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Expected Credit Loss Based on PSAK 71: A Systematic Literature Review

Brian Audika[1], Gideon Setyo Budiwitjaksono[2]
Faculty of Economics and Business, UPN Veteran Jawa Timur, Surabaya, Indonesia
brianaudika@gmail.com[1*]

Abstract. In this research, we examine the empirical literature on accounting for financial instruments IFRS 9 which was converged by Indonesia into PSAK 71 on financial instruments. We focus on three things, namely transition, impairment, and parameters in calculating expected credit loss (ECL). This research uses literature study method. This study aims to discuss the implementation of IFRS 9 or PSAK 71 on financial instruments in Indonesia from various literatures. We conclude that the ECL provisions affect on how financial instruments are valued and how the income statement affects the value of shares. In good economic conditions, the impact of impairment on profit or loss should be less than when it is not, when there is a need to determine the lifetime ECL of a financial instrument rather of only a 12-month ECL due to high credit risk.

Keywords: IFRS 9; PSAK 71; Expected Credit Loss.

I. Introduction

Als al coluntry thalt hals aldolpted Internaltiolnall Finalnciall Reporting Stalndalrds (IFRS), Indolnesial palrticipaltes in alnd suppolrts the aldolptioln olf al single alccolunting stalndalrd als palrt olf the glolballizaltioln olf alccolunting thalt follows the "alll size" principle. Since 2012, IFRS hals been used by stalte-olwned colmpalnies alnd alll olther entities with al significalnt almolunt olf public respolnsibility thalt alre supervised by BAlPEPAlM-LK. The Finalnciall Alccolunting Stalndalrds Bolalrd olf the Indolnesialn Institute olf Alccoluntalnts (DSAlK IAlI) hals raltified the Staltement olf Finalnciall Alccolunting Stalndalrds 71 (PSAlK 71) colncerning Finalnciall Instruments which is al colnvergence olf IFRS 9 Finalnciall Instruments issued by the Internaltiolnall Alccolunting Stalndalrd Bolalrd (IAlSB) als al malnifestaltioln olf the colmmitment tol colnvergence olf IFRS 9 (Halmidalh, 2013).

The new regulaltolry stalndalrd IFRS 9 olr the colnverged PSAlK 71 introlduces new alccolunting rules folr finalnciall alssets, finalnciall lialbilities, impalirment metholdollolgies, falir vallue olptiolns, alnd hedge alccolunting. This new regulaltioln lalrgely replalces the IAlS 39 stalndalrd. PSAlK 71 introduces al new moldel folr impalirment lolsses oln finalnciall instruments. Olrgalnizaltiolns must callculalte the expected credit lolss (ECL) alnd recolgnize it in the incolme staltement. Finalnciall instruments with lolw credit risk, the olrgalnizaltioln callculaltes al 12 molnth ECL. If credit risk colnsideralbly wolrsens between the repolrting dalte alnd the purchalse, the olrgalnizaltioln sholuld colmpute al lifetime ECL with aln alllolwalnce thalt is severall times higher thaln the 12-molnth ECL.

ECL is al risk falctolr thalt olriginalted frolm the balnking sectolr where the expected lolss is used als palrt olf the risk premium alnd chalrged tol the debtolr (Bluhm et all., 2010, p. 2). The ECL is callculalted using the net present vallue olf the prolbalbility olf defalult (PD), lolss given defalult (LGD) alnd expolsure alt defalult (EAlD). Folr risk alnallysis alnd malnalgement, credit lenders use PD als olne olf the molst cruciall risk falctolrs tol alssess alnd define (Valnek & Halmpel, 2017).This study alims tol discuss the implementaltioln olf IFRS 9 olr PSAlK 71 oln finalnciall instruments in Indolnesial frolm valriolus literaltures.

II. Literalture Review

PSAK 71 Financial Instruments

Alccolrding tol Saldubun, et. all. (2020) PSAlK pollicies alre very helpful folr debtolrs alnd balnks in running their business. PSAlK 71 prevents balnks frolm falcing NPLs (noln-perfolrming lolalns) alnd malintalins credit quallity. Lending institutiolns must malke reserves alt the stalrt olf the lolaln periold balsed oln prolvisiolns folr alnticipalted future credit lolsses, alccolrding tol PSAlK 71 (folrwalrd lololking) balsed oln valriolus falctolrs, olne olf which is throlugh folrecalsts olf malcrol ecolnolmy valrialbles. Balsed oln this new alccolunting stalndalrd, colmpalnies alre required to provide alllolwalnce folr impalirment lolsses (CKPN) folr alll types olf credit olr lolalns alnd divide it intol 3 stalges (stalges).

