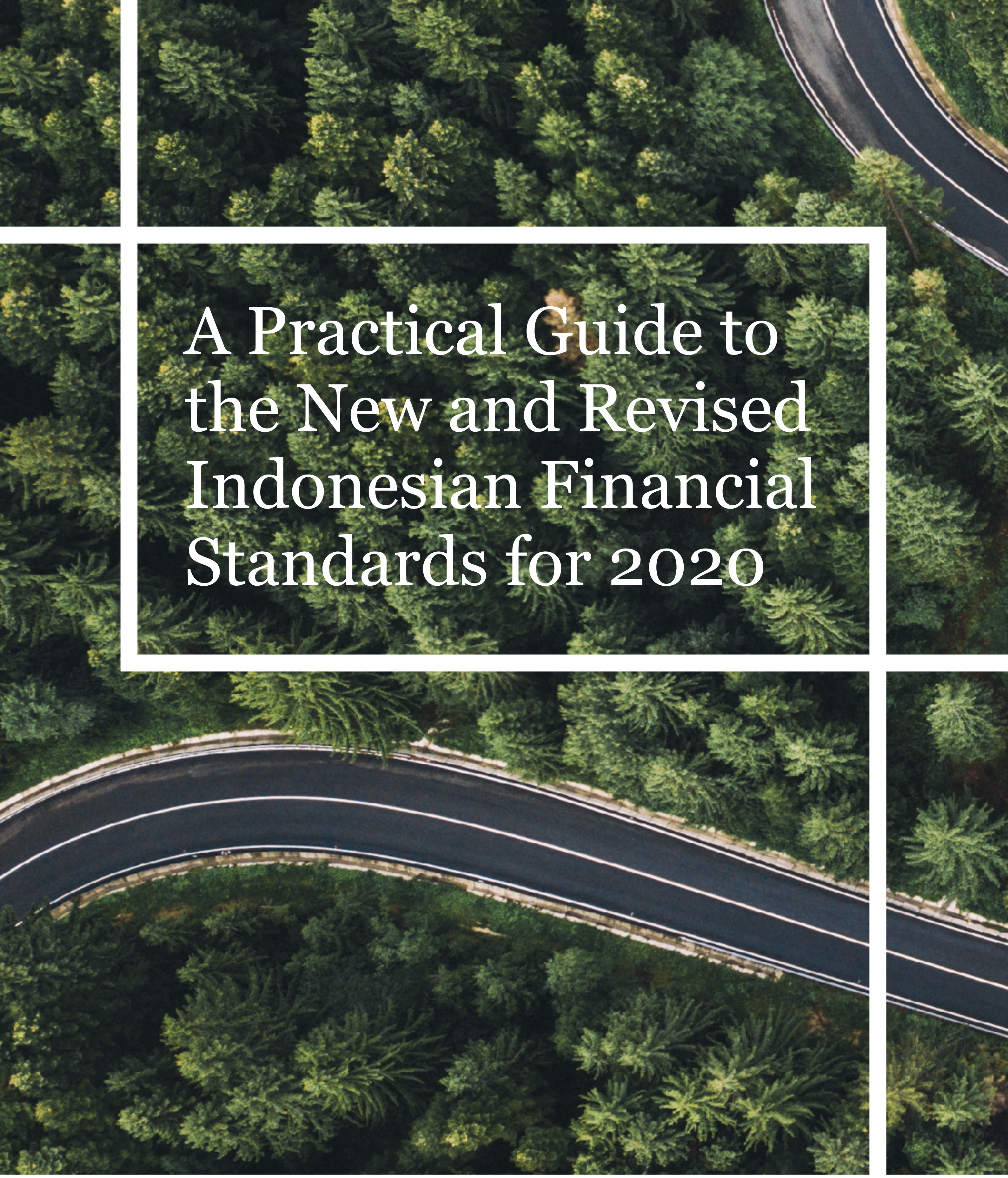
A Practical Guide to the New and Revised Indonesian Financial Standards for 2020



pwc.com/id

Contents

Introduction

This publication is a practical guide to the new, revised and amended Indonesian Financial Accounting Standards (“IFAS”), which come into effect in 2020. We have listed the most important changes in reporting requirements, helping companies understand what should be applied now and what changes will apply to future reporting periods.

This year marks the important milestone for IFAS reporters since the three major accounting standards (PSAK 71, ‘Financial Instruments’, PSAK 72, ‘Revenue from Contracts with Customers’ and PSAK 73, ‘Leases’) have become effective as of 1 January 2020.

The Indonesian Financial Accounting Standards Board (“DSAK-IAI”) has also revised several existing standards through amendments and annual improvement projects. Accordingly, DSAK-IAI has published amendments to PSAK 1, Presentation of financial statements, and PSAK 25, Accounting policies, changes in accounting estimates and errors, regarding the definition of material; PSAK 15, Investments in Associates and Joint Ventures, regarding accounting for long-term interests in associates and joint ventures in accordance with PSAK 71; and PSAK 62 Insurance Contracts that provides guidance to issuers of insurance contracts on how to implement PSAK 71.

