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New Financial Reporting Proposals and Rules on Financial Instruments, Shari'a Reporting and Joint Financing

IAI recently issued two groups of Exposure Drafts ("EDs") to revise the existing accounting standards, PSAKs. The first group proposes accounting treatments for financial instruments, whilst the second group addresses financial reporting standards for financial institutions operating on Islamic principles ("Shari'a"). In addition, IAI has also issued a technical bulletin on joint financing.

Proposals on Financial Instruments – ED 50 R and 55 R

- ED PSAK 50 (Revised 2006): Financial Instruments – Presentation and Disclosure and
- ED PSAK 55 (Revised 2006): Financial Instruments – Recognition and Measurement

ED PSAK 50 R provides a new definition of a financial instrument. It also clarifies what a financial asset is (such as cash, investments in securities and receivables), a financial liability (such as payables), and an equity instrument (such as shares issued by the company). The ED also offers guidance on how to differentiate a financial liability from an equity instrument. This guidance will be particularly useful for determining the classification of a financial instrument that seemingly has the characteristics of either a liability or an equity. When a financial instrument contains both a liability and an equity component (called "a compound instrument"), each component should be classified and presented separately.

Under the ED, offsetting of a financial asset and a financial liability is severely restricted only when there is a legally enforceable right to offset the amounts and there is an intention to settle the amounts on a

net basis or simultaneously.

ED PSAK 50 R proposes far more comprehensive disclosures than currently required by the existing PSAK 50 and 55.

The other proposal on financial instruments, ED PSAK 55 R, expands the current classification of financial assets into four categories:

- Financial assets measured at fair value through profit or loss ("FVTPL")
- Held-to-maturity investments
- Loans and receivables
- Available-for-sale financial assets.

Each of these financial assets have their own measurement rules, and depending on the type of asset, some might impact the income statement and some might impact the equity section in the balance sheet.

Reclassifications of financial instruments are more restricted under ED PSAK 55 R. For example, reclassifications into or out of financial assets measured at FVTPL are not allowed. In addition, when an investment originally designated as held-to-maturity is later sold there is now a tainting rule which states that any remaining held-to-maturity investments should be reclassified as available-for-sale assets for the two financial years which follow.

ED PSAK 55 R suggests a stricter rule when a company wants to "derecognize" or remove a financial asset (for example, a receivable or an equity investment) from its balance sheet.

ED PSAK 55 R might also change the way a company (for example, a

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bank) calculates impairment of a financial asset (for example, a loan provided to a customer). Impairment of a financial asset should only be conducted when there is objective evidence that a loss has been incurred, rather than based on expectation of losses.

Similar to the existing PSAK 55, the ED provides guidance for accounting for derivatives, embedded derivatives and hedging activities.

Originally PSAK 50 R and 55 R were proposed to be applicable for financial statements with periods beginning on or after 1 January 2008. However it now seems that DSAK, the standards-setting body of IAI, will decide that those standards will be applicable one year later in 2009 to give the stakeholders more time to prepare for these fairly complex standards.

Standards for Shari'a Financial Institutions

One of the major revisions introduced in the new Shari'a standards is the numbering system. Currently Shari'a financial reporting standards are accommodated in just one statement, PSAK 59. Shari'a financial reporting will now have its own conceptual framework and a block of numbers – block 100 - reserved for the Shari'a standards.

The recent Shari'a EDs issued are:

- ED – Framework for the Preparation and Presentation of Shari'a Financial Statement
- ED PSAK 101 (Revised 2006) : Presentation of Shari'a Financial Statements

- ED PSAK 102 (Revised 2006): Murabahah Accounting
- ED PSAK 103 (Revised 2006): Salam Accounting
- ED PSAK 104 (Revised 2006): Istishna' Accounting
- ED PSAK 105 (Revised 2006): Mudharabah Accounting
- ED PSAK 106 (Revised 2006): Musyarakah Accounting

The Shari'a standards are applicable for financial statements with periods beginning on or after 1 January 2008.

Technical Bulletin – Joint Financing on Credit Facility

In the hierarchy of Indonesian Generally Accepted Accounting Principles ("GAAP"), a technical bulletin sits lower than a Statement of Financial Accounting Standards (PSAK) or even an Interpretation (ISAK). Nevertheless, a technical bulletin is a professional publication that should be observed because it is part of Indonesian GAAP.

Technical Bulletin No. 2 – Joint Financing on Credit Facilities is applicable mostly for multi-finance companies that, with additional funding from banks, provide credit facilities to customers.

At the heart of the issue here is whether for such a multi-finance company the loans provided to customers should be presented either:

- on a gross basis, i.e. the multi-finance company records the full amount receivable from the customers on one hand, and records the amount payable to the bank on the other hand, or

- on a net basis, i.e. the multi-finance company records the net amount representing the difference between the amount receivable from the customers and the amount payable to the bank.

It seems that the widely prevailing practice in Indonesia adopted by multi-finance companies is to present the receivables from the customers on a net basis and this approach may not be correct conceptually. The Technical Bulletin clarifies that there should be an analysis of whether the risks and rewards relating to the receivables have been transferred when determining gross or net presentation. Consequently, for a joint financing with recourse, the presentation should be conducted on a gross basis but for a joint financing without recourse the presentation is on a net basis.

The Technical Bulletin is effective immediately.

The Exposure Drafts and the Technical Bulletin can be viewed in recent editions of Media Akuntansi magazine.

If you have any concern or question regarding matters in this NewsFlash, please contact your engagement partner or Dudi Kurniawan of PricewaterhouseCoopers' Technical Committee by email: dudi.m.kurniawan@id.pwc.com.

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