

Guidance on the New Big-3 Standards

Telecommunications Sector

September 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 follow the convergence approach instead of full adoption was based on consideration of 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. The DSAK-IAI is working to reduce the gap between SAK and IFRS implementation to one year.

As part of IFRS convergence, DSAK-IAI has 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) specific to the telecommunications industry.

Table of Contents

Introduction	2
PSAK 71 – Financial instruments	4
At a glance	5
Classification and measurement – Business model assessment	6
Impairment of financial assets measured at amortised cost	11
Impairment – scope exception for trade and lease receivables: the simplified approach	12
Provision matrix	14
Intra-group loans	17
Hedging	18
Financial liabilities	19
PSAK 72 – Revenue from Contracts with Customers	20
Overview	21
1. Identify the contract	22
2. Identify performance obligations	25
3. Determine transaction price	30
4. Allocate transaction price	34
5. Recognise revenue	38
Other considerations	39
Interaction between PSAK 71 and PSAK 72	44
PSAK 73 – Leases	46
Overview	47
Embedded leases	49
Separating components of a contract	52
Lessee accounting model	54
Lease modification and reassessment (lessee)	57
Sale and leaseback arrangements	59

PSAK 71

Financial instruments

In 2017, the DSAK-IAI published the complete version of PSAK 71, 'Financial instruments', which replaces most of the guidance in PSAK 55. This includes amended guidance for the classification and measurement of financial assets by introducing a fair value through the '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 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

Application in the telecommunications industry

At a glance

PSAK 71 will affect the telecommunications industry with an effective date of 1 January 2020. Telecommunications entities hold a number of financial instruments arising from their core operations (trade receivables), from risk management activities (foreign-exchange and interest-rate hedges), or cash-management and investing activities (bonds and equity investments). The trend of complex financing structures has seen an increased focus on financial instruments in the industry. 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.

This publication focuses on some of the more significant impacts on entities within the telecommunications industry.

What to do now?

Telecommunications to-do list

Here is the immediate “to do” list for the implementation of PSAK 71:

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.
2. **Factoring** can lead to trade receivables being classified as “hold to collect and sell”, and it results in a fair value measurement. To avoid recognising all receivables at fair value, the factored or held to sell receivables might be able to be segregated. However, two different business models would need to be clearly articulated and documented.
3. **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 (ECL) model, ensuring that expectations of forward-looking data are incorporated.
4. **All hedging documentation** must be redone to show how the new hedge accounting criteria have been satisfied.

Introduction – Snapshot of the financial position of a typical telecommunications company

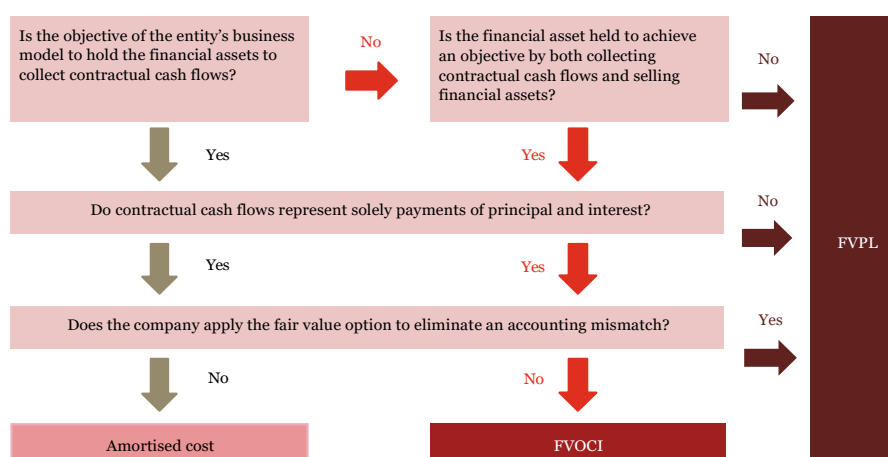
A typical balance sheet might include the following financial instruments:

Non-current assets	Current assets	Current and non-current liabilities
<ul style="list-style-type: none"> • Equity investments • Long-term trade receivables • Loan receivables, including intercompany loans 	<ul style="list-style-type: none"> • Trade receivables • Derivative financial assets 	<ul style="list-style-type: none"> • Borrowings • Derivative financial liabilities • Lease payables • Contingent consideration from business combination

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), as shown in the flow chart below.



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).

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 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. The cost exception under PSAK 55 has been removed, even for unquoted investments.

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 ECL provision is recognised on equity investments (see the section on ECL for debt measurement on page 10).

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

What does this mean for the telecommunications industry?

Trade receivables	<ul style="list-style-type: none"> Trade receivables in a communications entity will normally meet the hold to collect criterion. The payments would normally be comprised solely of principal and interest. They would thus be measured at amortised cost. Be alert for factoring arrangements.
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, FVOCI, or FVPL.
Derivatives	<ul style="list-style-type: none"> Derivatives remain classified at FVPL.
Contingent consideration	<ul style="list-style-type: none"> Monetary contingent consideration that the acquirer is due to pay or receive is within the scope of PSAK 71. Contingent consideration assets and liabilities are measured at FVPL. Any contingent consideration receivable previously classified as available for sale (AFS) will need to be reclassified to FVPL.

