

2017 CPA PNG Annual Conference

Constructive Assurance in an Emerging Economy – A PNG Perspective

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Role of accounting in Emerging markets - Global experience

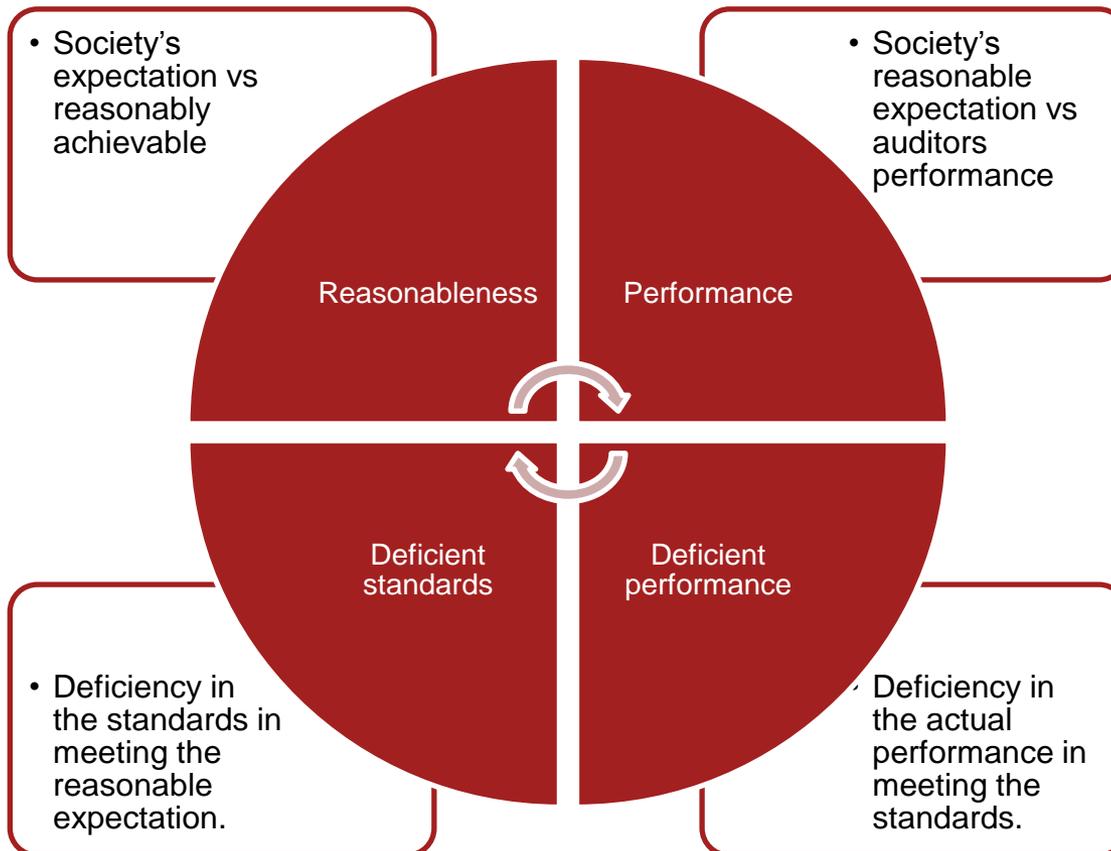
“Accounting plays an essential role in economic development. High quality corporate reporting is key to improving transparency, facilitating the mobilization of domestic and international investment, creating a sound investment environment and fostering investor confidence, thus promoting financial stability. A strong and internationally comparable reporting system facilitates international flows of financial resources while at the same time helping to reduce corruption and mismanagement of resources. It also strengthens international competitiveness of enterprises in attracting external financing and taking advantage of international market opportunities.

In the wake of various financial crises continued efforts are being made towards improving the quality of corporate reporting as an important part of measures toward strengthening the international financial architecture. In this regard the implementation and application of internationally recognised standards, codes and good practices in the area of corporate reporting has been strongly encouraged as a reflection of the increasing pace of globalization and international economic integration. However, the effective adoption and implementation of such standards and codes remains a challenge for many developing countries and economies in transition as they lack some of the critical elements of corporate reporting infrastructure –from weaknesses in their legal and regulatory frameworks, to lack of human capacity and relevant support institutions. In the face of these challenges there is a need for a coherent approach to building capacity in this area, as well as for tools to measure and bench mark progress and identify priorities for further actions”

