



# 2003 Model Annual Report

Differential Reporting — ClearCut Limited

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### KPMG DIRECTORY

## DISCLAIMER

The information contained in this model annual report is of a general nature and is not intended to address the specific circumstances of any particular individual or entity. The publication should be used as a guide rather than a definitive statement and must be used in conjunction with the relevant legislation and financial reporting standards.

Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. The information contained in this publication should not be used or relied upon as a substitute for detailed advice or as a basis for formulating business decisions.

The names of people and companies in this model annual report are fictitious. Any resemblance to any person or business is unintended and purely coincidental.

This publication has been designed to serve as a 'best practice' annual report for entities qualifying for differential reporting. It uses a fictitious company, **ClearCut Limited (ClearCut)**, to illustrate how an annual report should be prepared and presented under the Framework for Differential Reporting (Framework).

# Introducing ClearCut Limited

## **The Future of Differential Reporting**

Differential Reporting has been around since 1994 when it was introduced to reduce the burden of disclosures on smaller entities without public accountability. The Accounting Standards Review Board (the body who approves reporting standards in New Zealand) has recently announced that New Zealand will move to adopt International Financial Reporting Standards by 2007. One of the key unanswered questions at this stage, is how New Zealand will deal with small and medium-sized entities under an International Accounting Standard framework. A number of options are being considered, including a separate framework of “small GAAP”, and/or a revamp of the legislation to lift the bar on the requirement for small and medium-sized entities to prepare financial statements. Watch this space. We’ll keep you informed.

## **Not just for companies**

In addition to being a useful tool for companies, we believe that this publication will be a valuable reference in the preparation of financial statements for many other organisations that fall outside the Financial Reporting Act 1993 (FRA). The financial statements of clubs, charities, partnerships, sole traders and trusts not

only need to satisfy requirements contained in specific legislation and their constitutional documents, but should also be prepared in accordance with Generally Accepted Accounting Practice (GAAP).

## **Getting to the point quickly**

In focusing on the preparation of financial statements for entities that qualify for a less onerous type of reporting, we have recognised that primary stakeholders (e.g. shareholders and banks) like to receive clear and concise information from annual reports. It’s about getting to the point quickly. Most organisations that qualify for differential reporting have stakeholders who already have a good understanding of what’s going on - they don’t require large amounts of information. With this in mind, we have assumed that ClearCut is taking advantage of all of the differential reporting exemptions available to it.

## **Need full reporting?**

If you require guidance on preparing and presenting financial statements complying with full reporting requirements please refer to KPMG’s model annual report Diverse Group Limited.

### **The ClearCut story so far**

ClearCut is a reporting entity as defined in the FRA. As such ClearCut's financial statements have been prepared in accordance with GAAP. ClearCut is also a company registered under the Companies Act 1993.

ClearCut is a Nelson based manufacturer of outdoor clothing. The net assets of another entity were purchased when the company was formed three years ago. Most raw materials are imported from China and some goods are exported to Australia.

### **Application**

The content of this publication reflects accounting practice at the time of writing, but accounting practice is continually evolving. It is therefore necessary for preparers of financial statements, to keep abreast of accounting developments and their impact on financial statements. This publication should be used in conjunction with the underlying legislation and financial reporting standards, particularly where a specific disclosure area is not covered or where there is uncertainty regarding interpretation.

To keep up to date with financial reporting developments you can visit our website:

[www.kpmg.co.nz](http://www.kpmg.co.nz). Click on **services** on the left hand side, then **financial reporting**.

Alternatively you can visit

[www.kpmgmodels.co.nz](http://www.kpmgmodels.co.nz) where you can find a soft copy of this publication as well as the model annual report for full reporting – Diverse Group Limited. The on-line version is continuously updated for the latest developments.

If you require assistance in using this publication, please call your KPMG contact or KPMG's National Technical Department.

### **Abbreviations**

The following abbreviations are used in this model annual report:

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**FRS**    **Financial Reporting Standard**

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**SSAP**   **Statement of Standard  
Accounting Practice**

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**ED**    **Exposure Draft**

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**FRA**    **Financial Reporting Act 1993**

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**C93**    **Companies Act 1993**

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# Do you qualify for differential reporting?

In 1994, the Institute of Chartered Accountants of New Zealand established the *Framework for Differential Reporting* as a less onerous reporting regime for some entities. The Framework allows a reporting entity to be exempted from specific requirements of Financial Reporting Standards (FRSs) and Statements of Standard Accounting Practice (SSAPs).

The basic principle of differential reporting is that compliance with FRSs and SSAPs should be required only when the benefits of compliance exceed the costs.

## **Do you meet the requirements?**

An entity qualifies for differential reporting exemptions if it does not have public accountability and either all of its owners are members of its governing body at balance date or it is small.

## **What makes an entity publicly accountable?**

An entity has public accountability if it was an issuer, as defined in the FRA at any time during the current or preceding reporting period.

An entity is also publicly accountable if it has the coercive power to tax, rate or levy to obtain public funds. A golf club that charges its members a fee does not have coercive power. It is the member's decision to become a member of the golf club and they would not have to pay the fee if they chose to leave the golf club. On the other hand City council rates and government taxes are charged irrespective of the usage and services offered by the entity.

When an entity's parent or ultimate controlling entity has the coercive power to tax, rate or levy to obtain public funds, the entity will only qualify for differential reporting exemptions on the basis of small size. Entities such as local authority trading enterprises, crown entities, state-owned enterprises and government

departments are unable to apply differential reporting unless they qualify on the basis of small size.

An entity does not have public accountability solely because it receives public funds from another entity that has the coercive power to tax, rate or levy to obtain public funds. For example, a museum that receives a government grant is not publicly accountable.

## **How is it possible to identify that owners are also governors?**

Where every owner is also a member of the governing body, the owners are assumed to have access to any information they require and the 'separation' test is passed.

Where the owner is not a natural person, e.g. the owner is a trust or a company, and has appointed a representative to the governing body of the entity, that representative is considered to be the owner for the purposes of the Framework. For example, if the holding company appoints a director to the board of its subsidiary then there is no separation between the owner and the governing body. In the example of a wholly owned subsidiary, the directors appointed by the holding company are considered to be the owners of the subsidiary.

The true owners of trusts are the beneficiaries. Therefore, in order for the ‘non-separation’ criterion to be met, the beneficiaries should also be trustees. The settlor of a trust will sometimes have the right to appoint the trustees; therefore the settlor will also meet the definition of an owner and should be on the governing body. This means that in most cases the trust will not satisfy the ‘non-separation’ criterion. A trust will generally only qualify for differential reporting exemptions if it is not publicly accountable and is small.

This ‘non-separation’ test is applied at balance date.

### How are the size criteria applied?

An entity is classified as ‘small’ if it does not exceed any two of the following:

- total revenue of \$5 million;
- total assets of \$2.5 million;
- 20 employees.