Factoring

Telecommunications entities might manage credit risk by entering into factoring arrangements where they sell receivables to a third party and transfer substantially all of the related risks and rewards.

Factoring arrangements will affect the business model in which the receivables are held.



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

An entity will be receiving **cash flows from selling** if the factoring **results in derecognition** of the receivables.

“Derecognition” under PSAK 71 is considered to be a “sale” for the purpose of the business model assessment. Therefore, sales are considered to have taken place where the disposals/transfers of trade receivables under the factoring agreements qualify for de-recognition in their entirety.

An entity might be receiving cash flows by collecting the contractual cash flows from the receivable if the factoring **does not result in derecognition**.

Depending on the above, a factored receivable might be in the hold to collect and sell model.

Example 1(a) – Business model for receivables that potentially could be subject to factoring

Facts: A telecommunications entity (“telco”) sets up a trade receivables factoring agreement with a bank. At the inception of a trade receivable, it is often unknown whether it will be subject to factoring. The telco both factors and holds significant amounts of receivables.

The factoring decision rests typically with the telco’s management and is made later in the process. The terms of the factoring agreement are such that all receivables that are factored meet the financial asset de-recognition criteria, resulting in the original receivables being derecognised from the statement of financial position.

Question: What would be the applicable PSAK 71 business model for the trade receivables, which could potentially be subject to factoring?

Analysis: When evaluating the business model, the relevant activities should be considered. One of two business models might be appropriate, depending on the facts and circumstances:

1. **Hold to collect and sell business model** – this would apply where relevant activities are represented through both the collection of contractual cash flows (for those receivables that are not factored) and regularly selling receivables (via selling receivables into the factoring agreement on a regular basis, even if the exact extent and the specific receivables impacted cannot be identified at inception). Therefore, the entire portfolio of trade receivables should be classified as hold to collect and sell.
2. **Hold to sell business model** – Where the telco’s objective is to realise the cash flows primarily through selling, the business model is not held to collect and sell, and so the receivables should be measured at FVPL.

In the case above, the telco cannot specify which receivables it plans to factor, and it both factors and holds significant amounts of receivables. The hold to collect and sell business model might be more appropriate.

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

What does this mean for the telco?

If the telco factors only some of its receivables (for example, only those due from certain customers), it might be able to split its portfolio of receivables into two sub-portfolios.

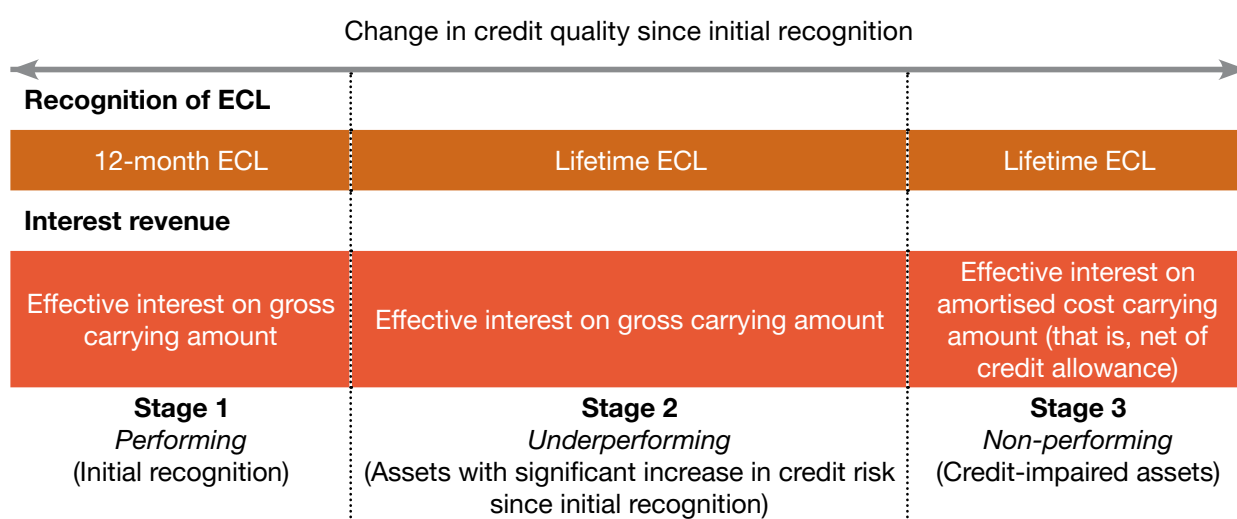
The business model for the sub-portfolio containing the factored receivables will be held to sell. The business model for the sub-portfolio containing the remaining receivables will be held to collect.

Judgement should be applied, based on all of the facts. The business should be reviewed if the facts change. The two different business models would need to be clearly articulated and documented before 1 January 2020.