UNCTAD’s Inter governmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) - 2012

Audit Expectation Gap (AEG)

“ Difference of expected performance perceived by the auditors and users of the financial statements”



- Scope of work
- Reporting
- Detection of errors and frauds
- Timing
- Stakeholder expectations
- Cost and benefit

“Auditing is a public good ,but we do harm to the public interest in that good when we forget that it is also a business”

James R Doty - Chairman
PCAOB (US)

Financial reporting regime in PNG

Accounting and auditing framework

- All PNG companies required to prepare general purpose finance statements – Full IFRS compliance
- Reporting company vs exempt company (mix of size and ownership criteria) – No change since 1997 -
- Exempt company – Limited financial reporting exemptions and no audit requirement
- Auditing standard is not specified in the legislations

The issues for SME's in PNG

- No real differential reporting for SME
- Size criteria for exempt companies not revised since 1997
- Even with the limited exemptions, full IFRS is far too complicated for most large enterprises, let alone SMEs
- IFRS for SMEs not approved for use in PNG
- Most SMEs do not have users who need or would benefit from general purpose financial statements

Timing, extent of compliance, stakeholder expectations and cost and benefit

2015 World Bank Report on the Observance of Standards and Codes (ROSC) – Areas for improvement

- ***Dualistic framework for financial reporting and audit*** – Opaque corporate financial reporting practice with many requirements on paper with little or no real compliance.
- ***Lack of operational and effective institutions*** – While power is granted by law to a number of regulatory bodies/institutions, they are hampered by lack of adequate financial and human resources
- ***Conflict in scope and responsibility and incompatibility between certain accounting and prudential standards*** - Companies Act vs Accountants Act, IFRS vs Prudential standards
- ***Lack of audit quality reviews*** - Lack of system to effectively monitor and enforce compliance with standards including no quality review program on the audits conducted by firms

In addition to the above, there are other issues - ***attitudes to compliance, training and development, depth of skill base, independence, susceptibility to fraud and error*** etc.

Highly demanding standards and lack of resources and the right attitude to ensure full and proper compliance

IFRS developments

Objective – single set of high quality global accounting standards

- The need for a harmonised high quality global standards (and convergence project between US FASB and IASB)
- Global Financial Crisis and the G20 summit (2009)
- Widespread adoption of IFRS (122 countries)

Major projects

- ✓ Financial instruments – IFRS 9 – effective 1 January 2018
- ✓ Revenue - IFRS 15 – effective 1 January 2018
- ✓ Leases – IFRS 16 – effective 1 January 2019
- ✓ Insurance contracts (phase II)– effective 1 January 2021

Continuous improvements and enhancements

New Standards

- Consolidation (IFRS 10) - 2013
- Joint Arrangement (IFRS 11) – 2013
- Disclosure of interest in other entities (IFRS 12) – 2013
- Fair value (IFRS 13) - 2013

Several amendments and enhancements to the existing standards including:

- Agriculture : bearer plants Investment entities exemption
- Income/deferred tax – investment properties, unrealised losses
- Investment entities – consolidation exemption

ISA developments

Clarity ISA Project (2010)

All International Standards on Auditing (ISAs) were redrafted including significant changes to certain standards (such as Audit of Estimates – ISA 540, Related party transactions – ISA 550, Group audits – ISA 600). The new redrafted and revised standards were effective from 2010.

Enhanced auditor reporting (2016)

Auditing standards covering the audit reports were revised to enhance the communicative value of the Auditor's Report. The reports now give prominence to the most important matters by re-ordering the contents, enhances reporting on going concern matters (if applicable), and provide enhanced descriptions of the respective responsibilities of directors/management and the auditor, provide an affirmative statement on auditor's independence and fulfilment of relevant ethical responsibilities and provide more information to users on the auditor's responsibilities, and the key features of an audit.

In addition, the listed entities audit reports communicate matters of most significance to the audit (**Key Audit Matters**) of the current period and how the auditor addressed these key audit matters. These changes became effective in 2016.