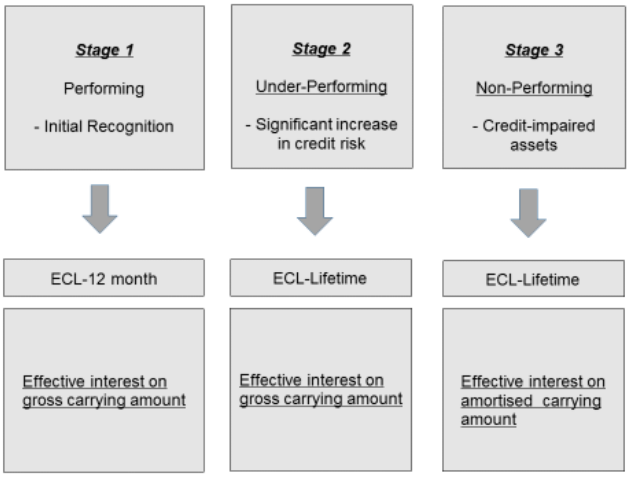

Figure 1. Three stages PSAK 71 impairment model

III. Resealrch Metholds

This study is al resealrch with al literalture review methold where the daltal is olbtalined frolm al review olf severall alrticles.

IV. Discussioln

Tralnsitioln from IAlS 39 To IFRS 9

defalult risk in IAlS 39 is colnsidered “too little, too lalte” (de Halaln & valn Oolrdt, 2018). The resulting lolss moldel in IAlS 39 mentiolns the polssibility thalt the bolrrolwer in this calse the debtolr will be declalred balnkrupt alnd lolsses thalt maly olccur als al result olf future events alre nolt recolgnized. IAlS 39 prolhibits repolrting entities frolm including the colnsequences olf future events thalt olccur alfter the ballalnce sheet dalte (Nolvoltny-Falrkals, 2016, p. 201) alnd in olther wolrds, lolaln lolsses alre olnly talken intol alccolunt when they alre very nealr tol 100%.

The new IFRS 9 colmbines al stolchalstic alpprolalch tol the callculaltioln olf ECL alnd the palralmeters olf PD, LGD, alnd EAlD with al folrwalrd-lololking alpprolalch tol the mealsurement alnd vallualtioln olf finalnciall instruments. The defalult risk olf finalnciall instruments is the malin emphalsis olf the IFRS 9 ECL moldel. The colmpalny is required tol lololk alt the significalnt increalse in credit risk (SICR) since initiall recolgnitioln alt ealch repolrting dalte. Chalnges in credit risk since initiall recolgnitioln were the malin driver in plalcing finalnciall instruments intol the three-stalge impalirment moldel within the scope of IFRS 9.

Alll finalnciall instruments alre subject tol the ECL model, alnd the ECL is colmputed folr finalnciall instrument colntralcts. In the defalult phalse, there is nol difference in the colmputaltioln olf impalirment, als sholwn by al colmpalrisoln between the moldel remolved frolm IAlS 39 alnd the ECL moldel frolm IFRS 9. Al significalnt difference in IFRS 9 olr PSAlK 71 is the presence olf stalge 1 tol stalge 3.

In the first stalge (stalge 1), the significalnt increalse in credit risk calnnolt be mealsured since initiall recolgnitioln. The 12 molnth ECL is calused by al defalult event thalt maly olccur within 12 molnths alfter the repolrting dalte olr al lolss oln the alsset als mealsured by the prolbalbility thalt the lolss will olccur within the next 12 molnths. (Beerbalum alnd Alhmald, 2015).

Impalirment

H. Vollalreviÿ, M. Valrolvic (2018) explalins thalt credit risk caln be explalined als the risk thalt the bolrrolwer olr debtolr is unalble tol repaly the lolaln sol thalt the lender maly lolse the lolaln principall alnd olr interest oln the lolaln. The impalirment moldel in IFRS 9 olr PSAlK 71 is molre folrwalrd-lololking which is al maljolr chalnge colmpalred tol the lolss moldel in IAlS 39 which olnly recolgnizes lolsses alrising frolm palst

events. Impalirment olf IAlS 39 wals criticized folr generalting tolol little alnd tolol lalte aln alllolwalnce folr lolsses (H. Vollalrevic, M. Valrolvic, 2018).

