PNG Accounting Technical Update

July 2017

In this issue:

Introduction 1

PNG GAAP developments 1

Implementation of IFRS 9, 15 & 16 reminder 2

IFRS 17 issued 4

New and revised IFRS 5

Contacts 7

Introduction

This publication relates to financial reporting requirements impacting on PNG entities as at 30 June 2017. It highlights the IFRS standards and interpretations issued as at 30 June 2017 and other topical PNG GAAP issues that entities should consider in their reporting.

PNG GAAP DEVELOPMENTS

The Accounting Standards Board of PNG (ASBPNG) has now been formally re-constituted and held it first meeting in almost 10 years on 31 May 2017. At this meeting the ASBPNG re-confirmed the existing policy of the Board that PNG GAAP for reporting companies would comprise International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. The ASBPNG would approve each new IFRS as an approved financial reporting standard under Section 206 of the Companies Act without modification and with the same effective implementation dates.

The ASBPNG also confirmed that any revisions or amendments made by the IASB to existing IFRS, together with any interpretations of IFRS issued by the International Financial Reporting Interpretations Committee, would apply automatically and not require formal approval by the ASBPNG.

Approval of financial reporting standards

The ASBPNG formally approved the following IFRS that had been issued since the last meeting in 2007, with effective dates as shown:

	Title	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

The Board also noted that the following previously approved IAS or IFRS have been withdrawn, or will be superseded, effective the dates shown:

	Title	Date
IAS 31	Interests in joint ventures	1.1.13
IAS 11	Construction contracts	1.1.18
IAS 18	Revenue	1.1.18
IAS 17	Leases	1.1.19
IFRS 4	Insurance contracts	1.1.21

Approval of *IFRS for SMEs*

The ASBPNG considered that adoption of the *IFRS for SMEs* standard would be of significant benefit to most small and medium sized enterprises in PNG. The *IFRS for SMEs* is a self-contained, globally recognised, standard of 230 pages, and has been widely adopted internationally since it was first issued in 2009.

Compared with full IFRSs, the *IFRS for SMEs* is less complex in a number of ways. Topics that are not relevant to SMEs have been omitted, and many principles for recognising and measuring assets, liabilities, income and expenses in full IFRSs are simplified.

pwc

Moreover, where full IFRSs allow accounting policy choices, the *IFRS for SMEs* allows only the easier option. There are significantly fewer disclosures required (roughly a 90% reduction), and the standard has been written in clear language.

IFRS for SMEs is designed to be applicable for companies of any size, provided it does not have 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".

The Board approved *IFRS for SMEs* as an approved financial reporting standard for use in PNG with an effective implementation date for accounting periods beginning on or after 1 January 2018. Adoption of the *IFRS for SMEs*, rather than compliance with full IFRS, is optional and available for all reporting and exempt companies other than those which have public accountability as defined above. This would include any entity whose shares are traded on POMSox or ASX. Entities that hold assets in a fiduciary capacity include banks and other licensed financial institutions, security brokers, insurance companies, superannuation funds, unit trusts, investment funds, and savings and loan societies.

The implementation date of 1 January 2018 was to allow for a period for raising awareness and providing training and resources for the transition to *IFRS for SMEs*.

Accounting by micro-enterprises and differential reporting

Whilst *IFRS for SMEs* is a simplified, single standard developed for medium and small entities, it may still not be the most appropriate for very small micro-enterprises, which covers many of the SMEs in PNG. A number of jurisdictions have developed national accounting standards and reporting rules specifically for very small micro-entities with limited internal capacity and users of the financial statements.

The ASBPNG agreed to commence a project to review international practice and develop recommendations for appropriate simplified financial reporting for micro-enterprises.

The Board also agreed to review the existing differential reporting regime under the PNG Companies Act and consider whether any changes should be recommended.

IMPLEMENTATION OF IFRS 9, 15 AND 16 REMINDER

The 2018 year will see the implementation of IFRS 9 "Financial Instruments" and IFRS 15 "Revenue from contracts with customers", whilst the 2019 year will bring adoption of IFRS 16 on leases. These new standards will potential have a significant impact on all entities, and management and directors should be considering now the specific impact on their own financial reporting, any changes in systems or processes that will be required and the transition adjustment on prior period comparatives and retained earnings.

