the list prices that are stipulated in the Program.
- Consider restrictions that attach directly to the asset rather than the holders of the asset. In this case, the fact that they can only be used by members of the Program.
- Consider the time period over which the benefits are expected to arise. This would take into account the ability to utilise the large holding received at any point in time relative to the general trading and available goods or services. Again this would be based on the market views and not restricted to BBX's anticipated usage.

As the Trade Dollars are not themselves traded, there is no readily available market value. Rather the fair value needs to be determined by looking at the underlying entitlement embodied in the asset. This means considering the full range of goods or services that the Trade Dollars could be exchanged for in the future. The fact that the transactions have to take place at the list price, while comparative cash transactions would receive a discount on the list price needs also to be taken into account, as this is prima facie indication that the Trade Dollars are not worth AUD1, but are actually worth less.

In the case of the Trade Dollars, this means considering the value that would attach to them by all market participants. There is an argument to say that this means considering the values that would attach to the Trade Dollars by both members of the Program and non-members. However, if the restrictions on the asset, which reflect the fact they can only be used by certain members of the community, are taken into account, it may be concluded that this is sufficient to reflect the different perspectives of the market participants.

BBX acquired a large holding of the Trade Dollars. On its own this should not affect the fair value of the assets, as generally bulk discounts are not taken into account, as the unit of account for the measure is the individual Trade Dollar rather than the portfolio of dollars.[4] However, the Panel understands that BBX's holding is larger than all other members of the Program, therefore in this case, they do not believe that this factor should be ignored when determining the fair value on initial recognition. The fair value should also reflect any uncertainty evident in the continuation of the Program as referred to in the Grant Thornton report (November 2009). However a valuer will be required to assess the amount of the discount that should be factored into the fair value as a result of these factors.

Should the fair value not be determinable, the fair value of the equity instruments, based on the trading and/or pricing on the National Stock Exchange of Australia (NSX) needs to be determined. It is the understanding of the Panel that there has been no trading in the shares of BBX on the NSX, therefore the determination of the fair value of the equity instruments of BBX will be difficult to determine, possibly requiring the services of a valuer.

A fair value of Trade Dollars was determined by Grant Thornton in 2009 for a different purpose which reflected consideration of the factors above – meaning that the determination of a fair value is possible.

3.4 Subsequent accounting for the intangible asset

AASB 138.72 states:

> 'An entity shall choose either the cost model in paragraph 74 or the revaluation model in paragraph 75 as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.'

AASB 138.75 further states:

> 'For the purpose of revaluations under this Standard, fair value shall be determined by reference to an active market.'

As noted above the Trade Dollars themselves are not traded, but are rather used to acquire services. That is, there is no active market for those assets. Therefore BBX must apply the cost model, as set out in AASB 138.74:

> 'After initial recognition, an intangible asset shall be carried at its cost less any accumulated amortisation and any accumulated impairment losses.'

AASB 138.88 further states:

> 'An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based

[4] There is no direct reference to the unit of account in the standards, but rather it is implied by numerous standards that discuss 'an asset' rather than 'assets' – AASB 136, AASB 138, AASB 139. Recent discussions by the IASB in finalising the standard on Fair Value Measurement have confirmed this approach.

on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.'

The Trade Dollars do not have an indefinite life. While there is no time limit attached to them, there is a foreseeable limit to the period over which it is expected to generate net cash inflows – up until it is actually used to trade for goods or services. Therefore they are considered to have a finite life.

AASB 183.97 states:

> 'The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life....The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consume by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used.'

BBX must therefore amortise the Trade Dollars over their useful lives. This useful life is the period over which the economic benefits are consumed. The benefits embodied in the Trade Dollars are only consumed by giving up the asset as consideration to acquire other goods or services. One view is that this may be akin to the 'units of production' method in which the 'exchange' of the Trade Dollar is the production unit - in which case it is amortised/expensed as it is given up, or capitalised if it meets the condition of other Standards.

When the Trade Dollars are given up for the purchase of assets accounted for in accordance with AASB 116 or AASB 140, this is considered an exchange transaction. BBX have utilised Trade Dollars to acquire land and buildings that have been classified as investment property. Therefore the requirements of AASB 140 are relevant to consider. AASB 140.27 states:

> 'One or more investment properties may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets...The cost of such an investment property is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable.'

