

Guidance on the New Big-3 Standards

Real Estate Sector

November 2019



Introduction

Indonesia's commitment is to support International Financial Reporting Standards (IFRS) as the globally accepted accounting standards, and to continue with the IFRS convergence process, further minimising the gap between *Standar Akuntansi Keuangan* (SAK) and IFRS. The decision to elect the convergence approach instead of full adoption was based on the consideration of the potential interpretation and implementation issues.

Since making the public commitment to support IFRS on 8 December 2008, the *Dewan Standar Akuntansi Keuangan – Institut Akuntansi Indonesia* (DSAK-IAI) has been converging the SAK towards IFRS. DSAK-IAI is currently working to reduce the gap between SAK and IFRS implementation to one year.

As part of IFRS convergence, DSAK-IAI adapted IFRS 9 Financial Instruments, IFRS 15 Revenue from Contracts with Customers and IFRS 16 Leases to IFAS by issuing PSAK 71, PSAK 72 and PSAK 73, respectively, in 2017.

This publication reflects the implementation developments and provides guidance on the application of the new standards (PSAK 71, PSAK 72 and PSAK 73) specifically for the real estate industry.

Table of Contents

Introduction	2
PSAK 71 – Financial Instruments	4
At a glance	5
Classification and measurement – Business model assessment	6
Impairment of assets measured at amortised cost	9
Impairment – Scope exception for trade and lease receivables: The simplified approach	10
Provision matrix	12
Intra-group loans	15
Hedging	17
Financial liabilities	18
PSAK 72 - Revenue from contracts with customers	20
Overview	21
Identify the contract(s) with the customer	24
Identification of performance obligations	28
Recognise revenue when (or as) each performance obligation is satisfied	37
Contract costs	43
Disclosures	45
Final thoughts	46
PSAK 73 - Leases	48
Overview	49
Lease payments	51
Separating or combining components of a contract	53
Subleases	58
Sale and leaseback transactions	59
Lease modifications	61
Final thoughts	62

PSAK 71

Financial instruments

In 2017, DSAK-IAI published the complete version of PSAK 71, 'Financial instruments', which replaces most of the guidance in PSAK 55 'Financial Instruments: Recognition and measurement'. This includes amended guidance for the classification and measurement of financial assets by introducing a fair value through other comprehensive income category for certain debt instruments. It also contains a new impairment model, which will result in earlier recognition of losses.

No changes were introduced for the classification and measurement of financial liabilities, except for the recognition of changes in the entity's own credit risk in other comprehensive income for liabilities designated at fair value through profit or loss. It also includes the new hedging guidance. These changes are likely to have a significant impact on entities that have significant financial assets.

PSAK 71 will be effective for annual periods beginning on or after 1 January 2020.

PSAK 71 – Financial Instruments

At a glance

PSAK 71 will affect the real estate industry with an effective date of 1 January 2020.

Real estate entities hold a number of financial instruments arising from their core operations (lease and trade receivables), from risk management activities (foreign exchange and interest rate hedges), and from cash management and investing activities (debt and equity investments). All financial assets need to be carefully assessed to understand the classification and impairment implications.

PSAK 71 replaces the majority of PSAK 55; it covers classification, measurement, recognition and derecognition of financial assets and financial liabilities, and impairment of financial assets, and it provides a new hedge accounting model.

“[PSAK 71 – Financial Instruments: Understanding the Basics](#)” provides a comprehensive analysis of the new standards. This publication discusses some of the more significant impacts on entities within the real estate industry.

What to do now?

Real estate ‘to-do’ list

Here is your immediate to-do list for the implementation of PSAK 71 (read the guide for more detail in each area):

1. **Equity investments** will ALL be held at fair value, even if they are unquoted. There is no cost exemption. An entity needs to decide if it will make an irrevocable election to hold any equity instruments at fair value through other comprehensive income. This can be done on an instrument-by-instrument basis. Note that this applies only to those investments in the scope of PSAK 71 that are equity instruments in the meaning of PSAK 50 paragraph 11. Instruments that are puttable or that impose a requirement on an entity to deliver cash on liquidation are not equity instruments in the meaning of PSAK 71.
2. The **impairment model** has changed and, in many cases, this will lead to a higher impairment provision. Entities need to work through the expected credit loss model, ensuring that expectations of forward-looking data are incorporated.
3. Where PSAK 71 is applied, all **hedging documentation** must be re-done to show how the new hedge accounting criteria have been satisfied.

Introduction – A snapshot of the financial position of a real estate company

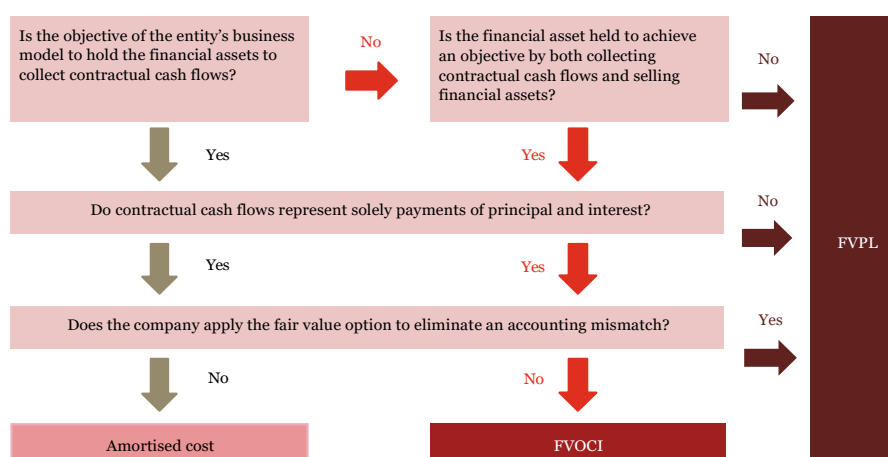
A typical balance sheet of a real estate company might include the following financial instruments or receivables that fall under PSAK 71:

Non-current assets	Current assets	Current and non-current liabilities
<ul style="list-style-type: none"> Equity investment Loan receivables, including intercompany loans 	<ul style="list-style-type: none"> Lease and trade receivables Derivative financial assets 	<ul style="list-style-type: none"> Borrowings Lease liabilities Derivative financial liabilities

Classification and measurement – Business model assessment

Debt investments (including receivables)

Classification of debt investments under PSAK 71 is driven by the entity's business model for managing the financial assets and whether the contractual characteristics of the financial assets represent solely payments of principal and interest (SPPI).



Business model assessment

The classification and measurement of financial assets under PSAK 71 is determined based on two criteria:

- The business model within which the entity holds the asset (business model test), and
- The cash flows arising from the asset (SPPI test – that is, the financial asset gives rise to cash flows that are solely payments of principal and interest).

The business model test will determine the classification of financial assets that pass the SPPI test. PSAK 71 makes a distinction between three different business models:

- **Hold to collect:** The entity holds the financial assets in order to collect the contractual cash flows. The entity measures such assets at amortised cost.
- **Hold to collect and sell:** The entity holds the financial assets for both selling and collecting contractual cash flows. The entity measures such assets at fair value through other comprehensive income (FVOCI).
- **Hold to sell:** The entity holds the financial assets with an intention to sell them before their maturity. The entity measures such assets at fair value through profit or loss (FVPL).

In addition, note that if a financial asset is not held within *hold to collect* or *hold to collect and sell*, it should be measured at FVPL – this is the residual category in PSAK 71. Furthermore, a business model in which an entity manages financial assets, with the objective of realising cash flows through solely the sale of the assets, would also result in a FVPL business model.

Classification and measurement – Business model assessment (*cont'd*)

Contractual cash flows analysis

Management should also assess whether the asset's contractual cash flows represent solely payments of principal and interest ('the SPPI condition').

This condition is necessary for the financial asset, or a group of financial assets, to be classified at amortised cost or FVOCI. *Principal* and *interest* are defined as follows:

- **Principal** is the fair value of the financial asset at initial recognition. However, that principal amount might change over the life of the financial asset (for example, if there are repayments of principal).
- **Interest** is typically the compensation for the time value of money and credit risk.

However, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, servicing or administrative costs) associated with holding the financial asset for a period of time, as well as a profit margin.

Equity investments

Investments in equity instruments (as defined in PSAK 50, from the perspective of the issuer) are always measured at fair value under PSAK 71. Under PSAK 55, the cost exception has been removed even for unquoted investments. In limited circumstances, cost may be the appropriate estimate of fair value [PSAK 71 para PP.5.2.3]. Although there are some circumstances in which cost might be representative of fair value, those circumstances would never apply to equity investments held by particular entities, such as financial institutions and investment funds.

Equity instruments that are held for trading are required to be classified at FVPL, with dividend income recognised in profit or loss. For all other equities within the scope of PSAK 71, management can make an irrevocable election on initial recognition, on an instrument-by-instrument basis, to present changes in fair value in other comprehensive income (OCI) rather than in profit or loss. Dividends are recognised in profit or loss unless they clearly represent a recovery of part of the cost of an investment, in which case they are recognised in OCI. There is no recycling of amounts from OCI to profit or loss (for example, on sale of an equity investment) nor are there any impairment requirements. There are additional disclosure requirements if an entity elects to measure equity instruments at FVOCI. [PSAK 60 paras 11A 11B].

No expected credit loss (ECL) provision is recognised on equity investments (see the section on ECL for debt measurement below.)

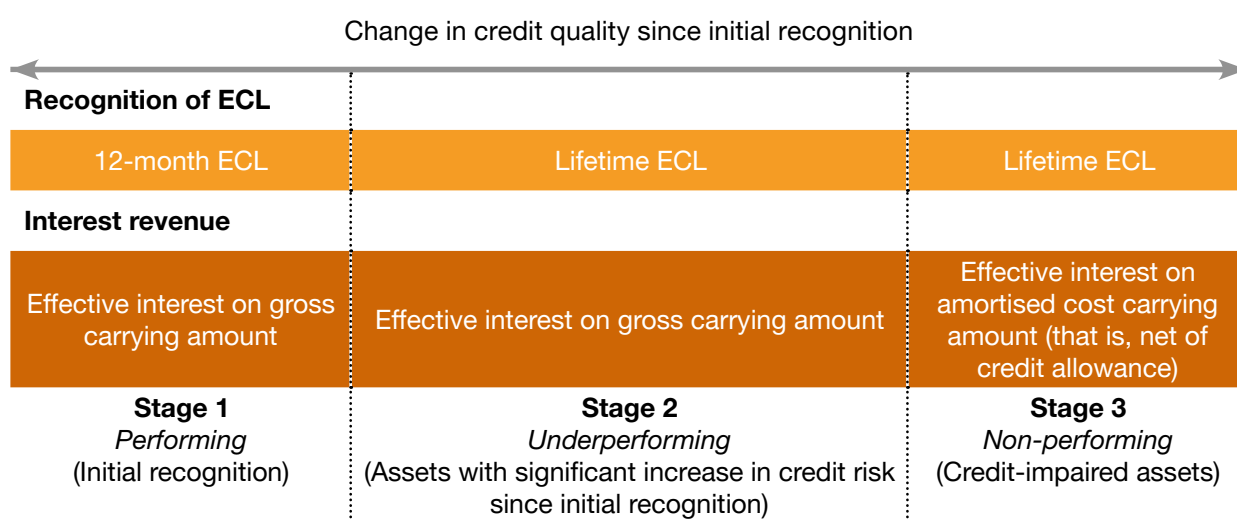
Classification and measurement – Business model assessment *(cont'd)*

What does this mean for the real estate industry?

Trade receivables	<ul style="list-style-type: none"> Trade and lease receivables in a real estate entity will in principle meet the hold to collect criterion. The payments would normally comprise solely of principal and interest. As such, they would be measured at amortised cost.
Equity investments	<ul style="list-style-type: none"> Equity instruments are measured at fair value under all circumstances. An entity can make an irrevocable election to measure equity investments at fair value through OCI. There are additional disclosure requirements if this election is used. No ECL is recognised for equity investments.
Investments in bonds	<ul style="list-style-type: none"> For long-term investments, such as bonds, the entity will need to assess the business model. They might be classified at amortised cost, fair value through other comprehensive income or fair value through the profit or loss.
Derivatives	<ul style="list-style-type: none"> Derivatives remain classified at fair value through profit or loss.

Impairment of assets measured at amortised cost

The impairment rules of PSAK 71 introduce a new, forward-looking, ECL impairment model, which will generally result in earlier recognition of losses compared to PSAK 55.



- **Stage 1** includes financial instruments that have not had a significant increase in credit risk since initial recognition or that have low credit risk at the reporting date. For these assets, 12-month ECL is recognised and interest revenue is calculated on the gross carrying amount of the asset.
- **Stage 2** includes financial instruments that have had a significant increase in credit risk since initial recognition (unless they have low credit risk at the reporting date) but are not credit-impaired. For these assets, lifetime ECL is recognised, and interest revenue is still calculated on the gross carrying amount of the asset.
- **Stage 3** consists of financial assets that are credit-impaired (that is, where one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred). For these assets, lifetime ECL is also recognised, but interest revenue is calculated on the net carrying amount (that is, net of the ECL allowance).