Under normal circumstances an entity may only qualify for differential reporting on the basis of size if the size criteria are met for two consecutive balance dates (or one if it is the entity’s first balance date).

The size criteria are applied after the application of differential reporting exemptions. For example, an entity that is applying differential reporting in relation to FRS-14 *Accounting for construction*

*contracts* may elect to use the completed contracts method rather than the percentage of completion method. This may alter the amount of revenue that is recognised in the financial statements. The entity should assess whether it meets the total revenue criterion using the completed contract method of accounting, i.e. after differential reporting has been applied.

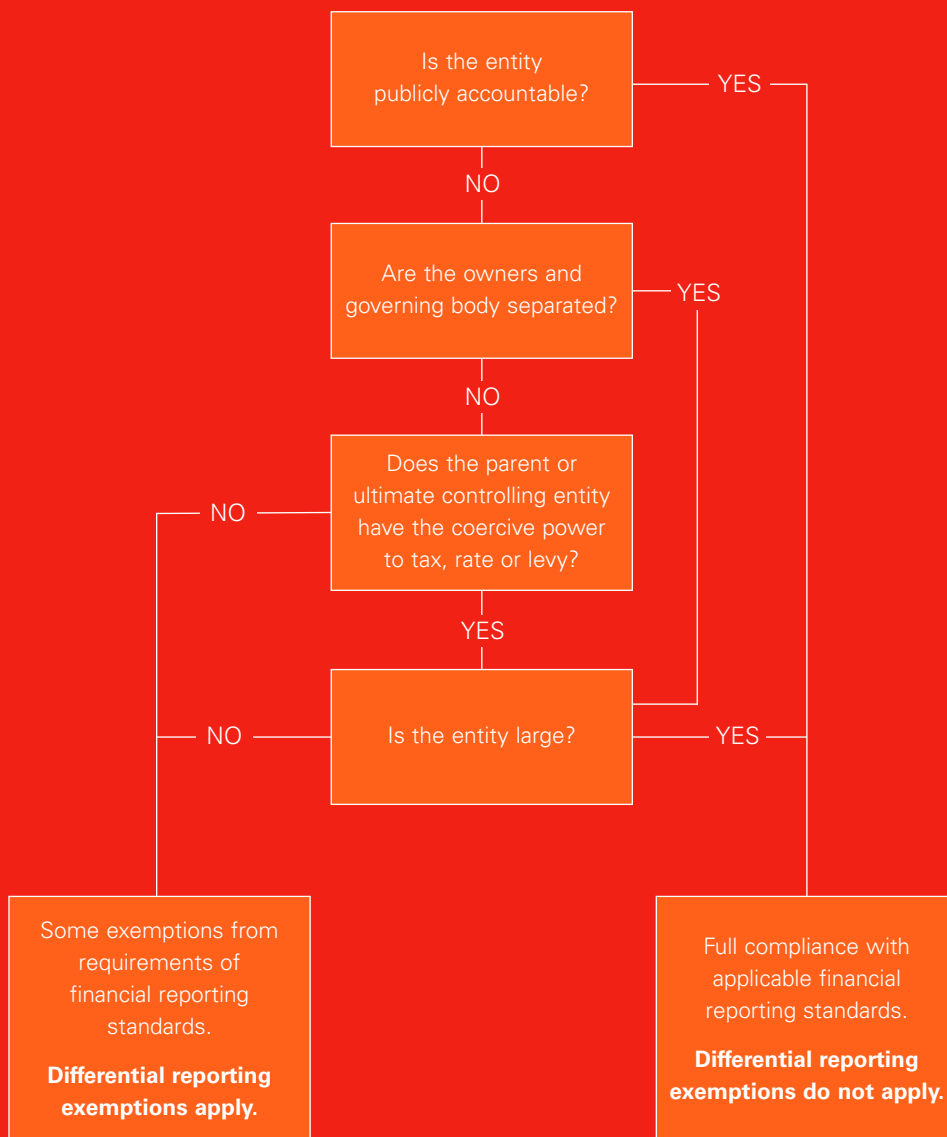
In trying to assess whether an entity meets the size criteria, the Framework provides guidance as to how the three criteria should be calculated:

- total revenue is the annualised gross operating revenue recorded in the entity’s statement of financial performance in the current reporting period;
- total assets include all assets, including intangible assets, recorded in the entity’s statement of financial position at the end of the current reporting period;
- total employees comprise the number of full-time equivalent persons in the paid employment of the entity, calculated on an annualised basis.

### Disclosure

If you do qualify for differential reporting you are required to disclose an accounting policy stating how you meet the Framework criteria and the exemptions you have adopted. Alternative disclosures to that used by *ClearCut Limited* can be found in appendix 2 on page 27.

# Framework for differential reporting flowchart



# Differential reporting exemptions

Following is a listing of New Zealand financial reporting standards as well as the measurement, recognition and disclosure exemptions available within the Framework for Differential Reporting.

## Full exemption

<b>FRS-10</b>	Statement of cash flows
<b>SSAP-23</b>	Financial reporting for segments
<b>FRS-31</b>	Disclosure of information about financial instruments

## No exemption

<b>FRS-1</b>	Disclosure of accounting policies
<b>FRS-2</b>	Presentation of financial reports (except requirements relating to statement of cash flows if applicable)
<b>FRS-5</b>	Events after balance date
<b>SSAP-6</b>	Materiality in financial statements
<b>FRS-7</b>	Extraordinary items and fundamental errors
<b>FRS-20</b>	Accounting for shares issued under a dividend election plan
<b>SSAP-25</b>	Accounting for interests in joint ventures and partnerships
<b>FRS-26</b>	Accounting for defeasance of debt
<b>FRS-27</b>	Right of set-off
<b>FRS-29</b>	Prospective financial information
<b>FRS-32</b>	Financial reporting by superannuation schemes
<b>FRS-33</b>	Disclosure of information by financial institutions
<b>FRS-34</b>	Life insurance business
<b>FRS-35</b>	Financial reporting of insurance activities
<b>FRS-36</b>	Accounting for acquisitions resulting in combinations of entities or operations
<b>FRS-37</b>	Consolidating investments in subsidiaries
<b>FRS-38</b>	Accounting for investments in associates
<b>FRS-39</b>	Summary financial reports