Therefore, regardless of the value assigned to the Trade Dollars, at the date they are given up as consideration to acquire assets, the asset acquired is recognised at its fair value. Any difference that exists between the value assigned to the asset (or portion of the asset) acquired with the Trade Dollars and their carrying value gives rise to a gain or loss on disposal.

There is no evidence that the values assigned on initial recognition of investment property do not represent fair value. Therefore any adjustment that is required due to the Trade Dollars being recognised at other than their fair value will not affect the carrying value of the assets acquired.

3.5 Impairment assessment of Trade Dollars

Trade Dollars as an intangible asset are subject to the impairment provisions of AASB 136 *Impairment of Assets*. As an intangible asset with an indefinite use life, the Trade Dollars are assessed at each reporting date in accordance with AASB 136.9:

> 'An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset'.

BBX must therefore assess at each reporting date whether there are indicators of impairment, and where such indicators exist, conduct an impairment test to identify if there is an impairment loss, and how much that is.

AASB 136.6 defines an impairment loss as:

> 'the amount by which the carrying amount of an asset or a cash-generating unit exceeds it recoverable amount.'

AASB 136.6 also defines the recoverable amount of an asset or cash-generating unit as:

> 'the higher of its fair value less costs to sell and its value in use.'

As it relates to the determination of fair value less costs to sell AASB 136.27 states:

> 'If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at the end of the reporting period, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal.'

While there is no market for the disposal or trading of the Trade Dollars themselves, there is a market for the use of the Trade Dollars – being exchanged to acquire goods or services. As discussed in section 3.3 above, this establishes a basis on which a fair value can be determined. The fact that there is a large quantity of the Trade Dollars on hand needs also to be taken into account, as it affects the period over which the Trade Dollars could actually be used. This would also take into account both the experience of BBX in using the Trade Dollars and the market trading levels between all members of the Program. Both of these factors affect the period of which the large holding could be used. This would result in an additional discount on the face value reflecting the long period over which such a large holding could be used.

The Panel expects that the fair value less cost to sell would be lower than the amount at which the Trade Dollars were initially recognised, due to the change in market conditions since the initial acquisition, the change in the composition of the members and the actual experience of BBX in using the Trade Dollars. That is, by virtue of having accumulated a large holding of Trade Dollars, there is a further discount to be considered due to the longer time over which the benefits would be expected to arise.

The Panel is not able to determine when this discount arose nor quantify this discount.

The value in use calculation, on the other hand would restrict the assessment to consider only how BBX would be expecting to utilise the Trade Dollars. As BBX is expecting to use the Trade Dollars to only acquire Property and limited ancillary services, it would be expected that the value in use would be lower than the fair value less costs to sell.

The Panel believes therefore that the determination of the impairment loss should not be restricted to only considering the value in use. Rather reference to the fair value less costs to sell should also be considered if this is expected to be higher than value in use.

4. Accounting correction

BBX are required to account for a prior period error in their next set of financial statements as set out in AASB 108.42 and .43:

> 'Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:
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> (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or
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> (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.
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> A prior period error shall be corrected by retrospective restatement except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error.'

Therefore the financial statements of BBX must reflect a retrospective restatement as at the beginning of the comparative period. In accordance with AASB 101.10(f), a balance sheet for the opening comparative period will also be required.

This will require BBX to recalculate the value of the Trade Dollars on hand at the beginning of the comparative period. In particular, the entity will need to:

- determine the fair value of the Trade Dollars (or equity instruments) at the date of initial recognition of the Trade Dollars.
- Determine an accounting policy for the utilisation of the Trade Dollars – ie FIFO or average cost - as the value of Trade Dollars may vary over time (particularly as the holdings of Trade Dollars increased).
- assess at each reporting date since acquiring the Trade Dollars, whether there were indicators of impairment at each date, and if there was, conduct an impairment test – which in most cases is likely to be the fair value of the Trade Dollars at those dates.
- any adjustments arising up to the beginning of the comparative period for the restatement of the Trade Dollars is adjusted against equity instruments (to the extent it relates to the initial issue of shares) or retained earnings (for all other changes in value).

AASB 108.52 and .53 states:

> 'Retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that
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> (a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and
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> (b) would have been available when the financial statements for that prior period were authorised for issue
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> from other information. For some types of estimates (e.g. an estimate of fair value not based on an observable price or observable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period.....The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.'

For the above assessments, the services of a valuer are likely to be needed. An assessment of the fair value must be carefully done in order not to take into account hindsight.