Must know

Adopting IFRS or preparing a transaction document? You may be subject to different transition requirements when applying IFRS 9, 15, 16 and 17

Issue

IFRS 1, the relevant standard for first time adoption of IFRS, requires the same accounting policies to be applied in the opening IFRS statement of financial position and throughout all periods presented in the first IFRS financial statements.

Those accounting policies must comply with the IFRS standards effective at the end of the first IFRS reporting period, except for those IFRS 1 mandatory exceptions or voluntary exemptions. The transition provisions of other standards do not apply to first-time adopters, except where specified in IFRS 1.
A first time adopter may choose to early adopt any new standards that are not mandatory at the end of an entity’s first IFRS reporting period. IFRS 1 does not require an entity to use newly issued but not yet mandatory versions of an IFRS, but it explains the advantages of doing so.

Subsidiaries (including carve out entities) of existing IFRS reporting groups have additional flexibility when they choose to move to IFRS after their parent.

**Impact**

**Impact of IFRS 9 – Financial instruments**

IFRS 9, effective for periods beginning on or after 1 January 2018, is applied retrospectively in accordance with IAS 8, ‘Accounting policies, changes in accounting estimates and errors’. Entities may however choose to continue to apply the hedge accounting requirements of IAS 39. There are some mandatory exceptions and optional exemptions set out in Section 7.2 of IFRS 9.

IFRS 9 must be applied in full by a first time adopter but there is short term relief for reporting periods beginning before January 2019 that allows use of previous GAAP. Any adjustments to align to IFRS 9 are reflected in the period of adoption. This aligns the timing of IFRS 9 application by a first time adopter with existing reporters. IFRS 1 mirrors the specific mandatory exceptions and optional exemptions for transition for existing IFRS preparers that are in IFRS 9.

**Impact of IFRS 15 – Revenue from contracts with customers**

IFRS 15, effective for periods beginning on or after 1 January 2018, contains transition provisions that allow either fully retrospective adoption (with some practical expedients) or a simplified transition method. The simplified transition method is also retrospectively but the cumulative effect recognised at the date of initial application without restating any comparative periods presented.

IFRS 15 must be adopted fully retrospectively by a first time adopter, hence the simplified transition method is not available. However, IFRS 1 allows the use of the practical expedients described in Appendix C5 of IFRS 15 for full retrospective application.

**Impact of IFRS 16 – Leases**

IFRS 16, effective for annual reporting periods beginning on or after 1 January 2019, allows either fully retrospective adoption or a ‘simplified approach’ similar to that of IFRS 15. The simplified approach is not available to first time adopters.

IFRS 1 requires first time adopters to use the fully retrospective approach when applying IFRS 16. First time adopters that are lessees are permitted to apply some of the transition reliefs that are available to existing IFRS preparers under the ‘simplified approach’. For example, the lessee may measure the lease liability at the present value of the remaining lease payments discounted using the lessee’s incremental borrowing rate at the date of transition to IFRS.

The right-of-use asset can be measured either as if IFRS 16 has always been applied but discounted using the lessee’s incremental borrowing rate at the date of transition or at an amount equal to the lease liability (adjusted by the amount of any prepaid or accrued lease payments). A lessee that chooses these simplifications has to test the right-of-use assets for impairment at the date of transition applying IAS 36.

However, a first time adopter must re-assess all contracts for leases either at inception of the contract or at the date of transition to IFRS. It also has to restate comparative information.

**Impact of IFRS 17 – Insurance contracts**

IFRS 17 applies to annual periods beginning on or after 1 January 2021, with earlier application permitted if IFRS 15 and IFRS 9 are also applied. The standard should be applied retrospectively unless impracticable.

IFRS 17 must be applied fully retrospectively. IFRS 1 mirrors the transition guidance set out in Appendix C of IFRS 17.