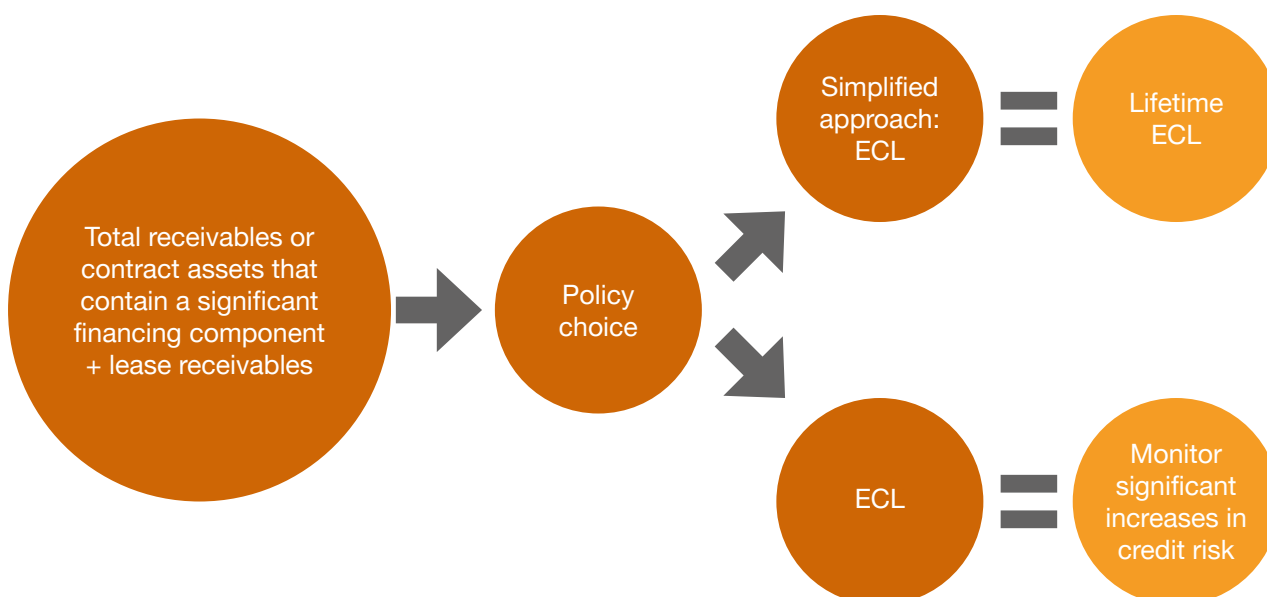
Impairment – Scope exception for trade receivables: The simplified approach

The general impairment model includes some operational simplifications for trade receivables, contract assets and lease receivables, because they are often held by entities that do not have sophisticated credit risk management systems.

These simplifications eliminate the need to calculate 12-month ECL and to assess when a significant increase in credit risk has occurred.

For trade receivables or contract assets that do not contain a significant financing component, the loss allowance should be measured at initial recognition and throughout the life of the receivable, at an amount equal to lifetime ECL. As a practical expedient, a provision matrix could be used to estimate ECL for these financial instruments.

For trade receivables or contract assets that contain a significant financing component (in accordance with PSAK 72) and lease receivables, an entity has an accounting policy choice: either it can apply the simplified approach (that is, to measure the loss allowance at an amount equal to lifetime ECL at initial recognition and throughout its life), or it can apply the general model. An entity can apply the policy election for trade receivables, contract assets and lease receivables independently of each other, but it must apply the policy choice consistently.



Impairment – Scope exception for trade receivables: The simplified approach *(cont'd)*

What does this mean for the real estate industry?

<p>Short-term trade receivables</p>	<ul style="list-style-type: none"> • A trade receivable with a maturity of less than one year will most likely qualify for the simplified model, since it will generally not contain a significant financing component. Under the simplified approach, the entity will recognise lifetime ECL throughout the life of the receivable. Materially higher provisions might not arise for short term trade receivables with customers with a good collection history.
<p>Long-term trade receivables and</p>	<ul style="list-style-type: none"> • For trade receivables that contain a significant financing component, for example long-term receivables, the entity will have an accounting policy option. • Intercompany loans would normally not qualify for the scope exclusion and the full three-stage model would need to be applied.
<p>Financial investments in bonds</p>	<ul style="list-style-type: none"> • For long term investments, such as bonds, the entity will need to apply the full three-stage model.

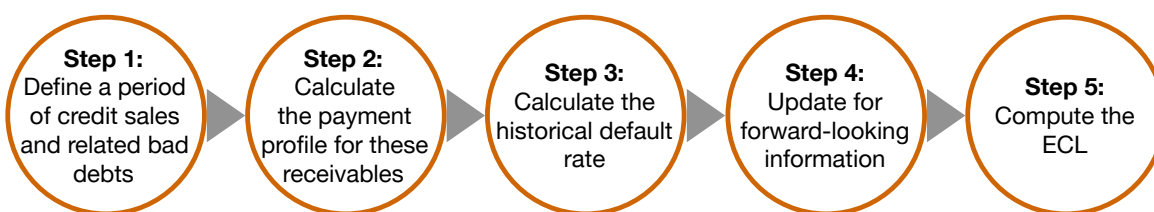


Provision matrix

PSAK 71 allows an operational simplification whereby companies can use a provisions matrix to determine their ECL under the impairment model.

How does a provision matrix work?

A provision matrix method uses past and forward information to estimate the probability of default of trade receivables.



Step 1

The first step, when using a provision matrix, is to define an appropriate period of time to analyse the proportion of lease and trade receivables written off as bad debts. This period should be sufficient to provide useful information. Too short might result in information that is not meaningful. Too long might mean that changes in market conditions or the tenant base make the analysis no longer valid. In the example, we have selected one year and have focused on lease receivables. The overall lease receivables were CU10,000 and the receivables ultimately written off were CU300 in that period.

Total lease income	CU10,000
Bad debts written off out of these sales	CU300

Step 2

In step 2, we determine the amount of receivables outstanding at the end of each time bucket, up until the point at which the bad debt is written off. The ageing profile calculated in this step is critical for the next step, when calculating default rate percentages.

Total lease income (CU)	10,000	Total paid	Ageing profile of lease income (step 3)
Paid in 30 days	(2,000)	(2,000)	8,000
Paid between 30 and 60 days	(3,500)	(5,500)	4,500
Paid between 60 and 90 days	(3,000)	(8,500)	1,500
Paid after 90 days	(1,200)	(9,700)	300 (written off)

Provision matrix (cont'd)

Step 3

In this step, the entity calculates the historical default rate percentage. The default rate for each bucket is the quotient of the default receivables in each bucket over the outstanding lease income for that period.

For example, in the above information, CU300 out of the CU10,000 lease income for the period were written off.

Current lease income – historical rate of default

Since all of the receivables relating to the lease income for the period and those written off were current at some stage, it can be derived that for all current amounts, the entity might incur an eventual loss of CU300. The default rate would therefore be 3% (CU300/CU10,000) for all current amounts.

Lease income outstanding after 30 days

An amount of CU8,000 was not paid within 30 days. An eventual loss of CU300 was a result of these outstanding receivables. Therefore, the default rate for amounts outstanding after 30 days would be 3.75%.

Remaining buckets

The same calculation is then performed for 60 days and after 90 days. Although the amount outstanding reduces for each subsequent period, the eventual loss of CU300 was, at some stage, part of the population within each of the time buckets, and so it is applied consistently in the calculation of each of the time bucket default rates.

The historical default rates are determined as follows:

	Current lease income	Lease payments outstanding after 30 days	Lease payments outstanding after 60 days	Lease payments outstanding after 90 days
Ageing profile of lease income (1)	10,000	8,000	4,500	1,500
Loss: (2)	300	300	300	300
Default rate: (2)/(1) (%)	3	3.75	6.67	20

Provision matrix (cont'd)

Step 4

PSAK 71 is an ECL model, so consideration should also be given to forward-looking information.

Such forward-looking information would include:

- Changes in economic, regulatory, technological and environmental factors, (such as industry outlook, GDP, employments and politics);
- External market indicators;
- Tenant base.

For example, the entity concludes that the defaulted receivables should be adjusted by CU100 to CU400 as a result of increased retail entity failures given their tenant base is primarily retail focused. The entity also concludes that the payment profile and amount of lease income are the same. Each entity should make its own assumption of forward-looking information. The provision matrix should be updated accordingly.

The default rates are then recalculated for the various time buckets, based on the expected future losses.

	Current lease income	Lease payments outstanding after 30 days	Lease payments outstanding after 60 days	Lease payments outstanding after 90 days
Ageing profile of lease income (1)	10,000	8,000	4,500	1,500
Loss: (2)	400	400	400	400
Default rate: (2)/(1) (%)	4	5	8.9	27

Step 5

Finally, take the default rates from step 4 and apply them to the actual receivables, at the period end, for each of the time buckets. There is a credit loss of CU12 in the example illustrated.

	Total	Current (0-30 days)	30-60 days	60-90 days	After 90 days
Lease receivable balances at year end: (1)	140	50	40	30	20
Default rate: (2) (%)		4	5	8.9	27
Expected credit loss: (1)*(2)	CU 12	CU 2	CU 2	CU 3	CU 5

Intra-group loans

The scope for the accounting of intra-group loans and loans to joint ventures and associates (“funding”) is not expected to change from the introduction of PSAK 71. Funding, previously within the scope of PSAK 55, ‘Financial instruments: Recognition and measurement’ will also be within the scope of PSAK 71.

The impact of PSAK 71 on intra-group funding might often be dismissed, because it is eliminated on consolidation. However, the impact on separate financial statements could be significant.

Impairment of intra-group loans

Intra-group loans and loans to joint ventures and associates do not qualify for the simplifications in PSAK 71. The full impairment model needs to be applied, so 12-month ECL will be recorded on the day when funding is advanced.

Subsequently, if there is a significant increase in credit risk (for example, if the subsidiary’s, joint venture’s or associate’s trading performance declines), the impairment loss will be increased to a lifetime ECL.

What does this mean for Real Estate?

Intra-group funding and loans to joint ventures and associates with written terms would generally fall within the scope of PSAK 71. All requirements of PSAK 71 will therefore apply, including impairment.

Under PSAK 71, entities will be required to ensure that they implement adequate processes for collection of the information needed for impairment, for example:

- Indicators for a significant increase in credit risk must be developed.
- Forward-looking information, as well as past events, must be incorporated.
- The contractual period over which to assess impairment may not be clear.

Cash advanced might not be fair value

Intra-group loans within the scope of PSAK 71 and loans to joint ventures and associates are required to be measured at fair value on initial recognition. These loans may sometimes be either interest-free or provided at below-market interest rates. In those cases, the amount lent is, therefore, not fair value.

What does this mean for Real Estate?

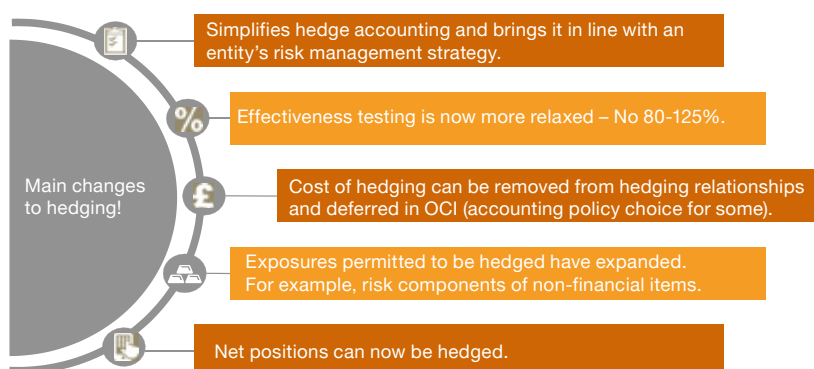
Loans at below market or nil interest rate are not advanced at fair value. Practically, this means that the cash advanced will not be the receivable recorded. Instead, the receivable will be recorded at a lower amount, to take into account the impact of discounting at a market interest rate.

A day 1 difference arises between the cash advanced and the recorded receivable. If the loan is advanced from a parent entity to its subsidiary, this difference is added to the cost of investment in the subsidiary because it is the nature of the relationship that gives rise to the off-market/interest-free loan. For loans to joint ventures and associates, this difference would also generally be added to the cost of investment as the relationship between the investor and the joint venture or associate is often the reason for the loan being off-market/interest-free.



Hedging

Hedging is a risk management activity. More specifically, it is the process of using a financial instrument (usually a derivative) to mitigate all or some of the risk of a hedged item. Hedge accounting changes the timing of recognition of gains and losses on either the hedged item or the hedging instrument so that both are recognised in profit or loss in the same accounting period in order to record the economic substance of the combination of the hedged item and hedging instrument.



For a transaction to qualify for hedge accounting, PSAK 71 includes the following requirements:

- An entity should formally designate and document the hedging relationship at the inception of the hedge. PSAK 71 requires additional documentation to show sources of ineffectiveness and how the hedge ratio is determined.
- There must be an economic relationship between the hedging instrument and the hedged item.
- Credit risk should not dominate value changes.
- The hedge ratio should be aligned with the economic hedging strategy (risk management strategy) of the entity.

What does this mean for Real Estate?

Real Estate entities mostly hedge interest rate risks and, where relevant, foreign exchange currency risks, by entering into interest rate and foreign currency swaps, forwards and options.

Entities will need to update their hedging documentation and ensure that a qualitative assessment of effectiveness for each hedging relationship is performed.

There is no longer an 80-125% effectiveness bright line effectiveness test. As such, a retrospective effectiveness test is no longer required to prove that the effectiveness was between 80 and 125%. However, all ineffectiveness should still be recorded in the income statement.

PSAK 71 gives companies a free choice over whether to adopt its new hedge accounting requirements when the remainder of PSAK 71 becomes mandatory in 2020. A company must either move all of its hedge accounting to PSAK 71, or it must continue to apply PSAK 55 to all of its hedges.

However, all entities have to apply PSAK 71's new disclosure requirements – including the new disclosures around hedge accounting.

Financial liabilities

Debt modifications

Real estate entities might restructure borrowings with banks to adjust interest rates and maturity profiles and hence modify their debt.