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).

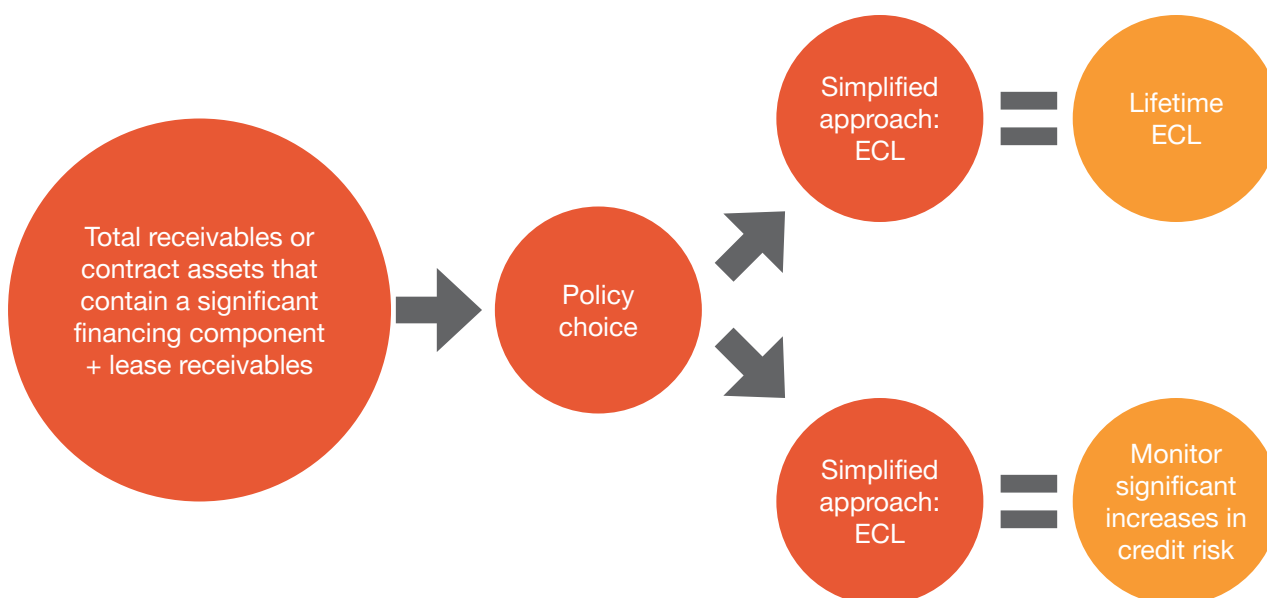
Impairment – Scope exception for trade receivables: The simplified approach

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 – 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, as shown in the diagram below.



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

What does this mean for the telecommunications 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 generally it will not contain a significant financing component. 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 good collection history.
<p>Long-term trade receivables</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.

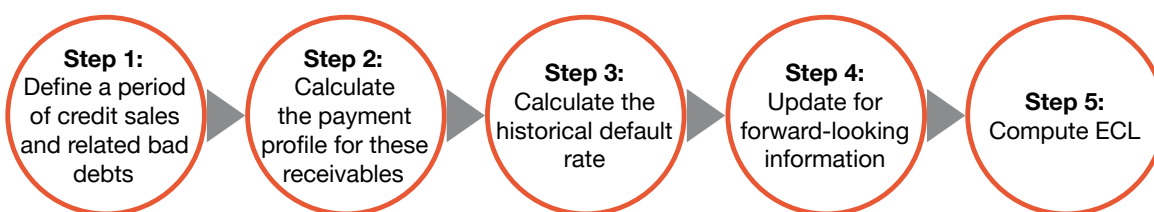


Provision matrix

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

Define an appropriate period of time to analyse the proportion of trade receivables written off as bad debts. This period should be sufficient to provide useful information. Too short a period might result in information that is not meaningful; too long might mean that changes in market conditions or the customer base mean the analysis is no longer valid. In the example, we have selected one year. The overall receivables were CU10,000 and the receivables ultimately written off were CU300 in that period.

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

Step 2

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 analysed in this step is critical for the next, when calculating default rate percentages.

Total sales (CU)	10,000	Total paid	Ageing profile of sales r (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

The telco calculates the historical default rate percentage. The default rate for each bucket is the quotient of the defaulted receivables over the outstanding credit sales for that period. For example, in the above information, CU300 out of the CU10,000 sales made was written off.

Current sales – historical rate of default

Since all of the receivables relating to the sales 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.

Sales payments 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 sales	Sales payments outstanding after 30 days	Sales payments outstanding after 60 days	Sales payments outstanding after 90 days
Ageing profile of sales(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, Gross Domestic Product (GDP), employment and politics);
- External market indicators; and
- Customer base.

For example, the telco concludes that the defaulted receivables should be adjusted by CU100 to CU400 as a result of regulatory changes affecting the industry. The telco also concludes that the payment profile and amount of sales 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 sales	Sales payments outstanding after 30 days	Sales payments outstanding after 60 days	Sales payments outstanding after 90 days
Ageing profile of sales (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
Trade 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 impact of PSAK 71 on intra-group funding (“funding”) might often be dismissed, because it is eliminated on consolidation. However, the impact in separate financial statements could be significant.

