KPMG

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Foreword

What is ESG? It is clear the consideration of this significant area is becoming unavoidable for all entities, especially in remaining relevant in the modern business world. Read the interesting article and start thinking about how you will need to adapt. This month also sees the changes in the PNG Companies Act highlighted, most notably around the concept of the beneficial ownership of shares. Further proposed movement in the compliance space includes PNGX having released the proposed new listing rules for consultation with a closing date of Friday 16 December 2022. Finally, and very relevant to all commercial entities, we discuss the concept of expected credit losses (ECL). Companies are required to measure the impairment of financial assets, including trade receivables, using an ECL model. The creation and annual updating of this model could be challenging, and we aim to provide some guidelines that may clarify this process.

KPMG in PNG has dedicated in-house specialists in all the following areas: internal audit/risk, visa migration, corporate finance, management consulting, IT advisory, fraud investigation as well as tax and assurance. As such we are well placed to provide a truly multi-disciplined approach to business advisory.

Please enjoy this month's Kundu and reach out to us at kmcentee@kpmg.com.au if you would like to see KPMG cover specific topics in future editions.

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What is ESG?

by Pieter Steyn, Partner, Audit & Assurance Services

The world is drastically changing. Alongside positive development associated with socio-economic growth, we are also faced with several environmental and social challenges including, but not limited to, climate change, poverty, hunger, rising unemployment and gender inequality, racial injustice, irresponsible consumption and production, pollution, bribery, and corruption.

As part of the global movement to address these challenges, governments, regulators, and international organizations are driving initiatives to push businesses, communities, and society to operate sustainably and responsibly. Consequently, businesses are now under greater scrutiny and must adapt to these changes by embedding ESG into their business strategies to convince their stakeholders that they can achieve the high standards they expect.

ESG, which stands for Environment, Social, and Governance, represents three core factors in measuring corporate sustainability. It represents stakeholders' expectations which include not harming the environment, operating with social responsibility, and displaying integrity in governance.

Under the Environment factor, a business must:
- Be sustainable
- Continuously examine its environmental impact throughout its supply chain
- Reduce, reuse, or recycle its waste
- Value nature and conservation

Under the Social factor, a business must:
- Be inclusive and play a positive role in the community
- Pay fair taxes
- Drive ethical behaviour throughout its supply chain
- Treat its workforce fairly in terms of pay and conditions and provide a safe and healthy working environment
- Encourage its employees to speak out if they see something wrong

Under the Governance factor, leadership and management must:
- Represent and champion the diversity of the stakeholders
- Be incentivized to drive sustainability performance
- Drive a culture of strong ethics and integrity
- Be transparent on environmental, social, and governance performance metrics.

ESG Globally and in PNG

In 2015 the United Nations developed 17 Sustainable Development Goals (SDGs). Together they form an urgent call to action for all countries across the globe. Each ESG action done by businesses to make a difference helps deliver the SDGs. ESG standards align with these goals. The 17 SDGs are as follows:

1. No Poverty
2. Zero Hunger
3. Good Health and Well-Being
4. Quality Education
5. Gender Equality
6. Clean Water and Sanitation
7. Affordable and Clean Energy
8. Decent Work and Economic Growth
9. Industry, Innovation, and Infrastructure
10. Reduced Inequalities
11. Sustainable Cities and Communities
12. Responsible Consumption and Production
13. Climate Action
14. Life Below Water
15. Life on Land
16. Peace, Justice, and Strong Institutions
17. Partnership for the Goals

According to the United Nations Department of Economic and Social Affairs Sustainable Development website (sdgs.un.org), notable progress and key challenges were noted toward the achievement of the SDGs after PNG adopted the 2030 Agenda for Sustainable Development and the Small Island Developing Stated Accelerated Modalities of Action (SAMOA Pathway) to achieve the country's Vision 2050. The SDGs were integrated into the Medium-Term Development Plan III (2018-2022) with other national policies, legislation, and budgets.