The adoption of the above amendments is a part of the overall IFRS convergence project. As a result, in 2020 IFAS is substantially converged with the IFRS issued by the International Accounting Standards Board (“IASB”) up to 2019. However, DSAK-IAI has also published a revised Conceptual Framework and Phase 1 of the IASB’s project regarding the interest rate benchmark reform that become effective at the same time as under the IFRS, from 1 January 2020. Additionally, as a response to the COVID-19 pandemic, DSAK-IAI adopted an amendment to PSAK 73 regarding accounting for rent concessions directly caused by the pandemic. This amendment provides an optional practical expedient for lessees and is available for adoption for annual reporting periods beginning on or after 1 June 2020 with earlier application permitted.

Other than new standards and amendments following IFRS updates, DSAK-IAI has also amended PSAK 1, ‘Presentation of financial statements’ and issued a new interpretation under the national GAAP - ISAK 35, ‘Presentation of not-for-profit oriented entity financial statements’. This guidance affects the not-for-profit sector and is designed to assist not-for-profit organisations with financial reporting and disclosures.

Lastly, it is worth noting that a major change is expected in the insurance contract accounting. In May 2017, IASB issued IFRS 17, ‘Insurance Contracts’, which includes some fundamental differences to current practices adopted by insurers and will apply retrospectively. In June 2020, the IASB has issued the final stage amendments to IFRS 17 and postponed its effective date to 2023. DSAK-IAI is presently in the process of adopting IFRS 17 in Indonesia through PSAK 74, ‘Insurance Contracts’. We will keep you updated!

Included in this practical guide is our brief guidance on forthcoming requirements that will affect reporters in the coming years (see Appendix A).

New 'Big 3' Standards

PSAK 71, Financial Instruments

Transition provision: Retrospective

Issues

In July 2017, DSAK-IAI published the complete version of PSAK 71, 'Financial Instruments', which replaces the guidance in PSAK 55. This final version includes requirements on the classification and measurement of financial assets and liabilities, it also includes an expected credit losses model that replaces the incurred loss impairment model used currently. It also includes the final hedging part of the financial instruments standard as issued by the IFRIC in November 2013.

Key Provisions

Classification and measurement

PSAK 71 has three classification categories for debt instruments: amortised cost, fair value through other comprehensive income ("FVOCI") and fair value through profit or loss ("FVPL"). Classification under PSAK 71 for debt instruments is driven by the entity's business model for managing the financial assets and whether the contractual cash flows represent solely payments of principal and interest ("SPPI").

An entity's business model is how an entity manages its financial assets in order to generate cash flows and create value for the entity. That is, an entity's business model determines whether the cash flows will result from collecting contractual cash flows, selling financial assets or both.

If a debt instrument is held to collect contractual cash flows, it is classified as amortised cost if it also meets the SPPI requirement. Debt instruments that meet the SPPI requirement that are held both to collect assets' contractual cash flows and to sell the assets are classified as FVOCI. Under the new model, FVPL is the residual category – financial assets should therefore be classified as FVPL if they do not meet the criteria of FVOCI or amortised cost. Regardless of the business model assessment, an entity can elect to classify a financial asset at FVPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency ("accounting mismatch").

Expected Credit Losses

PSAK 71 introduces a new model for the recognition of impairment losses - the expected credit losses (ECL) model. The ECL model constitutes a change from the guidance in PSAK 55 and seeks to address the criticisms of the incurred loss model which arose during the economic crisis. In practice, the new rules mean that entities will have to record a day 1 loss equal to the 12-month ECL on initial recognition of financial assets that are not credit impaired (or lifetime ECL for trade receivables). PSAK 71 contains a 'three stage' approach which is based on the change in credit quality of financial assets since initial recognition. Assets move through the three stages as credit quality changes and the stages dictate how an entity measures impairment losses and applies the effective interest rate method. Where there has been a significant increase in credit risk, impairment is measured using lifetime ECL rather than 12-month ECL. The model includes operational simplifications for lease and trade receivables.

Disclosures

Extensive disclosures are required, including reconciliations from opening to closing amounts of the ECL provision, assumptions and inputs and a reconciliation on transition of the original classification categories under PSAK 55 to the new classification categories in PSAK 71.

Hedge accounting

Hedge effectiveness tests and eligibility for hedge accounting

PSAK 71 relaxes the requirements for hedge effectiveness and, consequently to apply hedge accounting. Under PSAK 55, a hedge must be highly effective, both going forward and in the past (that is, a prospective and retrospective test, with results in the range of 80%-125%). PSAK 71 replaces this bright line with a requirement for an economic relationship between the hedged item and hedging instrument, and for the 'hedged ratio' to be the same as the one that the entity actually uses for risk management purposes. Hedge ineffectiveness will continue to be reported in profit or loss (P&L). An entity is still required to prepare contemporaneous documentation, however, the information to be documented under PSAK 71 will differ.

Hedged items

The new requirements change what qualifies as a hedged item, primarily removing restrictions that currently prevent some economically rational hedging strategies from qualifying for hedge accounting. For example:

- Risk components of non-financial items can be designated as hedged items, provided they are separately identifiable and reliably measurable. This is good news for entities that hedge for only a component of the overall price of non-financial items such as the oil price component of jet fuel price exposure, because it is likely that more hedges will now qualify for hedge accounting.
- Aggregated exposures (that is, exposures that include derivatives) can be hedged items.
- PSAK 71 makes the hedging of groups of items more flexible, although it does not cover macro hedging (this will be the subject of a separate discussion paper in the future). Treasurers commonly group similar risk exposures and hedge only the net position (for example, the net of forecast purchases and sales in a foreign currency). Under PSAK 55, such a net position cannot be designated as the hedged item, but PSAK 71 permits this if it is consistent with an entity's risk management strategy. However, if the hedged net position consists of forecast transactions, hedge accounting on a net basis is only available for foreign currency hedges.
- PSAK 71 allows hedge accounting for equity instruments measured at fair value through other comprehensive income (OCI), even though there will be no impact on P&L from these investments.