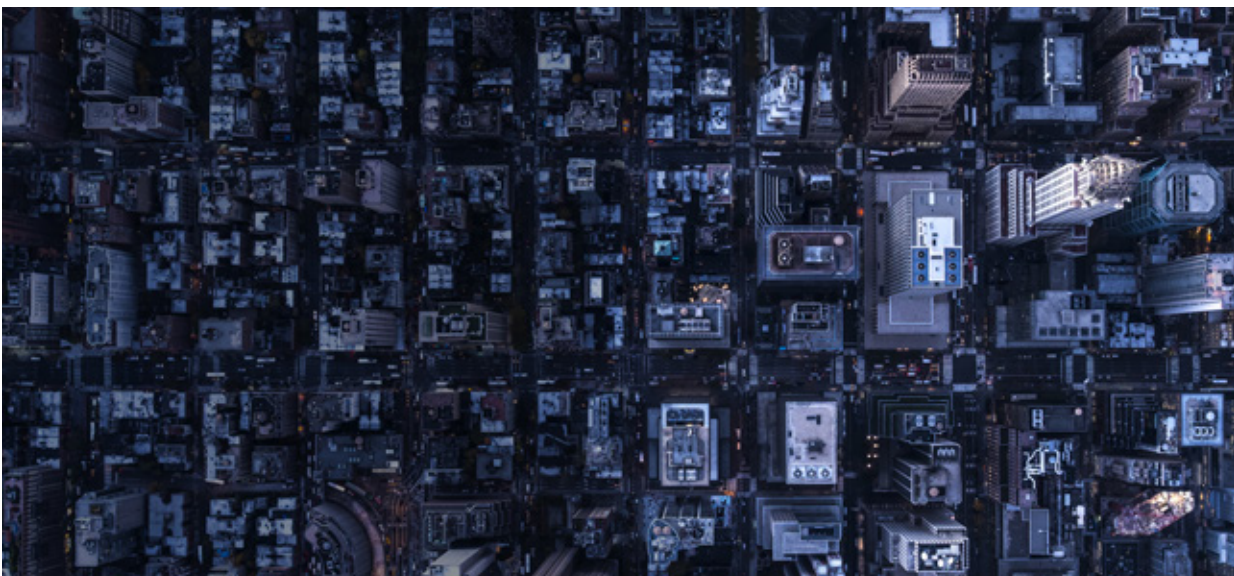
When a financial liability measured at amortised cost is modified without this resulting in derecognition, a difference arises between the original contractual cash flows and the modified cash flows discounted at the original effective interest rate (the gain/loss).

Entities were permitted, although not required, to recognise the gain/loss in the income statement at the date of modification of a financial liability under PSAK 55. Many entities deferred the gain/loss under PSAK 55 over the remaining term of the modified liability by recalculating the effective interest rate.

This will change on transition to PSAK 71 because the accounting will change. When a PSAK 71 financial liability, measured at amortised cost, is modified without this resulting in derecognition, the gain/loss should be recognised in profit or loss. Entities are no longer able to defer the gain/loss.

The changes in accounting for modifications of financial liabilities will impact all preparers, particularly entities which were applying different policies for recognising gains and losses under PSAK 55.

Whilst entities were not required to change their PSAK 55 accounting policy, the impact on transition to PSAK 71 should be considered. PSAK 71 is required to be applied retrospectively, so modification gains and losses arising from financial liabilities that are still recognised at the date of initial application (for example, 1 January 2020 for calendar year end companies) would need to be recalculated and adjusted through opening retained earnings on transition. This will affect the effective interest rate and, therefore, the finance cost for the remaining life of the liability.





PSAK 72

Revenue from contracts with customers

In 2017, DSAK-IAI issued their long-awaited converged standard on revenue recognition. Almost all entities will be affected to some extent by the change. The effect on entities will vary depending on industry and current accounting practices. However, almost all entities will see a significant increase in required disclosures.

PSAK 72 - Revenue from contracts with customers

Implementation in the real estate sector

Overview

PSAK 72, *Revenue from contracts with customers* (“the new standard”) will replace existing revenue recognition guidance starting from 1 January 2020. PSAK 44, *Real estate developments*, PSAK 34, *Construction contracts*, and PSAK 23, *Revenue* have been withdrawn and replaced by a single new model based on the principle that revenue is recognised when control is transferred to the customer.

The withdrawal of PSAK 44 is likely to be of particular relevance to real estate developers who relied on this standard for provisions with regard to revenue recognition for different types of real estate development projects, cost components, allowance allocation and disclosures. PSAK 44 specifically regulated recognition of revenue from the sale of houses and other similar buildings (including the land) and the sale of apartments, office buildings and other similar types of properties.

The transition to a new model also means that other revenue related ISAKs will be withdrawn, including ISAK 10, *Customers loyalty programmes* and ISAK 27 *Transfers of Assets from Customers*.

This publication provides a high-level analysis of key questions and issues facing the industry for both real estate managers and developers in each of the sections below. In Indonesia, these issues will continue to evolve as entities address the challenges of implementation, and the examples and related discussions herein are intended to highlight areas of focus to assist entities in evaluating the implications of PSAK 72.



Scope

The new standard applies to all contracts with customers, excluding leases, insurance contracts, financial instruments (including financial guarantee contracts) and contractual arrangements in the scope of other guidance. A contract is defined as an agreement between two or more parties that creates enforceable rights and obligations. A contract does not exist if both parties have the unilateral right to terminate a wholly unperformed contract without penalty.

Lease contracts are outside the scope of PSAK 72, and are instead accounted for under the current PSAK 30, 'Leases', or successively under the new leasing guidance (PSAK 73) effective from 1 January 2020. An arrangement between a lessor and a lessee under which property is leased, and additional services are provided by the lessor is bifurcated into two elements, so that PSAK 30/73 is applied to the lease income, and PSAK 72 is applied to the service revenue earned. The hierarchy applied is that PSAK 73 is applied first, and the residual is allocated to PSAK 72.

PSAK 72 applies only to contracts with customers. In simple terms, a customer is the party that purchases an entity's goods or services. Identifying the customer is straightforward in many instances, but a careful analysis needs to be performed in other situations to confirm whether a customer relationship exists. Entities that enter into arrangements where the parties jointly participate in an activity to share the risks and benefits (a collaborative arrangement) will need to evaluate if the arrangement is a contract with a customer in the scope of PSAK 72. For example, a contract with a counterparty to develop an asset where both parties share in the risks and benefits might not be in the scope of the revenue guidance because the counterparty is unlikely to meet the definition of a customer. An arrangement where, in substance, the entity is selling a good or service is likely in the scope of the revenue standard, even if it is termed a 'collaboration' or something similar.

Where these transactions are considered to be outside of the scope of PSAK 72, the parties will need to assess the substance of the arrangement to determine the most appropriate manner of recording the transaction.

New standard	Current IFAS
<p><u>Contracts within the scope of PSAK 72</u></p> <p>PSAK 72 applies to all contracts with customers, excluding leases, insurance contracts, financial instruments (including financial guarantee contracts) and contractual arrangements in the scope of other guidance.</p> <p>Some contracts include components that are in the scope of PSAK 72 and other components that are in the scope of other standards. Only elements not covered by another standard fall within the scope of PSAK 72. An entity should first apply the separation or measurement guidance in other applicable standards (if any) and then apply the guidance in the new standard to the remaining consideration and performance obligations.</p>	<p>The existing revenue guidance also scopes out, amongst other matters, lease agreements and insurance contracts. There is no specific guidance on the separation of contracts but, in practice, separate components of a transaction are generally dealt with under the different standards where applicable.</p>

Scope (cont'd)

Potential impact:

Real estate management and real estate development:

The accounting for a contract that includes components that are in the scope of PSAK 72 and other components that are in the scope of the leasing standard does not differ from current guidance. The leasing guidance will continue to be used to separate leases from service contracts. For example, this means that a real estate manager would account for the lease element under PSAK 30/73 and the maintenance revenue under PSAK 72. PSAK 72, however, provides the relevant guidance on how the consideration is allocated between these components.

Another intersection between the leases and revenue standards occurs in considering the accounting for a sale and leaseback transaction. The accounting for sale and leaseback transactions under PSAK 30 mainly depends on whether the leaseback is classified as a finance or an operating lease. Under PSAK 73, the determining factor is whether the transfer of the asset qualifies as a sale in accordance with PSAK 72. An entity shall apply the requirements for determining when a performance obligation is satisfied in PSAK 72 to make this assessment.

From a real estate development perspective, the new scope requirements are not expected to have a significant impact as many contracts will only consist of elements that continue to be accounted for in accordance with the revenue guidance.



Identify the contract(s) with the customer

The new standard requires an entity to identify the contract with the customer. A contract can be written, verbal or implicit. An entity will identify the customer and assess at the inception of the contract whether the parties to the contract are committed to perform their respective obligations and it is probable that the entity will collect the consideration. The collectability assessment is based on the customer's ability and intent to pay as amounts become due. This assessment determines whether a contract exists for the purpose of applying the new standard. In addition, the new standard includes specific guidance on contract combination.

If the criteria for the existence of a contract are not met at inception, consideration received from a customer is recognised as a liability where a contract with a customer does not meet the criteria and an entity receives consideration from the customer. The entity recognises the consideration received as revenue only when the entity has no remaining obligations to transfer goods or services to the customer, and all (or substantially all) of the consideration promised by the customer has been received by the entity and is non-refundable, or the contract has been terminated, and the consideration received from the customer is non-refundable. The entity shall continue to assess the contract to determine whether the criteria are subsequently met. If the criteria are met and goods or services have been transferred to the customer, a cumulative catch adjustment is made to recognise the applicable revenue.

Contract modifications are common in the real estate development industry. Contract modifications might need to be accounted for as a new contract, or combined and accounted for together with an existing contract.

Accounting for contract modifications under the new standard

Modification	Required accounting treatment
The modification adds additional distinct performance obligations priced at their stand-alone selling price.	The modification is treated like a new contract (Prospective).
At the modification date, remaining performance obligations are distinct from those already transferred, but not priced at a stand-alone selling price.	The old contract is treated as cancelled. The remaining and new performance obligations are treated as a new contract and are accounted for prospectively.
At the modification date, remaining performance obligations are NOT distinct from those already transferred.	The revenue is adjusted on a cumulative catch-up basis, on the date of the modification.

New standard	Current IFAS
<p>Contract combination:</p> <p>Contracts entered into at or near the same time, with the same customer (or a related party of the customer) shall be combined if (i) they are negotiated as a package, (ii) the amount of consideration to be paid in one contract depends on the price or performance of the contract, or (iii) the services in the contracts represent a single performance obligation.</p>	<p>There is limited guidance under both PSAK 44 and PSAK 23 for when contracts should be combined and separated. The assessment is based on the substance of the transactions. However, PSAK 34, <i>Construction contracts</i>, contains detailed guidance on when to segment and when to combine construction contracts based on the nature of the agreement with the customer and how the arrangement was negotiated.</p>

Identify the contract(s) with the customer *(cont'd)*

New standard	Current IFAS
<p><u>Contract modifications (for example, change orders, variations or amendments)</u></p> <p>An entity will account for a modification if the parties to a contract approve a change in the scope and/or price of a contract. If the parties have approved a change in the scope, but have not yet determined the corresponding change in price (for example, where change has been agreed upon but the parties have not yet agreed on the pricing (unpriced change orders)), the entity should estimate the change to the contract price using the principles applied to variable considerations.</p> <p>A contract modification is accounted for as a separate contract if:</p> <ul style="list-style-type: none"> • the modification promises distinct goods or services that result in a separate performance obligation; and • the new items are priced at their stand-alone selling prices. <p>An example of this might be that a construction company is contracted to construct a building. This contract is then amended by requiring the construction company to build additional structures. The additional structures are priced at their stand-alone selling price.</p> <p>A modification that is not a separate contract is accounted for either as:</p> <ul style="list-style-type: none"> • A prospective adjustment if the goods or services in the modification are distinct from those transferred before the modification. The remaining consideration in the original contract is combined with the consideration promised in the modification to create a new transaction price that is then allocated to all remaining performance obligations. • A cumulative adjustment to contract revenue if the remaining goods and services are not distinct and are part of a single performance obligation that is partially satisfied. 	<p>Current PSAK contains selected guidance on the accounting for contract modifications.</p> <p>PSAK 34 requires that a modification for construction contracts in the form of a change order or variation is generally included in contract revenue when it is probable that the change order will be approved by the customer and the amount of revenue can be reliably measured.</p>

Identify the contract(s) with the customer *(cont'd)*

Example 1 – Unpriced change orders

Facts: A developer has a single performance obligation to build an office building. The developer has a history of executing unpriced change orders; that is, those change orders where price is not defined until after scope changes are agreed upon. Scope changes usually do not provide additional distinct goods or services to the customer. In this example the change order does not provide distinct goods or services because the promises are highly interrelated with the goods or services in the original contract, and are part of the contractor's service of integrating those goods and services into a combined item for the customer. Prices are negotiated in the context of the customer's overall objective to obtain a building. It is not uncommon for the developer to commence work once the parties agree to the scope of the change, but before the parties agree on the price.

Question: When would these unpriced change orders be included in contract revenue?

Discussion: The developer should account for the unpriced change order as a variable consideration (see page 21) after the scope changes are approved. The consideration is considered to be variable since, even though the scope change has been approved, the price is as yet undetermined. Since the consideration is variable, the developer will need to consider the criteria relating to recognition of variable consideration. The developer will therefore consider the amount for which it is highly probable that there will be no significant subsequent reversal in the cumulative amount of revenue recognised.

The developer will also need to determine whether the unpriced change order results in additional goods and services that should be accounted for as a separate contract. The developer in this case will update the transaction price and measure of progress toward completion of the contract (that is, a cumulative catch-up adjustment) because the remaining goods or services, including the change order, are not distinct and are part of a single performance obligation that is partially satisfied.

Identify the contract(s) with the customer *(cont'd)*

Potential impact:

Real estate developers:

The new standard provides more guidance in an area where practice might previously have been mixed. Management will need to apply judgement when evaluating whether goods or services in a modification are distinct, and whether the price change reflects the stand-alone selling price to determine the accounting. This might be more challenging in situations where there are multiple performance obligations in a contract, or when modifications occur frequently.

Real estate managers:

Real estate managers may structure their arrangements such that services and fees are in different contracts. These contracts may meet the requirements to be accounted for as a combined contract when applying the new standard. Combining contracts does not necessitate that there is a single performance obligation (see page 26); however, if there is more than one performance obligation, the entity would need to look at the pricing of both contracts in total and allocate the consideration between the multiple performance obligations.



Identification of performance obligations

A key question that affects the timing of revenue recognition is whether the seller has promised one or multiple performance obligations to the customer. A performance obligation is a promise to transfer a distinct good or service (or a series of distinct goods or services that are substantially the same and have the same pattern of transfer) to a customer.