### Partial exemption

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- FRS-3**     *Accounting for property, plant and equipment*  
The same rates of depreciation can be used for financial reporting as for income tax purposes, except when assets have been revalued. The entity is not required to capitalise borrowing costs and where this exemption is taken the entity must expense all borrowing costs as incurred. Specific exemptions in disclosure are denoted with an asterisk in the standard.
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- FRS-4**     *Accounting for inventories*  
There is no requirement to sub-classify inventory into categories such as raw materials, work-in-progress and finished goods.
- 
- FRS-9**     *Information to be disclosed in financial statements*  
Specific exemptions are denoted with an asterisk in the standard.
- 
- SSAP-12**   *Accounting for income tax*  
The accounting policy adopted for income tax must be disclosed in all instances. This is one of the few standards that allows an entity qualifying for differential reporting a choice with regard to recognition and measurement. An entity may choose to adopt either the liability method or the taxes payable method. The selection of either method has no impact on which disclosure exemptions an entity chooses to elect. However, if an entity voluntarily makes disclosures from which it is exempt, they must be in accordance with SSAP-12.
- 
- FRS-13**    *Accounting for research and development activities*  
All research and development costs can be recognised as an expense during the period in which they were incurred.
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- FRS-14**    *Accounting for construction contracts*  
Profit on all construction contracts may be recognised on a completed contract method or a percentage of completion method. If the percentage of completion method is used, all the recognition and measurement requirements must be complied with, but there is still a choice regarding disclosure requirements of FRS-14. However, if an entity voluntarily makes disclosures from which it is exempt, they must be in accordance with FRS-14.
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- FRS-15**    *Provisions, contingent liabilities and contingent assets*  
Entities are not required to disclose additional provisions made in the period, amounts used during the period and the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.
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<b>SSAP-17</b>	<p><i>Accounting for investment properties and properties intended for sale</i></p> <p>Entities are not required to account for investment properties and properties intended for sale according to SSAP-17, but have the option of using the principles embodied in SSAP-28 instead. However this exemption is not available if investment property revaluations or development margins are recognised.</p>
<b>SSAP-18</b>	<p><i>Accounting for leases and hire purchase contracts</i></p> <p>Finance charges relating to finance leases do not have to be disclosed separately in the statement of financial performance. Entities are required to comply with all disclosure requirements except that they may disclose lease liabilities for finance leases and aggregate commitments for non-cancellable operating leases by classifying them into current and non-current amounts.</p>
<b>FRS-19</b>	<p><i>Accounting for goods and services tax</i></p> <p>There is a choice regarding the recognition of revenue and expense items inclusive or exclusive of GST, provided that the method adopted is applied consistently to all revenue and expense items and disclosed in the statement of accounting policies.</p>
<b>FRS-21</b>	<p><i>Accounting for the effects of changes in foreign currency exchange rates</i></p> <p>The net exchange difference does not have to be separately disclosed in the statement of financial performance. In addition, transactions measured in a foreign currency do not have to be translated using the exchange rate that applied at the transaction date or at a rate approximating that rate. If this exemption is applied, transactions settled in the accounting period must be translated at the settlement rate and transactions unsettled at balance date must be translated at the closing rate.</p>
<b>SSAP-21</b>	<p><i>Accounting for the effects of changes in foreign currency exchange rates</i></p> <p>The net exchange difference included in the statement of financial performance does not have to be disclosed.</p>
<b>SSAP-22</b>	<p><i>Related party disclosures</i></p> <p>The identity of each related party, the nature of each relationship and the types of transactions involved are only required to be disclosed if there have been material transactions with related parties at any time during the reporting period.</p>
<b>FRS-24</b>	<p><i>Interim financial statements</i></p> <p>Specific exemptions are denoted with an asterisk in the standard. In addition, differential reporting exemptions available under other specific financial reporting standards may be applied.</p>
<b>FRS-30</b>	<p><i>Reporting share ownership arrangements including employee share ownership plans</i></p> <p>Qualifying entities with one or more ESOP are exempt from disclosing abbreviated statements of financial position and financial performance on each ESOP.</p>

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# 2002 changes in financial reporting

Financial reporting, in New Zealand and overseas, and in both the private and public sectors, continues to evolve. This summary highlights the significant New Zealand changes and proposals in financial reporting during the 2002 calendar year that could affect the next annual report and/or annual reports in future periods.

## **FRS-39 Summary Financial Reports**

FRS-39 was approved by the Accounting Standards Review Board on 3 September 2002 and applies to periods ending on or after 31 December 2002.

FRS-39 specifies the accounting practice and minimum disclosure requirements for summary financial reports, although it does not prescribe the format in which that information is to be presented. The standard does not apply where summary financial reports appear in an annual report or in any other document containing the full financial reports.

There are no differential reporting exemptions available in FRS-39.

FRS-39 is not illustrated in this publication.

## **Consequential Amendments to FRS 36, 37 and 38**

The consequential amendments were approved by the Accounting Standards Review Board on 9 October 2002 and apply from 1 January 2003.

The consequential amendments impacted aspects of:

- FRS-2 Presentation of financial reports
- FRS-7 Extraordinary items and fundamental errors
- FRS-9 Information to be disclosed in financial statements

- FRS-10 Statement of cashflows
- FRS-24 Interim financial statements
- FRS-29 Prospective financial information

Some of the key changes include: a new presentation of “operating surplus (deficit)” before and after tax on the face of the statement of financial performance, and a new suggested order of presentation of the Statements of Movements in Equity (now beginning with the Net Surplus/deficit rather than opening equity).

The consequential amendments have been applied to Clearcut and this has resulted in a change to the presentation of the statement of movements in equity on page 18.

## **ED-90 Agriculture**

ED-90 was issued in April 2002 and comments were due by 31 July 2002.

The exposure draft is an almost verbatim copy of IAS-41 Agriculture, and is consistent with the Australian standard AASB 1037 Self-generating and Regenerating assets.

ED-90 covers many NZ activities such as farming, forestry and horticulture. The ED adopts fair value accounting and requires all fair value changes to be recognised in the statement of financial performance in the period in which they arise.

There are a few differential reporting exemptions relating to disclosure, however no exemptions exist for measurement.

The application of ED-90 is not illustrated in this publication.

### **ED-91 Related Party Disclosures**

ED-91 was issued in April 2002 and comments were due by 31 July 2002. The ED is a revision of SSAP-22 Related Party Disclosures, although SSAP-22 will continue to apply until a new Financial Reporting Standard is applicable.

The ED sets out numerous disclosures specifically required for directors and for other related parties.

Differential reporting entities are only exempted from having to disclose each individual director's remuneration.

The disclosures for a differential reporting entity under this ED are illustrated in Appendix 3.

### **ED-92 Preface to Financial Reporting Standards**

ED-92 was issued in June 2002 and comments were due by 31 August 2002.

The ED is a proposed revision of the Explanatory Foreword to General Purpose Financial Reporting. The key changes proposed are the board's policy on

international convergence and international harmonisation of NZ financial reporting standards.

This ED does not have an impact on financial reporting measurement or disclosure and is therefore not illustrated in this publication.

### **ED-93 Share-based Payment**

ED-93 was issued in November 2002 and comments were due by 31 January 2003.

The ED is a direct copy of the International Accounting Standards Board's ED 2 on Share-based payment issued earlier in November 2002.