Enhanced auditor reporting in PNG – effective December 2016 – Key audit matters



*Goodwill impairment test
Impairment provision*

*Investment in JV
Impairment assessment
Assessment cashflow estimate*

*Carrying value of assets
Accounting for income tax*

*Investment property
Impairment provisions
Valuation of investments*

*Goodwill impairment test
Employee sharebased plan
Assessment of insurance claim*

*Asset impairment assessment
Goodwill impairment
assessment*

Newly approved PNG Accounting Standards

	Title	Effective Date
IFRS 9	Financial instruments	1.1.18
IFRS 10	Consolidated financial statements	1.1.13
IFRS 11	Joint arrangements	1.1.13
IFRS 12	Disclosure of interests in other entities	1.1.13
IFRS 13	Fair value measurement	1.1.13
IFRS 14	Regulatory deferral accounts	1.1.16
IFRS 15	Revenue from contracts with customers	1.1.18
IFRS 16	Leases	1.1.19
IFRS 17	Insurance contracts	1.1.21

Formal adoption of all IFRS (after IFRS 8) by the PNG Accounting Standards Board (ASB)

IFRS 9 on a page (effective 1 January 2018)

Classification & measurement

Financial assets

Equity instruments

- Fair value

Debt Instruments

- SPPI (cashflow test)
- Business model

Financial liabilities

- amortised cost/FV

(AC, FVTPL, FCTOCI)

Impairment

Model

- Expected loss model
- Forward looking

Implementation challenges:

- Expected Loss Model
- Fair value exercise
- Investment in IT system
- Alignment with regulatory compliance requirements

Hedging

Requirements

- Qualitative assessment
- Quantitative assessment
- Effectiveness test relaxed

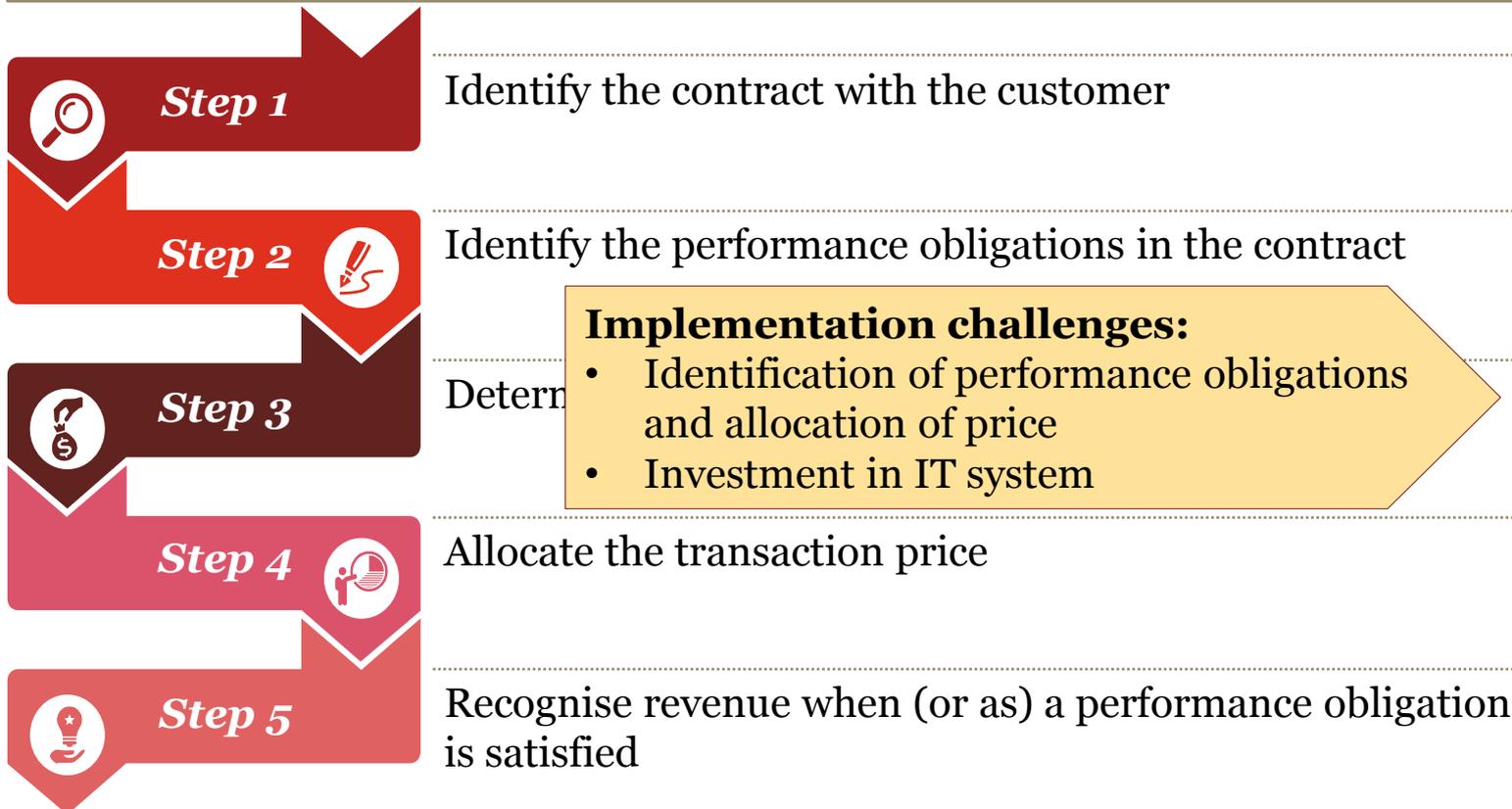
Ready for this?