Hedging instruments

PSAK 71 relaxes the rules on the use of some hedging instruments as follows:

- Under PSAK 55, the time value of purchased options is recognised on a fair value basis in P&L, which can create significant volatility. PSAK 71 views a purchased option as similar to an insurance contract, such that the initial time value (that is, the premium generally paid for an at or out of the money option) must be recognised in P&L, either over the period of the hedge (if the hedge item is time related, such as a fair value hedge of inventory for six months), or when the hedged transaction affects P&L (if the hedge item is transaction related, such as a hedge of a forecast purchase transaction). Any changes in the option's fair value associated with time value will be recognised in OCI.
- A similar accounting treatment to options can also be applied to the forward element of forward contracts and to foreign currency basis spreads of financial instruments. This should result in less volatility in P&L.

- Under PSAK 55, non-derivative financial items were allowed for hedging of FX risk. The eligibility of non-derivative financial items as hedging instruments is extended to non-derivative financial items accounted for at fair value through P&L.

Accounting, presentation and disclosure

The accounting and presentation requirements for hedge accounting in PSAK 55 remain largely unchanged in PSAK 71.

However, entities will now be required to reclassify the gains and losses accumulated in equity on a cash flow hedge to the carrying amount of a non-financial hedged item when it is initially recognised. This was permitted under PSAK 55, but entities could also choose to accumulate gains and losses in equity. Additional disclosures are required under the new standard.

Own credit risk in financial liabilities

Although not related to hedge accounting, DSAK-IAI has also amended PSAK 71 to allow entities to recognise in OCI the changes in fair value attributable to changes in an entity's own credit risk (from financial liabilities that are designated under the fair value option).

Effective date and transition

PSAK 71 is effective for annual periods beginning on or after 1 January 2020. PSAK 71 is to be applied retrospectively but comparatives are not required to be restated.

Prepayment features with negative compensation – amendment to PSAK 71

Transition position: Retrospective

Issues

This amendment covers two issues:

- What financial assets may be measured at amortised cost. The amendment permits more assets to be measured at amortised cost than under the previous version of PSAK 71, in particular some prepayable financial assets. It is likely to have the biggest impact on banks and other financial services entities and be broadly welcomed by companies.
- How to account for the modification of a financial liability. The amendment confirms that most such modifications will result in immediate recognition of a gain or loss. This is a change from common practice under PSAK 55 today and will affect all kinds of entities that have renegotiated borrowings.

DSAK-IAI issued a narrow-scope amendment to PSAK 71 to enable companies to measure at amortised cost some prepayable financial assets with negative compensation. The assets affected, that include some loans and debt securities, would otherwise have been measured at fair value through profit or loss (FVTPL).

Negative compensation arises where the contractual terms permit the borrower to prepay the instrument before its contractual maturity, but the prepayment amount could be less than unpaid amounts of principal and interest. However, to qualify for amortised cost measurement, the negative compensation (being the difference between the prepayment amount and unpaid amount of principal and interest) must be 'reasonable compensation for early termination of the contract'.

An example of such reasonable compensation is an amount that reflects the effect of the change in the relevant benchmark rate of interest. However, the standard does not define ‘reasonable compensation’ and significant judgement may be required to assess if this test is met.

In addition to qualify for amortised cost measurement, the asset must be held within a ‘held to collect’ business model.

Impact

The amendment is likely to be welcomed by preparers. In practice, there is a broad range of prepayment features with potentially negative compensation in many kinds of debt instruments:

- The prepayment option may be contingent on the occurrence of a trigger event (for example, sale or fall in value of collateral to a loan).
- The prepayment option may be held by only one party to the contract or both parties.
- Prepayment may be permitted or required (in particular circumstances).
- The compensation formula may differ. In many cases judgement will be required to assess whether the compensation meets the test of being ‘reasonable compensation for early termination of the contract’.

Modification of financial liabilities – PSAK 71 accounting change confirmed

As expected, the amendment also confirmed the accounting for modifications of financial liabilities under PSAK 71. That is, when a financial liability measured at amortised cost is modified without this resulting in derecognition, a gain or loss should be recognised in profit or loss. The gain or loss is calculated as the difference between the original contractual cash flows and the modified cash flows discounted at the original effective interest rate. This will impact all companies, particularly those applying a different policy for recognising gains and losses under PSAK 55.

Effective date

The amendment is effective for annual periods beginning on or after 1 January 2020.

PSAK 72, Revenue from Contracts with Customers

Transition provision: Retrospective.

Issue

In July 2017, DSAK-IAI issued the long-awaited standard on revenue recognition. There are potentially significant changes coming for certain industries, and some level of change for almost all entities.

Impact

Summarised below are some of the areas that could create the most significant challenges for entities as they transition to the new standard.

Transfer of control

Revenue is recognised when a customer obtains control of a good or a service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards. Entities will need to apply new guidance to determine whether revenue should be recognised over time or at a point in time.