There is currently no existing standard in New Zealand on share-based payments. The proposal in ED-93 is that entities recognise share based payment transactions in their financial statements at fair value in the period that the goods or services are received. All share-based transactions are to be recognised in an entity's financial statements as non-recognition results in an understatement of expense.

There are no differential reporting exemptions proposed in the ED.

The application of ED-93 is not illustrated in this publication.

### **TPA-9 Service Performance Reporting**

TPA-9 was issued in September 2002.

The TPA only applies to public sector or not-for-profit entities and provides best practice guidance in relation to the specification, measurement and reporting of service performance.

The application of TPA-9 is not illustrated in this publication.

ClearCut Limited  
Model Annual Report  
2003  
Differential Reporting

Our aim is that this model annual report applies the issues discussed earlier in as realistic a situation as practicable. Hopefully, it reflects some of the reporting and disclosure issues that you face in reporting your own progress and operations to stakeholders.

If you would like to view this publication online check out [www.kpmgmodels.co.nz](http://www.kpmgmodels.co.nz)  
The online version is continuously updated for the latest developments.



<sup>1</sup>Section 211(1)(k) of the Companies Act 1993 requires the annual report to be signed and dated on behalf of the Board by two Directors unless there is only one Director. Section 10(1)(b) of the Financial Reporting Act 1993 requires the financial statements to be signed and dated on behalf of the Board by two Directors unless there is only one Director. (Section 13(1)(b) contains the same requirement in respect of the Group financial statements). Although many companies place these signatures at the bottom of the statement of financial position, this is not a requirement of the Act. This approval may be made anywhere in the annual report.

<sup>2</sup>Signing and dating the financial statements implies that the financial statements have been authorised for issue to meet the requirements of FRS-5 6.1.

The Directors are pleased to present the annual report including the financial statements of ClearCut Limited for the year ended 31 January 2003.

For and on behalf of the Board of Directors<sup>1,2</sup>



**LP Brook**

*Director*

15 March 2003



**K Dobson**

*Director*

15 March 2003

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Company directory<sup>1</sup>

**'This information is provided for illustrative purposes only. There is no legislative requirement to include a company directory.'**

<b>NATURE OF BUSINESS</b>	Clothing manufacturer
<b>REGISTERED OFFICE</b>	164 All Views Road NELSON Telephone: 03 363 5764 Facsimile: 03 363 5765 E-mail: HeadOffice@ClearCut.co.nz
<b>INCORPORATION NUMBER</b>	99 0724 11
<b>IRD NUMBER</b>	62-101-898
<b>DIRECTORS</b>	Ms LP Brook Mr K Dobson Dr N Coffey
<b>SHAREHOLDERS</b>	Ms LP Brook Mr K Dobson Dr N Coffey (Australian Resident)
<b>AUDITOR</b>	KPMG
<b>BANKERS</b>	Simplicity Banking
<b>SOLICITORS</b>	Distinct and Co
<b>BUSINESS LOCATION</b>	Nelson



## Audit report

### **TO THE SHAREHOLDERS OF CLEARCUT LIMITED**

We have audited the financial statements on pages 4 to 13. The financial statements provide information about the past financial performance of the company and its financial position as at 31 January 2003. This information is stated in accordance with the accounting policies set out on pages 4 to 6.

### **DIRECTORS' RESPONSIBILITIES**

The Directors are responsible for the preparation of financial statements which give a true and fair view of the financial position of the company as at 31 January 2003 and the results of its operations for the year ended on that date.

### **AUDITORS' RESPONSIBILITIES**

It is our responsibility to express an independent opinion on the financial statements presented by the Directors and report our opinion to you.

### **BASIS OF OPINION**

An audit includes examining, on a test basis, evidence relevant to the amounts and disclosures in the financial statements. It also includes assessing:

- the significant estimates and judgements made by the Directors in the preparation of the financial statements;
- whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We conducted our audit in accordance with New Zealand Auditing Standards issued by the Institute of Chartered Accountants of New Zealand. We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to obtain reasonable assurance that the financial statements are free from material misstatements, whether caused by fraud or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Our firm has also provided other services to the company in relation to taxation and general accounting services. Partners and employees of our firm may also deal with the company on normal terms within the ordinary course of trading activities of the business of the company. These matters have not impaired our independence as auditors of the company. The firm has no other relationship with, or interest in, the company.

### **UNQUALIFIED OPINION**

We have obtained all the information and explanations we have required.

In our opinion:

- proper accounting records have been kept by the company as far as appears from our examination of those records;
- the financial statements on pages 4 to 13:
  - comply with New Zealand generally accepted accounting practice;
  - give a true and fair view of the financial position of the company as at 31 January 2003 and the results of its operations for the year ended on that date.

Our audit was completed on 15 March 2003 and our unqualified opinion is expressed as at that date.

Christchurch

## Statement of accounting policies

FOR THE YEAR ENDED 31 JANUARY 2003

### (A) BASIS OF PREPARATION

ClearCut Limited is a company domiciled in New Zealand and registered under the Companies Act 1993. The company is a reporting entity for the purposes of the Financial Reporting Act 1993 and its financial statements comply with that Act.

The financial statements comprise statements of: accounting policies; financial performance; movements in equity; financial position; as well as the notes to these statements contained on pages 9 to 13 of this annual report.

The financial statements have been prepared in accordance with generally accepted accounting practice in New Zealand.

The financial statements have been prepared on the basis of historical cost except that land and buildings are stated at valuation.

To ensure consistency with the current period, comparative figures have been restated where appropriate.

### (B) RECEIVABLES

Receivables are stated at estimated realisable value after providing against debts where collection is doubtful. Bad debts are written off during the period in which they are identified.

### (C) INVESTMENTS IN SHARES

Non-current investments in shares are stated at the lower of cost and market value. Dividend income is recognised in the statement of financial performance when received.

### (D) INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Cost is based on the first-in first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing condition and location. In the case of manufactured inventories and work-in-progress, cost includes an appropriate share of overheads. Fixed overhead costs are allocated on the basis of normal operating capacity.

### (E) PROPERTY, PLANT AND EQUIPMENT

All owned items of property, plant and equipment are initially recorded at cost and, except for land, depreciated as outlined below. Initial cost includes the purchase consideration, or fair value in the case of a donated asset and those costs directly attributable to bringing the asset to the location and condition necessary for its intended use. These costs include, where appropriate, site preparation costs and installation costs. Costs cease to be capitalised when substantially all the activities necessary to bring an asset to the location and condition for its intended use are complete. All feasibility costs are expensed as incurred.

Subsequent expenditure relating to an item of property, plant or equipment is added to its gross carrying amount when such expenditure either increases the future economic benefits beyond its existing service potential, or is necessarily incurred to enable future economic benefits to be obtained, and if that expenditure would have been included in the initial cost of the item had it been incurred at that time.