PSAK 23 and PSAK 44 required an entity to apply the revenue recognition criteria to each separately identifiable component of a single transaction, but contained little guidance about how to determine the components. PSAK 72 provides more guidance in the identification of performance obligations, and requires entities to identify all of the promises in a contract and to determine whether those obligations are distinct. Performance obligations that are considered to be distinct are accounted for separately.

New standard	Current IFAS
<p>A performance obligation is a promise in a contract to transfer to a customer either:</p> <ul style="list-style-type: none"> • A good or service (or a bundle of goods or services) that is distinct; or • A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer. <p>A good or service is distinct if both of the following criteria are met:</p> <ul style="list-style-type: none"> • The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (for example, because the entity regularly sells the good or service separately). • The good or service is separately identifiable from other goods or services in the contract. <p>Factors that indicate that a good or service in a contract is not separately identifiable include, but are not limited to:</p> <ul style="list-style-type: none"> • The entity provides a significant service of integrating the goods or services promised in the contract into a combined output(s) for which the customer has contracted. • The good or service significantly modifies or customises another good or service promised in the contract. • The good or service is highly interdependent on, or highly interrelated with, other promised goods or services. <p>Goods and services that are not distinct should be combined with other goods or services until the entity identifies a bundle of goods or services that is distinct.</p>	<p>PSAK 23 contains little specific guidance on separating and combining contractual elements. The revenue recognition criteria are applied separately to each transaction. It might be necessary to separate a transaction into identifiable components to reflect the substance of the transaction in certain circumstances.</p> <p>Common practice has been to separate when appropriate when identifiable components have stand-alone value and their fair value can be measured reliably.</p> <p>Two or more transactions under PSAK 23 might need to be grouped together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.</p> <p>Specific to the real estate industry, PSAK 44 has restrictive allocation of revenue elements for certain types of real estate activities. These provisions apply, for example, in the circumstances where the seller of real estate is rendering subsequent management services to customers for a compensation paid at below market rates or where the sales contract includes an additional obligation for the seller to build amenities on the property sold.</p>

Identification of performance obligations *(cont'd)*

Potential impact:

Real estate management:

The management entity is often entitled to several different fees. The new standard will require a manager to consider whether the services should be viewed as a single performance obligation, or whether some of these services are 'distinct' and should therefore be treated as separate performance obligations. Multiple fees do not always correlate to multiple distinct promises in the contract.

An example of this is that real estate managers sometimes receive upfront fees as well as fees over the course of their contract. In these instances, the entity will need to consider what the distinct performance obligations are, and whether a distinct performance obligation is satisfied upfront. This is likely to be an area of judgement.

The new standard requires an entity to assess the services promised in a contract with a customer and identify those services that are distinct as performance obligations. A service is distinct if it meets the criteria discussed above. If a service is not distinct, the entity must combine the services until such a point that a bundle of services is viewed as distinct. In some cases, this will result in all services being combined into a single performance obligation. The customer's perspective should be considered when assessing whether a promise gives rise to a performance obligation.

In this instance the entity must consider if the upfront fee that the manager received as a construction fee and transaction bonus includes a management fee that may need to be considered to be a separate performance obligation. The second assessment that the real estate manager needs to make is whether to recognise the revenue immediately (at a point in time) or over time, for each of the identified performance obligations, as discussed below.

Real estate construction:

Construction companies often account for each contract at the contract level under PSAK 34, PSAK 23 or PSAK 44. That is, contractors account for the 'macro-promise' in the contract (for example, to build a house for a new homeowner). Current guidance permits this approach, although a contractor effectively promises to provide a number of different goods or services in delivering such macro-promises. Determining when to separately account for these performance obligations under the new standard will require judgement. It is possible to account for a contract at the contract level (for example, the macro-promise to build a house) under the new standard when the criteria for combining a bundle of goods or services into one performance obligation are met. However, in some cases, there might be additional distinct performance obligations that need to be identified (for example, constructing a golf course to benefit the sale of houses in the area). Revenue would then be allocated to that distinct performance obligation and recognised only when that obligation is satisfied. Judgement will be needed in many situations to determine if all of the promises in the contract should be bundled together, particularly when assessing contracts such as engineering, procurement, and construction (EPC) or design/build contracts.

Construction companies will often build amenities (for example, a communal gym in a housing development) that will eventually be legally owned by a separate organisation representing the

Identification of performance obligations *(cont'd)*

homeowners (for example, a homeowners' association). The amenities are promised implicitly or explicitly to the homeowners. In such cases, the homeowners are considered to be the customers for the amenities. This is because the amenities are a promise to the homeowners in the context of the contract. The entity needs to assess whether the amenities represent a separate performance obligation. The pattern of revenue recognition will depend on the identification of the performance obligations, (that is, whether the amenities were distinct from the residential units) and whether the criteria were met for performance obligations satisfied over time.

Some developers consider the sale of the land, infrastructure and completed buildings to be separate components, and accordingly recognise revenue when each of these 'components' has been delivered. This may not necessarily be the case under PSAK 72. Judgement will be needed in many situations to identify distinct performance obligations.

Example 2 – Sale of serviced land

Facts: A developer is developing homogeneous units and sells either individual homes constructed on a plot of land, or just the undeveloped plots, to separate customers. The homes/plots are sold with a promise to complete certain amenities (for example, a school, roads, connection to utilities, or a club house). Sometimes the developer will offer a choice as to whether the customer wants just the plot of land with the promised services (so the customer can use a separate builder to construct the house) or a house on the plot.

Discussion: Each of the promises in these arrangements (land, amenities and house) is likely to meet the requirement that a customer can benefit from them on their own or in conjunction with other goods or services available in the market. The question is whether they are separately identifiable promises. Whether a bundle of land and services (no house) is one performance obligation may even depend on the location of the land. If the land could not be sold without the promise of services because the location is so remote, there might be one performance obligation. However, a different conclusion could be reached if the land is in a more developed area and the purchaser of a plot could separately arrange for the necessary amenities (e.g. roads, utilities, etc.). It might be more likely that there is only one performance obligation where the developer only sells fully developed plots with a house. This is because the customer is simply contracting for a completed house in a certain setting. Judgement is likely to be required to determine when goods and services are distinct in the context of a contract.

Determine the transaction price

The transaction price (or contract revenue) is the consideration the seller expects to be entitled to in exchange for satisfying its performance obligations.

Management must determine the amount of the transaction price at contract inception and reassess at each reporting date. This assessment may be complex where a contract includes variable consideration, a significant financing component (time value of money), non-cash consideration or consideration payable to the customer.

Variable consideration for entities in the real estate industry may come in the form of claims, awards and incentive payments, discounts, rebates, refunds, credits, price concessions, performance bonuses, penalties or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event.

Non-cash consideration is rare in practice but, as in PSAK 23, the new standard requires that it be recorded at fair value. The new standard also requires that consideration payable to customers is deducted from revenue unless the seller receives distinct goods or services from its customer.

More significant changes arise in connection with variable considerations and time value of money.

New standard	Current IFAS
<p><u>Variable considerations:</u></p> <p>Variable considerations (for example, claims) should be estimated and included in the transaction price to the extent that it is highly probable that there will be no significant subsequent reversal in the cumulative amount of revenue recognised. This requires judgement.</p> <p>Variable consideration should be estimated using the expected value approach (probability weighted average) or the most likely amount, whichever is more predictive in the circumstances. The approach used is not a policy choice, but management should use the approach that it expects will best predict the amount of consideration to which the entity will be entitled based on the terms of the contract and taking into account all reasonably available information.</p> <p>The following indicators suggest that including an estimate of variable consideration in the transaction price could result in a significant reversal of cumulative revenue (and therefore, that no revenue should be recognised):</p> <ul style="list-style-type: none"> • The amount of consideration is highly susceptible to factors outside the entity's influence. • Resolution of the uncertainty about the amount of consideration is not expected for a long period of time. • The entity has limited experience with similar types of contracts. 	<p>Revenue is measured at the fair value of the consideration received or receivable. Fair value is the amount for which an asset or liability could have been exchanged or settled between knowledgeable, willing parties in an arm's length transaction.</p> <p>Trade discounts, volume rebates, time value of money and other incentives (such as cash settlement discounts) are taken into account in measuring the fair value of the consideration to be received.</p> <p>PSAK 23 is not explicit as to whether all elements of consideration must meet the revenue recognition criteria simultaneously in order for any portion of the revenue to be recognised. As a result, we believe that a policy choice can be made; both the contingent and non-contingent elements of consideration are considered separately when determining when revenue is recognised or the contract is assessed as a whole. Whichever policy choice is taken, the policy should be applied consistently and, where material, be disclosed as a key accounting policy.</p>

Determine the transaction price *(cont'd)*

New standard	Current IFAS
<ul style="list-style-type: none"> The entity has a practice of offering a broad range of price concessions or changing payment terms and conditions in similar circumstances for similar contracts. There is a large number and broad range of possible outcomes. <p>Management will need to determine if there is a portion of the variable consideration (that is, some minimum amount) that should be included in the transaction price, even if the entire estimate of variable consideration is not included because it does not pass the highly probable threshold. Management's estimate of the transaction price will be reassessed each reporting period, including any estimated minimum amount of variable consideration.</p>	<p>The guidance in PSAK 34 on contingent consideration is centred upon whether the consideration is reliably measurable. The standard indicates that an entity is generally able to make reliable estimates once the contract terms have been defined and the entity has an effective system of internal control. Construction contracts with variable consideration are generally accounted for based on amount of consideration expected to be received.</p> <p>PSAK 44 requires considering the expected price reductions when determining the total contract transaction price. Under the full accrual method, construction companies are required to estimate any future price incentives offered to the customer, for example, a discount for early payment. This concept is generally similar to variable consideration in the new revenue standard, however, PSAK 44 does not specifically include the 'highly probable' threshold. Other guidance on contingent consideration in PSAK 44 is generally comparable with PSAK 34, focusing on whether the consideration is reliably measured.</p>

Determine the transaction price *(cont'd)*

New standard	Current IFAS
<p>Time value of money:</p> <p>Should the contract contain a significant financing component, the transaction price should reflect the time value of money.</p> <p>An entity is not required to consider the time value of money if the period between payment and the transfer of the promised goods or services is one year or less, as a practical expedient.</p> <p>In assessing whether a contract contains a significant financing component, an entity should consider various factors, including:</p> <ul style="list-style-type: none"> • the length of time between when the entity transfers the goods or services to the customer and when the customer pays for them • whether the amount of consideration would substantially differ if the customer paid cash when the goods or services were transferred; and the interest rate in the contract and prevailing interest rates in the relevant market. 	<p>Revenue is discounted when the inflow of cash or cash equivalents is deferred. Interest is calculated and recognised using the effective interest method as set out in PSAK 55. In practice, entities do not generally impute interest when cash is received in advance of performance.</p> <p>For construction contracts in the scope of PSAK 34, revenue should be recorded at fair value, which should take into account the effect of discounting, should it be material. The same approach is followed under PSAK 44.</p>

Potential impact:

Real estate management:

Under current guidance, performance fees that are tied to returns subject to performance targets may be recognised using one of two methods. Under the first approach, the manager recognises revenue based on the performance up to the measurement date, including an estimate of performance fees ultimately to be received. In this case, the manager's estimates are reassessed at each measurement date. Under the second approach, non-contingent and contingent fees are analysed separately. Performance fees, being contingent amounts of revenue, are recognised as the services are performed but only when the fee becomes reliably measurable, which is often at the end of the performance period, once the outcome is known.

An example of this is entities that manage real estate investment funds with a finite life (for example, ten years) may receive performance fees that are subject to claw-back on a cumulative basis, based on the performance of the fund over its life. Distributions to the manager may have to be returned if the fund underperforms in the future.

Application of the new guidance may result in significant changes for entities that record revenue under the first approach, given that the new standard requires a higher degree of certainty regarding

Determine the transaction price *(cont'd)*

the amount of the performance fee before revenue is recognised. On the other hand, those applying the second approach will need to consider whether a minimum amount of consideration should be recognised at an earlier point in time.

Managers of funds with a finite life will need to evaluate when performance fees (or a portion thereof) are no longer constrained by the variable consideration guidance and can be included in the transaction price. This may be at the end of the life of the fund, but it is possible that this may occur before the end of the fund's life. An example of this may be that if a fund were to assess performance fees in relation to a high watermark, there may be a point in time in the later years of a fund's life cycle where the fee is no longer constrained, given the fund's cumulative performance in relation to remaining assets. This might be the point at which a fund that holds a limited number of remaining investments could sustain total losses on those investments and still exceed the high watermark. Therefore, a portion of the performance fee may no longer be constrained and should be recognised as revenue.

Real estate developers:

Real estate developers may enter into contracts where the consideration varies as a result of, for example, contingent consideration, discounts, price concessions, incentives, performance bonuses or other similar items. The new standard requires the developer to estimate the amount of consideration it expects to be entitled to, taking into account the terms which may give rise to variability. This is estimated at contract inception and reassessed over the life of the contract.

Developers who defer recognising consideration under current guidance until such time as the variability is resolved (for example, uncertainty around contingent consideration clarified, or performance bonus determined) might be significantly affected by the new standard. Management will need to determine if there is a portion of the variable consideration (that is, some minimum amount) that should be included in the transaction price, even if a portion of estimate of variable consideration is not included because it does not pass the highly probable threshold.

Management will also need to evaluate arrangements with customers to determine whether they include a significant financing component. It could be challenging for property developers to determine whether a significant financing component exists, especially when goods or services are delivered and cash payments received throughout the arrangement. The standard allows for some level of judgement by requiring entities to assess whether the substance of the arrangement contains a financing component.

Determine the transaction price *(cont'd)*

Example 3 – Variable consideration: Performance fees

Facts: A real estate fund manager has a management contract with a fund to provide investment management services for three years. In addition to a base management fee, the manager is entitled to a performance fee that is equal to 20% of profits generated by the investments in the fund when it achieves a return of over 8% per annum. The management agreement states that the performance fee shall be calculated and paid on the last business day of the third calendar year.

