KPMG

Accounting Outlook

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IFRS	International Financial Reporting Standards
PSAK	Pernyataan Standar Akuntansi Keuangan
ISAK	Interpretasi Standar Akuntansi Keuangan

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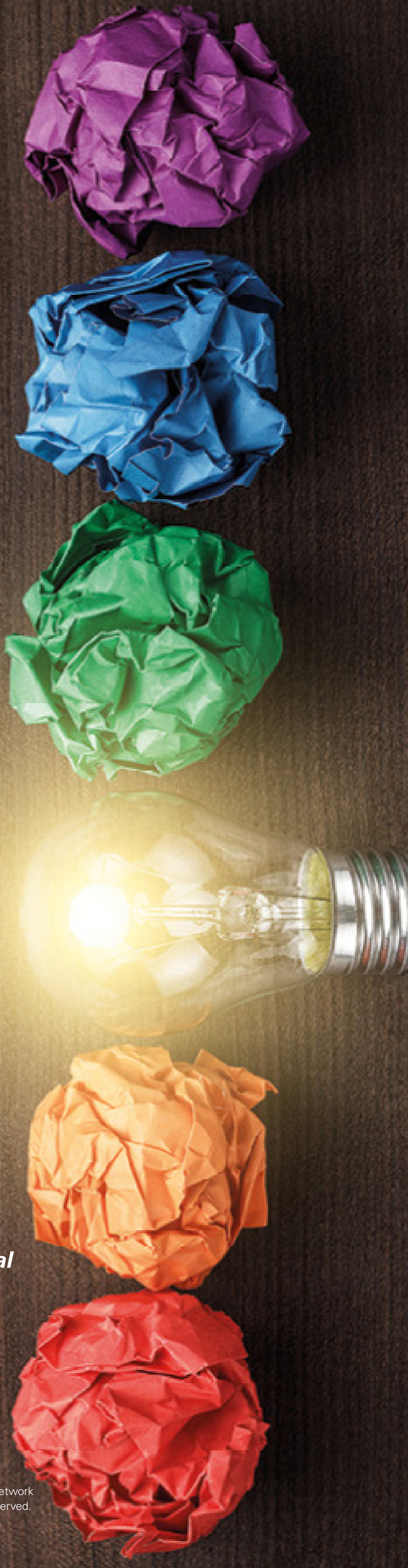

Introduction

The long-anticipated new Indonesian Financial Accounting Standards on financial instruments and revenue have just been finalized and issued. PSAK 71 *Financial Instruments*, PSAK 72 *Revenue from Contracts with Customers* and Amendments to PSAK 62 *Applying PSAK 71 Financial Instruments with PSAK 62 Insurance Contracts* were issued at the end of July 2017.

Content wise, as compared to the exposure drafts, the only differences are on the effective dates, which have been pushed back to 1 January 2020, resulting in a 2-year gap with the equivalent IFRS Standards. Nonetheless, the option to early adopt remains, primarily for the benefits of entities which have financial reporting requirements under IFRS.

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PSAK 71 *Financial Instruments*