As IFRS 9 and IFRS 15 are both applicable for 2018, entities will need to consider what specific disclosures of the likely impact are required in their 2017 financial statements and start thinking now about how they will determine the impact on comparatives and opening retained earnings.

IFRS 9 Financial Instruments

IFRS 9, 'Financial Instruments' (effective 1 January 2018) replaces the guidance in IAS 39 with a standard that is less complex and principles based. The new standard simplifies the model for classifying and recognising financial instruments and aligns hedge accounting more closely with common risk management practices. Changes in own credit risk in respect of liabilities designated at fair value through profit or loss shall now be presented within OCI.

IFRS 9's new impairment model is a move away from IAS 39's incurred credit loss approach to an expected credit loss model. Earlier recognition of impairment losses is likely to result and for entities with significant lending activities, an overhaul of related systems and processes will be needed.

The main changes in IFRS are summarised below:

- IFRS 9 replaces the multiple classification and measurement models in IAS 39 *Financial instruments: Recognition and measurement* with a single measurement model driven by an

entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets.

- A 'debt instrument is measured at amortised cost if: a) the objective of the business model is to hold the financial asset for the collection of the contractual cash flows, and b) the contractual cash flows under the instrument represent solely payments of principal and interest.
- A 'fair value through other comprehensive income' category has been introduced for financial assets that are debt instruments held in a business model whose objective is achieved by both collecting its contractual cash flows, which consist of principal and interest only, *and* selling to realise gains. An entity must recognise all other financial assets, including investments in complex debt instruments and equity investments, at fair value through profit or loss.
- Entities may also make an irrevocable election on initial recognition for equity investments not held for trading to record fair value changes in other comprehensive income and not subsequently recycle to the income statement when realised. Dividends from these investments, however, are recognised in the income statement.
- Changes in fair value of financial liabilities measured at fair value through profit and loss due to changes in the entity's own credit risk shall be recorded in other comprehensive income provided they do not create or increase accounting mismatches in profit or loss. This requirement can be early adopted selectively.
- Impairment losses will be recognised using the expected credit loss (ECL) model. This involves a three-stage approach whereby financial assets move through the three stages as their credit quality changes. The stage dictates how an entity measures impairment losses and applies the effective interest rate method. A simplified approach is permitted for financial assets that do not have a significant financing component (eg. trade receivables). On initial recognition, entities will record a day-1 loss equal to the 12 month ECL (or lifetime ECL for trade receivables), unless the assets are considered credit impaired.
- Under the new hedging requirements, an entity will be able to align its hedge accounting more closely with its risk management practices. As a general rule, it will be easier to apply hedge accounting. Entities will be required to make additional disclosures and implement changes in presentation. The bright line 80-125% retrospective hedge effectiveness test has been replaced with an economic relationship effectiveness test. Under the new hedging rules, there are a number of hedged items that are now eligible for designation such as risk components of non-financial items. Regarding hedge instruments, if hedging with forwards or options and designating only the spot element of those instruments, the related forward points or time value may be deferred in other comprehensive income. Notwithstanding these benefits, voluntary de-designation of hedges is not permitted under the new hedging rules.

The main impact of IFRS 9 will be on banks and other financial institutions, and regulators and other users will be expecting banks to provide comprehensive disclosure of the expected impacts of IFRS 9 and their implementation strategy in their 2017 financial reports.

However, corporates will also be impacted by the changes to impairment loss provisioning on trade and other receivables and the new rules for hedge accounting.

IFRS 15 Revenue from contracts with customers

IFRS 15 'Revenue from contracts with customers' (effective 1 January 2018) is a converged standard from the IASB and FASB on revenue recognition. The core principle of IFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard is based on the principle that revenue is recognised when control of a good or service transfers to a customer – so the notion of control replaces the existing notion of risks and rewards.