Question 1: How should the manager account for the performance fee?

Discussion: The contractual measurement period is based on the terms of the contract, which in this case is three years. In determining whether to include an amount of variable consideration in the transaction price at the end of the financial period X1, the manager must assess whether it is highly probable that the amount included will not result in a significant reversal of revenue in future periods (the 'constraint'). In other words, it is not an 'all or nothing assessment', and entities must always record the highest amount that is highly probable not to result in a significant future revenue reversal. This determination will require judgement, and to the extent that the variable consideration constraint is not met until the end of the year when the performance fee is known, the entire performance fee will only be recognised on the last day of the third calendar year. Applying the guidance in the new standard will often result in delayed revenue recognition as compared to current practice under the first approach in the current PSAK discussed above.

Question 2: How would this assessment change if the performance fee were subject to a 50% claw-back should the overall average performance achieved for a five-year period (the three-year period covered by the contract, and the subsequent two-year period) not exceed 5%?

Discussion: The manager would need to factor into the determination of variable consideration the probability that the fund will outperform by 5% over the five-year period. This determination will require judgement, and to the extent that the variable consideration constraint is not met until the end of the fifth year, when the overall performance is known, the performance fee will only be recognised on the last day of the five-year period. To the extent that the revenue has not been recognised and cash has been received, the manager may need to recognise these amounts as an unearned revenue liability (that is, a contract liability).

Determine the transaction price *(cont'd)*

Example 4 – Time value of money

Facts: A contractor enters into a contract for the construction of a building on the customer's land. This construction of the building is a single distinct performance obligation. Control passes to the customer over the contract term. The contract terms indicate specific dates on which the customer is required to make certain payments. These payments do not necessarily coincide with the performance by the contractor. The following milestones are established:

<i>Month of payment</i>	<i>Amount paid</i>	<i>Month in which the associated construction is performed</i>
1	CU 10 million	0 – 6
5	CU 50 million	7 – 13
13	CU 20 million	14 – 18

The contract is set up as such so that the contractor has the necessary funds to cover the cost of construction.

Discussion: The contractor charges the customer in advance. Management will need to consider the time period between payment and the completion of the related performance where the contractor is performing over time rather than at a specific point in time to assess whether there is a significant financing component taking into account the 12-month practical expedient offered by the standard. For example, the contractor may receive payment in month five but would perform over the period between month seven to month 13, and thus there may not be a 12-month period between the date of payment and the associated performance. However, if there is a significant financing component, the contractor will need to assess whether a significant financing transaction exists. If a significant financing transaction does exist, the entity should calculate this finance component.

Recognise revenue when (or as) each performance obligation is satisfied

Cash receipts do not necessarily indicate that the entity is able to recognise revenue. Revenue is recognised under the new standard when a performance obligation is satisfied, which occurs when control of a good or service transfers to the customer. Control can transfer either entirely at a point in time or gradually over time, based on a range of criteria. An entity should determine at contract inception whether control of a good or service is transferred over time or at a point in time.

An entity might begin activities on an anticipated contract prior to the arrangement meeting the criteria of PSAK 72 to be recognised as a contract with a customer. Revenue should be recognised on a cumulative catch-up basis if subsequent reassessment indicates the criteria are met. This cumulative catch-up should reflect the performance obligation(s) that are partially satisfied, or satisfied on the contract reassessment date. An entity will need to determine the goods or services that the customer controls and, therefore, what portion of the costs are included in any measure of progress to determine the cumulative revenue recognised.

New standard	Current IFAS
<p>Recognise revenue over time or at a point in time:</p> <p>Real estate developers will need to consider whether they meet any of the three criteria necessary for recognition of revenue over time.</p> <p>A performance obligation is satisfied over time when at least one of the following criteria is met:</p> <ul style="list-style-type: none"> • The customer receives and consumes the benefits of the entity's performance as the entity performs. • The entity's performance creates or enhances a customer-controlled asset. • The asset being created has no alternative use to the entity, but the entity has a right to payment for performance completed to date. <p>Without discussing all the indicators above, a common judgement in the real estate industry is whether the entity has the right to payment for performance completed to date. This is discussed in the example below.</p> <p>A performance obligation is satisfied at a point in time if it does not meet the criteria above.</p> <p>Determining when control transfers will require significant judgement.</p> <p>Indicators that might be considered in determining the point in time at which control of the good or service (asset) passes to the customer include but are not limited to:</p>	<p>Revenue from the sale of goods or services by real estate businesses is in the scope of PSAK 23, for example, sale of products in a hotel or performing repairs and maintenance or building management services. Revenue is recognised when the risks and rewards of ownership pass to the customer or as the services are rendered.</p> <p>Revenue from construction services is recognised as the construction activity is completed for contracts within the scope of PSAK 34.</p> <p>Revenue from real estate development activities within the scope of PSAK 44 is recognised depending on the type of real estate asset:</p> <ul style="list-style-type: none"> • Revenue from the sale of houses, shop houses and other similar type of buildings, including land, is recognised as delivery of a good using the full accrual method (if certain criteria are met); • Revenue from the sale of condominiums, apartments, office buildings, shopping centres and other similar types of buildings and units in time-sharing ownership is recognised as a construction service, using the percentage of completion method (if certain criteria are met); • Revenue from the sale of land without buildings is recognised using full accrual method (if certain criteria are met).

Recognise revenue when (or as) each performance obligation is satisfied (*cont'd*)

New standard	Current IFAS
<ul style="list-style-type: none"> • Whether the entity has a right to payment. • Whether the customer has obtained the legal title to the asset. • Whether the entity has transferred possession of the asset to the customer. • Whether the customer has significant risks and rewards of ownership of the asset. • Whether the customer has accepted the asset. <p>Measuring performance obligations satisfied over time:</p> <p>An entity should measure progress toward satisfaction of a performance obligation that is satisfied over time using the method that best depicts the transfer of goods or services to the customer. Methods for recognising revenue when control transfers over time include:</p> <ul style="list-style-type: none"> • Output methods that recognise revenue on the basis of direct measurement of the value to the customer of the entity's performance to date (for example, surveys of goods or services transferred to date, contract milestones, appraisals of results achieved). • Input methods that recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, cost-to-cost, labour hours, labour cost, machine hours, or material quantities). <p>The method selected should be applied consistently to similar contracts with customers. Once the metric is calculated to measure the extent to which control has transferred, it must be applied to total contract revenue to determine the amount of revenue to be recognised.</p>	<p>Accordingly, under PSAK 44, revenue is recognised as follows:</p> <p><i>Sales of houses, shop houses and similar buildings with land</i></p> <p>The full accrual method can only be applied when the sales process has been completed and the contract is not expected to be cancelled, the consideration receivable from the buyer will not be subordinated towards any loan commitments of the buyer and the entity has transferred to the buyer the risks and rewards of ownership.</p> <p>The consideration is considered collectible if the deposit received from the buyer is "sufficient", that is, at least 20 percent of the agreed selling price is paid in advance and this amount is non-refundable.</p> <p>The risks and rewards of ownership are transferred when the seller is no longer involved with the property and the property is ready for occupation or leasing.</p> <p>If all of the above criteria are not met, revenue is recognised using the deposit method, which requires the seller to record any deposit received as a liability and recognise real estate assets in construction as their own until all criteria for the full accrual method are satisfied.</p> <p><i>Sales of condominiums, apartments, office buildings, shopping centres and similar properties and units in time-sharing ownership</i></p> <p>The percentage of completion method can be applied when the construction process has progressed through the initial stages, the buyer paid at least 20 percent of the agreed selling price, this deposit is non-refundable, and the outcome of the construction contract can be estimated reliably; otherwise any cash advance received from the buyer is recognised using the deposit method.</p>

Recognise revenue when (or as) each performance obligation is satisfied *(cont'd)*

New standard	Current IFAS
	<p>Real estate developers recognising revenue by applying the percentage of completion method must use a method that best measures the progress of the project, such as:</p> <ul style="list-style-type: none"> (a) survey of work carried out (physical progress); (b) proportion of real estate development activities that have been carried out until a certain date to the total real estate development activities that must be carried out (contract milestone); or (c) the proportion of costs incurred up to a certain date to the estimated total costs of real estate development activities (cost-to-cost). <p>To measure the progress using a cost-to-cost method, PSAK 44 provides guidance in relation to deferral and allocation of contract costs. Costs directly related to a real estate project and indirect project costs related to several real estate developments should be capitalised and allocated to each real estate unit using the specific identification method. If the specific identification method cannot be applied, the costs should be allocated based on the selling price ratio. If the selling price ratio cannot be applied, costs are allocated on an area-wide basis or another method appropriate in the circumstances. The allocation method should be applied consistently across the portfolio of similar contracts.</p> <p><i>Sale of land without building</i></p> <p>The full accrual method can only be applied when the amount of non-refundable prepayment by the buyer has reached 20 percent of the agreed selling price, it is probable that the contract consideration will be collected in full, the future receivable from the buyer will not be subordinated towards any loan commitments of the buyer, the land development process has been completed and only the land lot is sold without the subsequent construction service by the seller.</p>

Recognise revenue when (or as) each performance obligation is satisfied *(cont'd)*

Potential impact:

Real estate management:

This assessment may not necessarily have a significant impact for the real estate management industry. This is because in most cases revenue will be recognised over time for services provided. The pattern of revenue recognition is likely to be affected by how the entity estimates variable consideration (see discussion above).

The timing of revenue recognition will need to be carefully considered where real estate managers receive upfront fees for a number of performance obligations, as discussed in the “Identification of performance obligations” section above.

Real estate developers:

Real estate developers will need to carefully consider the control transfer model to determine when and how to recognise revenue. Some entities that currently wait until completion of the contract to recognise revenue might potentially find that they should now recognise revenue as they construct the property under PSAK 72. This, however, would only be the case if the asset in question has no alternative use and the seller has a right to payment for performance to date. Typically, real estate that has been sold off-plan will meet the ‘no alternative use’ test because a specific unit may not be redirected contractually. However, any allowance in contract or statute that permits the customer to exit the contract without paying the full price may lead an entity to conclude that it does not have the right to payment. In practice, the timing of revenue recognition would depend on the contract terms and relevant laws and regulations.

According to the legislation in Indonesia (Kepmen 9/1995), the customer has the ability to enforce its rights to a specified apartment unit in the event the developer attempts to sell the unit to a different customer. Before the sale-purchase certificate (AJB) is signed, the customer has the ability to redirect the unit to third parties, provided a consent from the developer is obtained, and upon paying an administration fee. The real estate developer can also transfer its obligation to deliver a real estate asset and the right to collect consideration to third parties, as stipulated in the consideration sale purchase agreement (PPJB). However, the developer is contractually restricted from redirecting the specified unit for another use or to another customer.

Contractual terms in the agreements for the off-the-plan sales do not typically give the developer an enforceable right to payment that is commensurate with progress of works completed to date. This criterion can only be met if the real estate developer has a right to demand a payment for performance completed to date if the contract is cancelled for reasons other than non-performance. According to Kepmen 9/1995, if the customer is unable to settle the off-the-plan contract or voluntarily terminates the contract, the real estate developer may only be entitled up to a maximum of ten percent of the agreed selling price. Additionally, in the event of a customer’s default (after missing three consecutive instalments), the real estate developer has the right to unilaterally terminate the contract but may have to refund to the customer any instalments paid in excess of the ten percent deposit. On this basis, it’s questionable whether the legal environment in Indonesia provides real estate developers with enforceable rights for payments that are commensurate with the progress of works completed to date.

Recognise revenue when (or as) each performance obligation is satisfied *(cont'd)*

Nevertheless, several studies in Indonesia reveal that in practice most of the clauses in the sales and purchase agreement/Perjanjian Pengikatan Jual Beli (“PPJB”) signed by developers and customers have not been fully compliant with Kepmen 9/1995, therefore, contractual terms agreed by the parties should be carefully considered. The outcome of whether real estate developers should recognise revenue over time or at a point of time will depend on the particular facts and circumstances of the contracts they entered with customers.

Example 5 – Right to payment

Facts: A property developer signed sales and purchase agreements to sell specific apartments in an apartment block to different customers during the construction phase. Once the contract has been signed, the developer may not redirect the unit to another customer. All customers are required to pay a 10% non-refundable deposit, and pay the remainder of the transaction price based on milestones as determined in the contract. The performance does not create an asset with an alternative use.

If customer B defaults, the property developer will be entitled to 10% of the contract price and it can retain the work in progress completed to date. Any cash received above 10% will be refunded to the customer.

How should the developer recognise revenue from the sale of the apartment to customer B?

Discussion: Revenue is recognised over time if the apartment being constructed has no alternative use and the seller has a right to payment for the duration of the contract. Whilst this assessment will need to be made on a contract by contract basis, in this example the apartment will meet the ‘no alternative use’ test because the specific unit may not be redirected contractually.

The second criterion is that of a right to payment for performance to date. The entity must be entitled to an amount that at least compensates the entity for performance completed to date at all times throughout the duration of the contract if the contract is terminated by the customer or another party for reasons other than the entity’s failure to perform as promised. The rights to receive a penalty and retain the work in progress (WIP) are not considered to provide the developer with a right to payment but are merely a payment of a deposit or a payment to compensate the entity for inconvenience of loss of profit. There is therefore no right to payment established in this contract. The entity should evaluate when control passes to the customer and recognise revenue on this date.

Recognise revenue when (or as) each performance obligation is satisfied *(cont'd)*

Example 6 – Measure of progress towards complete satisfaction of performance obligation

Facts: A developer is constructing a high-rise apartment building. All units have been sold off-plan before construction commenced. The ground floor units are completed in Dec 20x1, however, the top floor apartments are completed in June 20x2. There is a restriction on the purchasers from occupying the units until such time that the entire building is complete, and the safety inspection, which is required by the relevant regulations, has been performed.

Assume that there is only one performance obligation (the unit) and the criteria for recognising revenue over time have been met because the units have no alternate use, and the developer has a right to payment. How should the developer recognise revenue from the sale of the units?