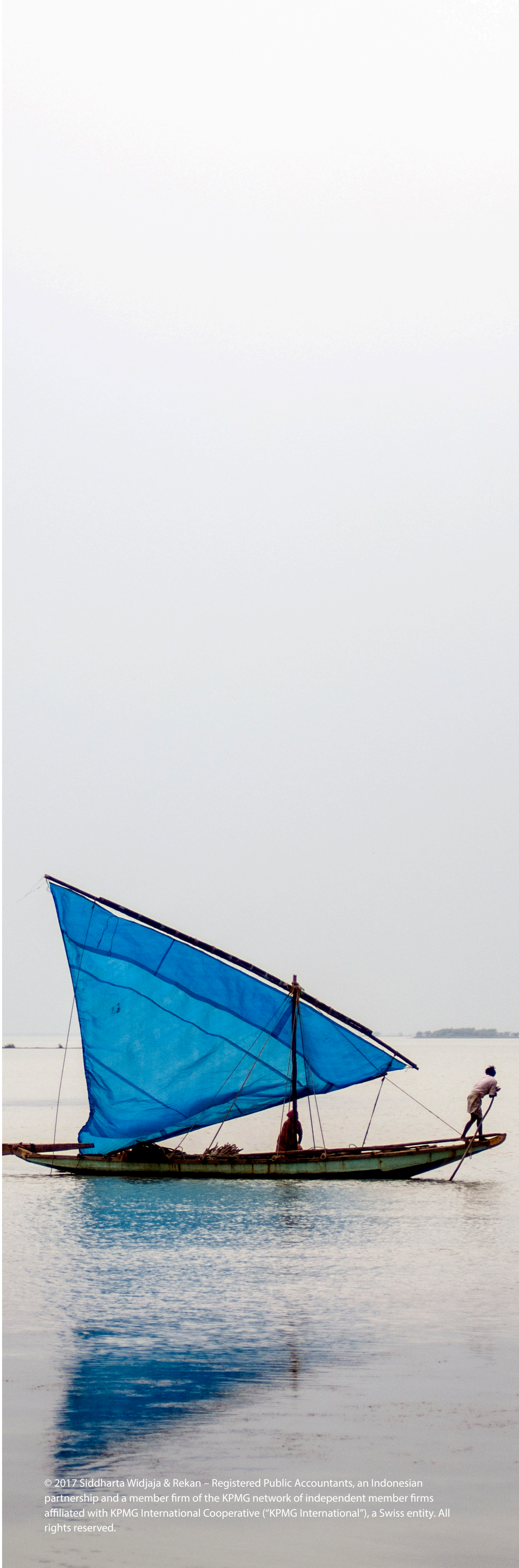
PSAK 71 adopts the full version of IFRS 9 *Financial Instruments* that is effective for IFRS reporters on 1 January 2018. PSAK 71 replaces PSAK 55 *Financial Instruments: Recognition and Measurement*, and brings together all the accounting requirements for financial instruments: classification and measurement, impairment, hedge accounting and disclosures.

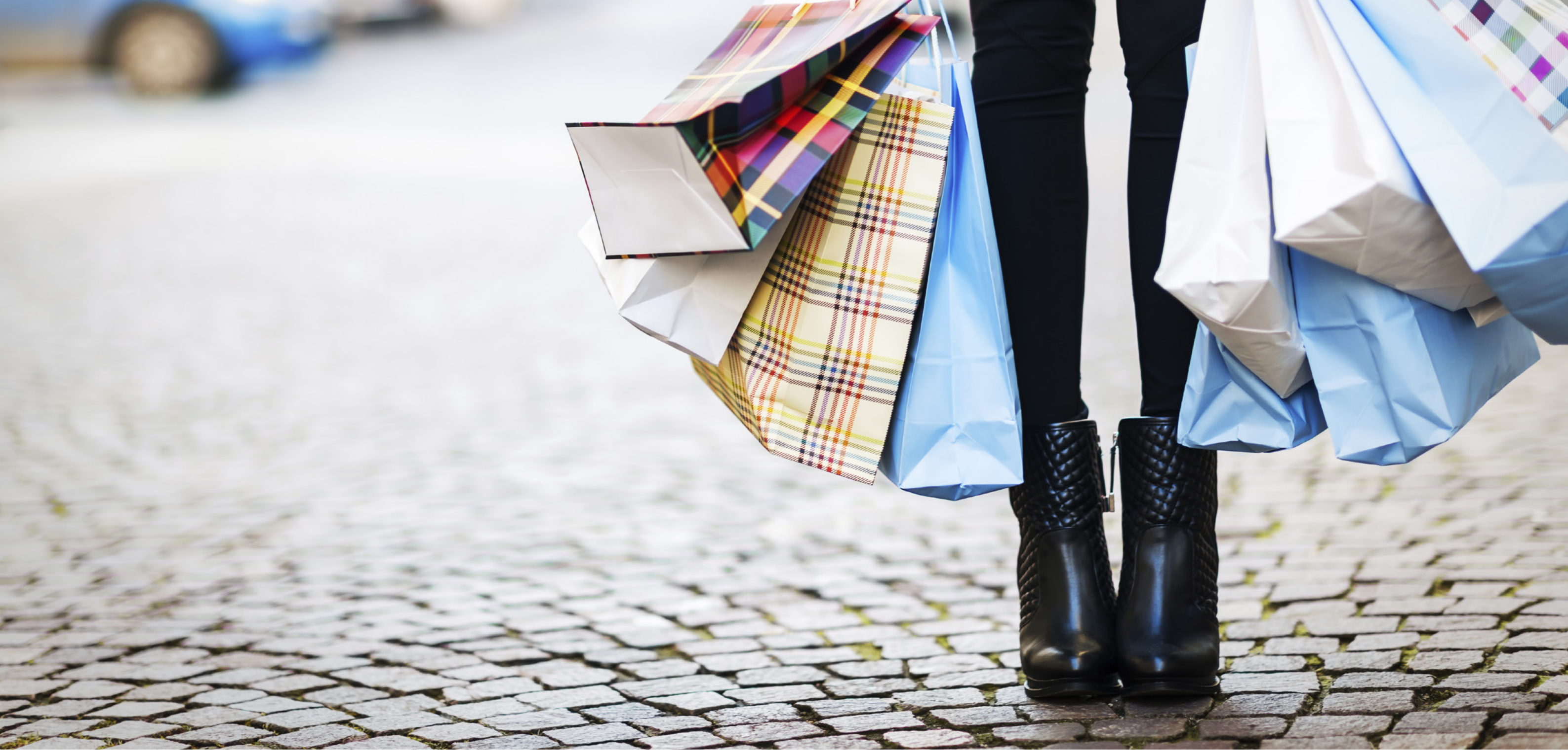
- The new model for classification of financial assets is driven by cash flow characteristics and the business model in which an asset is held. This principle-based approach replaces existing rule-based requirements under PSAK 55 that are considered to be overly complex and difficult to apply.
- The biggest change introduced by PSAK 71 is the expected-loss impairment model that requires more timely recognition of expected credit losses. The new model addresses concerns about the recognition of impairment being "too little and too late". PSAK 71 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. Entities will be required to use all relevant information—without undue cost or effort— in applying the expected credit loss model, including not only historical losses and current information, but also reasonable and supportable forward-looking information.
- The new hedge-accounting model aligns the accounting treatment with risk management activities, so as to better reflect hedge activities in the financial statements and includes additional disclosures of information about risk management and the effect of hedge accounting on the financial statements.