What does this all mean for organisations?

Regulators, investors and other stakeholders are driving companies to ESG reporting but this is just the tip of the iceberg.

ESG is a critical design principle for the organization of the future.

ESG is about opportunity as organizations that capitalize on this opportunity and transform their operations for better will be rewarded, with all manner of financial and non-financial benefits on the table.

ESG is about business continuity. Factoring ESG into the transformation agenda is imperative to risk mitigation, change management and building trust, which are all key to ensuring the company's longevity and success.

ESG is top of mind for our clients - a changing regulatory environment compounded by heightened expectations from stakeholder groups from investors to employees to customers has made ESG a business imperative that cannot be ignored.

Stakeholders are demanding more from corporations and addressing these concerns may require companies to rethink the way they do business.

Important amendments to the Companies Act

by Cieran Kelly, Senior Tax Consultant, Tax, Transactions & Accounting

On 2 September 2022 legislation amending the Companies Act was certified. It will not come into force until commencement is gazetted in the National Gazette.

The stated aims of the amendments are to reform the law relating to companies, combat money-laundering, provide for better internal governance and to facilitate re-registration of companies.

To these ends the new legislation changes the Companies Act in four ways:

1. There is a new section 72 titled "beneficial ownership of shares". It requires companies to obtain and maintain sufficient information to identify the beneficial owners of issued shares. In this context, the reference to a beneficial owner means one of two things. Either a natural person who owns or controls a share or other membership interest in a company; or a natural person who exercises ultimate effective control directly or indirectly over a legal person or arrangement affecting shares or membership interests or decisions in a company. This is to allow a competent authority to request that information if the need for it arises.

   For context, these new rules are part of wider international efforts to protect against the misuse of corporate vehicles to facilitate a broad range of financial crimes. As corporate vehicles can obscure the identity of natural persons, the purpose of assets and the sources of funds; international transparency standards require governments to be able to have access to adequate, accurate and timely beneficial ownership information.

   While there may be some overlap a beneficial owner, in this context should not be confused with a beneficiary in the trust sense. The phrase has a statutory meaning which contains two limbs both of which are intended to describe natural persons who control the capital or assets of a company. Under the first limb, a beneficial owner means a natural person who owns or controls a share or other membership interest in a company. This is a direct test and, in most cases, will be straightforward to apply because ownership or control must be exercised over the relevant company share(s).

   The second limb is much wider. It covers natural persons who exercise "ultimate effective control" directly or indirectly over a legal person or arrangement affecting shares or membership interests or decisions in a company. In a simplified sense, it is necessary to take a look through the approach to determine the ultimate "beneficial ownership" of the shares. The element of control does not need to be exercised by the beneficial owner over a share. Instead, it can be exercised over some other person or arrangement which itself affects shares or membership interests or even decisions in a company. The reference to "ultimate effective control" refers to situations where control is exercised by a natural person through chains of interposed legal persons or arrangements for example cascading holding companies or complex trust structures.

At present there are limited legislative mechanisms to compel beneficial owners to provide information to a company, so the risk of non-compliance is borne directly by the company and its directors.

The penalty for failing to obtain and maintain the information required or failing to disclose it to a competent authority, if requested, is a fine not exceeding K50,000.00 for the company and a fine not exceeding K100,000.00 for every director.

2. When the amendments to the Companies Act come into force companies can be removed from the register without notice when their company annual return is six months or more overdue. In such cases, objections by the company are not allowed.

   Where a company that has been removed from the register and wishes to apply is restored, it will have two years to do so. It is a condition of restoration that the company pays all outstanding fees. The amendments also permit existing companies, both domestic and overseas, to apply for reregistration. The reason for these rules, as we understand, is that the current database that runs the registry is being upgraded to a newer one. Part of that transition will require existing companies to re-register on the new database.