Land and buildings are stated at valuation as determined by an independent registered valuer. The basis of valuation of the land and buildings is highest and best use.<sup>1</sup>

FRS-1 5.1, 5.5(c)  
FRS-2 5.2(f), 5.17

FRS-1 5.5(a)

FRS-1 5.5(b)

FRS-4 5.29(a)

FRS-3 5.3, 5.22, 5.35

FRS-3 6.1

FRS-3 7.1, 11.4(e)  
FRS-1 5.14

<b>FRS-3 9.1, 9.10, 9.11</b>	Items of property, plant or equipment are written down immediately if an impairment in the value of the asset causes its recoverable amount to fall below its carrying amount. The impairment is recognised in the statement of financial performance.
<b>FRS-3 10.1</b>	Where an item of property, plant or equipment is disposed of, the gain or loss recognised in the statement of financial performance is calculated as the difference between the net sale price and the carrying amount of the asset. Any revaluation surplus is reduced or increased by the amount applicable to that item.
<b>FRS-3 11.1(b)(c)</b>	<p><b>(F) DEPRECIATION</b></p> <p>Depreciation is charged at the same rate as is allowed by the Income Tax Act 1994. The following rates have been used:</p> <ul style="list-style-type: none"> <li>• Fixtures, fittings and equipment      9% – 24% diminishing value</li> <li>• Office furniture                              18% – 40% diminishing value</li> <li>• Leased motor vehicles                      15% straight line</li> <li>• Leasehold improvements                  6.6% – 18% straight line</li> <li>• Plant and machinery                        11% – 18% diminishing value</li> <li>• Buildings                                        3% straight line</li> </ul>
<b>FRS-3 8.1</b>	
<b>FRS-3 2.2(a)</b>	
<b>SSAP-18 5.1,5.2</b>	
<b>SSAP-18 5.1,5.2</b>	<p><b>(G) LEASES</b></p> <p>Assets acquired by way of finance lease are stated initially at an amount equal to the present value of the future minimum lease payments, and are depreciated as assets. The interest expense component of finance lease payments is recognised in the statement of financial performance using the effective interest rate method.</p>
<b>SSAP-18 5.4</b>	<p>Payments made under operating leases are recognised in the statement of financial performance on a basis representative of the pattern of benefits expected to be derived from the leased asset.</p> <p><b>(H) INTANGIBLE ASSETS AND GOODWILL</b></p> <p>Goodwill arising on the acquisition of a business represents the excess of the purchase consideration over the fair value of the identifiable net assets acquired. Goodwill is amortised to the statement of financial performance on a straight line basis over the period during which benefits are expected to be derived – a period of 5 years.</p> <p>All costs related to internally generated intangible assets are expensed as incurred.</p>
<b>SSAP-12 5.14(a)</b>	<p><b>(I) TAXATION</b></p> <p>The income tax expense recognised in the statement of financial performance is the estimated income tax payable in the current year, adjusted for any differences between the estimated and actual income tax payable in prior years.<sup>1</sup></p>
<b>FRS-21 7.1(a)</b>	<p><b>(J) FOREIGN CURRENCIES</b></p> <p>Transactions covered by short term forward contracts are translated at the exchange rates specified in those contracts. Other foreign currency transactions are translated to New Zealand currency at the exchange rates ruling at the dates of the transactions.</p>
<b>FRS-21 5.3(a)</b>	Monetary assets and liabilities in foreign currencies are translated at the exchange rate at balance date.
<b>FRS-21 5.4(a)</b>	Exchange differences arising on the translation of monetary assets and liabilities are recognised in the statement of financial performance.

<sup>1</sup>Some differential reporting entities may choose to report income taxes on a comprehensive basis taking account of all timing differences. In these circumstances the following taxation policy should be included: "Income tax expense is recognised on the operating surplus before taxation adjusted for permanent differences between taxable and accounting income. Deferred tax is calculated using the comprehensive basis under the liability method.

This method involves recognising the tax effect of all timing differences between accounting and taxable income as a deferred tax asset or liability in the statement of financial position. The future tax benefit or provision for deferred tax is stated at the income tax rates prevailing at balance date. Future tax benefits are not recognised unless realisation of the asset is virtually certain." – SSAP-12 5.14

**(K) GOODS AND SERVICES TAX**

All amounts are shown exclusive of Goods and Services Tax (GST), except for receivables and payables that are stated inclusive of GST.

FRS-19 2.2

**(L) ONEROUS CONTRACTS**

Where the benefits expected to be derived from a contract are lower than the unavoidable costs of meeting the company's obligation under the contract, a provision is recognised. The provision is stated at the present value of the future net cash outflows expected to be incurred in respect of the contract.

FRS-15 10.4

**(M) DIVIDENDS**

Provisions for dividends are recognised in the period that they are authorised and approved.

FRS-5 5.5

**(N) DIFFERENTIAL REPORTING**

The company is an entity qualifying for differential reporting exemptions as it has no public accountability and all shareholders are Directors of the company. All available differential reporting exemptions allowed under the framework for differential reporting have been adopted.

FRS-1 5.19(a),(b)(i)

**(O) CHANGES IN ACCOUNTING POLICY**

The FRSB recently issued a new standard FRS-3 *Accounting for property, plant and equipment*.

FRS-1 5.5(d),5.11,  
5.12, 5.14

FRS-3 requires revaluations to be stated at highest and best use without deducting disposal costs. This change in accounting policy has not had a material effect during the current period.

With the exception of the above change in accounting policy, uniform accounting policies have been applied throughout the company and on a consistent basis with those of the previous period.

FRS-2 5.2(a)  
FRA S8(1)  
FRS-2 5.17

## Statement of financial performance

FOR THE YEAR ENDED 31 JANUARY 2003

		2003	2002
		\$	\$
	Note		
FRS-9 6.6	Total operating revenue	12,038,115	11,674,867
FRS-2 6.7, 6.13(a)	Operating surplus before income tax	527,108	416,683
FRS-2 6.12	Income tax	(186,720)	(152,608)
FRS-2 6.3	<b>Net surplus for the year</b>	<b>340,388</b>	<b>264,075</b>

FRS-2 5.2(b),72

## Statement of movements in equity

FRS-2 5.17

FOR THE YEAR ENDED 31 JANUARY 2003

		2003	2002
		\$	\$
	Note		
FRS-2 7.3(a)(i)	Net surplus for the year	340,388	264,075
	Other recognised revenue and expenses:		
FRS-2 7.3(a)(ii),FRS-3 11.8(a)	Revaluation of land and buildings	139,973	–
FRS-2 7.3(c)	<b>Total recognised revenues and expenses</b>	<b>480,361</b>	<b>264,075</b>
	Distribution to owners:		
FRS-2 7.3(b)	Dividends	–	(37,500)
	<b>Movements in equity for the period</b>	<b>480,361</b>	<b>226,575</b>
	Equity at beginning of year	894,848	668,273
FRS-2 7.2	<b>Equity at end of year</b>	<b>1,375,209</b>	<b>894,848</b>