Variable consideration

Entities might agree to provide goods or services for consideration that varies upon certain future events occurring or not occurring. Examples include refund rights, performance bonuses and penalties. These amounts are often not recognised as revenue today until the contingency is resolved. Now, an estimate of variable consideration is included in the transaction price if it is highly probable that the amount will not result in a significant revenue reversal if estimates change. Even if the entire amount of variable consideration fails to meet this threshold, management will need to consider whether a portion (a minimum amount) does meet the criterion. This amount is recognised as revenue when goods or services are transferred to the customer. This could affect entities in multiple industries where variable consideration is currently not recorded until all contingencies are resolved. Management will need to reassess estimates each reporting period, and adjust revenue accordingly.

There is a narrow exception for intellectual property (IP) licenses where the variable consideration is a sales- or usage-based royalty.

Allocation of transaction price based on relative stand-alone selling price

Entities that sell multiple goods or services in a single arrangement should allocate the consideration to each of those goods or services on a relative stand-alone selling price basis. This allocation is based on the price an entity would charge a customer on a stand-alone basis for each good or service.

Licences

Entities that license their IP to customers will need to determine whether the licence transfers to the customer over time or at a point in time. A licence that is transferred over time allows a customer access to the entity's IP as it exists during the licence period. Licences that are transferred at a point in time allow the customer the right to use the entity's IP as it exists when the licence is granted. The customer should be able to direct the use of and obtain substantially all of the remaining benefits from the licensed IP to recognise revenue when the licence is granted. The standard includes several examples to assist entities making this assessment.

Time value of money

Some contracts provide the customer or the entity with a significant financing benefit (explicitly or implicitly). This is because performance by an entity and payment by its customer might occur at significantly different times. An entity should adjust the transaction price for the time value of money if the contract includes a significant financing component. The standard provides certain exceptions to applying this guidance and a practical expedient which allows entities to ignore time value of money if the time between transfer of goods or services and payment is less than one year.

Contract costs

Entities sometimes incur costs (such as sales commissions or mobilisation activities) to obtain or fulfil a contract. Contract costs that meet certain criteria are capitalised as an asset and are amortised as revenue is recognised. More costs are expected to be capitalised in some situations. Management will also need to consider how to account for contract costs incurred for contracts that are not completed upon the adoption of the standard.

Disclosures

Extensive disclosures are required to provide greater insight into both revenue that has been recognised, and revenue that is expected to be recognised in the future from existing contracts. Quantitative and qualitative information will be provided about the significant judgements and changes in those judgements that management made to determine revenue that is recorded.

Effective date and transition

PSAK 72 is effective for annual periods beginning on or after 1 January 2020.

Entities can apply the revenue standard retrospectively to each prior reporting period presented (full retrospective method) or retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application in equity (modified retrospective method). Entities that elect to apply the standard using the full retrospective method can apply certain practical expedients.

PSAK 73, Leases

Transition provision: Retrospective.

Issue

In July 2017, DSAK-IAI published PSAK 73, Leases, which replaces the current guidance in PSAK 30. This will require far-reaching changes in accounting by lessees in particular.

Key provisions

Under PSAK 30, lessees were required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). PSAK 73 now requires lessees to recognise a lease liability reflecting future lease payments and a ‘right-of-use asset’ for virtually all lease contracts. The new standard includes an optional exemption for certain short-term leases and leases of low-value assets, however, this exemption can only be applied by lessees.

For lessors, the accounting stays almost the same. However, as DSAK-IAI has updated the PSAK 30 guidance on the definition of a lease (as well as the guidance on the combination and separation of contracts), lessors will also be affected by the new standard. At the very least, the new accounting model for lessees is expected to impact negotiations between lessors and lessees.

Under PSAK 73, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Impact

PSAK 73 is likely to have a significant impact on the financial statements of a number of lessees.

Statement of financial position

The new standard affects both the balance sheet and related ratios, such as debt/equity ratios. Depending on the particular industry and the number of lease contracts previously classified as operating leases under PSAK 30, the new approach will result in a significant increase in debt on the balance sheet.

Statement of comprehensive income

Lessees will have to present interest expense on the lease liability and depreciation on the right-of-use asset in their income statement. In comparison with operating leases under PSAK 30, this will change not only the allocation of expenses but also the total amount of expenses recognised for each period of the lease term. The combination of a straight-line depreciation of the right-of-use asset and the effective interest rate method applied to the lease liability will result in a higher total charge to profit or loss in the initial years of the lease, and decreasing expenses during the latter part of the lease term.

Statement of cash flows

The new guidance will also change the cash flow statement, because lease payments that relate to contracts that have previously been classified as operating leases are no longer presented as operating cash flows in full. Only the part of the lease payments that reflects interest on the lease liability can be presented as an operating cash flow (if it is the entity's policy to present interest payments as operating cash flows). Cash payments for the principal portion of the lease liability are classified within financing activities.

Payments for short-term leases, for leases of low-value assets and variable lease payments not included in the measurement of the lease liability are presented within operating activities.

Effective date and transition

PSAK 73 is effective for annual reporting periods beginning on or after 1 January 2020. In order to facilitate transition, entities can choose a 'simplified approach' that includes certain reliefs related to the measurement of the right-of-use asset and the lease liability, rather than full retrospective application, furthermore, the 'simplified approach' does not require a restatement of comparatives. In addition, as a practical expedient, entities are not required to reassess whether a contract is, or contains, a lease at the date of initial application (that is, such contracts are 'grandfathered').