- PSAK 71 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.
- PSAK 71 also requires disclosures to assist users in understanding the amount of expected credit losses, the basis for their measurement and the reasons for changes in expected credit losses over time. In particular, entities are required to provide information about key assumptions used in the measurement of expected credit losses, and how an entity determines whether there has been a significant increase in credit risk.

PSAK 71 is effective for annual periods beginning on or after 1 January 2020, and earlier adoption is permitted. 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. 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 PSAK 71.

Although in principle PSAK 71 is to be applied retrospectively upon transition, it contains certain exemptions from full retrospective application for the classification and measurements requirements, including impairment. These include an exception from the requirements to restate comparative information, whereby in that case the difference between the previous carrying amount and the carrying amount at the beginning of the annual period that includes the date of initial application ("DIA") of PSAK 71 is recognized in opening retained earnings that includes the DIA. Entities are allowed to restate comparatives only if this is possible without the use of hindsight.





PSAK 72 *Revenue from Contracts with Customers*

PSAK 72 adopts the full version of IFRS 15 *Revenue from Contracts with Customers* that is effective for IFRS reporters on 1 January 2018. PSAK 72 will 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, PSAK 44, ISAK 10, ISAK 27 and the issued-but-deferred ISAK 21).

Existing revenue standards have limited guidance on revenue recognition, which has led to diversity in practice. For example, revenue has not always been recognized for subsequent services such as extended warranties that are promised in addition to the goods delivered to customers. In addition, there has been uncertainty about whether, for some construction or production contracts, revenue should be recognized as the construction or production occurs or when the construction or production is complete.

PSAK 72 provides a consistent and comprehensive framework for recognizing revenue that applies consistently to all contracts for goods or services. The effect that those changes have on the amount and timing of revenue recognition will differ depending on the entities, the transactions and industry sectors. In some cases, there will be no change to the amount and timing of revenue recognition. In other cases, there will be changes and those changes could be significant.

The core principle of PSAK 72 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. PSAK 72 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 model includes a contract-based five-step analysis of transactions to determine when and how much revenue is recognized and 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:

- identify the contract with the customer;
- identify separate performance obligations in the contract;
- determine the transaction price;
- allocate the transaction price to the separate performance obligations in the contract; and
- recognize revenue when (or as) each performance obligation is satisfied; i.e. at a point in time, or over time.