3. There are several minor amendments. For example, references to the repealed Securities Act are replaced with references to its successors, the Securities Commission Act, and the Capital Market Act.

4. The fourth and final major change to the Companies Act is the reduction in the number of items that must be contained in an annual return

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How are expected credit losses on trade receivables impacted?

What's the issue?

IFRS 9 *Financial Instruments* requires companies to measure impairment of financial assets, including trade receivables, using the expected credit loss model. Accordingly, companies are required to account for what they expect the loss to be on the day they raise the invoice – and they revise their estimate of that loss until the date they get paid. The concept of expected credit losses (ECLs) means that companies are required to look at how current and future economic conditions impact the amount of loss. Credit losses are not just an issue for banks and economic uncertainty is likely to have an impact on many different receivables.

ECLs on trade receivables are measured by applying either the general model or the simplified model. This article considers issues particularly relevant to the simplified model, in which ECLs are measured at an amount equal to lifetime ECLs. Companies using the simplified model often use provisioning matrices that are based on historical data. Those matrices have to be adjusted to incorporate reasonable and supportable information that is available at the reporting date, including economic uncertainty resulting from events such as a natural disaster, geopolitical event or pandemic. This may include considering the need for additional scenarios and the impact of any government support schemes.

In addition, certain assumptions used in the ECL estimate – e.g., about segmentation of a portfolio or the effective interest rate used to discount expected future cash flows – may no longer be appropriate in the changing economic conditions and so may need revising. Companies will need to update provision models to reflect credit losses resulting from economic uncertainty.

Reflecting information available at the reporting date

ECLs are measured at an unbiased, probability-weighted amount, using reasonable and supportable information that is available without undue cost or effort at the reporting date. This includes information about past events, current conditions and forecasts of future economic conditions. Due to the short-term nature of trade receivables, many companies may not have needed to consider updating ECL estimates for changes in future economic conditions relative to historic experience. However, in some cases the impact of economic and/or geopolitical uncertainty may be immediate and may significantly alter the historical collection patterns for some segments of trade receivables. Companies may need to reassess the impact of external events on future economic conditions and consider a longer time horizon – e.g. when payment dates are deferred for a significant period.

IFRS 9 allows the use of practical expedients when measuring ECLs under the simplified approach – e.g. using a provision matrix. A company that applies a provision matrix may be applying segmentation to capture the significantly different historical credit loss experiences for different customer segments. However, the segmentation has to be kept under review to reflect the different ways in which economic uncertainties affect different types of customers.

Provision matrices are based on historical loss experience but need to be adjusted to reflect information about current conditions and reasonable and supportable forecasts of future economic conditions. Certain economic uncertainties may lead to a significantly different loss rate for trade receivables compared with prior periods. Companies will need to consider how the timing and amount of cash flows generated by outstanding trade receivables might be affected and amend loss rates as necessary.

Companies that have credit insurance for their trade receivables need to consider how this affects the measurement of ECLs and ensure that measurement is consistent with updated loss estimates and any limitations on coverage. The accounting will depend on whether the insurance is considered to be a financial guarantee integral to the contractual terms of the trade receivable. If the guarantee is integral, then it will be included in the measurement of ECLs on the trade receivable. If it is not, then separate accounting considerations will apply depending on whether the loss event has occurred. Companies may also have to consider whether the insurance they hold covers losses arising from external events, such as the war in Ukraine. If there are contractual exclusions, some losses may not be covered.

Discount rate

Trade receivables without a significant financing component are measured on initial recognition at the transaction price determined under IFRS 15 *Revenue from Contracts with Customers* and do not have a contractual interest rate. This implies that the effective interest rate for these receivables is zero. Accordingly, discounting of cash shortfalls to reflect the time value of money when measuring ECLs is generally not required.