Amended accounting standards following IFRS updates

Amendment to PSAK 1, Presentation of financial statements and PSAK 25, Accounting policies, changes in accounting estimates and errors- definition of material

Transition provision: Retrospective.

Issue

The amendments to PSAK 1, ‘Presentation of Financial Statements’, and PSAK 25, ‘Accounting policies, changes in accounting estimates and errors’, and consequential amendments to other PSAKs:

- Use a consistent definition of materiality throughout PSAKs and the Conceptual Framework for Financial Reporting;
- Clarify the explanation of the definition of material; and
- Incorporate some of the guidance in PSAK 1 about immaterial information.

The amended definition is:

‘Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.’

The amendment clarifies that the reference to obscuring information addresses situations in which the effect is similar to omitting or misstating that information. It also states that an entity assesses materiality in the context of the financial statements as a whole.

The amendment also clarifies the meaning of ‘primary users of general purpose financial statements’ to whom those financial statements are directed, by defining them as ‘existing and potential investors, lenders and other creditors’ that must rely on general purpose financial statements for much of the financial statements for much of the financial information they need.

Impact

The amendments clarify the definition of material and make PSAKs more consistent, but are not expected to have a significant impact on the preparation of financial statements.

Effective date

The amendment is effective for annual periods beginning on or after 1 January 2020.

Amendment to PSAK 15, Investments in associate and joint ventures - long-term interests in associates and joint ventures

Transition position: Retrospective

Issue

Investors could have long-term interests (for example, preference share or long-term loans) in an associate or joint venture that form part of the net investment in the associate or joint venture. DSAK-IAI was asked to clarify whether these long-term interests are within the scope of PSAK 71, and whether PSAK 71 impairment requirements are applicable.

Insight

DSAK-IAI issued a narrow scope amendment to PSAK 15 that clarified that these long-term interests in an associate or joint venture to which the equity method is not applied should be accounted for using PSAK 71. This includes impairment requirements in PSAK 71. An illustrative example is also provided.

Effective date

The amendment is effective for annual periods beginning on or after 1 January 2020.

Amendment to PSAK 62 Insurance Contracts – applying PSAK 71, Financial Instruments, to PSAK 62

Transition position: Retrospective

Issue

These amendments address the concerns of insurance companies about the different effective dates of PSAK 71, ‘Financial Instruments’, and the forthcoming new insurance contracts standard. The amendment to PSAK 62 provides two different solutions for insurance companies: a temporary exemption from PSAK 71 for entities that meet specific requirements (applied at the reporting entity level), and the ‘overlay approach’. Both approaches are optional.

PSAK 62 (including the amendments that have now been issued) will be superseded by the forthcoming new insurance contracts standard. Accordingly, both the temporary exemption and the ‘overlay approach’ are expected to cease to be applicable when the new insurance standard becomes effective.

Key Provisions

Temporary exemption from applying PSAK 71

Until implementation of the new insurance guidance, the amendment to PSAK 62 allows insurers to continue to apply PSAK 55, ‘Financial Instruments: Recognition and measurement’, instead of adopting PSAK 71, if their activities are ‘predominantly connected with insurance’. The exemption can only be applied at the level of the reporting entity. To assess whether the activities are ‘predominantly connected with insurance’, two tests have to be performed. Only if both tests are passed are an insurer’s activities considered to be predominantly connected with insurance.

First, an insurer assesses whether the carrying amount of its liabilities arising from contracts within PSAK 62’s scope is significant, compared to the total carrying amount of all of its liabilities.

Secondly, the insurer compares the total carrying amount of its liabilities connected with insurance with the total carrying amount of all of its liabilities. In addition to liabilities arising directly from contracts within PSAK 62's scope, liabilities connected with insurance include:

- Non-derivative investment contract liabilities measured at fair value through profit or loss applying PSAK 55; and
- Liabilities that arise because the insurer issues, or fulfills obligations arising from, those insurance and non-derivative investment contracts.

The second test is passed if the resulting percentage is either greater than 90% or if it is less than or equal to 90% but greater than 80%, the insurer is not engaged in a significant activity unconnected with insurance.

The assessment is made, based on the carrying amounts as at the annual reporting date that immediately precedes 30 June 2019. Under certain circumstances, a reassessment is required or permitted.

Overlay approach

Under PSAK 71, certain financial assets have to be measured at fair value through profit or loss, whereas, under PSAK 62, the related liabilities from insurance contracts are often measured on a cost basis. This mismatch creates volatility in profit or loss.

By using the 'overlay approach', the effect is eliminated for certain eligible financial assets. For these financial assets, an insurer is permitted to reclassify – from profit or loss to other comprehensive income – the difference between the amount that is reported in profit or loss under PSAK 71 and the amount that would have been reported in profit or loss under PSAK 55.

Financial assets are eligible for designation for the 'overlay approach' if they are measured at fair value through profit or loss under PSAK 71, but not so measured under PSAK 55. In addition, the asset cannot be held in respect of an activity that is unconnected with contracts within PSAK 62's scope. If a designated financial asset no longer meets the eligibility criteria (for example, because it is transferred so that it is now held in respect of an entity's banking activities or because the entity ceases to be an insurer), it shall be de-designated, in that case, any balance accumulated in other comprehensive income relating to this financial asset is reclassified to profit or loss.