PSAK 72 is effective for annual periods beginning on or after 1 January 2020, and early adoption is permitted. Entities can make the transition to PSAK 72 in one of two ways:

- Retrospectively (with some practical expedients) with adjustments on transition made to the opening balances of the earliest comparative period presented. For entities that use this transition method, all contracts would have to be restated (if necessary).
- Retrospectively with adjustments made to the appropriate opening balances of the current period (that is, the first period in which PSAK 72 is applied) upon transition. For entities that use this transition method, contracts that were determined to be complete using previous revenue guidance would not need to be restated. However, to preserve trend information, existing and new contracts would have to be presented under previous requirements in the notes to the financial statements in the year of initial application.

Amendments to PSAK 62 *Applying PSAK 71 Financial Instruments with PSAK 62 Insurance Contracts*

Adopting amendments to IFRS 4 *Insurance Contracts*, these Amendments allow insurance entities to apply either a deferral approach or an overlay approach, which essentially temporary exemptions from PSAK 71 *Financial Instruments*. The differing effective dates of PSAK 71 and the upcoming Indonesian Financial Accounting Standard on insurance contracts (i.e. the equivalent of recently issued IFRS 17 *Insurance Contracts*) could have significant impacts 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 PSAK 71 in 2020, qualifying entities are permitted to continue to apply PSAK 55. To qualify for such an exemption, a reporting entity's activities must 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 PSAK 71 and those that would have been reported under PSAK 55.

The Amendments are applicable for all entities that issue insurance and reinsurance contracts and to all entities that hold reinsurance contracts, and are effective for annual periods beginning on or after 1 January 2020, the same as the effective date of PSAK 71.

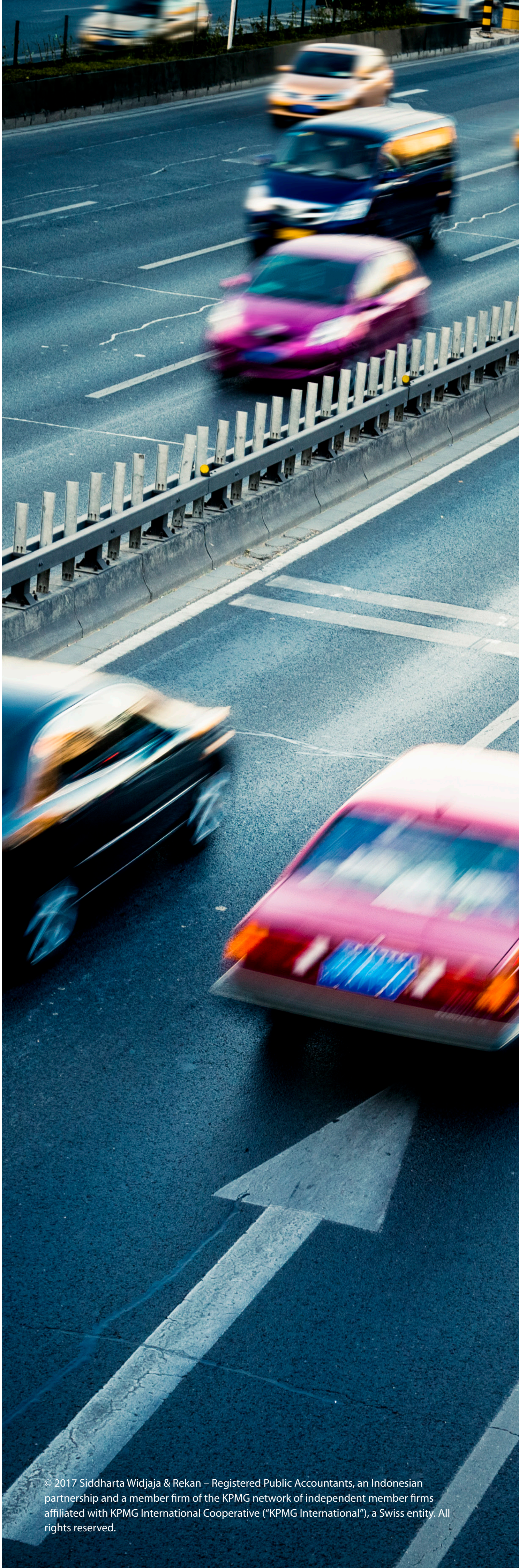
KPMG Comments:

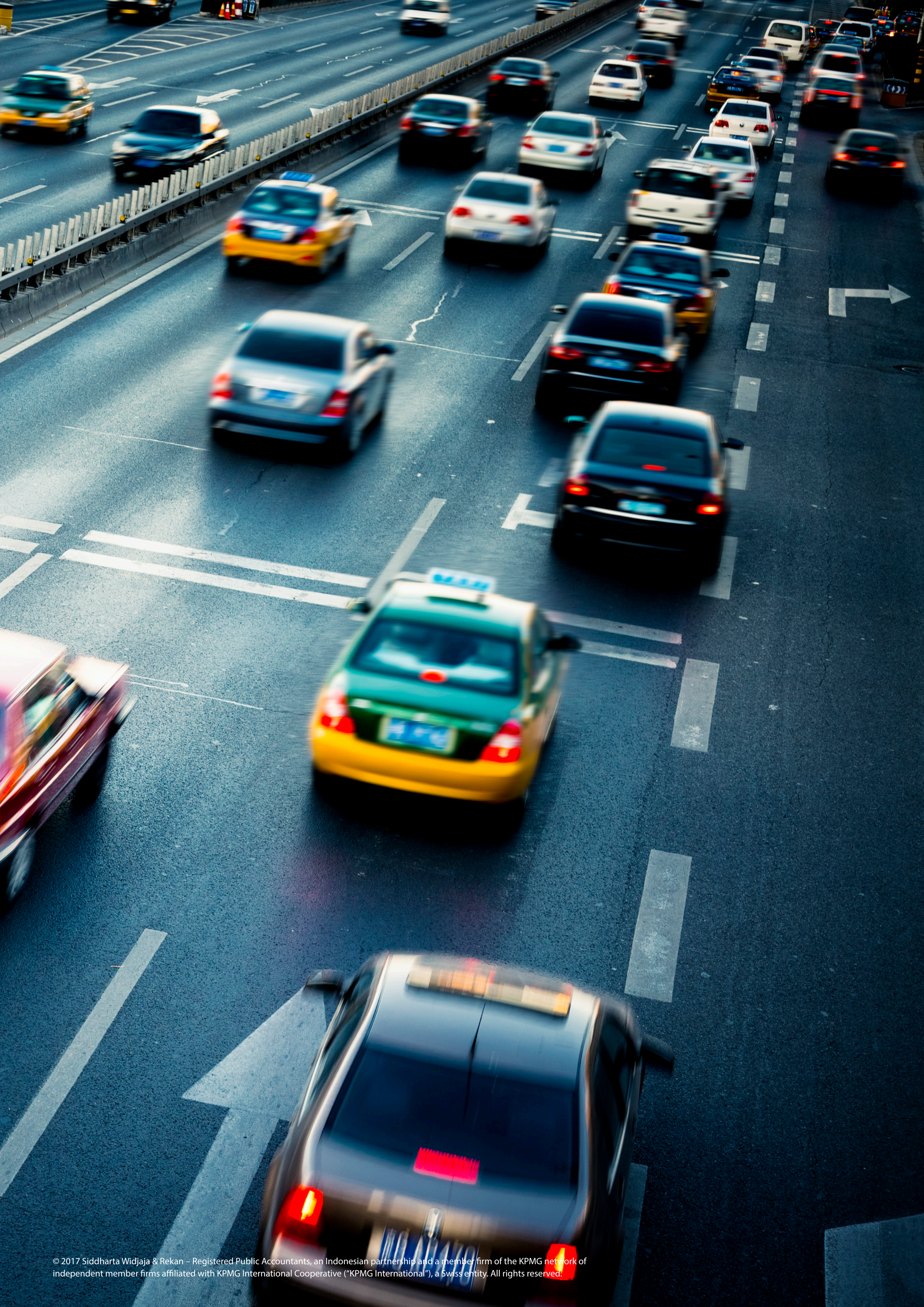
The new requirements of PSAK 71 could have major impacts across an organization, particularly for financial institutions, as larger and more volatile impairment provisions are likely. Entities need to start planning for the transition, including managing changes to systems and processes. The extensive changes that are introduced by the new forward-looking expected credit loss model mean that entities will need to begin implementation promptly.

The new requirements of PSAK 72 suggest that some entities may want to reassess their current customer contract terms. In any event, transition planning should be initiated promptly.

Issuers of insurance and reinsurance contracts, as well as entities holding reinsurance contracts, need to consider modelling the deferral and overlay approaches to determine which of the two is most appropriate to adopt.

If you would like to discuss these new standards in more detail, please do not hesitate to contact us!





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