An entity recognises revenue in accordance with that core principle by applying the following 5 steps:

i. Identify the contract(s) with a customer
ii. Identify the performance obligations in the contract

iii. Determine the transaction price
iv. Allocate the transaction price to the performance obligations in the contract, and
v. Recognise revenue when (or as) the entity satisfies a performance obligation.

IFRS 15 also includes a cohesive set of disclosure requirements that will result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers.

Subsequent amendments to IFRS 15 provided clarifications of the guidance on identifying performance obligations, accounting for licences of intellectual property and the principal versus agent assessment (gross versus net revenue presentation).

Almost all entities will be affected to some extent by the significant increase in required disclosures. But the changes extend beyond disclosures, and the effect on entities will vary depending on industry and current accounting practices. Entities will need to consider changes that might be necessary to information technology systems, processes, and internal controls to capture new data and address changes in financial reporting.

IFRS 16 Leases

IFRS 16, 'Leases' (effective 1 January 2019) replaces the guidance in IAS 17 and will have a significant impact on accounting by lessees.

Key Impact on Lessees:

- Almost all leases go on balance sheet because the distinction between operating and finance leases is removed for lessees.
- The income statement will also be affected because operating lease expenses will be replaced by interest and depreciation. The timing of expenses will also change, typically higher in the earlier years of a lease and lower in later years.
- Key ratios and metrics are likely to be affected - EBITDA will increase and recognising new lease assets and liabilities will significantly affect balance sheet ratios such as leverage.
- Lease term and lease payment are defined more broadly under IFRS 16 than under the previous standard. Specifically, there is more guidance on whether to include extension options in the lease term and how to treat variable lease payments for clauses including CPI increases and turnover-based rent.
- The removal of 'off-balance sheet' operating leases brings into focus the distinction between a lease and a service arrangement, which is not accounted for on balance sheet. The new guidance focuses on the principle of control and whether a lessee has the right to control the use of an identified asset during the lease term; it may give a different classification to the previous standard, which focused on risk and rewards.

Key Impact on Lessors

- The distinction between operating leases and finance leases remains for lessors; there is no fundamental change to lessor accounting. Lessors will, however, be interested commercially in understanding their customers' incentives and the potential for behaviour to change. The new definition of a lease may also give lessors an opportunity to structure arrangements as services instead of leases.

Given pre-existing leases are not grandfathered under the new standard, all leases will need to be reassessed when IFRS 16 is adopted.

20 YEARS IN THE MAKING: IFRS 17 HAS FINALLY BEEN ISSUED.

IFRS 17 is the biggest shake up of insurance reporting for decades – it has taken 20 years to reach final publication by the IASB. It will impact insurers reporting under IFRS and some other companies, for example banks, who may issue insurance contracts. The aim is to provide more transparency and comparability than the current accounting standard, which grandfathered a myriad of existing accounting policies, even if they were inconsistent within a group.

It is, however, complex and the detail of the standard, together with guidance the IASB issues around implementation, will play a significant role in how the standard is implemented. IFRS 17 will be mandatory for accounting periods beginning on or after 1 January 2021.

Overview of measurement model

IFRS 17 requires a current measurement model where estimates are re-measured each reporting period. Contracts are measured using the building blocks of:

- discounted probability-weighted cash flows;
- an explicit risk adjustment and
- a contractual service margin ('CSM') representing the unearned profit of the contract which is recognised evenly over the coverage period.

The standard allows a choice between recognising changes in discount rates either in the income statement or directly in other comprehensive income. The choice is likely to reflect how insurers account for their financial assets under IFRS 9. Many insurers will take advantage of the option to defer implementation of IFRS 9 until they adopt IFRS 17.

An optional, simplified premium allocation approach is permitted for the liability for the remaining coverage for short duration contracts, which are often written by non-life insurers.

There is a modification of the general measurement model called the 'variable fee approach' for certain contracts written by life insurers where policyholders share in the returns from underlying assets. The modification allows certain changes to be recognised against the CSM and the results of insurers using this model are therefore likely to be less volatile than under the general model.