## Statement of financial position

AS AT 31 JANUARY 2003

		2003	2002	
		\$	\$	
	Note			
<b>CURRENT ASSETS</b>				
Cash balances	3	254,376	–	FRS-2 8.5(a)(i)
Receivables	4	485,998	332,720	FRS-9 8.2(c)
Loan to director	5	12,000	12,000	FRS-9 8.2(a)
Inventories	7	560,725	409,176	FRS-9 8.2(a)(ii)
Total current assets		1,313,099	753,896	FRS-4 5.29(b)(i)
<b>NON-CURRENT ASSETS</b>				
Property, plant and equipment	8	1,658,421	1,492,518	FRS-2 8.5(a)(ii)
Goodwill		40,000	60,000	FRS-9 8.2(f)
Investments	9	515,544	588,445	FRS-9 8.2(b)
Loan to director	5	60,000	72,000	FRS-9 8.2(a)(ii)
Total non-current assets		2,273,965	2,212,963	
<b>Total assets</b>		<b>3,587,064</b>	<b>2,966,859</b>	
<b>CURRENT LIABILITIES</b>				
Bank overdraft	3	–	10,442	FRS-2 8.5(a)(iii)
Payables	10	397,960	295,393	FRS-9 8.10(b)
Finance lease	11	40,450	40,450	
Dividends payable	17	–	37,500	FRS-9 8.10(d)
Loans	12	281,496	211,832	
Provisions	13	14,417	–	
Total current liabilities		734,323	595,617	
<b>NON-CURRENT LIABILITIES</b>				
Finance lease	11	39,285	79,735	FRS-2 8.5(a)(iv)
Loans	12	1,394,995	1,396,659	
Provisions	13	43,252	–	
Total non-current liabilities		1,477,532	1,476,394	
<b>Total liabilities</b>		<b>2,211,855</b>	<b>2,072,011</b>	
<b>Net assets</b>		<b>1,375,209</b>	<b>894,848</b>	
<b>Equity</b>	2	<b>1,375,209</b>	<b>894,848</b>	FRS-2 8.5(a)(v) FRS-9 8.17

## Notes to the financial statements

**1 OPERATING SURPLUS BEFORE INCOME TAX**

	2003	2002
	\$	\$
After deducting		
Auditors' remuneration	14,972	15,181
Interest and finance charge	94,300	106,280
Directors' fees	50,000	45,000
Operating lease expense	188,000	184,314
Bad and doubtful debts	16,348	11,509
Depreciation of property, plant and equipment	175,877	174,512
Amortisation of goodwill	20,000	20,000
Impairment loss – plant and machinery	3,200	–
Loss on disposal of property, plant and equipment	7,078	–

**2 EQUITY**

	2003	2002
	\$	\$
Paid in capital	750,000	750,000
Retained earnings	485,236	144,848
Asset revaluation reserve	139,973	–
<b>Total equity</b>	<b>1,357,209</b>	<b>894,848</b>

The company has 750,000 fully paid shares on issue (2002: 750,000). All shares have equal voting rights and share equally in dividends and surplus on winding up.

**3 CASH BALANCES**

A short term deposit of \$30,000 was made on 18 October 2002 with the company's banker and was set off against the bank overdraft of \$16,055 at balance date. The company has signed an agreement with its banker, acknowledging the right to set off amounts owing to and from each other in case of default by either party. The Directors are of the opinion that the risk of default from either party is remote.

**4 RECEIVABLES**

	2003	2002
	\$	\$
Trade receivables	447,373	327,990

Included in trade receivables is \$92,242 (\$AUS85,462) (2002:\$67,627 (\$AUS55,501)) which is not hedged.

**5 LOAN TO DIRECTOR**

	2003	2002
	\$	\$
Current portion	12,000	12,000
Non-current portion	60,000	72,000
<b>Total loan to director</b>	<b>72,000</b>	<b>84,000</b>

FRS-9 8.2(a)(ii)

The loan to Ms Brook bears interest of 8 per cent per annum and is repayable in monthly instalments of \$1,000. The loan is secured by a first mortgage registered over Ms Brook's residence.

FRS-9 8.6

**6 RELATED PARTIES**

The company made a loan to one of the Directors, Ms Brook, and received loans from other Directors, Mr Dobson and Dr Coffey.

SSAP-22 5.1(a),(b)

Remuneration has been paid to the shareholders as Directors and employees of the company. The company leases property from a trust of which Mr Dobson's children are beneficiaries. The operating lease was entered into on a commercial basis.

**7 INVENTORIES**

Certain inventory items are subject to retention of title clauses.

FRS-4 5.29(d), FRS-9 8.8

**8 PROPERTY, PLANT AND EQUIPMENT**

	COST/ REVALUATION	CURRENT DEPRECIATION CHARGE	CURRENT IMPAIRMENT LOSSES	ACC. DEPRECIATION/ IMPAIRMENT	CARRYING VALUE
	2003	2003	2003	2003	2003
	\$	\$	\$	\$	\$
Land (at valuation)	340,000	–	–	–	340,000
Buildings (at valuation)	410,000	(9,891)	–	–	410,000
Plant and machinery	1,034,000	(118,610)	–	(378,750)	655,250
Plant and machinery – not in use	21,500	(3,225)	(3,200)	(6,425)	15,075
Plant and machinery – WIP	69,058	–	–	–	69,058
Leasehold improvements	40,153	(6,023)	–	(18,069)	22,084
Leased motor vehicles	151,850	(22,778)	–	(68,333)	83,517
Fixtures, fittings and equipment	77,304	(9,470)	–	(27,587)	49,717
Office furniture	40,000	(5,880)	–	(26,280)	13,720
<b>Total</b>	<b>2,183,865</b>	<b>(175,877)</b>	<b>(3,200)</b>	<b>(525,444)</b>	<b>1,658,421</b>

FRS-3 11.3(a)(c)(d)

FRS-9 8.2(d)

FRS-9 8.2(e)

FRS-3 11.3(b)(i)

FRS-3 11.3(b)(ii)

SSAP-18 5.15(a)

	COST/ REVALUATION	CURRENT DEPRECIATION CHARGE	CURRENT IMPAIRMENT LOSSES	ACC. DEPRECIATION/ IMPAIRMENT	CARRYING VALUE
	2002	2002	2002	2002	2002
	\$	\$	\$	\$	\$
Land	310,000	–	–	–	310,000
Buildings	329,700	(9,891)	–	(19,782)	309,918
Plant and machinery	934,500	(119,149)	–	(259,324)	675,176
Plant and machinery – not in use	–	–	–	–	–
Plant and machinery – WIP	–	–	–	–	–
Leasehold improvements	40,153	(6,023)	–	(12,046)	28,107
Leased motor vehicles	151,850	(22,778)	–	(45,555)	106,295
Fixtures, fittings and equipment	61,539	(8,271)	–	(18,117)	43,422
Office furniture	40,000	(8,400)	–	(20,400)	19,600
<b>Total</b>	<b>1,867,742</b>	<b>174,512</b>	<b>–</b>	<b>375,224</b>	<b>1,492,518</b>

FRS-9 6.13(a)  
FRS-3 11.3(d)

Due to damage to a new item of plant and machinery, which is now not currently in use, the Directors believe that the future economic benefits embodied in the item have been reduced. As a result an impairment loss of \$3,200 has been recognised in the statement of financial performance to write down the carrying value of the asset.