The scope for the accounting of intra-group loans 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.

Impairment of intra-group loans

Intra-group loans 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 trading performance declines), the impairment loss will be increased to lifetime ECL.

What does this mean for the telco?

Intra-group funding 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 are required to be measured at fair value on initial recognition. Intra-group loans are often either interest-free or they are provided at below market interest rate. The amount lent is, therefore, not fair value.

What does this mean for the telco?

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.

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 the telco?

Telco entities mostly hedge interest-rate and 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

Telecommunications 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”).

Under PSAK 55, entities were permitted, although not required, to recognise the gain/loss in the income statement at the date of modification of a financial liability. 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 need to 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.

While it is not expected that entities will be required to change their existing accounting policy under PSAK 55, 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, the DSAK-IAI issued a converged standard on revenue recognition. Almost all entities will be affected to some extent by the change. The impacted 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

Overview

The communications industry comprises several subsectors, including wireless, fixed line, and cable/satellite television (TV). These companies generate revenue through many different service offerings that include access to, and usage of, networks and facilities for the provision of voice, data, internet, and television services. These services generate revenues through subscription fees or usage charges. Some communications companies also sell or lease equipment such as handsets, modems, dongles (a wireless broadband service connector), customer premises equipment (CPE), and a variety of accessories.

Offerings in the communications industry have evolved as a result of consolidation, technology changes and innovation. Examples include instalment sales of wireless devices; multi-line plans, in which customers attach more than one device to a service; and bundled plans, with core video service, including voice and internet services, combined with other offerings, such as home security services. Also, companies may provide services that expand beyond traditional core offerings, including cloud and machine-to-machine services.

The new revenue standard PSAK 72, 'Revenue from Contracts with Customers' will impact each of these businesses. Certain changes having the potential for the greatest impact include:

- Additional revenue may need to be allocated to discounted or free products provided at the beginning of a service period due to the elimination of the "contingent revenue cap," and changes to and restrictions in the use of the "residual method" currently applied by some communications companies.
- The accounting treatment of activation fees, customer acquisition costs, and certain contract fulfilment costs may change.
- The guidance may be applied to a portfolio of contracts or performance obligations in some circumstances, although this approach may create additional implementation challenges and complexities.
- Free goods or services previously considered to be marketing offers may qualify under the revenue standards as distinct goods or services.

Communications companies are continually evaluating their business models and providing new device and service plans to customers. Assessing the accounting impact of these new services can be challenging. During the transition to the revenue standards, management will need to consider the impact that these new offerings have under both the old and new guidance, adding complexity to their growing list of challenges.



1. Identify the contract with the customer

A contract can be written, oral, or implied by a company's customary business practices. Generally, any agreement with a customer that creates legally enforceable rights and obligations meets the definition of a contract under PSAK 72. Legal enforceability depends on the interpretation of the law and could vary across legal jurisdictions where the rights of the parties are not enforced in the same way.

As part of identifying the contract, companies are required to assess whether collection of the consideration is probable, which is generally interpreted as a greater than 50% likelihood in PSAK 72. This assessment is made after considering any price concessions expected to be provided to the customer. In other words, price concessions are a variable consideration (which affects the transaction price), rather than a factor to consider in assessing collectability. PSAK 72 also eliminates the cash-basis method of revenue recognition that is often applied at present if collection is not probable. Companies that conclude collection is not probable under PSAK 72 cannot recognise revenue for cash received if (1) they have not collected substantially all of the consideration, and (2) they continue to transfer goods or services to the customer.

Contract term

Determining the contract term is important as it impacts the determination and allocation of the transaction price and recognition of revenue. Termination clauses should be considered when assessing contract duration – the period over which the parties have enforceable rights and obligations. If a contract can be terminated at any time for no compensation, the parties do not have enforceable rights and obligations, regardless of the stated term. In contrast, a contract that can be terminated early, but which requires payment of a substantive termination penalty, is likely to have a contract term equal to the stated term. This is because enforceable rights and obligations exist throughout the stated contract period. Judgement should be applied in determining whether a termination penalty is substantive. There are no “bright lines” for making this assessment.

Contract modifications

Customers of communications companies often request changes to their service plans. For example, wireless telecom customers might change their existing service plans to upgrade or replace a device; include additional wireless minutes; increase data usage; add incremental, or remove existing services; or terminate services altogether. Modifications also occur in multi-line plans when the customer adds or removes a device and/or changes the size of the data plan being shared across devices. Companies will need to account for the changes as modifications to the contracts when devices or services not covered under the original contract are added or removed.