Principle based approach to the classification, impairment and hedge accounting

IFRS 15 Revenue on a page – (effective 1 January 2018)

Core principle – Revenue recognised to depict transfer of goods or services



IFRS 16 on a page – effective 1 January 2019

Rights and obligations relating to leases are recognised on the lessee's balance sheet

“One of my great ambitions before I die is to fly in an aircraft that is on an airline's balance sheet.”

Sir David Tweedie Chairman of the IASB (25 April 2008)

Implementation challenges:

- Fixed vs variable lease payments
- Discounting lease payments
- Reassessment for changes in circumstances

Lessee recognises use asset and liability for almost all leases

as under current guidance

Exemptions for short-term leases and leases of low-value assets

Enhanced disclosure requirements

Comprehensive guidance on the definition of a lease

Huge impact on KPI (debt/equity ratio; EBIT/EBITDA/operating cash flow)

Is this plane on the balance sheet?



IFRS Insurance Project - Completed

Phase I
IFRS 4
(2004)

Implementation challenges:

- Complex modelling
- Wider actuarial involvement
- Investment in IT system

IFRS 17 is applicable to all insurance and reinsurance companies in PNG.

- Comprehensive insurance/reinsurance accounting model
- Introduction of general and simplified premium allocation approach
- Building block on insurance assets/liabilities including discounted cashflows, risk adjustment and service margin.

IFRS 17 !



Phase II
IFRS 17
(Issued in May 2017)
Effective 1 Jan 2021

More to come - Ongoing IFRS Projects

Maintenance Project

Research Project

Standard setting Project

Maintenance Project	Research Project	Standard setting Project
Accounting Policies and Accounting Estimates (Amendments to IAS 8)	Business Combinations under Common Control	Conceptual Framework
Accounting policy changes (Amendments to IAS 8)	Discount Rates	Definition of Material (Amendments to IAS 1 and IAS 8)
Availability of a refund (Amendments to IFRIC 14)	Dynamic Risk Management	Rate-regulated Activities
Borrowing costs eligible for capitalisation (Amendments to IAS 23)	Financial Instruments with Characteristics of Equity	
Classification of Liabilities (Amendments to IAS 1)	Goodwill and Impairment	
Definition of a business (Amendments to IFRS 3)	Post-implementation Review of IFRS	
Fees in the '10 per cent' test for derecognition (Amendments to IFRS 9)	Post-implementation Review of IFRS 13 Fair Value Measurement	
Improvements to IFRS 8 Operating Segments (Amendments to IFRS 8 and IAS 34)	Primary Financial Statements	
Income tax consequences of payments on instruments classified as equity (Amendments to IAS 12)	Principles of Disclosure	
Plan Amendment, Curtailment or Settlement (Amendment to IAS 19)		
Previously Held Interests in a Joint Operation (Amendments to IFRS 3 and IFRS 11)		
Property, Plant and Equipment: Proceeds before Intended Use (Amendments to IAS 16)		



**IFRS for SME
(1 January 2018)**

IFRS for SME in PNG

- Approved for use in PNG effective 1 January 2018
- Full IFRS was largely designed for the consolidated statements of listed companies
- Some parts of full IFRS are unnecessary, too complex or too expensive for other sorts of reporting: e.g. unconsolidated statements or most unlisted companies
- IFRS for SMEs, published in July 2009, is designed for this other reporting
- ***Who can apply IFRS in PNG?***
- Size doesn't matter - applicability is based on **publicly accountability**

