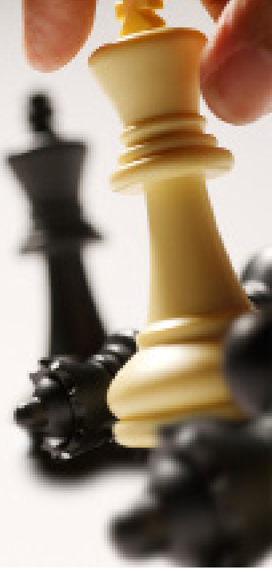
# Accounting News Flash

January 2017



## Exposure Drafts issued in Q4 - 2016

A number of exposure drafts ("EDs") of new/amended standards and interpretations were released during the last quarter of 2016, and some remained open for public comment up to first quarter of 2017. The following are highlights of the EDs.

### ED PSAK 71 – Financial Instruments

The ED of PSAK 71 adopts the latest version of IFRS 9: Financial Instruments (i.e. the version that is effective on 1 January 2018 for IFRS reporters). It includes a logical model for classification and measurement; a forward-looking 'expected loss' impairment model; and a substantially-reformed approach to hedge accounting.

- The new model for classification of financial assets is driven by cash flow characteristics and the business model in which an asset is held. This principle-based approach replaces existing rule-based requirements under PSAK 55 that are considered to be overly complex and difficult to apply.
- The impairment for financial assets is based on the expected-loss impairment model that will require more timely recognition of expected credit losses. This ED requires entities to account for expected credit losses from when financial instruments are first recognized, and to recognize full lifetime expected losses on a more timely basis.
- The new hedge-accounting model aligns the accounting treatment with risk management activities, so as to better reflect hedge activities in the financial statements. As a result of these changes, this ED includes additional disclosures of information about risk management and the effect of hedge accounting on the financial statements.
- The ED also removes the volatility in profit or loss that was caused by changes in the credit risk of liabilities elected to be measured at fair value. As such, entities will no longer recognize gains in profit or loss that are caused by the deterioration of the entities' own credit risk on such liabilities.

The new requirements of this ED could have a major impact across an organization, particularly for financial institutions, and larger and more volatile impairment provisions are likely. Entities may need to start planning for transition and understanding the expected changes to systems and processes.

The effective date of this ED is expected to be 1 January 2019, and earlier adoption is permitted. As for hedge accounting, entities may elect to either continue to apply the existing hedge accounting requirements in PSAK 55, or apply the new requirements in ED PSAK 71. In general, the option to early adopt this new standard is for the benefit of subsidiaries of IFRS reporters, so as to avoid the need to maintain separate records/systems as a result of different effective dates between IFRS 9 and PSAK 71 (once it is issued and finalized). This ED is open for comment until 31 December 2016.

### ED Amendments to PSAK 62 - Applying ED PSAK 71 Financial Instruments with PSAK 62 Insurance Contracts

This ED adopts the amendments to IFRS 4, allowing insurance entities to apply either deferral approach or overlay approach, which is essentially a temporary exemption from the ED of PSAK 71 – Financial Instruments. The differing effective dates of ED PSAK 71 and the upcoming insurance contracts standard (i.e. IFRS 17, which is expected to be issued in 2017) could have a significant impact on insurers, particularly relating to concerns regarding temporary

accounting mismatches and volatility, and increased costs and complexity.

Under the deferral (temporary exemption approach), rather than having to implement ED PSAK 71 in 2019 the qualifying entities will be permitted to continue to apply PSAK 55. To qualify for such an exemption, a reporting entity's activities need to be predominantly connected with insurance.

The overlay approach provides an optional approach to presentation, in order to alleviate temporary accounting mismatches and volatility. For designated financial assets, an entity is permitted to reclassify between profit or loss and other comprehensive income (OCI), the difference between the amounts recognized in profit or loss under ED PSAK 71 and those that would have been reported under PSAK 55.

The amendment will be applicable for all entities that issue insurance and reinsurance contracts, and to all entities that hold reinsurance contracts. The proposed effective date is 1 January 2019, the same as the proposed effective date of ED PSAK 71. The ED of this Amendment is open for comment until 23 March 2017.

## ED PSAK 72 – Revenue from Contract with Customers

This ED adopts the latest version of IFRS 15 – Revenue from Contracts with Customers (i.e. version that is effective on 1 January 2018 for IFRS reporters). This ED would be the single standard for revenue recognition that applies to most contracts with customers, replacing existing guidance under SAK that is dispersed in various standards/ interpretations (e.g. PSAK 18, PSAK 34, ISAK 10, ISAK 27, and the issued-but-deferred ISAK 21).