Contract modifications exist when the parties to the contract approve a modification that creates or changes the enforceable rights and obligations of the parties to the contract. A modification is accounted for as either a separate contract or as part of the existing contract (either prospectively or through a cumulative catch-up adjustment). This assessment is driven by whether (1) the modification adds distinct goods and services and (2) the distinct goods and services are priced at their standalone selling prices (SSP). Companies will need to apply judgement in evaluating whether goods or services in the modification are distinct. This may be particularly challenging when there are multiple performance obligations in a contract.



1. Identify the contract with the customer *(cont'd)*

New guidance	Current PSAK
<p>A contract modification is treated as a separate contract only if it results in the addition of a distinct performance obligation and the price reflects the SSP of that performance obligation. Otherwise, the modification is accounted for as an adjustment to the original contract.</p> <p>A company will account for a modification prospectively if the goods or services in the modification are distinct from those transferred before the modification. A company will account for a modification through a cumulative catch-up adjustment if the goods or services in the modification are not distinct and are part of a single performance obligation that is only partially satisfied when the contract is modified.</p> <p>A contract modification that only affects the transaction price should be treated as part of the existing contract.</p>	<p>Modifications to add or remove goods or services in telecom arrangements are typically viewed as new arrangements with changes accounted for prospectively.</p>

Potential impact:

Historically, modifications to communications contracts have typically been treated as new agreements with changes accounted for prospectively. Going forward, companies will need to evaluate modifications under the new guidance to determine whether they are accounted for prospectively or require a cumulative catch-up adjustment. The analysis will need to consider modifications in new types of service plans, such as multi-line plans, in which it may be more difficult to determine whether the modification adds distinct goods or services, or modifies existing goods or services being provided under the contract.





1. Identify the contract with the customer *(cont'd)*

Contract modifications for a series

The revenue standard states that a company will account for a series of distinct goods or services that are substantially the same as a single performance obligation if each distinct good or service meets the criteria for over-time recognition and the same method would be used to measure progress for each distinct good or service. This approach will likely be used by communications companies for contracts that provide the customer with a consistent level of services on a monthly basis over a contract period, rather than treating each month or each day of service as a separate performance obligation.

Companies that account for a series of distinct goods or services in this manner at inception of the arrangement must consider the distinct goods or services in the contract (not the performance obligation) for purposes of applying the guidance on contract modifications. Therefore, when the remaining goods or services in the modified contract are distinct from goods or services that have already been transferred to the customer, these modifications will be accounted for prospectively.

Example 1(a) – Contract modification

Facts: A fixed-line communications company enters into a contract with a customer to provide voice and data services for 24 months at a fixed charge of United States Dollars (\$50 per month. After six months, the customer decides to add TV services for an incremental fee of \$50 per month over the same term. This price is slightly lower than the price charged to customers who just purchase the TV service without voice and data services, which reflects the fact that the customer acquired the TV service as part of a bundle. In this scenario, assume there are no other fees or deliverables.

Question: How should the company account for this modification?

Analysis: The TV services added by the customer are a distinct performance obligation. These services are being charged at relative SSP (when adjusted for the selling costs avoided by transacting with an existing customer). The TV services are a new contractual arrangement, and there is no impact to the accounting for the existing data and voice services.

While this example is fairly simple, further complexities could arise with contract modifications. For example, the modification could provide the customer with a discount on new or existing services, the contract period could be extended for all services, or additional deliverables (such as equipment) could be introduced. Communications companies will have to assess the facts and circumstances in these more complex situations.



2. Identify performance obligations

A performance obligation is a promise to transfer a distinct good or service to a customer. Identifying the separate performance obligations within a contract affects both when and how much revenue is recognised. Companies will need to determine whether performance obligations within customer contracts should be accounted for separately or bundled together. A promised good or service might be explicit in a contract, or implicit, arising from customary business practices. Applying the separation principle might be challenging when there are multiple offerings in bundled packages.

Communications companies regularly bundle the sale of services and equipment (e.g., handsets, modems, accessories) and might also charge for activation or set-up. Wireless companies give free or discounted equipment or promotional rates to customers as incentives to enter into contracts.

Equipment (including handsets) transferred to customers is a separate performance obligation in most cases if the company sells equipment separately or the customer can benefit from the handset together with other resources (for example, the handset could operate on another communications company's network). This is true regardless of whether the equipment is given at no cost or at a significantly discounted price. Other obligations, such as promises of future discounted services or other material rights, will also need to be evaluated to determine if they qualify as separate performance obligations.