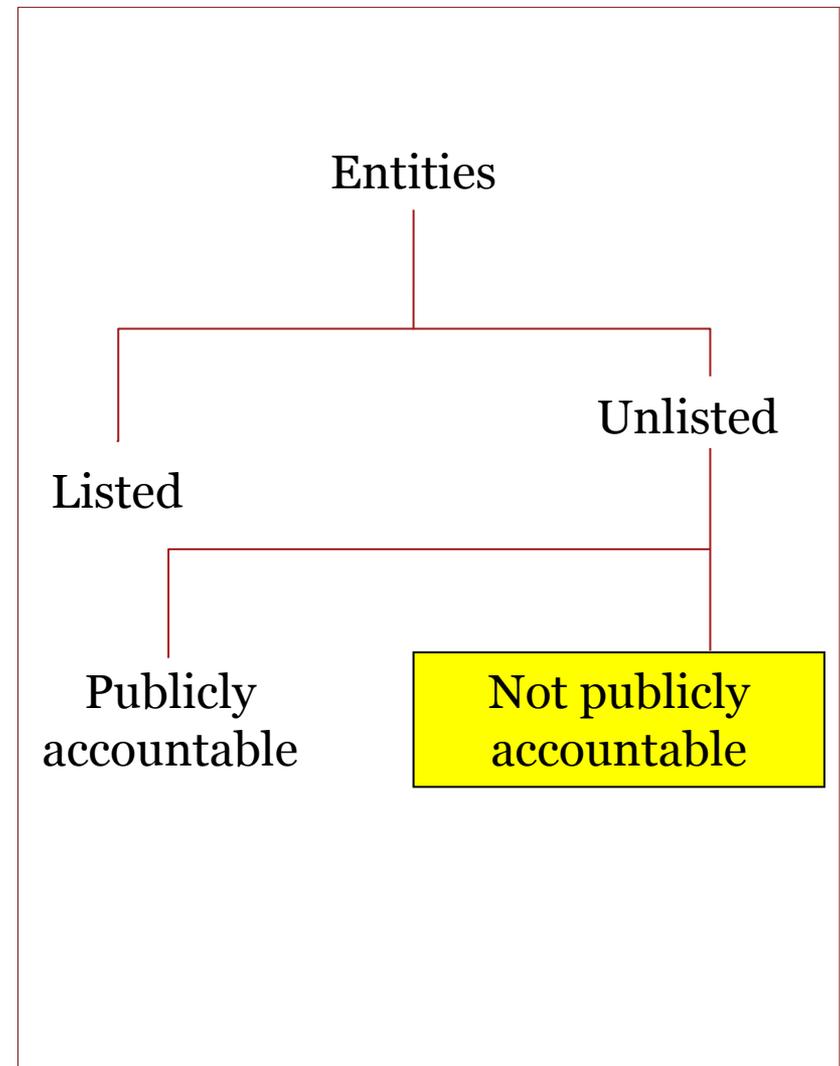
IFRS for SME in PNG – Public accountability

“An entity has public accountability if its debt or equity instruments are traded in a public market, or if it is in the process of issuing such instruments for trading in a public market, or if it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.”

Includes all listed entities, banks, Insurance companies, superannuation funds, investment funds, unit trusts, securities brokers and other financial institutions

No size criteria applied by ASB

Over 90% of companies in PNG eligible to adopt IFRS for SMEs



Overview of IFRS for SMEs

Structure

- IFRS for SMEs is 230 pages long (156 pages in A4)
- Full IFRS over 4,000 pages, with currently 41 separate standards plus interpretations
- There are 35 sections on various accounting topics, plus a preface and a glossary
- Amendments were expected every 3 years, but since 2009 only amended once in 2015

Transition

- Full retrospective application including comparative information is prepared and presented on the basis of the IFRS for SMEs (there are exemption).
- Likely to be straightforward for most PNG companies

Simplified accounting requirements

- Combined profit and loss and SOCE
- Business combination – transaction costs treatment
- Options in JV accounting – cost, equity or proportionate consolidation
- Borrowing costs – expense
- Financial instruments – simple differentiation – basic vs complex
- Intangible (including goodwill) – amortisation
- Deferred tax and hedge accounting – simplified criteria

International experience on differential reporting for micro-enterprises

- IFRS for SMEs is not the magic bullet solution
- IFRS for SMEs is a simplified version of full IFRS and makes compliance easier for medium and small entities with limited resources
- No significant impact on current practise for most PNG entities – just makes it easier for Directors to confirm compliance with confidence and less frequent changes
- IFRS for SMEs is still overly burdensome for micro-enterprises with limited resources

Most micro-enterprises do not require general purpose financial statements as they have limited users who have the ability to demand or access information to meet their own needs

- owner-managers
- Financiers
- tax authorities

Need for a basic special-purpose financial reporting framework for micro-enterprises that provides basic information that meets the needs of owners, banks and tax authorities.