FRS-3 11.4(a)

	2003	2002
	\$	\$
Amount by which land and buildings have been revalued above historical cost:		
Land	30,000	–
Buildings	109,973	–

FRS-3 11.4(c)(d)(e)

Land and buildings were valued on 31 January 2003 by Mr Cloud, a valuer registered with the New Zealand Institute of Valuers, at \$750,000. The valuations placed on land and buildings were based on highest and best use.<sup>1</sup>

FRS-9 8.2(b)(v)

## 9 OTHER INVESTMENTS

	2003	2002
	\$	\$
Shares in listed company	154,084	117,359
Shares in unlisted companies	361,460	471,086
<b>Total investments</b>	<b>515,544</b>	<b>588,445</b>

FRS-9 8.3

The market value of the listed company shares at balance date was \$194,270 (2002: \$131,243).

**Any significant assumption of limiting conditions upon which a valuation is based must also be disclosed – FRS-3 11.4(f)**

**10 PAYABLES**

	2003	2002
	\$	\$
Trade creditors	368,967	270,507
Shareholder current accounts	16,240	15,112

FRS-9 8.10(a)  
FRS-9 8.10(b)(iii)

Included in trade creditors is an amount of \$295,174 (\$US160,678) (2002:\$216,406 (\$US89,949)) which is unhedged.

FRS-21 7.1(e)(i)

**11 FINANCE LEASE LIABILITIES**

	2003	2002
	\$	\$
Current portion	40,450	40,450
Non-current portion	39,285	79,735
<b>Total lease liabilities</b>	<b>79,735</b>	<b>120,185</b>

SSAP-18 4.36,5.15(c)

The motor vehicles obtained through the finance lease serves as security over this liability.

FRS-9 8.13

**12 LOANS**

	2003	2002
	\$	\$
<b>CURRENT PORTION</b>		
Loans from directors	174,000	100,000
Unsecured loans	11,496	15,832
Secured loans	96,000	96,000
Total current portion	281,496	211,832
<b>NON-CURRENT PORTION</b>		
Loans from directors	150,000	250,000
Unsecured loans	20,104	17,768
Secured loans	1,224,891	1,128,891
Total non-current portion	1,394,995	1,396,659
<b>Total loans</b>	<b>1,676,491</b>	<b>1,608,491</b>

FRS-9 8.10(b)(iii)  
FRS-9 8.10(f)  
FRS-9 8.10(e)

FRS-9 8.10(b)(iii)  
FRS-9 8.10(f)  
FRS-9 8.10(e)

The loan is secured by a floating charge over the assets of the company.

FRS-9 8.13



# Appendices

Appendix 1: Statutory information

Appendix 2: Differential reporting accounting policies

Appendix 3: ED 91 Disclosures

# Appendix 1

## Statutory information

### Assumptions

In preparing the annual report of *ClearCut Limited* it has been assumed that a unanimous shareholder resolution was passed in accordance with section 211(3) of the Companies Act 1993. This allows an entity to gain an exemption from paragraphs (a) and (e) to (j) of section 211(1) of this Act. The following is an example of the disclosure requirements required by section 211, assuming the section 211(3) resolution has not been passed:

### Statutory information

for the year ended 31 January 2003

C93 S 211(1)(e)

#### Entries recorded in the Interests Register

##### Directors' remuneration

Authorised remuneration for the 2004 financial year:

Ms LP Brook \$126,000; Mr K Dobson \$64,000; Dr N Coffey \$21,000

##### Directors' indemnity and insurance

The company has insured its Directors against liabilities to other parties (except to the company or a related party of the company) that may arise from their positions as Directors. The insurance does not cover liabilities arising from criminal actions.

##### Transactions

The company rents a property from a trust of which Mr Dobson's children are beneficiaries. The rental for 2003 was \$94,000 and increases two per cent per annum (refer to notes 6, 13 and 14 of the financial statements).

##### Loans to and from Directors

The company made a loan to Ms Brook, which is secured by a mortgage over her residential property. The loan is repayable by 31 January 2009. The company also received loans from Mr Dobson and Dr Coffey, repayable by 31 August 2006.

C93 S211(1)(f),(i)

#### Directors' Remuneration

The Directors' remuneration for the current year was as follows:

Ms LP Brook \$117,000; Mr K Dobson \$55,000; Dr N Coffey \$19,500, Mr D James \$5,000.

C93 S211(1)(g)

#### Executive Employees' Remuneration

One employee received remuneration in the \$100,000 to \$109,000 bracket during the current year. The amount received includes redundancy payments and the employee's salary before they were made redundant.

C93 S211(1)(h)

#### Donations

The company donated \$3,982 to various charitable organisations during the year.

C93 S211(1)(j)

#### Auditors' Remuneration

The following amounts were payable to the auditors of the company during the year:

KPMG

- audit fees                   \$11,000
- other services               \$ 3,972

# Appendix 2

## Differential reporting accounting policies

FRS-1 requires entities qualifying for differential reporting to disclose an accounting policy that states the following:

- the criteria that establish the entity as a qualifying entity for differential reporting;
- either:
  - that the entity has taken advantage of all differential reporting exemptions;
  - financial reporting standards where the entity has not taken advantage of differential reporting exemptions;
  - financial reporting standards where differential reporting exemptions have been applied.

In complying with the requirements of FRS-1, we also recommend that the entity briefly explains what differential reporting is.

The following are alternatives to note (N) of the accounting policies adopted by *ClearCut Limited* regarding the criteria for qualifying for differential reporting exemptions under the *Framework for Differential Reporting*.

### **Accounting policies – Differential Reporting**

#### **Alternative 1**

The company is a qualifying entity by virtue of the fact that it has no public accountability and is small as defined by the *Framework for Differential Reporting*.

All available differential reporting exemptions allowed under the *Framework for Differential Reporting* have been adopted except for FRS-10 *Statement of cash flows*, as a statement of cash flows has been disclosed.