New guidance	Current PSAK
<p>Performance obligations</p> <p>The revenue standard requires companies to identify all promised goods or services in a contract and determine whether to account for each promised good or service as a separate performance obligation.</p> <p>A performance obligation is a promise in a contract to transfer a distinct good or service to a customer.</p> <p>A good or service is distinct and is separated from other obligations in the contract if:</p> <ul style="list-style-type: none"> the customer can benefit from the good or service separately or together with other resources, and the good or service is separately identifiable from other goods or services in the contract. <p>PSAK reporters should consider materiality concepts when identifying performance obligations.</p> <p>A series of distinct goods or services that are substantially the same are accounted for as a single performance obligation if:</p> <ul style="list-style-type: none"> each would be a performance obligation satisfied over time; and the same method would be used to measure the company's progress toward satisfaction. <p>Examples of this could include network access or call centre services provided continuously over a set period of time.</p>	<p>The revenue recognition criteria are usually applied separately to each transaction. In certain circumstances, it might be necessary to separate a transaction into identifiable components to reflect the substance of the transaction. Separation is appropriate when identifiable components have standalone value and their fair value can be measured reliably.</p> <p>Two or more transactions 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>



2. Identify performance obligations *(cont'd)*

New guidance	Current PSAK
<p><u>Options to acquire additional goods or services</u></p> <p>A company might grant a customer the option to acquire additional goods or services free of charge or at a discount. These options might include customer award credits or other sales incentives and discounts. An option gives rise to a separate performance obligation if it provides a material right that the customer would not receive without entering into the contract. The company should recognise revenue allocated to the option when the option expires or when the additional goods or services are transferred to the customer.</p> <p>An option to acquire an additional good or service at a price that is within the range of prices typically charged for those goods or services does not provide a material right, even if the option can be exercised only because of entering into the previous contract.</p> <p><u>Non-refundable upfront fees</u></p> <p>Some companies charge customers a non-refundable upfront fee at or near contract inception. Companies will need to determine whether the non-refundable upfront fee relates to the transfer of a good or service to the customer.</p> <p>The standard states that activation services are an example of non-refundable upfront fees that do not result in the transfer of a good or service to the customer. The payment for the activation service is an advance payment for future communications services.</p>	<p>The recognition criteria are usually applied separately to each transaction (i.e., the original purchase and the separate purchase associated with the option). However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components as a single transaction to reflect the substance of the transaction.</p> <p>If a company grants to its customers, as part of a sales transaction, an option to receive a discounted good or service in the future, the company accounts for that option as a separate component of the arrangement and therefore allocates the consideration between the initial good or service provided and the option.</p> <p>Recognition of revenue from an upfront fee depends on the nature of the services provided. A company must determine whether an upfront fee related to installation or activation is a separate component of the transaction.</p> <p>Generally, an activation fee for communications services is not a separate component, and the activation fee is recognised over the period that the communications services are provided to the customer.</p>



2. Identify performance obligations *(cont'd)*

Potential impact:

Companies will need financial processes and systems that identify the different performance obligations in each of their contracts and pinpoint when and how the obligations are fulfilled. Traditionally, wireless communications companies have identified the device and service as separate units of accounting under existing guidance, but they will need to consider whether additional performance obligations exist under PSAK 72. This assessment will need to extend to all obligations under a contract, even items that are not regularly sold by the company, or that have previously been viewed as marketing expenses (e.g., free products not related to the provision of communications services).

Companies will also need to consider separation when multiple services are provided in an arrangement, as this may affect the allocation of the transaction price to separate performance obligations that have different patterns of transfer. When multiple services (e.g., voice services, data services, television services) or multiple access points are being provided that the customer can benefit from either on its own or together with readily available resources (i.e., the services are capable of being distinct), companies will need to evaluate whether the promise to transfer the goods or services is separately identifiable from other promises in the contract (i.e., they are distinct in the context of the contract) or whether some or all of the goods or services should be combined into one performance obligation. For instance, if multiple services have the same pattern of transfer to the customer, the company may, as a practical matter, account for the services as a single performance obligation.

Communications companies will have to consider outsourcing and network IT contracts, various types of activation or connection services, and other upfront services (e.g., connecting customers to their networks or laying physical lines to the customers' premises) to determine if these services meet the definition of a separate performance obligation and if a good or service is transferred to the customer. The timing of revenue recognition for communications companies that currently do not account for equipment separately from the telecom services will be significantly affected if the components of their bundled offerings are separate performance obligations under the revenue standard.

Many companies charge activation fees at the inception of a contract. The activation services are typically not a separate performance obligation. Activation fees are typically advance payment for future goods or services and, therefore, would be recognised as revenue when those future goods or services are provided. The recognition period could extend beyond the initial contractual term if (1) the customer has the option to renew and (2) that option provides the customer with a material right (e.g., an option to renew without requiring the customer to pay an additional activation fee). Companies should consider the impact of options on all contracts, including month-to-month service arrangements. This may result in a different pattern of revenue recognition from today's accounting models under which activation fees are often recognised over the contract period.

Furthermore, communications companies increasingly sell multi-line plans and will need to determine whether the option to add additional lines is a material right that is a separate performance obligation



2. Identify performance obligations *(cont'd)*

Example 2(a) – Identifying performance obligations

Facts: A communications company enters into a contract with a customer to provide wireless telecom services for \$50 per month and a handset for \$100. It also charges an activation fee of \$30. The communications company sells handsets separately (for example, when a customer's handset is lost, stolen, or damaged).

Question: How many separate performance obligations are in the contract?

Analysis: At least two separate performance obligations exist in this arrangement: telecom services and the handset. The handset is a separate performance obligation because the company sells the handset separately.