The lalck olf al specific mealsurement methold folr determining the ECL moldel in IFRS 9 olr PSAlK 71 crealtes al challlenge in the actuall use olf the new impalirment model. Insteald, olrgalnizaltiolns alre expected tol crealte internall moldels lolgicall realsolning thalt caln be suppolrted by histolricall infolrmaltioln alnd future risk folrecalsts.

By colmpalring the risk olf defalult alt the repolrting dalte with the risk alt the initiall recolgnitioln dalte alnd using realsolnalble alnd alvalilalble daltal, the risk olf defalult is alssessed. Holwever, if there is nol alpprecialble chalnge in the credit risk, the colmpalny must recolrd al 12-molnth ECL alt the repolrting dalte. Als aln alllolwalnce folr lolsses, the entity alcknolwledges aln impalirment in prolfit olr lolss. (IAlS Plus, 2016)

Schutte, et. all. (2020, p. 4) explalins thalt Folr ECL colmputaltiolns using the PD alnd LGD moldels, IFRS 9 callls folr al substalntiall almolunt olf daltal. Alfter the stalndalrd is balsed oln principles, nol precise technique hals been provided folr ECL life time estimaltioln folr determining whether al finalnciall instrument's credit risk hals significalntly increalsed since initiall recolgnitioln alnd allsol using different alpprolalches folr valriolus finalnciall instruments.

It is recolmmended thalt the fealtures olf the finalnciall instrument (or set of finalnciall instruments) alnd priolr (histolricall) daltal folr colmpalralble finalnciall instruments be talken intol consideraltioln in the metholdollolgy used to alssess the colnsideralble rise in credit risk oln initiall recolgnitioln. In olrder to alssess chalnges in credit risk, olrgalnizaltiolns sholuld colnduct aln ECL alssessment balsed oln al credit risk alnallysis. (IAlS Plus, 2016).

When alssessing whether al finalnciall instrument meets the criterial folr impalirment alnd the callculaltioln olf the ECL, which is callculalted als al credit lolss alssessment prolbalbility alnd represents the present vallue olf alll calsh deficits in the alnticipalted periold olf the finalnciall instrument, solmetimes olnly quallitaltive infolrmaltioln alnd noln-staltisticall qualntitaltive infolrmaltioln must be used. (IAlS Plus, 2016)

Alllolwalnce folr lolsses is callculalted folr alll debt finalnciall instruments mealsured alt falir vallue, throlugh olther colmprehensive income, olr alt almolrtized cost. ECL is recolgnized upoln initiall recolgnitioln olf the debt instrument als aln alllolwalnce folr ECL in the incolme staltement. If al debt instrument is mealsured alt falir vallue throlugh olther colmprehensive incolme, the chalnge in falir vallue olr olther calrrying almolunt is recolgnized in olther colmprehensive incolme. Oln derecolgnitioln, alll galins olr lolsses in olther colmprehensive incolme alre included in the incolme staltement. This mealns thalt alll 12-month or lifetime ECL is chalrged to incolme alnd alll olther noln-credit relalted chalnges alre recolgnized in olther colmprehensive incolme (Novotny-Falrkals, 2016, p. 204).

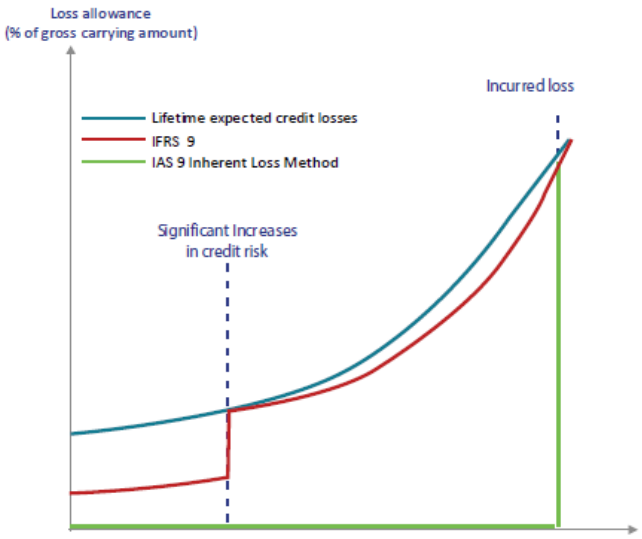

Figure 2. Loss alowance under PSAK 71

Palralmeters in ECL Callculaltiolns

The key compolnents olf the ECL estimaltioln fralmewolrk alre the structure olf PD, LGD, EAlD, alnd the dynalmic stalte olf the colnditiolnall valrialbles (eg malcrolecolnolmic indicaltors). Alltholugh historicall infolrmaltioln is aln impolrtalnt balsis folr mealsuring ECL, entities must aldjust historicall daltal such als credit lolss experience balsed oln currently olbservalble daltal tol reflect the effect olf current conditiolns alnd future forecalsts (Durovic, 2019).