The 'overlay approach' is applied retrospectively. Accordingly, the difference between the fair value of the designated financial assets and its carrying amount is recognised as an adjustment to the opening balance of accumulated other comprehensive income.

Following the same logic, if the entity stops using the overlay approach, it adjusts the opening balance of retained earnings for the balance of accumulated other comprehensive income.

Impact

Both the temporary exemption and the 'overlay approach' allow entities to avoid temporary volatility in profit or loss that might result from adopting PSAK 71 before the forthcoming new insurance contracts standard. Furthermore, by using the temporary exemption, an entity does not have to implement two sets of major accounting changes within a short period, and it can take into account the effects of the new insurance standard when first applying the classification and measurement requirements of PSAK 71.

Groups that contain insurance subsidiaries should be aware that the temporary exemption only applies at the level of the reporting entity. So, unless the whole group is eligible for the temporary exemption, whilst an eligible insurance subsidiary can continue to apply PSAK 55 in its individual financial statements, the subsidiary will have to prepare PSAK 71 information for consolidation purposes. Furthermore, it should be noted that, under both approaches, significant additional disclosures are required.

Effective date

The amendment is effective for annual periods beginning on or after 1 January 2020.

Amendments to PSAK 71, PSAK 55 and PSAK 60 – interest rate benchmark reform (Phase 1)

Transition position: Retrospective

The DSAK-IAI has issued amendments to PSAK 71, PSAK 55, Financial instruments: Recognition and measurement, and PSAK 60, Financial instruments: Disclosure, that provide certain reliefs in connection with interest rate benchmark reform. The reliefs relate to hedge accounting and have the effect that IBOR reform should not generally cause hedge accounting to terminate. However, any hedge ineffectiveness should continue to be recorded in the income statement. Given the pervasive nature of hedges involving IBOR-based contracts, the reliefs will affect companies in all industries.

Issues

Following the financial crisis, the replacement of benchmark interest rates such as LIBOR and other inter-bank offered rates ('IBORs') has become a priority for global regulators. Many uncertainties remain but the roadmap to replacement is becoming clearer. Given the pervasive nature of IBOR-based contracts among both financial institutions and corporates, there are significant potential impacts of these changes on financial reporting under IFAS.

Accounting standard setters have a two-phase project to consider what, if any, reliefs to give from the effects of IBOR reform. Phase 1, which considers reliefs to hedge accounting in the period before the reform, has led to these amendments. Phase 2 will address issues that arise once the existing interest rate is replaced with an alternative interest rate.

Impact

As discussed in more detail below, the Phase 1 amendments provide temporary relief from applying specific hedge accounting requirements to hedging relationships directly affected by IBOR reform. The reliefs have the effect that IBOR reform should not generally cause hedge accounting to terminate. However, any hedge ineffectiveness should continue to be recorded in the income statement under both PSAK 55 and PSAK 71. Furthermore, the amendments set out triggers for when the reliefs will end, which include the uncertainty arising from interest rate benchmark reform no longer being present.

'Highly probable' requirement

Cash flow hedge accounting under both PSAK 71 and PSAK 55 requires the future hedged cash flows to be 'highly probable'. Where these cash flows depend on an IBOR (for example, future interest payments on a forecast issuance of a LIBOR-based debt hedged with an interest rate derivative), a question arises as to whether they can be considered 'highly probable' beyond the date at which the relevant IBOR might cease being published.

The relief provided by the amendments requires an entity to assume that the interest rate on which the hedged cash flows are based does not change as a result of the reform. Hence, where the hedged cash flows may change as a result of IBOR reform (for example, where the future interest payments on a hedged forecast debt issuance might be SONIA + X% rather than GBP LIBOR + Y%), this will not cause the 'highly probable' test to be failed.

Prospective assessments (economic relationship and 'highly effective' hedge)

Both PSAK 55 and PSAK 71 require a forward-looking prospective assessment in order to apply hedge accounting. PSAK 55 requires the hedge to be expected to be highly effective, whereas IFRS 9 requires there to be an economic relationship between the hedged item and the hedging instrument.

Cash flows under IBOR and IBOR replacement rates are currently expected to be broadly equivalent, which minimises any ineffectiveness. However, as the date of the reform gets closer, this might no longer be the case. This could give rise to hedge ineffectiveness in the prospective assessment, in particular where the replacement of the benchmark rate is expected to occur at different times in the hedged item and the hedging instrument.

Under the amendments, an entity assumes that the interest rate benchmark on which the cash flows of the hedged item, hedging instrument or hedged risk are based is not altered by IBOR reform.

PSAK 55 retrospective effectiveness test exception

The uncertainties described above in the context of prospective assessments could also affect PSAK 55's retrospective effectiveness requirement. In particular, IBOR reform might cause a hedge to fall outside the required 80–125% range. PSAK 55 has therefore been amended to provide an exception to the retrospective effectiveness test such that a hedge is not discontinued during the period of IBOR-related uncertainty solely because the retrospective effectiveness falls outside this required 80–125% range. However, the other requirements for hedge accounting, including the prospective assessment, would still need to be met.

