Asia e-Alert

Milliman

Indonesia: Proposed updates to PSAK 74 in response to amendments to IFRS 17 (Part I- reducing costs)

Introduction

The Institute of Indonesian Chartered Accountants (IAI) represents the accounting profession in Indonesia. Its responsibilities include the development of the accounting profession and the provision of accounting standards. It consists of various boards, including the Financial Accounting Standards Board (DSAK). The DSAK is responsible for formulating, developing and endorsing various Financial Accounting Standards (PSAKs). The version of the Indonesian Financial Accounting Standards, effective on 1 January 2018, are substantially converged with International Financial Reporting Standards with authorities being committed to achieving full convergence.

On 26 September 2018, the DSAK issued the PSAK 74 Exposure Draft, (PSAK 74), an adaption of the IFRS 17 *Insurance Contracts* (IFRS 17) reporting standard issued by the International Accounting Standards Board (IASB) in May 2017. Following feedback from industry stakeholders, the IAS Board considered three criteria when deciding to amend IFRS 17. The criteria used were:

- To reduce the implementation and system development costs of IFRS 17
- To make results easier to explain
- To make the transition to IFRS 17 easier

The IASB published proposed amendments to IFRS 17 in June 2019 with the revised standard published in June 2020. The IAI published PSAK 74 Amendments Exposure Draft on 4 May 2020 to include these same changes in PSAK 74, with some exceptions and differences as detailed below. The IAI held a public hearing of the PSAK 74 Amendments Exposure Draft on 15 July 2020 and public comments are to be submitted by 30 October 2020. The DSAK plans to formalise the PSAK 74 Amendments Exposure Draft in December 2020.

We have prepared a series of three e-Alerts to discuss the changes to IFRS 17 and the IAI's proposed changes to PSAK 74. Each e-Alert will focus on one of the IASB's criteria for deciding to change IFRS 17. In this first e-Alert of three, we discuss the amendments introduced to reduce the costs of IFRS 17, their impact on insurers and the likely impact on PSAK 74. Separate e-Alerts covering the IASB's other criteria of making results easier to explain and easing the transition to IFRS 17 will be released over the next week. The amendments aimed at reducing the costs of IFRS 17 cover the following areas:

- Excluding some credit card and loan contracts from the scope of IFRS 17
- Presenting portfolios of contracts on the balance sheet
- Changing accounting estimates in previous interim financial statements

Amendment 1: Scope exclusion

Some contracts that provide credit or payment arrangements - such as credit cards, charge cards, consumer financing contracts or bank accounts - have an insurance component embedded in the contract and so meet the definition of an insurance contract. However, the amendments now exclude such contracts from the scope of IFRS 17 if the company does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer. The IASB concluded that the existing accounting for these contracts under IFRS 9 *Financial Instruments* (IFRS 9) would continue to provide useful information to users of financial statements. However, if a company provides the insurance coverage as part of the contractual terms of the product, then the company should separate the insurance component and apply IFRS 17 only to that component and IFRS 9 to the non-insurance components of the credit card.

Some other contracts may meet the definition of an insurance contract, but with the insurance cover limited to the customer's obligation to the entity. For example, this includes loans with death waivers or lifetime mortgages. IFRS 17 now allows an entity to choose whether to account for these contracts under IFRS 17 or IFRS 9. The choice of which standard to apply is made once for the whole portfolio of contracts and is irrevocable. This contrasts with specified financial guarantee contracts and specified fixed-fee service contracts where the decision of which standard to apply is made for each individual contract. The requirement to make one choice for the whole portfolio mitigates the lack of comparability that might arise between similar contracts issued by the same company.

Without these banking products being excluded from scope, companies would incur costs for implementing IFRS 17 as well as the ongoing costs of managing systems and processes that comply with IFRS 17 but without a corresponding level of benefit.

Amendment 2: Balance sheet presentation

A key requirement of IFRS 17 is to identify groups of insurance contracts for separate financial measurement and reporting. While an insurer may already manage and report insurance business by different portfolios of contracts, separate groups are required for each year of business issued and for varying levels of profitability.

A group of insurance contacts is in an asset or liability position depending on the net future cashflows for that group. Identifying those net cashflows for each group of insurance contracts could involve integrating cash management systems and actuarial systems at the level of a group of contracts in order to correctly determine the net liability position. However, in general most groups of insurance contracts are most often in a liability position.

Previously, IFRS 17 required an insurer to present groups that are assets separately from those that are liabilities on the balance sheet. This requirement is now relaxed so that the assets and liabilities are presented at the level of portfolios rather than groups. The diagram below illustrates the concept:

				PRESENTATION AT PORTFOLIO LEVEL (A+B+C)	
GROUP	A	B	C	BEFORE AMENDMENTS	AFTER AMENDMENTS
Insurance contract asset	20	-	-	20	-
Insurance contract liability	-	30	40	70	50
Net liability	(20)	30	40	50	50

Amendment 3: Previous interim reports

Under IFRS 17, an insurer reflects changes in accounting estimates by either adjusting the Contractual Service Margin (CSM) - in the case of changes in estimates of the future fulfilment cashflows - or recognising the changes immediately in profit and loss as an experience adjustment. As a result, how often an insurer reports under IFRS 17 can affect how results are measured. Originally, IFRS 17 required insurers not to change how accounting estimates were treated in previous interim reports when preparing later interim reports or the annual report. This original requirement conflicted with the requirement under IAS 34 *Interim Financial Reporting* that the frequency of reporting should not affect how annual results are measured as well as increasing costs for insurers. For example, insurers may have the costs of changing their systems and processes and maintaining two records. Insurers can now choose whether to change the estimates in previous financial statements when applying IFRS 17.

In case an insurer chooses not to change the treatment of accounting estimates in previous interim reports, but does not have the information required to apply that choice retrospectively at transition, IFRS 17 now allows an insurer to determine the CSM or loss component at the transition date as if the insurer had not prepared interim financial statements before the transition date.

The PSAK 74 Amendments Exposure Draft does not propose the same changes to paragraph PP137 in PSAK 74, preventing insurers from changing estimates in prior reports. Potentially, this is one difference between the Indonesian and international standards. However, the IAI stated during the public hearing in July 2020 that changes other than those in the exposure draft may be made to the final version published in December 2020. Companies should monitor this change closely so they comply with the requirements in respect of past interim reports correctly.

Feedback in response to proposed changes to PSAK 74

The IAI has requested feedback from the industry on the proposed changes to PSAK 74. The PSAK 74 Amendments Exposure Draft is available on the IAI's website here. The IAI have asked to receive written feedback to the exposure draft by 30 October 2020 at the latest. Insurers can provide their responses using the online form on the IAI's website or by sending them to:

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