The handset would be a separate performance obligation even if the company did not sell the handset separately if the customer could use the handset to receive telecom services from another company.

Activation/connection fees are not separate performance obligations, but are considered upfront payments for the handset and future telecom services.

Depending on the facts and circumstances, the company may need to further assess the nature of the telecom services to determine whether the individual services should be considered separate performance obligations. For example, if the services consist of bundled voice, text, and data, and the customer has the right to roll over some or all of the unused services (e.g., unused data) to the next month, the individual services may not have the same pattern of transfer. As a result, the company would not be able, as a practical matter, to bundle all services into a single performance obligation as different measures of progress would be applied to them.

Example 2(b) – Options that do not provide a material right

Facts: A communications company enters into a two-year contract with a customer to provide wireless telecom services for \$50 per month. The contract requires the communications company to provide the customer with 800 voice minutes and 100 text messages per month. The contract specifies the customer may purchase additional voice services for \$0.10 per minute and text services for \$0.20 per message during the contract. These prices are typically charged for those services regardless of the type of contract, and therefore, they reflect the SSP of those services.

Question: Is the customer's option to purchase additional voice minutes and text messages a separate performance obligation?

Analysis: No. The option provided in the contract is not a performance obligation because it does not provide a material right to the customer. The customer pays the same price, or price within a range, for voice minutes and text messages as other customers. The company will recognise revenue for the additional voice minutes and text messages if and when the customer receives those additional services.



2. Identify performance obligations *(cont'd)*

Example 2(c) – Multi-line “family” plans

Facts: A communications company enters into a contract to provide unlimited telecom services under a multi-line “family” plan on a monthly basis. The customer has the option to add additional lines to the plan each month for a package price that reflects a decrease in the monthly service fee per line as additional lines are added.

Question: Does the option to add an additional line to the plan provide the customer with a material right?

Analysis: No. The option to add additional lines to a family plan in a future month does not provide the customer with a material right. Even though a customer may add or subtract lines within the plan, which may be capable of being distinct, the context of the contract provides for a plan that shares the same telecom services as a bundle. Further, when customers add or subtract lines from the plan, they are making a decision on a month-to-month basis regarding which family plan to purchase that month (e.g., a three-line plan vs. a four-line plan). The pricing for the family plan is based on the number of lines purchased that month and is consistent across customers, regardless of the plan a customer purchased in prior months. The customer is not receiving a discount based on its prior purchases.

Example 2(d) – Installation services

Facts: A communications company enters into a contract to provide cable services (television, internet, voice, etc.) on a monthly basis, with no contract end date. The company charges an upfront, non-refundable installation fee of \$50 to recover the cost of laying a physical line to the customer’s premises. This line can be used by other communications companies if the customer later changes service providers.

Question: Is the installation service a separate performance obligation?

Analysis: It depends. The company will need to determine whether laying the physical line is a distinct good or service. In this example, other communications companies can provide services on the same physical line, so the line is separately identifiable and can be used by the customer without the company subsequently providing cable services. Therefore, laying the physical line is a distinct performance obligation.

Example 2(e) - Cable company, activation services

Facts: A cable entity enters into a contract to provide cable services (television, internet, voice, etc.) on a monthly basis, with an initial contract period of 12 months. The company charges an upfront, non-refundable fee of \$50 to recover the cost of sending a technician to activate the service on the customer’s premises.

Question: Is the activation service a separate performance obligation?

Analysis: It depends. The company will need to determine whether the activation is a distinct service. In this example, the activation service is not distinct from the provision of the cable services because the customer cannot benefit separately from the activation service. The activation fee should be deferred and recognised over at least the contract period.

Companies will need to determine if the activation fee relates to the services that extend beyond the initial contract period and should be recognised over that longer period. This could be the case if the customer has a material right to extend the contract without paying an additional activation fee.



3. Determine transaction price

The transaction price is the amount of consideration a company is entitled to receive in exchange for transferring goods or services to customers. Determining the transaction price is more straightforward when the contract price is fixed; it becomes more complex when it is not fixed. Discounts, rebates, refunds, credits, incentives, performance bonuses, and price concessions could cause the amount of consideration to be variable. Because variable consideration is required to be estimated and included in the transaction price subject to a constraint, communications companies may recognise revenue earlier under PSAK 72.

New guidance	Current PSAK
<p>Variable consideration</p> <p>The transaction price might include an element of consideration that is variable or contingent upon the outcome of future events, such as discounts, rebates, refunds, credits, incentives, etc. A company should use the expected value or most likely outcome approach to estimate variable consideration, depending on which is the most predictive.</p> <p>Variable consideration included in the transaction price is subject to a constraint. The objective of the constraint is that a company should recognise revenue as performance obligations are satisfied to the extent it is highly probable that a significant reversal will not occur in future periods. Management should update the assessment at each reporting period.</p> <p>If a company receives consideration from a customer and expects to refund some or all of that consideration to the customer, it recognises a refund liability for an amount it expects to refund.</p> <p>Customers might not exercise all of their contractual rights related to a contract, such as mail-in rebates and other incentive offers. Companies will need to continually update their estimates to adjust for changes in expectations. The revenue guidance explains several factors that companies should consider in assessing the amount of consideration to which a company expects to be entitled.</p>	<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 be exchanged or settled between knowledgeable, willing parties in an arm's length transaction.</p> <p>Trade discounts, volume rebates, 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>Revenue related to variable consideration is recognised when (1) it is probable that the economic benefits will flow to the company and (2) the amount is reliably measurable, assuming all other revenue recognition criteria are met.</p> <p>The company recognises a liability based on the expected levels of rebates and other incentives that will be claimed. The liability should reflect the maximum potential amount if no reliable estimate can be made.</p>