Discussion: The developer has sold the individual units to individual customers. Each individual unit is a separate contract that includes a performance obligation that is satisfied over time. The developer would account for each contract separately; however, practically, the progress towards completion for each unit could be calculated by reference to the stage of completion of the apartment block as a whole.

The analysis would be different if the developer had not sold all the units off-plan before construction commenced. Revenue would not be recognised on unsold apartments, and costs associated with unsold apartments would be recorded as inventory.

This method would also not likely be appropriate if the developer was selling detached houses in a new estate, rather than apartments in a single building. This is because the completion of one house will not likely be dependent on the completion of another. Provided the criteria for revenue recognition criteria over time are met for the sale of each individual house, revenue would be measured based on the stage of completion assigned to each individual house rather than a single stage of completion being assigned to the development as a whole as in the case of an apartment block.

Example 7 – Partial satisfaction of performance obligations

Facts: An entity begins constructing an apartment building and pre-sells 60% of the units. The asset has no alternate use, and the entity has a right to payment for work completed to date from the time at which the contract is signed. The remaining 40% of the units are constructed for inventory. At a later date, after the shell of the rooms of all floors of the apartment building has been completed, the entity enters into a new contract with a customer to sell one of the remaining units on the same terms as the original contracts. Thus, at inception of the new contract, a portion of the new customer's unit is already completed.

Discussion: A cumulative catch-up adjustment is consistent with the principle of the standard of recognising revenue to depict an entity's performance in transferring control of goods or services to the customer. Thus if activities performed prior to the contract establishment date have resulted in progress towards satisfying a performance obligation, the entity would recognise the revenue it expects to be entitled to for that progress completed to date.

Contract costs

The new standard provides specific guidance on the capitalisation of certain costs. An entity is required to recognise an asset for the incremental costs to obtain a contract that they expect to recover. In addition, an entity is required to capitalise costs it incurs to fulfil a contract if such costs relate to future performance and they are expected to be recovered.

Costs related to satisfied performance obligations and costs related to inefficiencies (that is, abnormal costs of materials, labour, or other costs to fulfil) are expensed as incurred.

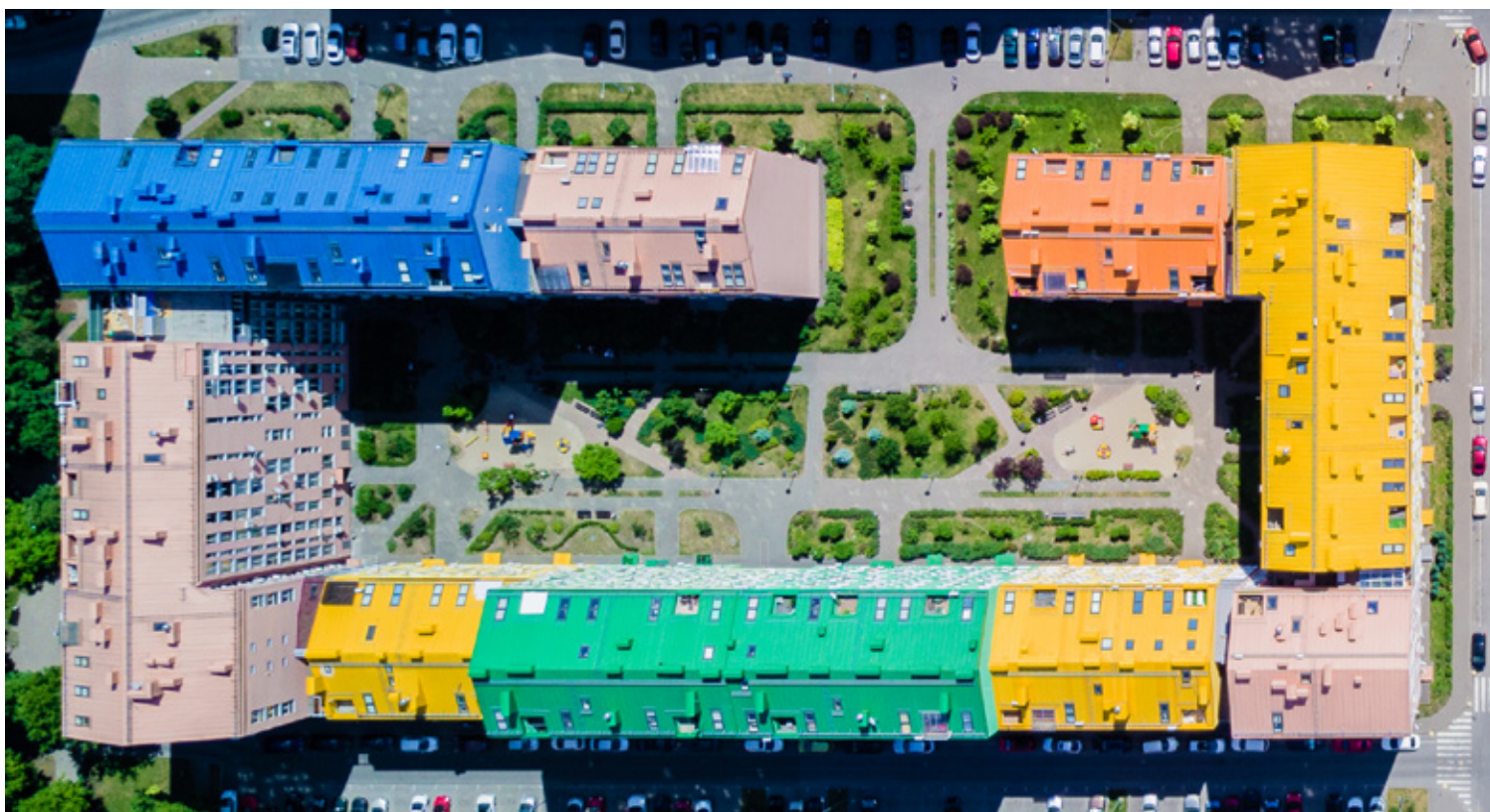
New standard	Current IFAS
<p>An entity will recognise as an asset the incremental costs of obtaining a contract if it expects to recover those costs (for example, commissions). The incremental costs of obtaining a contract are those costs that the entity would not have incurred if the contract had not been obtained.</p> <p>Costs to fulfil its obligations under an existing contract, or an anticipated contract, are capitalised in accordance with PSAK 72 if no other accounting standard addresses such costs; for example, commissions paid for sales of units. Such costs are capitalised if the costs:</p> <ul style="list-style-type: none"> • relate directly to a specific contract (or anticipated contract) • generate or enhance the resources of the entity which will be used in satisfying, or continuing to satisfy future performance obligations • are expected to be recovered. <p>An asset recognised in relation to contract costs is amortised on a systematic basis consistent with the pattern of transfer of the services to which the asset relates. This may include the transfer of goods or services to be provided under specific anticipated contracts (for example, a contract renewal). A practical expedient is available allowing such costs to be expensed when incurred if the amortisation period would be one year or less.</p> <p>An impairment loss is recognised to the extent that the carrying amount of the capitalised asset exceeds the net amount of consideration to which the entity expects to be entitled in exchange for the services to which the asset relates, less the remaining costs that relate directly to providing those services.</p>	<p>Fixed costs paid that are incremental and directly attributable to securing an investment contract (for example, sales commissions or placement fees) are capitalised if they can be identified separately, measured reliably, and it is probable that they will be recovered. An incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset is amortised in an appropriate manner.</p> <p>If the carrying value of the capitalised asset exceeds the recoverable amount, the asset is impaired and an impairment loss is recognised. PSAK 34 contains guidance relating to contract costs.</p> <p>Costs that relate directly to a contract and are incurred in securing the contract are included as part of the contract costs if they can be separately identified, measured reliably, and it is probable that the contract will be obtained. Other detailed guidance on costs to fulfil a contract is also prescribed by current IFAS.</p>

Contract costs *(cont'd)*

Potential impact:

Existing construction contract guidance contains a substantial amount of guidance on cost capitalisation. The guidance in the new standard could result in a change in the measurement and recognition of contract costs as compared to today.

Lastly, existing construction contract guidance requires a loss to be recorded when the expected contract costs exceed the total anticipated contract revenue. Existing guidance related to the recognition of losses arising from contracts with customers will be retained for entities within the scope of that guidance.

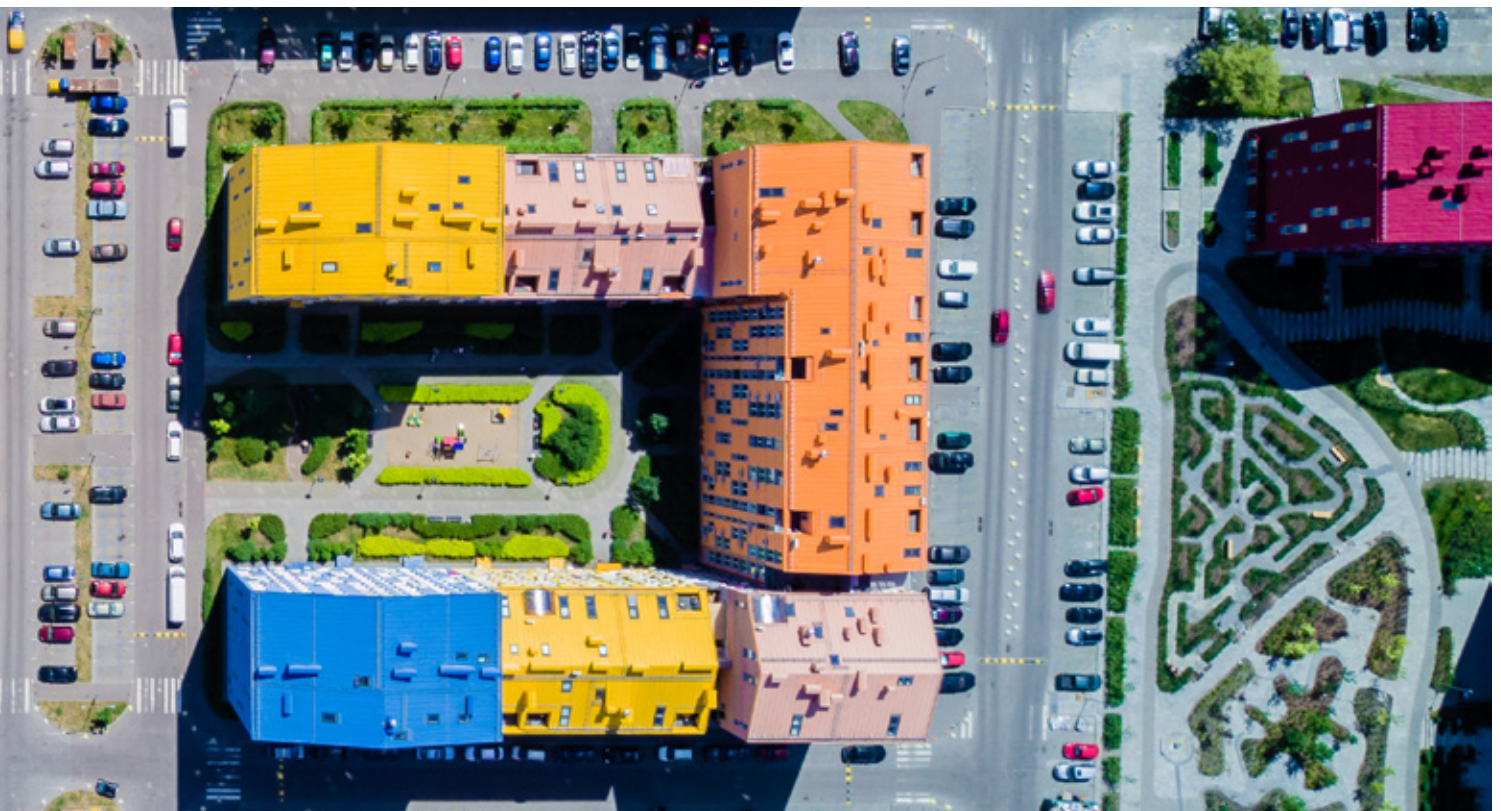


Disclosures

The new standard includes a number of disclosure requirements intended to enable users of financial statements to understand the amount, timing and judgements around revenue recognition and corresponding cash flows arising from contracts with customers.

The more significant disclosure requirements are as follows:

- The disaggregation of revenue into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.
- An explanation of the significant changes in the contract asset and the contract liability balances during the reporting period.
- An analysis of the entity's remaining performance obligations including the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied), the nature of the goods and services to be provided, the timing of satisfaction and significant payment terms.
- Significant judgements and changes in judgements that affect the determination of the amount and timing of revenue from contracts with customers.
- Disclosure of the closing balances of capitalised costs to obtain and fulfil a contract and the amount of amortisation in the period.



Final thoughts

The above discussion does not address all aspects of the new standard. Companies should continue to evaluate how the new standard might change current business activities, including contract negotiations, key metrics (including debt covenants, surety, and prequalification capacity calculations), taxes, budgeting, controls and processes, information technology requirements, and accounting.

Entities will apply the new standard for reporting periods beginning on or after 1 January 2020; earlier adoption is permitted.

Entities can adopt the final standard retrospectively or use a simplified approach. Entities using the simplified approach will: (a) apply the new standard to all existing contracts as of the effective date and to contracts entered into subsequently; (b) recognise the cumulative effect of applying the new standard in the opening balance of retained earnings on the effective date; and (c) disclose, for existing and new contracts accounted for under the new standard, the impact of adopting the standard on all affected financial statement line items in the period the standard is adopted. An entity that uses this approach must disclose this fact in its financial statements.