The core principle of this ED is for entities to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (i.e. payment) to which the entities expect to be entitled in exchange for those goods or services. The ED also includes enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improves guidance for multiple-element arrangements. The key principles on which this ED is based – that revenue is recognized on transfer to the customer, measured at the transaction price – are consistent with much of current practice.

The model includes a contract-based five-step analysis of transactions to determine whether and how much revenue is recognized, and it is focused on transfer of control (i.e. the 'risks and rewards' concept is retained as an indicator of control transfer). The five steps are comprised of the following:

a. identify the contract with the customer
b. identify separate performance obligations in the contract
c. determine the transaction price
d. allocate the transaction price to the separate performance obligations in the contract
e. recognize revenue when (or as) each performance obligation is satisfied. The revenue recognition is confined to 2 approaches: at a point in time, or over time.

The impact of this ED will vary by industry. Entities that currently use the percentage-of-completion or proportional performance method (e.g. property developers) will need to reassess whether to recognize revenue over time or at a point in time. To apply the new criteria under ED PSAK 72, an entity will need to evaluate the nature of its performance obligation, and review its contract terms, considering which one is legally enforceable.

The effective date is proposed to be 1 January 2019. Earlier adoption is permitted. The ED is open for comment until 23 March 2017.

## ED ISAK 32 - Definition and Hierarchy of SAK

This ED is a locally developed interpretation, to clarify the hierarchy and definition of SAK (as currently defined in PSAK 1 and PSAK 25), particularly in case capital market authorities issue accounting pronouncements that are inconsistent with existing requirements under SAK.

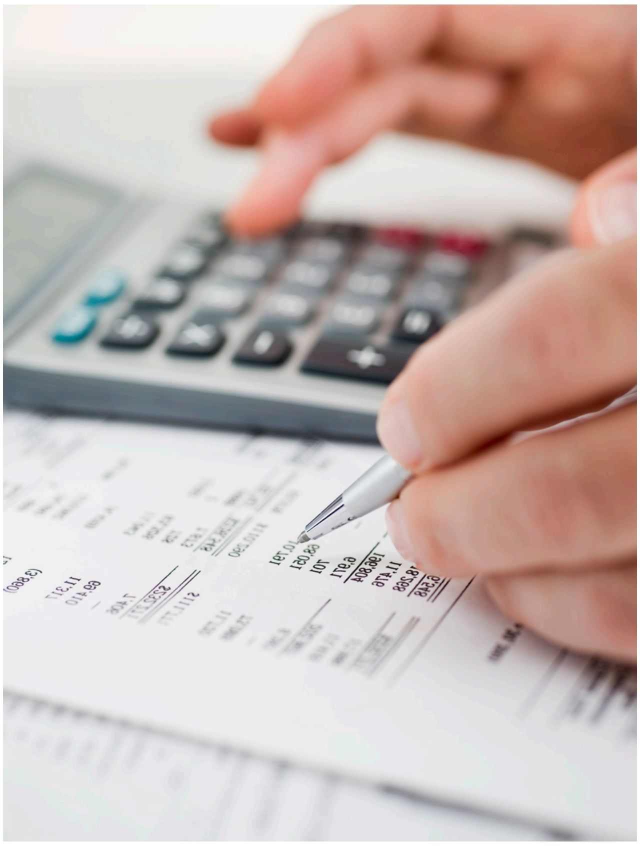
The definition of SAK in PSAK 1 (as is carried forward to PSAK 25) refers to the definition of IFRS in IAS 1, but is modified with the following phrase (among others): "including the pronouncements issued by capital market regulator for entities under its oversight". Questions arise as to which standard takes precedent (i.e. PSAK/ISAK or capital market pronouncements) in case that, for a specific transaction/event, a capital market pronouncement is inconsistent with existing requirements in a PSAK/ISAK.

This ED reiterates the hierarchy of SAK (as currently included in PSAK 25) in that if a PSAK/ISAK is applicable to account for a specific transaction/event, an entity is required to follow existing requirements in that PSAK/ISAK. In the absence of specific guidance, an entity needs to develop an accounting policy by reference to:

a. the PSAK/ISAK applicable for similar transaction/event,
b. the Conceptual Framework, and
c. standards issued by another standard setter, to the extent that they are built-upon a framework that is consistent with SAK and its Conceptual Framework.

Consequently, if capital market authorities issue accounting pronouncement that are inconsistent with existing requirements in a PSAK/ISAK, this ED requires an entity to follow the requirements in that PSAK/ISAK. Otherwise, the entity will not be able to make an explicit and unreserved statement of compliance to SAK as required by PSAK 1.

The proposed effective date is 1 January 2017. The ED is open for comment until 23 December 2016.



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