Key changes from current accounting
The new standard is likely to have a more significant impact on many life insurers, given the long term contracts they write. However, non-life insurers will also see changes in the accounting for reinsurance and they will be required to discount claims.

Some of the key changes from today's accounting will be:

- All cash flows will be based on current assumptions whereas for some insurance contracts today (often written overseas) insurance is measured using historic assumptions.
- Revenue will be more consistent with IFRS 15, excluding deposit components, and will not be recognised on a cash basis as is currently the case for life insurers.
- The measurement will require historic data, such as discount rates and unearned profit; data has not been captured for current accounting and regulatory reporting.
- The calculation will be at a lower level of granularity than many insurers use today.

Impact
IFRS 17 will impact businesses well beyond the finance, actuarial and systems development areas. For example, it could affect product design and distribution, incentive plans and wider remuneration policies, and budgeting. There could also be an impact on the cash tax position and dividends, depending on local regulation.

The introduction of IFRS 17 will be a significant challenge for many insurers. This is viewed as the price of improved accounting practices and comparability. Many hope that better accounting practices will improve how investors see the industry and will reduce the cost of capital for the industry in the future.

IFRS CHANGES APPLICABLE FOR JUNE 2017 YEAR ENDS

Summarised below are the new and revised IFRS standards and interpretations that became effective for companies with 30 June 2017 years ends:

- Amendment to IFRS 11 'Joint arrangements' on acquisition of an interest in a joint operation. These amendments provide new guidance on how to account for the acquisition of an interest in a joint operation that constitutes a business.

- Amendment to IAS 16 'Property, plant and equipment' and IAS 41 'Agriculture', regarding bearer plants. These amendments require bearer plants to be accounted for in the same way as property, plant and equipment because their operation is similar to that of manufacturing. The produce growing on bearer plants will remain within the scope of IAS 41.

- Amendment to IAS 16 'Property, plant and equipment' and IAS 38 'Intangible assets', on depreciation and amortisation. These amendments clarify that the use of revenue-based methods to calculated depreciation and amortisation is not appropriate.

- IFRS 14 'Regulatory deferral accounts' permits first-time adopters to continue to recognise amounts related to rate regulation in accordance with their previous GAAP requirements when they adopt IFRS. This is unlikely to be applicable to PNG entities.

- Amendments to IAS 27 'Separate financial statements' on the equity method. These amendments allow entities to use the equity method to account for investments in subsidiaries, joint ventures and associates in their separate financial statements.

- Annual improvements 2014 makes minor changes to IFRS 5, IFRS 7, IAS 19, and IAS 34.

- Amendments to IAS 1 'Presentation of Financial Statements' form a part of the IASB's Disclosure Initiative and clarify guidance in IAS 1 on a number of issues including:

– Materiality – disclosures specified in IFRS only need to be included in financial statements if they are material to the entity

– Disaggregation and subtotals – line items specified in IAS 1 may need to be disaggregated where this is relevant to an understanding of the entity's financial position or performance. However, entities should not aggregate or disaggregate information in a manner that obscures useful information. There is also new guidance on the use of subtotals.

– Notes – confirmation that the notes do not need to be presented in a particular order

– Other comprehensive income (OCI) arising from investments accounted for under the equity method: the share of OCI arising from equity-accounted investments is grouped based on whether the items will or will not subsequently be reclassified to profit or loss. Each group should then be presented as a single line item in the statement of OCI.

- Amendment to IFRS 10 and IAS 28 on investment entities applying the consolidation exemption. The amendments to IFRS 10 clarify that the exception from preparing consolidated financial statements is available to intermediate parent entities which are subsidiaries of investment entities. The exception is available when the investment entity parent measures its subsidiaries at fair value. The amendments to IAS 28 allow an entity which is not an investment entity, but has an interest in an associate or joint venture which is an investment entity, a policy choice when applying the equity method of accounting.

