

Indonesia: Proposed updates to PSAK 74 in response to amendments to IFRS 17 (Part III – easing transition)

Introduction

This e-Alert is Part III in a series of three e-alerts we have prepared to discuss the changes to IFRS 17 and the Institute of Indonesian Chartered Accountants' (IAI) proposed changes to PSAK 74, an adaptation of IFRS 17 issued by the International Accounting Standards Board (IASB). Each e-Alert focuses on one of the IASB's three criteria for deciding to change IFRS 17:

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

If you would like to read Part I which covers the IASB's criterion of reducing costs (and also provides the background behind these updates), or Part II which discusses the criterion of making results easier, you can download them [here](#).

In this third e-Alert of three, we discuss the amendments to IFRS 17 related to making the transition to IFRS 17 easier, their impact on insurers and likely impact on PSAK 74. We then discuss the revised transition requirements of the amendments aimed at making results easier to explain. The amendments to IFRS 17 easing transition cover the following areas:

- Deferring the effective date of IFRS 17 and IFRS 9
- Transition relief for contracts with direct participation features
- Transition relief for contracts acquired before transition to IFRS 17.

Amendment 1: Deferral of Effective Date

All companies applying IFRS standards are required to apply both IFRS 17 and IFRS 9 *Financial Instruments* (IFRS 9) for annual reporting periods beginning on or after 1 January 2023, changed from 1 January 2021. Eligible insurers' temporary exemption from applying IFRS 9 was extended until 1 January 2023. This means those insurers can still first apply IFRS 17 and IFRS 9 at the same time without the need to adopt IFRS 9 early.

The PSAK 74 Amendments Exposure Draft proposes deferring the effective date of PSAK 74 to annual reporting periods on or after 1 January 2025 – two years after the effective date of IFRS 17 – but with early adoption allowed. The deferred effective date will allow companies in Indonesia more time to implement PSAK 74. Multinational companies may face the challenge of being required to report under both IFRS 17 and the existing requirements of PSAK 62 Insurance Contracts and PSAK 36 Accounting for Life Insurance unless they choose to adopt PSAK 74 early.

Amendment 2: Investment Contracts with DPF

The amendments to IFRS 17 provide additional relaxations to the initial assessments required on transition. In the modified retrospective and fair value approaches, IFRS 17 permitted an insurer to use information available at the transition date instead of information at initial recognition to perform the following initial assessments:

- identify groups of insurance contracts
- identifying discretionary cashflows for insurance contracts without direct participation features
- assessing whether a contract meets the definition of an insurance contract with direct participation features.

Insurers can now use information at the transition date to whether a contract meets the definition of an investment contract with discretionary participation features.

Amendment 3: Contracts Acquired Before Transition

An insurer is required to classify a liability for insurance contracts acquired in their settlement period as a "liability for remaining coverage" when applying IFRS 17 retrospectively. However, it might be difficult to identify these contracts separately from other contracts acquired. IFRS 17 now provides a simplification in both the modified retrospective and fair value approaches. These simplifications allow an insurer to

account for a liability for claims settlement of a contract acquired before the date of transition as a “liability for incurred claims” instead of a “liability for remaining coverage”. An insurer can apply these simplifications in the modified retrospective approach only to the extent the insurer does not have reasonable and supportable information to apply a full retrospective approach.

Amendment 4: Effect of Interim Reports

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 Contractual Service Margin (CSM) or loss component at the transition date as if the insurer had not prepared interim financial statements before the transition date.

Amendment 5: Acquisition Cashflows

At transition under the full retrospective approach, insurers must recognise and measure assets for acquisition cashflows as if IFRS 17 had always applied, except they are not required to assess the recoverability before the transition date. Under the modified retrospective approach, an insurer adjusts the CSM for groups of contracts recognised at the transition date, while the acquisition cashflows are an asset for contracts expected to be recognised after the transition date. Acquisition cashflows paid before the transition date are nil if an insurer does not have the information to apply the relief. In applying the fair value approach, the asset equals the amount the insurer would incur, at the transition date, to obtain specific rights.

Amendment 6: Mismatch on Reinsurance Contracts

If a full retrospective approach is applied at transition, then the loss recovery at the transition date will be the loss recovery component that would have applied at initial recognition of the underlying contracts, rolled forward to the transition date. The requirements of subsequent measurement apply at each reporting date between initial recognition of the underlying contracts and the transition date. Under the modified retrospective or fair value approach, an entity determines the loss recovery component at the transition date by multiplying the:

- loss component of the underlying insurance contracts; and
- proportion of claims reinsured using the expectation at the transition date.

The insurer is not required to calculate what the loss recovery component would have been at initial recognition of the underlying contracts or at any reporting date between initial recognition and the transition date.

Amendment 7: Application of the risk mitigation option

IFRS 17 prohibited insurers from applying the option retrospectively but this could lead to inconsistent treatment of risk mitigation activities before and after transition. Two amendments to the transition requirements have been made:

- An insurer can now apply the option prospectively from the transition date instead of the date of initial application.
- An insurer with the information to apply a full retrospective approach is now allowed apply the fair value approach for a group of contracts with direct participation features when conditions relating to risk mitigation are met.

An insurer using the fair value approach avoids the situation where changes in the value of risk mitigation instruments are reflected in opening retained earnings or equity, while the corresponding changes in insurance contracts are reflected in CSM. At the transition date the fair value of the insurance contracts and risk mitigating instrument will include only expectations about future cashflows.

Feedback in Response to Proposed Changes to PSAK 74

The IAI have requested feedback from industry on the proposed changes to PSAK 74, which mirror those made to IFRS 17 other than to the effective date. 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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