International experience on differential reporting for micro-enterprises (contd)



	PNG (exempt)	Australia (small PL)	NZ (tier 2)	Europe (small)	UK (Micro)	Sri Lanka (Smaller)
Revenue	n/a	65m	71m	32m	2.7m	2m
Total assets	5m	32.5m	142m	16m	1.4m	1m
Employees	100	50	n/a	50	10	n/a
Shareholders	25	n/a	10	n/a	n/a	n/a

Most countries have some form of differential reporting regime for listed, large and small entities, with different auditing and lodgement requirements and either disclosure exemptions or different accounting standards. There is scope for PNG to increase the exempt company thresholds and introduce a third micro-enterprise tier.

Micro/smaller industries reporting (Sri Lanka and UK)

In addition to IFRS for SME, some countries have further simplified differential reporting for micro/smaller entities. For example, UK (FRS 105 – effective 2015) and Sri Lanka (SLAS for smaller entities – effective 2016). They only require:

- Simplified balance sheet and profit and loss statement
- No cash flow, equity statement or accounting policies – limited notes

Differential Reporting - The way forward for PNG



IFRS for SME

- IFRS for SMEs available for use from 1 January 2018.
- No significant impact on the financial statements for the majority of PNG entities.
- Benefits for directors, CFO's and auditors in ensuring compliance.
- Education and training requirements
- Not the solution for most SMEs in PNG

Further simplifications

- Companies Act amendments required to:
 - ✓ Change the definition of exempt companies
 - ✓ Increase the size limits for exempt companies (suggested increase total assets limit from K5m to K10m, but add a turnover limit of K20m)
 - ✓ Consider a new category of “Small Exempt Company” that can choose to prepare special purpose financial statements under a new micro-enterprise framework (eg:assets <K1m , turnover < K2m)
- CPAPNG and ASB to develop and adopt a micro-enterprise reporting standard

2015 World Bank Report on the Observance of Standards and Codes (ROSC) Recommendations

Short term

Improvement to the Statutory Framework

- *Review of the Accountants Act*
- *Reconstitution of ASB*
- Policy and advisory work to support ASB

Clarifying and simplifying the Accounting and Auditing Statutory Framework

- Grouping of medium, small and micro non-listed entities
- *An additional study on the suitability of IFRS for SME*

Short term

Improving compliance and enforcement with standards

A program of quality assurance reviews by CPA PNG

Building capacity of the profession

- Increase capacity of CPA PNG
- Review of the ARB
- Update of CPAPNG's code of ethics to align with IESBA

Building capacity of the profession

Conduct Corporate Governance ROSC assessment

2015 World Bank Report on the Observance of Standards and Codes (ROSC) Recommendations (contd)

Medium term

Establishment of Financial Reporting Council(FRC) – Single regulator

Adopt review IFRS and ISA, issue policies and guidance

Structured collaboration between educational institutions, CPA PNG and business

Coordinated effort between the educational institutions and business to improve the curriculum and strengthen quality of accounting graduates

Increase the number CPDs and providers

Increase accredited CPD providers to provide more CPD activities.

Medium term

Strengthen monitoring of members CPDs

Strengthen CPA PNG monitoring capacity of the members CPD hours

In summary – Constructive assurance

- PNG GAAP (IFRS) continues to evolve and the new changes have significant impact on PNG entities (that apply full IFRS). Need urgent work to avoid reporting issues.
- The current financial reporting regime is still onerous for small entities. IFRS for SME is the first step in the right direction. Further simplification is necessary for smaller/micro entities.
- Continuous Professional Development (CPDs) and training and development among the preparers and auditors, Quality control and monitoring, institutional strengthening of regulators (ROC, CPA PNG, ASB and BPNG) are necessary to facilitate effective implementation of the standards and promote a full compliance culture.



Thank you!