However, if a trade receivable becomes overdue and is then modified to effectively incorporate a significant financing component, then further analysis and judgment may be required, because using an effective interest rate of zero may no longer be appropriate. Certain economic uncertainties may lead to more renegotiations of trade receivables or changes to the effective terms of the receivables. For example, this may be the case for receivables impacted by the legal prohibition for Russian businesses to make payments in currencies other than Russian roubles.

Disclosures

Under IFRS 7 *Financial Instruments: Disclosures*, a company is required to disclose the nature and extent of risks arising from financial instruments and how it manages those risks. Therefore, a company will need to explain the significant impacts of the economic uncertainties on the risks arising from financial instruments, including trade receivables, and how it is managing those risks. It will need to use judgement to determine the specific disclosures that are both relevant to its business and necessary to meet these disclosure objectives.

Examples of specific disclosures include the following.

- Information about a company's credit risk management practices and how they relate to the recognition and measurement of ECLs. A company may have changed its risk management practices in response to the economic uncertainty caused by external events – e.g. by changing payment terms for trade receivables or by implementing a new law or guidance issued by governments.
- The methods, assumptions and information used to measure ECLs – e.g. a company may need to explain how it has incorporated updated forward-looking information into measuring ECLs, in particular, how it has:
    - dealt with the challenge of simplified ECL models that were not designed for issues arising from economic uncertainty;
    - calculated any overlays and adjustments to these simplified models;
    - reflected the impact of any credit insurance;
    - reflected the impact of any changes to law; and
    - incorporated the provision of government support that might aid recovery of balances.
- Quantitative and qualitative information that enables evaluation of the amounts arising from ECLs. The types of analysis disclosed previously may need to be adjusted or supplemented to clearly convey economic uncertainty.

- Information on the assumptions that the company has made about the future and other major sources of estimation uncertainty at the reporting date that have a significant risk of resulting in material adjustment within the next financial year.

Actions for management to take now

When measuring ECLs for trade receivables:

- assess how to incorporate forward-looking information reflecting economic uncertainty.
- consider whether the segmentation applied to measure ECLs appropriately captures the different types of customers or regions that are affected in different ways by the economic uncertainty.
- assess whether a trade receivable has been modified and, if so, whether it continues to be appropriate to use a discount rate of zero; and
- consider how to incorporate the impact of any credit insurance, new legislation and government support.

PNGX has released proposed new Listing Rules for consultation

PNG's national stock exchange, PNGX, has released proposed new listing rules for consultation with a closing date of Friday 16 December 2022. The modernisation of the PNGX Listing Rules, which were last amended in 2012, is seen as a key step towards the development of a more effective secondary market in equity securities.

PNGX is proposing to introduce new Listing Rules to replace the existing Listing Rules. The aim is to:

- Update the Listing Rules to reflect the Capital Market Act 2015
- Introduce Listing Rules which are "fit for purpose" for the nature and scale of the PNG capital market and
- Align the proposed rules with contemporary ASX Listing Rules, but not replicate the ASX Listing Rules, in recognition of the significant portion of the PNGX market which is dual listed on ASX, thereby minimizing compliance costs that would arise from the significant variance between the rules

To date, PNGX has operated a single equities market. Having regard to the nature of the PNG capital market, PNGX will be developing specialist markets for differing sectors of the capital market in order to better facilitate access to capital for issuers with different levels of maturity and for different financial products and services.

The markets which have been or are being developed are as follows:

- The current equities market will be known as the BikMaket or Main Market;
- The new corporate debt market will be known as the DinauMaket or Debt Market;
- A new market for medium-sized issuers will be developed and known as the PasisMaket or Passage Market; and
- A new platform for small and medium-sized issuers to access funding and social fundraising will be developed and known as the GroMaket or Growth Market.

The current consultation relates solely to the BikMaket or Main Market. The proposed rules refer to reporting corporate governance matters as set out in the PNGX Corporate Governance Standards. These standards are presently under development with the assistance of the International Finance Corporation.

Our social media presence

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