#### **Alternative 2**

The company is a qualifying entity by virtue of the fact that it has no public accountability and is small as defined by the *Framework for Differential Reporting*. Differential Reporting exemptions have been applied in relation to:

- FRS-4 *Accounting for inventories*
- FRS-10 *Statement of cash flows*
- SSAP-12 *Accounting for income tax*
- SSAP-22 *Related party transactions*

# Appendix 3

## ED 91 Disclosures

Many of the disclosures required under ED-91 are entries required to be recorded in the interest's register and disclosed in the Statutory information. However, as a section 211 resolution can be passed to avoid these statutory disclosures, often the information in the interest's register is not disclosed. The new ED-91 will mean that these disclosures cannot be avoided simply by passing a section 211 resolution, as they will be required to be disclosed within the financial statements in the related parties note. The example below shows the information that would need to be disclosed under ED-91 for Clearcut:

### Statement of accounting policies

ED-91 6.1 (d)

#### Directors' remuneration

Directors' remuneration is any money, consideration or benefit received, receivable or otherwise made available, directly or indirectly, to a director during the reporting period. The value of non-monetary remuneration is determined using fair value. The term Directors includes those directors who were only directors for part of the reporting period.

### Note 5 Director's Disclosures

ED-91 5.1 (a)

#### Directors

The following people held office as Directors of the entity during the reporting period:

Ms L P Brook

Mr K Dobson

Dr F Coffey

ED-91 5.5

Mr D James (Resigned 30.6.02)

#### Remuneration

ED-91 6.8 (a)(b)

Aggregate remuneration to the four directors during the year totalled \$196,500. This remuneration can be classified as follows:

Director's fees	\$50,000
Other remuneration	-
Remuneration as an employee	\$146,500

ED-91 7.1

#### Directors' loans

The following loans were made:

	(a)	(b)	
	Ms. LP Brooks	Machines Ltd	
ED-91 7.1(a)	Opening loan balance	\$84,000	\$50,224
ED-91 7.1(b)	Loans advanced during the period	-	\$20,000
ED-91 7.1 (c)	Loan repayment during the period	(\$12,000)	(\$15,048)
	Interest charged during the period	\$6,720	\$ 5,570
ED-91 7.1 (d)	Interest paid during the period	(\$6,720)	(\$4,645)
ED-91 7.1 (f)	Loan outstanding at balance date	\$72,000	\$56,101

**ED-91 7.1 (g)** (a) A loan was made to Ms LP Brook, a Director of Clearcut. The loan bears interest of 8% per annum and is repayable in monthly instalments of \$1,000. The loan is secured by a first mortgage registered over Ms Brook's residence.

**ED-91 7.1 (g, h)** (b) Clearcut acts as guarantor for a loan made by a financial institution to a company called Machines Ltd. Mr K Dobson, a Director of Clearcut, is a substantial shareholder of Machines Ltd. The loan bears interest of 9.25% per annum and is repayable in monthly instalments of \$1,254 by September 2005. The loan is secured by a first mortgage registered over the inventory of Machines Ltd.

#### **Other**

**ED-91 8.1 (a)(b)** (a) The company received loans from Mr K Dobson and Dr Coffey, Directors of Clearcut, repayable by 31 August 2005. These loans are unsecured and bear interest of 0.5% per annum above the bank bill rate.

**ED-91 8.1(c), 8.3(d)**

Loans to directors:	\$324,000
Current	\$174,000
Non-current	\$150,000

**ED-91 8.3 (b)** Interest expense paid on the loan during the year amounted to \$19,440.

**ED-91 8.1(a)(b)(c)** (b) The company purchased \$28,000 of sewing equipment from Machines Ltd, a company partly owned by Mr K Dobson

**ED-91 8.3 (b)** The purchase was on normal terms and conditions at an arms-length price.

(c) During the course of the year the company purchased \$26,000 of consulting on clothing designs from Designz Limited, a company in which Mr D James is a significant shareholder. The purchase was on normal terms and conditions at an arms-length price.

(d) The company leases property from a trust of which Mr K Dobson's children are beneficiaries for \$94,000 per annum. The operating lease was entered into on a commercial basis.

#### **Note 6 Related Parties**

**ED-91 9.4(a)(b)(c)** The Marketing Manager and Financial Controller of the Company are shareholders of a contracting company that provides contract employment to the entity. A total of \$123,934 was paid for contracting services on normal terms and conditions at an arms-length price.

# KPMG directory

## Offices

### Auckland

CPO Box 1584  
KPMG Centre  
9 Princes Street  
Telephone: +64 9 367 5800  
Facsimile: +64 9 367 5872

### Christchurch

PO Box 274  
KPMG at Cranmer  
34-36 Cranmer Square  
Telephone: +64 3 363 5764  
Facsimile: +64 3 363 5766

### Hamilton

PO Box 929  
KPMG Centre  
85 Alexandra Street  
Telephone: +64 7 858 6500  
Facsimile: +64 7 858 6501

### Tauranga

PO Box 110  
NZI Building  
35 Grey Street  
Telephone: +64 7 578 5179  
Facsimile: +64 7 578 2555

### Wellington

GPO Box 996  
KPMG Centre  
135 Victoria Street  
Telephone: +64 4 382 8800  
Facsimile: +64 4 802 1224

## Associate Offices

### Christchurch

Hadlee Kippenberger & Partners  
PO Box 577  
Clarendon Tower  
78 Worcester Street  
Telephone: +64 3 363 5700  
Facsimile: +64 3 363 5701

### Dunedin

Taylor McLachlan  
PO Box 188  
44 York Place  
Telephone: +64 3 477 5790  
Facsimile: +64 3 474 1564

### Gisborne

McCullochs  
PO Box 169  
1 Peel Street  
Telephone: +64 6 868 5069  
Facsimile: +64 6 867 8533

### Gore

Ward Wilson  
PO Box 77  
33A Main Street  
Telephone: +64 3 208 9055  
Facsimile: +64 3 208 1534

### Invercargill

Ward Wilson  
Private Bag 90106  
62 Deveron Street  
Telephone: +64 3 211 0103  
Facsimile: +64 3 218 3623

### Milton

Taylor McLachlan  
PO Box 33  
6 Shakespeare Street  
Telephone: +64 3 417 8066  
Facsimile: +64 3 417 8064

### Napier

Palairt Pearson  
PO Box 944  
86 Station Street  
Telephone: +64 6 835 3364  
Facsimile: +64 6 835 3388

### New Plymouth

Landrigan Waite  
PO Box 332  
10 Young Street  
Telephone: +64 6 759 9034  
Facsimile: +64 6 759 9047

### Otautau

Ward Wilson  
PO Box 50  
119 Main Street  
Telephone: +64 3 225 8244  
Facsimile: +64 3 225 8237

### Palmerston North

McKenzie McPhail  
PO Box 1242  
FMG Building  
68 The Square  
Telephone: +64 6 358 4163  
Facsimile: +64 6 356 5196

### Queenstown

Ward Wilson  
PO Box 123  
9 Shotover Street  
Telephone: +64 3 442 8554  
Facsimile: +64 3 442 8594

### Winton

Ward Wilson  
PO Box 28  
221 Great North Road  
Telephone: +64 3 236 7264  
Facsimile: +64 3 236 7184



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**New Zealand**

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