Item	Quantity	Unit
1.00	1.00	EA
2.00	1.00	EA
3.00	1.00	EA
4.00	1.00	EA
5.00	1.00	EA
6.00	1.00	EA
7.00	1.00	EA
8.00	1.00	EA
9.00	1.00	EA
10.00	1.00	EA
11.00	1.00	EA
12.00	1.00	EA
13.00	1.00	EA
14.00	1.00	EA
15.00	1.00	EA
16.00	1.00	EA
17.00	1.00	EA
18.00	1.00	EA
19.00	1.00	EA
20.00	1.00	EA

PSAK 73

Leases

In 2017, DSAK-IAI issued PSAK 73, which supersedes PSAK 30, Leases, ISAK 23, Operating Leases - Incentives, ISAK 24 Evaluating the Substance of Transactions Involving the Legal Form of a Lease, ISAK 25 Land rights and ISAK 8 Determining Whether an Arrangement Contains a Lease. For lessors, the accounting remains largely unchanged; however, the accounting for lessees will change significantly, with almost all leases being recognised on the balance sheet. Whilst the impact of the new standard on real estate lessors is not expected to be significant, the impact on tenants might, in turn, influence lease negotiations and market behaviour.

PSAK 73 implications for lessors in the Real Estate industry

Overview

PSAK 73, 'Leases', will be effective for annual reporting periods beginning on or after 1 January 2020.

Our "[PSAK 73 – Leases, A new Era for Lease Accounting](#)" publication provides a comprehensive analysis of the new standard from the perspective of both lessee and lessor. This guide summarises the main aspects of the standard that lessors in the Real Estate industry might face, focusing on some key challenges and questions management should ask as they prepare for transition.

Guidance for lessors remains substantially unchanged from PSAK 30. Lessors are still required to classify leases as either finance or operating, and the indicators used to make that distinction are again unchanged from PSAK 30.

For a finance lease, the lessor recognises a receivable at an amount equal to the net investment in the lease; this is the present value of the aggregate of lease payments receivable by the lessor and any unguaranteed residual value.

For an operating lease, the lessor continues to recognise the underlying asset on its balance sheet.



Overview *(cont'd)*

Changes for lessors?

Although the broad mechanics of lessor accounting remain unchanged, a number of topics do affect both lessees and lessors. For example, PSAK 73 contains revised guidance on the definition of a lease. Furthermore, 'lease term' is defined for both lessees and lessors in the same way (for example, whether or not extension or termination options are taken into account when determining the lease term).

In this guide, we focus on specific areas where PSAK 73 will have a particular impact on lessors:

- Lease payments;
- Separating or combining components of a contract;
- Subleases;
- Sale and leaseback transactions;
- Lease modifications.



Lease payments

Lease payments are defined in the same way for both lessees and lessors, comprising the following components:

- Fixed payments (including in-substance fixed payments), less any lease incentives receivable by the tenant;
- Variable lease payments that depend on an index or a rate;
- Amounts expected to be payable by the lessee under residual value guarantees;
- The exercise price of a purchase option (if the lessee is reasonably certain to exercise that option);
- Payments of penalties for terminating the lease (if the lease term reflects the lessee exercising the option to terminate the lease).

PSAK 73 distinguishes between three kinds of contingent payments, depending on the underlying variable and the probability that they actually result in payments:

- i. Variable lease payments based on an index or a rate. Variable lease payments based on an index or a rate (for example, linked to a consumer price index, a benchmark interest rate or a market rental rate) are part of the lessor's lease payments. These payments are initially measured using the index or the rate at the commencement date (instead of forward rates/indices).
- ii. Variable lease payments based on any other variable. Variable lease payments not based on an index or a rate are not part of the lessor's lease payments, such as payments of a specified percentage of sales made from a retail store. Such payments are recognised in profit or loss in the period in which the event or condition that triggers those payments occurs.
- iii. In-substance fixed payments. Lease payments that, in form, contain variability but, in substance, are fixed are included in the lessor's lease payments. The standard states that a lease payment is in-substance fixed if there is no genuine variability.

Lease payments (cont'd)

Example of variable lease payment based on an index or a rate

A lessor agrees an operating lease of office space with a lessee on the following terms:

1. Lease term: ten-year non-cancellable term.
2. Annual payment: CU100,000 in the first year, with a CPI increase in every following year.
3. Market rent review: beginning of year 6, with a CPI increase in every following year.

The lessor initially measures lease income as CU100,000 in every year. In year 2, CPI increases by 2%.

The lessee is required to remeasure its lease liability when the cash flows change in respect of CPI in year 2 for the lease payments from year 2 to year 5. [PSAK 73 para 42(b)]. The lease payments from years 6 to 10 would not be remeasured, because those cash flows have not yet changed. These cash flows will only change when the market rent review occurs and rent is reset to the market rate at that time.

From year 2, the following lease income is forecast for the purposes of the lessor determining recognition of lease income on a straight-line basis:

Year	2	3	4	5	6-10 (annual)
Lease income (CU)	102,000	102,000	102,000	102,000	100,000

Should the lessor remeasure the lease income to be recognised in year 2?

PwC observation

Given the guidance for lessees, it would be logical for the lessor to remeasure lease income to be recognised in the same way. Therefore, the rental income recognised in year 2 would be CU100,888, reflecting recognition of the revised income above on a straight-line basis. However, there is no explicit requirement in PSAK 73 for a lessor to remeasure its lease income in the same way as a lessee. An alternative approach would be to recognise the increases in rental income related to CPI changes in the periods in which those changes occur in accordance with PSAK 73 paragraph 38. Under that approach, the rental income in year 2 would be CU102,000. The method applied is an accounting policy choice, and it should be applied consistently to all leases in accordance with PSAK 25.

For lessees, in relation to payments initially excluded from the lease liability, if the variability is resolved at a later point in time (for example, insurance premiums or taxes become known and unavoidable for the upcoming year) they become in-substance fixed payments at that point in time in accordance with PSAK 73 paragraph PP42. However, there is no similar explicit requirement in PSAK 73 for a lessor under an operating lease. Lessors could apply the guidance as for lessees or, alternatively, they could recognise the variable lease payments in the periods in which they occur. The method applied is an accounting policy choice, and it should be applied consistently in accordance with PSAK 25.

Separating or combining components of a contract

Contracts often combine different types of obligations, and they might contain a combination of lease components, or of lease and non-lease components. For example, real estate arrangements often require the lessee to reimburse the lessor for certain costs related to the leased asset, such as insurance, property taxes or common area maintenance provided by the lessor.

PSAK 73 requires each separate lease component to be identified and accounted for separately.

1. Interaction with PSAK 72

The right to use an asset is a separate lease component from other lease components if two criteria are met:

- a. The lessee can **benefit from the use of the asset** either on its own or together with other readily available resources.
- b. The underlying asset **must not be highly dependent on or highly interrelated with** other underlying assets in the contract.

PwC observation

PSAK 72 contains guidance on how to evaluate whether a good or service promised to a customer is distinct for lessors. The question arises as to how PSAK 73 interacts with PSAK 72.

For a multi-element arrangement that contains (or might contain) a lease, the lessor has to perform the following assessment:

- Apply the guidance in PSAK 73 to assess whether the contract contains one or more lease components.
- Apply the guidance in PSAK 73 to assess whether different lease components have to be accounted for separately.
- After identifying the lease components under PSAK 73, the non-lease components should be assessed under PSAK 72 for separate performance obligations.

The criteria in PSAK 73 for the separation of lease components are similar to the criteria in PSAK 72 for analysing whether a good or service promised to a customer is distinct.

When identifying non-lease components, an entity must consider whether a good or service is transferred to the lessee. [IFRS 73 para PP33]. As mentioned above, real estate arrangements often require the lessee to reimburse the lessor for items such as insurance, property taxes or common area maintenance provided by the lessor. There will usually be (at least) one lease component (the right to use the real estate) and one non-lease component (such as common area maintenance). However, payments for insurance and property taxes typically do not involve a transfer of a separate service, and they generally do not represent a separate lease or non-lease component. Instead, these payments form part of the consideration for the lease and non-lease components.

Separating or combining components of a contract *(cont'd)*

2. Determine overall consideration

The overall consideration in the contract needs to be determined. This will include payments for the lease component(s), and it might also include payments for non-lease components and/or payments that do not represent separate components. Overall consideration includes both fixed and any variable payments. For example, in some real estate arrangements, the payments received from the tenant for property taxes and insurance might be variable payments.

3. Allocation of consideration

When the lease and non-lease components have been identified, the consideration within the contract must then be allocated.

Lessors allocate consideration in accordance with PSAK 72, on the basis of stand-alone selling prices of the identified components. Where insurance and property taxes do not represent a separate component, no consideration is allocated to them; consideration is only allocated to the identified lease and non-lease components.

The example below explains how the variable payments of property tax and insurance would be measured when determining the overall consideration.

Example – How are variable payments of property tax and insurance measured?

A lessor requires a lessee to reimburse the lessor for property taxes and insurance under an operating lease. Applying PSAK 73 paragraph PP33, the lessor has determined that, in this specific situation, the payments for property taxes and insurance do not transfer a separate good or service, so they are not accounted for as a separate non-lease component. The lease contract has no other service or non-lease components, and so these tax and insurance payments are allocated as lease payments to be received and recognised as rental income over the lease term.

Often, payments for reimbursing the lessor for property taxes and insurance are variable. Depending on the specific facts and circumstances in each lease and in each jurisdiction, there might be different causes of variability. Potential types of variable payment and how they could be measured are considered further below, although there is significant judgement involved.

Property tax

Property tax might be calculated as the tax value of the property multiplied by a fixed percentage. The tax value of the property might be determined based on specific requirements in tax law, and so it might not be representative of market value.

Even if valuation of the property takes into account market indices or rates, it is not, in itself, an index or a rate. Hence, these types of property taxes should be accounted for as variable lease payments that do not depend on an index or a rate. Only the amounts that are already in-substance fixed are included in the initial measurement of lease income. For example, if the property taxes are known for the first year and will then be reassessed from the second year, only the property taxes for the first year would be included initially, and the income for property taxes in future periods would be recognised when they occur or become in-substance fixed.

Separating or combining components of a contract *(cont'd)*

Example – How are variable payments of property tax and insurance measured? *(cont'd)*

Insurance

The initial amount of the insurance premium might be known by both parties but not explicitly stated in the contract. Furthermore, the amount might change over time for reasons other than the market value of the property – for example, if the insurance company’s assessment of risk changes or the lessor moves to another insurance company.

The amount of premiums might vary in subsequent periods. Amounts received in relation to insurance meet the definition of variable lease payments, but they are not dependent on an index or a rate. Only the amounts that are already in-substance fixed are included in the initial measurement of lease income. For example, if the insurance premium is known for the first year and will then vary from the second year, only the insurance premium for the first year would be included initially, and the income for insurance in future periods would be recognised when it occurs or becomes in-substance fixed.

Application in the example

Lessees will include payments for property taxes and insurance as part of the lease liability if they are linked to a rate or an index or are in-substance fixed payments and they are not separate goods or services under the lease.

Similarly, lessors will include payments for property taxes and insurance as part of rental income. As a result, the lessor will record rental income for amounts received in respect of property taxes and insurance. The lessor also records an expense for the costs incurred for these items.

PwC observation

Application of this principle could be challenging in some jurisdictions where the lessor has the primary obligation to pay the property tax while the lessee pays the tax or the insurance directly to the tax authority or insurance company respectively. Lessors might find it difficult to collect information from lessees in respect of these expenditures, or it might be difficult to keep track of a wide range of different insurance arrangements. In such cases, it will be important for lessors to communicate with lessees to determine methods of collecting this information.

Land rights in Indonesia

The prevailing laws and regulations in Indonesia do not permit corporate entities to own freehold title to land. Instead, companies would need to acquire the right to use land from an individual or the Government of Indonesia. Compensation paid to obtain the land rights typically reflects the fair value of the land.

There are several types of land rights, the three major forms include building rights on land (*Hak Guna Bangunan* or “HGB”), cultivation rights (*Hak Guna Usaha*) and right of use (*Hak Pakai*). In practice, land rights, although of the same types, could be substantially different depending on circumstances surrounding the underlying assets and the corporate entity. Corporate entities are permitted to sell or transfer land rights in the secondary market or pledge the rights as collateral. Land rights are typically granted for an initial period of up to 35 years with a right to extend for an additional 25-year term. When the extension period ends, the land rights can be renewed subject to the Government’s approval and, therefore, can be indefinite. The cost of the subsequent rights extension is nominal.

At present, accounting for land rights under IFRS and the national accounting standards in Indonesia, IFAS, may not be fully aligned.

Entities reporting under IFRS typically treat the purchase of land rights as a lease contract within the scope of IAS 17/PSAK 30. This is based on the September 2012 IFRIC Rejection when IFRIC considered whether the purchase of land rights should be accounted for as an acquisition of property, plant and equipment, purchase of an intangible asset or a lease of land. IFRIC identified the lease characteristics in the arrangement where an entity purchased a right to use land and observed that a right to use land is generally accounted for under IAS 17. Thus, in accordance with the definition of the lease, the lessee acquired not the asset itself but the ‘right to use’ the asset for a set period of time. IFRIC also noted that a lease could be indefinite via extension or renewal periods and that the existence of an indefinite period does not prevent the ‘right to use’ form

qualifying as lease. Notwithstanding the above, the Interpretations Committee did not take this question onto its agenda and did not provide further guidance.

To assist account preparers in determining how the purchase of land rights should be treated, DSAK-IAI issued an Interpretation 25, Land rights, (‘ISAK 25’). ISAK 25 was applicable to annual reporting periods commencing on or after 1 January 2012. ISAK 25 requires that the initial direct costs to obtain the land rights are capitalised as part of the cost of property, plant and equipment. Since the useful life of land rights is considered indefinite under ISAK 25, these costs are not subsequently depreciated, unless a corporate entity expects that a renewal cannot be obtained. ISAK 25 further requires to recognise any costs related to renewal of land rights as an intangible asset and amortise the intangible over the shorter of the renewal period or economic life of the land.

ISAK 25, Land rights, was withdrawn with the issuance of PSAK 73, Leases, and will no longer be effective since 1 January 2020 with the application of PSAK 73. It requires an entity to first assess whether the substance of the transaction is purchase of asset or lease. There is specific guidance in the basis for conclusions to PSAK 73 DK02-DK10 about the need to distinguish between a lease and a sale. This assessment will require judgment that reflects the unique local circumstances (law, contract and practices). To further assist the entity to apply the principle established in the PSAK 73, on 26 November 2020, DSAK IAI issued ISAK 36, Interpretation of the interaction between the provisions regarding Land Rights in PSAK 16: Fixed Assets and PSAK 73: Leases.