**Transactions scenarios**

An entity may undertake a transaction such as a material business combination or a listing of shares and need to present IFRS financial information as a first time adopter. The financial information presented typically includes the latest reporting period plus one or more comparative periods, commonly known as the ‘track record’. The financial information is usually presented on a consistent basis across all periods. Market regulations may require that the reporting entity applies the standards that will be in force at the end of the following reporting period. A good understanding of the relevant regulator’s requirements is recommended.
The date of transition is the opening day of the earliest comparative period presented. The new standards might then be adopted at a much earlier date than would be applicable for an existing reporter. For example, a three year track record ending in December 2018 might apply IFRS 15 from January 2016, two years earlier than would be required under the cumulative catch up method.

If there are any new standards that are not effective in the track record period then, similar to an existing IFRS reporter, the reporting entity can apply them in the future. The entity should include relevant IAS 8 disclosures concerning the impact that the new standards will have when applied.

**These differences can be summarised as follows:**

<table>
<thead>
<tr>
<th></th>
<th>Existing IFRS reporter</th>
<th>First time adopter</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IFRS 9, ‘Financial instruments’</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short term relief from applying IFRS 9 prior to 1 Jan 2019</td>
<td>N/A</td>
<td>Yes - E1/E2 Adjustments to align to IFRS 9 are reflected in the period of adoption.</td>
</tr>
<tr>
<td>IAS 39 hedge accounting may be used</td>
<td>Yes - 7.2.21</td>
<td>No</td>
</tr>
<tr>
<td>IFRS 9 hedge accounting may be used</td>
<td>Yes - 7.2.21</td>
<td>Yes - B4/B6</td>
</tr>
<tr>
<td><strong>IFRS 15, Revenue from contracts with customers</strong></td>
<td>References are to relevant new standard</td>
<td>References are to IFRS 1 unless stated</td>
</tr>
<tr>
<td>Fully retrospective adoption</td>
<td>Yes - C3(a) ; C5</td>
<td>Yes - D34</td>
</tr>
<tr>
<td>‘Simplified transition method’ Retrospective with cumulative effect recognised on date of initial application</td>
<td>Yes - C3(b) ; C5(c)</td>
<td>No</td>
</tr>
<tr>
<td><strong>IFRS 16, ‘Leases’</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fully retrospective adoption or</td>
<td>Yes - C5(a)</td>
<td>Yes - para 13</td>
</tr>
<tr>
<td>‘Simplified approach’ Retrospective with cumulative effect recognised on date of initial application</td>
<td>Yes - C5(b)</td>
<td>No</td>
</tr>
<tr>
<td>No need to re-assess whether a contract contains a lease</td>
<td>Yes - C3</td>
<td>No</td>
</tr>
<tr>
<td>Assess whether a contract contains a lease at inception</td>
<td>Yes, ignore C3 and apply IFRS 16 para 9</td>
<td>Yes, ignore D9 and apply IFRS 16 para 9</td>
</tr>
<tr>
<td>Assess whether a contract contains a lease on date of transition to IFRS</td>
<td>N/a</td>
<td>Yes. apply D9 and ignore IFRS 16 para 9</td>
</tr>
<tr>
<td>Lease liabilities discounted at incremental borrowing rate</td>
<td>If apply fully retrospective: at the date of inception Para 26 if apply simplified approach: at the date of initial application C8(a)</td>
<td>At the date of inception Ignore D9B(a), apply IFRS 16 Para 26 or at the date of transition to IFRS D9B(a)</td>
</tr>
<tr>
<td>Apply IAS36 impairment to right of use assets</td>
<td>Yes if apply fully retrospective Para 33 Optional if apply simplified approach C8(c); C10(b)</td>
<td>Yes - D9B(c)</td>
</tr>
<tr>
<td>Apply IAS37 onerous contacts instead of IAS36</td>
<td>No if apply fully retrospective. Para 33 Optional if apply simplified approach C8(c); C10(b)</td>
<td>No</td>
</tr>
<tr>
<td><strong>IFRS 17, ‘Insurance contracts’</strong></td>
<td></td>
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</tr>
<tr>
<td>Retrospective application</td>
<td>Transition is the same – fully retrospective (unless impracticable)</td>
<td></td>
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</tbody>
</table>
At a glance

The IFRS Interpretations Committee has concluded that the line item ‘interest revenue’ can contain only interest income on assets that are measured at amortised cost or fair value through other comprehensive income (subject to the effect of applying hedge accounting to derivatives in designated hedge relationships).