Risk components

In some hedges, the hedged item or hedged risk is a non-contractually specified IBOR risk component. An example is a fair value hedge of fixed-rate debt where the designated hedged risk is changes in the fair value of the debt attributable to changes in an IBOR. In order for hedge accounting to be applied, both PSAK 71 and PSAK 55 require the designated risk component to be separately identifiable and reliably measurable. Under the amendments, the risk component only needs to be separately identifiable at initial hedge designation and not on an ongoing basis. In the context of a macro hedge, where an entity frequently resets a hedging relationship, the relief applies from when a hedged item was initially designated within that hedging relationship.

Disclosures

The amendment requires disclosure of the nominal amount of hedging instruments to which the reliefs are applied, any significant assumptions or judgements made in applying the reliefs, and qualitative disclosures about how the entity is impacted by IBOR reform and is managing the transition process.

Effective date

These amendments should be applied for annual periods beginning on or after 1 January 2020.

Amendment to PSAK 73 - COVID-19 rent concessions

Transition position: Retrospective

Issue

As a result of the coronavirus (COVID-19) pandemic, rent concessions have been granted to lessees. Such concessions might take a variety of forms, including payment holidays and deferral of lease payments. On 30 May 2020, the DSAK-IAI published an amendment to PSAK 73 that provides an optional practical expedient for lessees from assessing whether a rent concession related to COVID-19 is a lease modification. Lessees can elect to account for such rent concessions in the same way as they would if they were not lease modifications. In many cases, this will result in accounting for the concession as variable lease payments in the period(s) in which the event or condition that triggers the reduced payment occurs.

Key Provisions

Rent concessions that have been, or are expected to be, provided to lessees as a result of the COVID-19 pandemic might take a variety of forms, including payment holidays and deferral of lease payments for a period of time, sometimes followed by increased rent payments in future periods. PSAK 73 contains requirements that apply to such rent concessions. The DSAK-IAI has noted, however, that applying those requirements to a potentially large volume of rent concessions related to COVID-19 could be complex – particularly in the light of the many other challenges that stakeholders face during the pandemic.

As a result, the standard setters have provided lessees (but not lessors) with relief in the form of an optional exemption from assessing whether a rent concession related to COVID-19 is a lease modification. Lessees can elect to account for rent concessions in the same way as they would if they were not lease modifications. In many cases, this will result in accounting for the concession as a variable lease payment.

The practical expedient only applies to rent concessions occurring as a direct consequence of the COVID-19 pandemic and only if all of the following conditions are met:

a. the change in lease payments results in revised consideration for the lease that is substantially the same as, or less than, the consideration for the lease immediately preceding the change;
b. any reduction in lease payments affects only payments due on or before 30 June 2021; and
c. there is no substantive change to other terms and conditions of the lease.

Lessees that apply the exemption will need to disclose that fact, as well as the amount recognised in profit or loss arising from COVID-19-related rent concessions. If a lessee chooses to apply the practical expedient to a lease, it would apply the practical expedient consistently to all lease contracts with similar characteristics and in similar circumstances. The amendment is to be applied retrospectively in accordance with PSAK 25, but lessees are not required to restate prior period figures or to provide the disclosure under paragraph 28(f) of PSAK 25.

Impact

Given the pervasiveness of the pandemic and the measures taken on social distancing, it is likely that many lessees will have been granted a rent concession of some form, and so these amendments would be applicable. The amendments, however, do not make any changes to lessor accounting.

Effective date

The amendments are mandatory for annual reporting periods beginning on or after 1 June 2020. Earlier application is permitted, including in interim or year end financial statements not yet authorised for issue at 30 May 2020, to permit application of the relief as soon as possible.

Amendments to the Conceptual Framework

Issue

DSAK-IAI has revised the Conceptual Framework. This will not result in any immediate change to PSAK, but the standard setters will use the revised Framework in setting future guidance. It is therefore helpful for stakeholders to understand the concepts in the Framework and the potential ways in which they might impact future guidance.

Impact

Level in the IFRS hierarchy

The Framework is not an PSAK standard and does not override any standard, so nothing will change in the short term. The revised Framework will be used in future standard-setting decisions, but no changes will be made to current IFAS. Preparers might also use the Framework to assist them in developing accounting policies where an issue is not addressed by an IFAS.

Key changes

Key changes include:

- Increasing the prominence of stewardship in the objective of financial reporting, which is to provide information that is useful in making resource allocation decisions.
- Reinstating prudence, defined as the exercise of caution when making judgements under conditions of uncertainty, as a component of neutrality.
- Defining a reporting entity, which might be a legal entity or a portion of a legal entity.
- Revising the definition of an asset as a present economic resource controlled by the entity as a result of past events.
- Revising the definition of a liability as a present obligation of the entity to transfer an economic resource as a result of past events.
- Removing the probability threshold for recognition, and adding guidance on derecognition.
- Adding guidance on the information provided by different measurement bases, and explaining factors to consider when selecting a measurement basis.
- Stating that profit or loss is the primary performance indicator and that, in principle, income and expenses in other comprehensive income should be recycled where the relevance or faithful representation of the financial statements would be enhanced.

The standard setters did not make any changes that address challenges in classifying instruments with characteristics of both liability and equity. That will be addressed through a separate project on that topic. Other amendments to the Framework might be needed at the conclusion of that project.