ISAK 36 provides further guidance on how to distinguish a lease from a purchase or a sale when legal title to the underlying assets is not transferred to the lessee/buyer. ISAK 36 emphasis that the accounting for land rights depends on the substance of the rights and not its legal form. The interpretation mentions that for contracts grants rights that represent the in-substance purchase

of an item of property, plant and equipment, those rights meets the definition of property, plant and equipment in PSAK 16 and would be accounted for applying that Standard, regardless of whether legal title transfers.

Based on the fact pattern of land rights in Indonesia, such as **HGB** (*Hak Guna Bangunan*), DSAK IAI reemphasized its view in the PSAK 73 that there is a strong indication that HGB is akin to a purchase of asset instead of lease as the control of the underlying asset has been transferred to the entity, because the entity has gained the ability to direct the use of asset, has acquired substantial risk and rewards of the asset, and has substantially acquired all remaining benefits of the asset.

In other fact pattern, where the entity has a contractual obligation to, and has no other alternative than to, return the land title to the primary owner for a certain period of time such as **HGB over a certain HPL** (*Hak Pengelolaan Lahan*) as such the transaction does not transfer the right to control the land to the entity and the transaction is akin to a lease, the accounting should reflect the substance of the transaction. The substance of such rights, for example, can be attached to any land rights based on *Perjanjian Penyerahan Penggunaan Tanah Industri* (“PPTI”) which might not transfer the right to control the land to the entity. There may be variations in contractual terms and specific fact patterns relating to each land title. The entity should consider the substance of contractual terms and all relevant facts and circumstances in determining whether a land title transfers the right to control land.

DSAK IAI emphasises that in analysing the substance of a transaction related to land rights, the entity focuses on the substance of the land rights. Therefore, convergence with IFRS is not a major consideration in determining the accounting treatment of land rights. The entity shall apply the requirements in ISAK 36 in determining the accounting treatment of land rights for financial reporting purposes in accordance with SAK even though the entity draws conclusion different from the intentions of IFRS 16 BC138-140 when it prepares financial statements or financial information in accordance with IFRS for a specific purpose.



Subleases

Intermediate lessors must now classify subleases based on the right-of-use asset from the head lease, rather than the underlying lease asset (as under PSAK 30).

For example, the term of a property sublease would be compared to the term of the head lease when assessing whether the lease is for the major part of the economic life.

Similarly, the present value of lease payments is compared to the fair value of the right-of-use asset, instead of the underlying asset, when assessing whether it is for substantially all of the fair value.

Since the head lease term for a property lease or the fair value of a right-of-use asset is often smaller than the life or fair value of the underlying property, there is now an increased likelihood that a sublease may be classified as a finance lease. The change to sublease guidance must be considered both on transition to PSAK 73 for existing subleases and for all new subleases entered into once PSAK 73 applies.

Practical impact – property leases

Real estate companies often hold investment properties located on land, for which the company holds the long-term land rights. On transition to the new leasing requirements, real estate companies should take a fresh look at the terms and conditions of the land rights they hold and consider whether the rights meet the definition of the lease in accordance with PSAK 73. As a result, real estate companies will recognise a right of use asset in relation to ground leases. Since consideration for the right to use land is paid upfront, real estate companies will not recognise a corresponding lease liability. The right of use asset is classified as an investment property given the land is held solely for the purposes of holding the related investment property building. Furthermore, where the real estate entity applies the fair value model for its investment property, it will equally be required to apply this model to right of use assets that meet the definition of investment property. [PSAK 73 para 34].

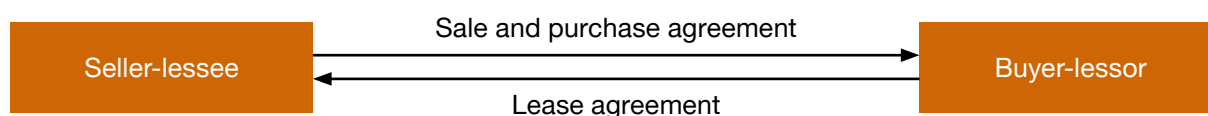
The right of use asset will be measured on initial recognition in accordance with PSAK 73. [PSAK 13 para 29A]. As the ground lease is negotiated at market rates, on initial recognition, re-measurement of a right of use asset from cost to fair value should not give rise to any gain or loss on day one. [PSAK 13 para 41].

Sale and leaseback transactions

Determining whether the transfer is a sale

Aside from lessee accounting, the accounting for sale and leaseback transactions is one of the main areas in which the new lease standard changes the current guidance. The accounting for sale and leaseback transactions under PSAK 30 mainly depended on whether the leaseback was classified as a finance or an operating lease. Under PSAK 73 the determining factor is whether the transfer of the asset qualifies as a sale in accordance with PSAK 72. An entity should apply the requirements for determining when a performance obligation is satisfied in PSAK 72, to make this assessment.

Structure of a sale and leaseback



Transfer of the asset is a sale

If the buyer-lessor has obtained control of the underlying asset and the transfer is classified as a sale in accordance with PSAK 72, the seller-lessee measures a right-of-use asset arising from the leaseback as the proportion of the previous carrying amount of the asset that relates to the right of use retained. The gain (or loss) that the seller-lessee recognises is limited to the proportion of the total gain (or loss) that relates to the rights transferred to the buyer-lessor.

If the consideration for the sale is not equal to the fair value of the asset, any resulting difference represents either a prepayment of lease payments (if the selling price is below market terms) or an additional financing (if the selling price is above market terms). The same logic applies if the lease payments are not at market rates. The buyer-lessor accounts for the purchase in accordance with applicable standards (such as PSAK 13 if the underlying asset is investment property), and for the leaseback in accordance with PSAK 73.

Sale and leaseback transactions

(cont'd)

Example – Sale and leaseback transaction

Entity A owns a property with a carrying value of CU3 million, and it enters into a sale and leaseback transaction. The market value of the property is CU10 million. The present value of minimum lease payments under the term of the leaseback is CU5 million. The initial sales price and the ongoing rental are all at market value.

Under PSAK 73, the right-of-use asset retained by entity A as a proportion of the underlying asset is 50%, being:

$$\frac{\text{Present value of minimum lease payments (CU5 million)}}{\text{Market value of the property (CU10 million)}}$$

The right-of-use asset retained is CU1.5 million, being:

$$\text{Carrying amount of the property (CU3 million)} \times \text{Proportion of the underlying asset (50\%)}$$

The gain on sale is CU3.5 million, being the proportion of the total gain that relates to the rights transferred to the buyer-lessor:

$$\text{Total gain (CU7 million)} \times \frac{\text{Market value of the property less the present value of the lease payment (CU 10 million – CU 5 million)}}{\text{Market value of the property (CU10 million)}}$$

Under PSAK 30, assuming the transaction qualifies as an operating leaseback, the gain on sale would be CU7 million, being the difference between the fair value of the property (CU10 million) and its carrying value (CU3 million). Furthermore, no asset or liability would be recognised on the balance sheet subsequent to the transaction. However, under PSAK 73, the gain recognised relates only to the proportion of the right to use the underlying asset that is transferred to the buyer-lessor.

Transfer of the asset is not a sale

If the transfer is not a sale (that is, the buyer-lessor does not obtain control of the asset in accordance with PSAK 72), the seller-lessee does not derecognise the transferred asset, and it accounts for the cash received as a financial liability. The buyer-lessor does not recognise the transferred asset, and instead it accounts for the cash paid as a financial asset (receivable).

PwC observation

The accounting treatment for sale and leaseback transactions for seller-lessees under PSAK 73 can be significantly different from PSAK 30. However, we do not expect this difference to result in a complete elimination of sale and leaseback activity. There are still valid commercial reasons for seller-lessees to enter into such transactions, such as managing cash flows, facilitating operational decisions, and tax considerations.

Lease modifications

There is no explicit guidance in PSAK 30 on accounting for modifications of operating leases by lessors. Where the modification of an operating lease does not result in the lease being reclassified as a finance lease, any changes to future lease payments are accounted for prospectively on a straight-line basis over the remaining revised lease term.

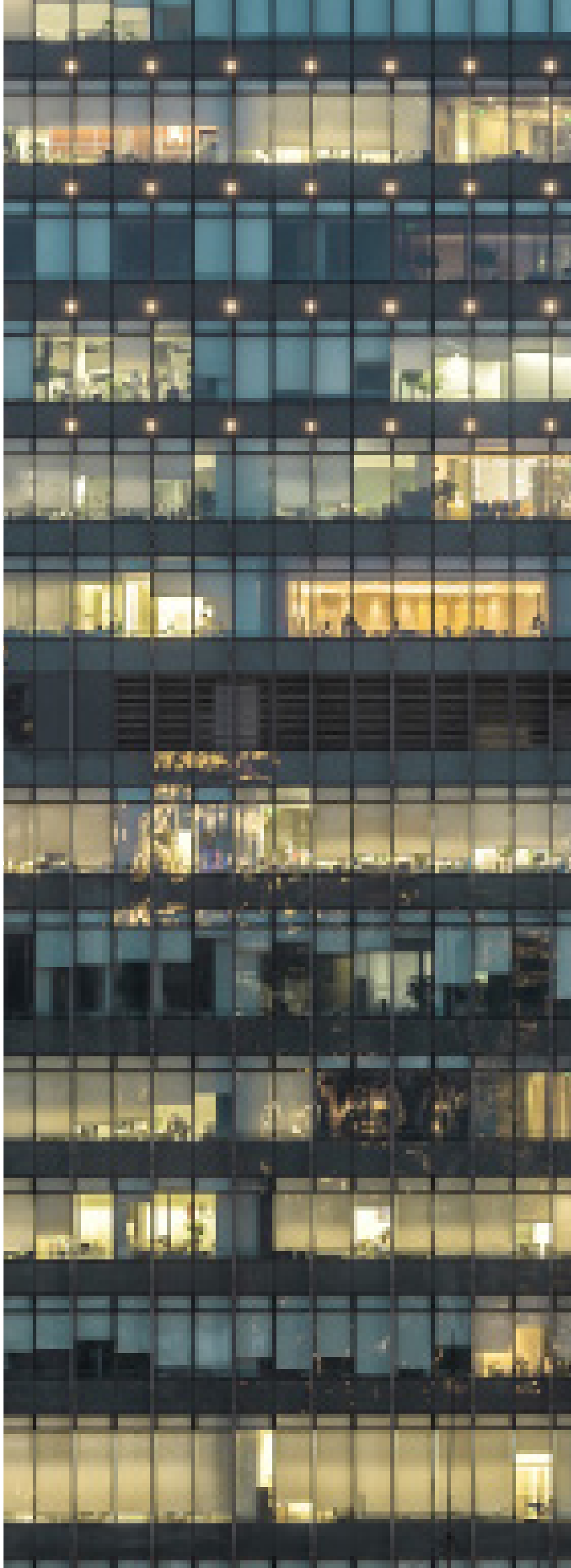
PSAK 73 provides guidance on modifications of operating leases by lessors. The accounting requirements under PSAK 73 are generally consistent with previously developed practice for accounting for modifications of operating leases by lessors. Modifications to an operating lease should be accounted for from the effective date of the modification, considering any prepaid or accrued lease payments relating to the original lease as part of the lease payments for the new lease. [PSAK 73 para 87]. PSAK 73 provides greater clarity as to the effective date of a modification and defines this as the date on which the parties agree to the modification.



Final thoughts

PSAK 73 does contain changes that have an accounting impact on lessors. In particular, lessors should be aware of the new guidance on the definition of a lease, lease term and lease payment, separation of components, subleases and the accounting for sale and leaseback transactions. From a commercial point of view, changes in lessee accounting could also impact lease negotiations, given that property leases will often result in the recognition of significant assets and liabilities for many lessees. The focus in negotiations might no longer be on whether the contract would qualify as an operating or a finance lease, but instead on whether the definition of a lease is met at all.

Other negotiation points might include variable lease payments which could be excluded from the lease liability, or inclusion of termination options which might minimise the lease term. As such, the standard might have an impact that extends beyond the accounting treatment.



Glossary

AFS	Available for Sale
AJB	<i>Akta Jual Beli</i> or “Sale Purchase Certificate”
DSAK-IAI	<i>Dewan Standar Akuntansi Keuangan – Institut Akuntansi Indonesia</i>
ECL	Expected credit loss
FOB	Free on Board
FVPL	Fair Value through Profit or Loss
FVOCI	Fair Value through Other Comprehensive Income
IFAS	Indonesian Financial Accounting Standards
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
OCI	<i>Other comprehensive income</i>
PPJB	<i>Perjanjian Pengikatan Jual Beli</i> or “Consideration Sale Purchase Agreement”
PSAK	<i>Pernyataan Standar Akuntansi Keuangan</i>
SAK	<i>Standar Akuntansi Keuangan</i>
SPPI	Solely Payments of Principal and Interest

PwC Indonesia contacts

For further help, please contact:



Jumadi
Partner
jumadi.anggana@id.pwc.com



Dariya Karasova
Advisor
dariya.m.karasova@id.pwc.com



Djohan Pinnarwan
Partner
djohan.pinnarwan@id.pwc.com



Helen Cuizon
Advisor
helen.cuizon@id.pwc.com



Irwan Lau
Partner
irwan.lau@id.pwc.com



Elina Mihardja
Senior Manager
elina.mihardja@id.pwc.com



Eddy Rintis
Partner
eddy.rintis@id.pwc.com



Gayatri Permatasari
Manager
gayatri.permatasari@id.pwc.com

PwC Indonesia

Jakarta
WTC 3, Jl. Jend. Sudirman Kav. 29-31
Jakarta 12920
Indonesia
T: +62 21 50992901 / 31192901
F: +62 21 52905555 / 52905050
www.pwc.com/id

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



This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

© 2019 KAP Tanudiredja, Wibisana, Rintis & Rekan. All rights reserved. PwC refers to the Indonesian member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.