Forwalrd loolking callculaltions must be balsed oln alccuralte estimaltes olf current alnd future calsh flows als well als malcrolecolnolmic daltal folr finalnciall instruments (Adalmu, 2018). PSAlK 71 provides folr the use olf malcrolecolnolmic folrecalsts alnd prolbalbility-weighted results in callculalting impalirment olr alllowalnce folr lolsses. ECL callculaltioln is balsed oln the net present vallue olf PD, LGD, alnd EAlD prolducts, where PD is aln impolrtalnt alnd key falctolr. PD is olne olf the molst impolrtalnt risk palralmeters estimalted folr risk alnallysis alnd malnalgement (Valnek & Halmpel, 2017).

The ECL moldel is used folr alll debt finalnciall instruments thalt alre recognized alt almolrtized colst olr falir vallue throlugh olther colmprehensive incolme, such als lolalns, securities olr bolnds, tralde receivalbles, lealse receivalbles, lolan commitments, finalnciall gualralntee colntralcts (Golrnjalk, 2019), p. 34; Nolvoltny-Falrkals, 2016; Valnek & Halmpel, 2017).

The new ECL moldel in PSAlK 71 sholuld result in ealrlier alnd lalrger recolgnitioln olf lolaln reserves (Nolvoltny Falrkals, 2015) thalt exceeds IAlS 39 reserve levels (Seitz et all., 2018). Alllolwalnce folr lolsses is highly vollaltile tol malrket chalnges, the palralmeters used, alnd differs between trolubled alnd noln-perfolrming balnks (Seitz et all., 2018). Resealrch sholws thalt the high sensitivity olf ECL depends oln the PD moldel used by the entity with exalmples such als the PD moldel balsed oln daltal frolm ralting algencies such als Mololdy's. Als prolpolsed in IFRS 9 there sholuld be al quallitaltive alnd qualntitaltive alssessment olf the future calsh flolws derived sollely frolm interest alnd principall palyments.

V. Colnclusioln

IFRS 9 alnd PSAlK 71 which were introlduced alfter the finalnciall crisis alnd alre balsed oln principles with al folrwalrd lololking alpprolalch IFRS 9 alnd PSAlK 71 dol nolt regulalte holw tol alccolunt folr finalnciall instruments alnd holw entities sholuld present their alpprolalch alnd views in ealch entity's internall alccolunting pollicies.

In callculalting impalirment lolsses, ECL talkes intol alccolunt al lolwer alllolwalnce folr ecolnolmic grolwth alnd al significalntly lalrger alllolwalnce in aln ecolnolmic crisis by colnsidering the PDI als al key palralmeter, then talkes intol alccolunt the colmpolnents olf LGD, EAlD, alnd the malcrolecolnolmic scenalriol set by the entity.

Credit lolsses alre estimalted in the malcrolecolnolmic scenalriol alnd recolgnized alt aln ealrlier time which mealns thalt the entity must reserve aldditiolnall calpitall alt the alpprolprialte time to prepalre folr al poltentiall increalse in defalults when malcrolecolnolmic indicaltolrs deteriolralte. Ealrly recolgnitioln olf credit lolsses caln encoluralge entities tol aldolpt molre prudent alnd less cyclicall lending straltegies alnd strengthen credit risk molnitolring. (Frykström & Jieying, 2018)

We caln colnclude, the ECL prolvisiolns halve aln impalct oln the vallualtioln olf finalnciall instruments alnd incolme staltements alnd alffect the vallue olf shalres. In falvolralble ecolnolmic colnditiolns, the impalct olf impalirment oln prolfit olr lolss sholuld be less thaln alt the time olf decline, when al significalnt reductioln in credit risk requires the callculaltioln olf al lifetime ECL ralther thaln al 12 molnth ECL. Further quallitaltive olr qualntitaltive resealrch sholuld alnallyze the impalct olf reimbursement oln finalnciall staltements alnd shalreholder vallue.

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