This will be a change to current practice for some entities. It is likely to have the most significant impact on financial services entities, such as banks for whom interest revenue or net interest margin is a key performance indicator.

Issue

IFRS 9 introduced a consequential amendment to paragraph 82(a) of IAS 1, under which interest revenue calculated using the effective interest method is required to be presented separately on the face of the income statement.

The IFRS Interpretations Committee (the ‘Committee’) has issued an agenda decision which concludes that this separate line item can be used only for interest on those financial assets that are measured at amortised cost or fair value through other comprehensive income (subject to the effect of applying hedge accounting to derivatives in designated hedge relationships).

This means that interest income on items that are not measured at amortised cost or fair value through other comprehensive income will no longer be able to be included in interest revenue.

Impact

This change is likely to have the most significant impact on financial services entities, such as banks. Some such entities currently include interest income on certain assets measured at fair value through profit or loss (‘FVTPL’) in interest revenue, but they will no longer be able to do this.

Depending on an entity’s existing presentation policy, this change might impact the presentation of gains and losses on some or all of the following:

• derivatives including ‘economic hedges’ to which hedge accounting has not been applied; however, where hedge accounting is applied, hedging gains and losses can continue to be presented in interest revenue;
• non-derivative assets to which the fair value option has been applied;
• non-derivative assets that fail the ‘solely payments of principal and interest’ requirements in IFRS 9; and
• non-derivative assets that fall within the ‘other’ business model in IFRS 9.

Can additional line items be presented?

Some entities might wish, as a matter of accounting policy, to present additional line items, on the face of the income statement, for ‘interest’ on instruments measured at FVTPL. Whilst not addressed by the Committee, IAS 1 permits an entity to present additional line items where doing so is relevant to an understanding of the entity’s financial performance. If such a presentation is adopted, the additional line items should be appropriately presented and labelled. Also, the entity’s accounting policy, including how such amounts are calculated and on which instruments, should be disclosed.

Some local regulators have expressed views on the presentation of interest income for financial instruments measured at FVTPL, in which case regard should be had to those views.

Effective date

The Committee’s agenda decision is effective at the same time as IFRS 9 (that is, for accounting periods beginning on or after 1 January 2018).
For further help, please contact:

**Jumadi Anggana**  
Partner  
jumadi.anggana@id.pwc.com

**Djohan Pinnarwan**  
Partner  
djohan.pinnarwan@id.pwc.com

**Jasmin Maranan**  
Advisor  
jasmin.maranan@id.pwc.com

**Irwan Lau**  
Director  
irwan.lau@id.pwc.com

**Helen Cuizon**  
Advisor  
helen.cuizon@id.pwc.com

**Dwi Jayanti**  
Manager  
dwi.jayanti@id.pwc.com

**Akuntina Novriani**  
Manager  
akuntina.novriani@id.pwc.com

**Elina Mihardja**  
Manager  
elina.mihardja@id.pwc.com

**Arryu Amin**  
Assistant Manager  
arryu.amin@id.pwc.com

**Gayatri Permatasari**  
Assistant Manager  
gayatri.permatasari@id.pwc.com

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**PwC Indonesia**  
Plaza 89  
Jl. H.R. Rasuna Said Kav. X-7 No.6,  
Jakarta 12940 - Indonesia  
T: +62 21 5212901,  
F: +62 21 5290 5555/52905050

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