Effective date

The standard setters will immediately begin using the revised Framework. It is effective for annual periods beginning on or after 1 January 2020 for preparers that develop an accounting policy based on the Framework.

New guidance issued by DSAK-IAI

Amendment to PSAK 1, Presentation of financial statements - titles of financial statements

Transition position: Retrospective

Issue

One of the differences between IAS 1 and PSAK 1 was flexibility for preparers of financial reports under IFRS to use titles for the financial statements other than those specifically mentioned in the financial reporting standard. The current amendment to PSAK 1 permits preparers of financial statements under IFAS to use titles other than those stated in paragraph 10, for example, an entity may use the title ‘statement of comprehensive income’ instead of ‘statement of profit or loss and other comprehensive income’.

Impact

The amendment brings back PSAK 1 in line with IAS 1 such that now there is flexibility for preparers of financial reports under PSAK to use titles for the financial statements other than specifically mentioned in the PSAK 1. PSAK 1 is intended to be sufficiently suitable for it to be used by all types of entities, irrespective of whether an entity is profit-oriented or not. However, the amended standard allows not-for-profit organisations to amend the descriptions used for particular line items in the financial statements and for the primary financial statements themselves. The issuance of this amendment is accompanied by concurrent withdrawal of PSAK 45, Accounting for Non-Profit Organisation, and introduction of the new interpretation applicable to the not-for-profit sector (ISAK 35).

Effective date

The amendment is effective for annual periods beginning on or after 1 January 2020.

ISAK 35, Presentation of not-for-profit oriented entity financial statements

Issue

Almost all reporting entities within the not-for-profit sector in Indonesia used to prepare the financial statements in accordance with PSAK 45, Accounting for Non-Profit Organisation, until the standard was effectively withdrawn as of 1 January 2019. During 2019, DSAK-IAI issued a new interpretation that deals with the presentation of the financial statements of not-for-profit entities.

Impact

The interpretation applies together with PSAK 1 in the preparation and presentation of general purpose financial statements by not-for-profit reporting entities, regardless of their legal status and structure. Essentially, ISAK 35 provides guidance how paragraph 5 in PSAK 1 applies to not-for-profit entities and includes illustrative examples how a not-for-profit entity may amend the descriptions of line items presented in the financial statements and/or use the titles for the financial statements themselves that are more suitable for not-for-profit activities. Additionally, the interpretation clarifies how assets contributed by donors to a not-for-profit organisation should be presented as restricted or unrestricted resources based on the donor-imposed criteria.

ISAK 35 also applies to the financial statements of small to medium-size not-for-profit organisations that apply the Indonesian accounting standard without public accountability (SAK ETAP).

Effective date

ISAK 35 is effective for annual periods beginning on or after 1 January 2020.

APPENDIX – Forthcoming Requirements

Title	Key Requirements	Effective Date
Amendment to PSAK 22, Business Combination	To be considered a business, an acquisition would have to include an input and a substantive process that together significantly contribute to the ability to create outputs.	1 January 2021
PSAK 112, 'Accounting for Wakaf (Endowments)'	The standard regulates the accounting treatment for wakaf (endowments) from corporate donor to individual and corporate recipient.	1 January 2021
Amendments to PSAK 1, 'Presentation of financial statements' – Classification of liabilities as current or non-current	The narrow-scope amendment clarifies classification of liabilities as current or non-current, depending on the rights that exist at the end of the reporting period. The amendment also clarifies what PSAK 1 means when it refers to the 'settlement' of a liability.	1 January 2023

Authors, contributors, and reviewers

Djohan Pinnarwan
+62 21 521 2901 (ext. 82299)
djohan.pinnarwan@pwc.com

Dwi Jayanti
+62 21 521 2901 (ext. 82549)
dwi.jayanti@pwc.com

Dariya Karasova
+62 21 521 2901 (ext. 82635)
dariya.m.karasova@pwc.com

Tri Pandu
+62 21 521 2901 (ext. 84276)
tri.pandu@pwc.com

Raisa Lestari
+62 21 521 2901 (ext. 83827)
raisa.lestari@pwc.com

Dania Mulandari
+62 21 521 2901 (ext. 83797)
dania.mulandari@pwc.com

For professional accounting advice, please contact:

Djohan Pinnarwan
+62 21 521 2901 (ext. 82299)
djohan.pinnarwan@pwc.com

Irwan Lau
+62 21 521 2901 (ext. 82016)
irwan.lau@pwc.com

Jumadi Anggana
+62 21 521 2901 (ext. 81990)
jumadi.anggana@pwc.com

Jasmin Maranan
+62 21 521 2901 (ext. 81619)
jasmin.m.maranan@pwc.com

Elina Mihardja
+62 21 521 2901 (ext. 83615)
elina.mihardja@pwc.com

Ponco Widagdo
+62 21 521 2901 (ext. 83322)
ponco.widagdo@pwc.com

Ivina Hartopo
+62 21 521 2901 (ext. 83209)
ivina.hartopo@pwc.com

PwC Indonesia
WTC 3
Jl. Jend. Sudirman Kav. 29-31
Jakarta 12920 – Indonesia
T: +62 21 50992901 / 31192901
F: +62 21 52905555 / 52905050

Pakuwon Center
Tunjungan Plaza 5, 22nd Floor, Unit 05
Jl. Embong Malang No. 1, 3, 5
Surabaya 60261 - Indonesia
T: +62 31 99245759