IFRS DEVELOPMENTS EFFECTIVE FOR SUBSEQUENT PERIODS

The following is a full list of the new and revised IFRS issued up to 30 June 2017 which are effective for accounting periods beginning on or after 1 July 2017, although early adoption is permitted:

- Amendments to IAS 7 'Statement of Cash Flows' on disclosure initiative (effective 1 January 2017). These amendments to IAS 7 introduce an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities. This disclosure includes changes arising from cash flows, such as drawdowns and repayments of borrowings, and non-cash changes, such as acquisitions, disposals and unrealised exchange differences.

- Amendments to IAS 12 'Income Taxes' on recognition of deferred tax assets for unrealised losses (effective 1 January 2017). These amendments on the recognition of deferred tax assets for unrealised losses clarify how to account for deferred tax assets related to debt instruments measured at fair value.

- Amendments to IFRS 2 'Share based payments' on clarifying how to account for certain types of share-based payment transactions (effective 1 January 2018). This amendment clarifies the measurement basis for cash-settled, share-based payments and the accounting for modifications that change an award from cash-settled to equity-settled. It also introduces an exception to the principles in IFRS 2 that will require an award to be treated as if it was wholly equity-settled, where an employer is obliged to withhold an amount for the employee's tax obligation associated with a share-based payment and pay that amount to the tax authority.

- IFRS 9, 'Financial Instruments' (effective 1 January 2018) – see detailed analysis above.

- IFRS 15 'Revenue from contracts with customers' (effective 1 January 2018) – see detailed analysis above.

- IFRS 16, 'Leases' (effective 1 January 2019) – see detailed analysis above.

- Amendments to IFRS 4, 'Insurance contracts' (effective 1 January 2018) regarding implementation of IFRS 9. These amendments introduce two approaches: an overlay approach and a deferral approach. The amended standard will:

  – give all companies that issue insurance contracts the option to recognise in OCI, rather than profit or loss, the volatility that could arise when IFRS 9 is applied before the new insurance contracts standard is issued; and

  – give companies whose activities are predominantly connected with insurance an optional temporary exemption from applying IFRS 9 until 2021, in which case they will continue to apply IAS 39.

- Amendments to IAS 40, 'Investment property' (effective 1 January 2018) relating to transfers of investment property. These amendments clarify that to transfer to, or from, investment properties there must be a change in use. To conclude if a property has changed use there should be an assessment of whether the property meets the definition. This change must be supported by evidence.

- Annual improvements 2014 – 2016 makes minor changes to IFRS 1, IFRS 12 and IAS 28.

- IFRIC 22, 'Foreign currency transactions and advance consideration' (effective 1 January 2018) addresses foreign currency transactions or parts of transactions where there is consideration that is denominated or priced in a foreign currency. The interpretation provides guidance for when a single payment/receipt is made as well as for situations where multiple payments/receipts are made.

- IFRS 17, "Insurance contracts" (effective 1 January 2021) – see detailed analysis above.

For further help on IFRS technical issues, accounting advice or training needs please contact our Accounting Technical Support Team or your Assurance Partner:

Stephen Beach, Partner
stephen.beach@pg.pwc.com
+675 472 2644 / +675 7100 9535

Kanthan Rajadurai, Principal
kanthan.rajadurai@pg.pwc.com
+675 305 3236 / +675 7100 9531

Craig Ross, Director
craig.x.ross@pg.pwc.com
+675 305 3148 / +675 7086 0544

Jonathan Seeto, Territory Senior Partner
jonathan.seeto@pg.pwc.com
+675 305 3223 / +675 7100 9520

Christopher Hansor, Assurance Leader
christopher.hansor@pg.pwc.com
+675 305 3206 /+675 7199 6333

Jonathan Grasso, Partner
jonathan.a.grasso@pg.pwc.com
+675 305 3260 / +675 7072 7461

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. It does not take into account any objectives, financial situation or needs of any recipient; any recipient should not act upon the information contained in this publication without obtaining independent professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwC, its partners, employees and agents do not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2017 PricewaterhouseCoopers. All rights reserved. PwC refers to PricewaterhouseCoopers PNG which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate and independent legal entity.

pwc