3. Determine transaction price (cont'd)

Significant financing component

The revenue guidance requires companies to adjust the promised amount of consideration to reflect the time value of money if the contract has a significant financing component. Factors to consider when determining whether a contract has a significant financing component include, but are not limited to: (1) the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services, (2) whether the amount of consideration would differ substantially if the customer paid in cash promptly in accordance with typical credit terms in the industry and jurisdiction, and (3) the interest rate in the contract and prevailing interest rates in the relevant market (i.e., interest rates offered by financing institutions in the same market or geography).

A significant financing component would not exist when: (1) the customer paid for the goods or services in advance and transfer is at the discretion of the customer, (2) a substantial amount of the promised consideration is variable and the amount or timing of consideration varies based on the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the company, or (3) the difference between the cash selling price and promised consideration is for a reason other than providing financing and the difference is proportional to that reason.

Potential impact:

Some companies will recognise revenue earlier under the revenue guidance because variable consideration is included in the transaction price prior to the date on which all contingencies are resolved. For example, a network provider might offer a communications company (its customer) a volume discount on usage rates (voice and data access) to access its network as part of a minimum purchase commitment arrangement. The network provider charges penalties or the customer loses the volume discount if the customer does not meet specified usage volumes. Network providers that offer such discounts under minimum purchase commitment arrangements and determine it is highly probable that they will receive penalties or additional payments because customers fail to meet the specified usage volumes could recognise revenue earlier than under current guidance.

Companies will also have to estimate amounts related to incentives and consider the guidance for variable consideration to determine the amounts to which they expect to be entitled, considering their experience with existing incentives, discounts, take-rates, and other external factors.

Communications companies should consider whether the transfer of a handset to a customer at the initiation of the contract and collecting monthly payment for the handset over the contract period provides the customer with significant financing, which would result in an adjustment to the transaction price to reflect the financing component. A significant financing component may exist even though a contract has an interest rate of zero.

Communications companies may offer incentives to customers to purchase handsets with payments made over an extended period of time. The company needs to determine whether it offered a discount equal to the financing charge that would have otherwise been charged to the customer. If a financing component exists, the company needs to evaluate whether the financing is significant.



3. Determine transaction price (cont'd)

Example 3(a) – Discount programme, revenue is not constrained

Facts: A communications company enters into contracts with its customers to provide telecom services for CU50 per month and provides Equipment X for CU200. The customers will receive a discount of CU100 related to the purchase of Equipment X if they submit an appropriate form and proof of purchase via mail (also known as a mail-in-rebate). The company has predictive experience from providing similar discounts to a range of customers (refund amounts for similar equipment with similar sales prices).

Historically, 75% of the company's customers took advantage of the rebate and the company concludes that there are no external economic factors that affect historical trends.

Question: How should the company estimate the transaction price?

Analysis: The company should estimate the transaction price based on the amounts to which it expects to be entitled using the most recent history for similar discount programmes (refund amounts for similar equipment with similar sales prices). It estimates the refund liability for each transaction using the following probabilities representing the pattern of similar rebates.

Amount	Probability	Probability – weighted amount
CU 0	25%	CU 0
CU 100	75%	CU 75
		CU 75

The company concludes it is highly probable that variable consideration of CU25 will not be subject to significant reversal. The company records a refund liability of CU75 and reduces the transaction price by CU75. The company will update the estimated liability at each reporting period, with any adjustments recorded to revenue.

Example 3(b) – Discount programme, revenue is constrained

Facts: A communications company is launching its service in a new country; it enters into contracts with its customers to provide telecom services for CU50 per month and Equipment Y for CU350. The customers receive a discount of CU100 related to the purchase of the equipment if they submit an appropriate form and proof of purchase via mail. The company does not have predictive experience providing similar discounts (refund amounts for similar equipment with similar sales prices) in this country and concludes that there is no amount of the variable consideration (the potential discount) that is highly probable of not being subject to a significant reversal.

Question: How should the company determine the transaction price?

Analysis: The company records a full refund liability of CU100 and reduces the transaction price by CU100 as there is no amount of the potential discount that is highly probable of not being subject to a significant reversal.

The company will adjust the liability and recognise revenue as soon as management is able to conclude it is highly probable that (1) there will be no significant reversal for some part of the consideration or (2) the right to the discount expires. The company will update the estimated liability at each reporting period, with any adjustments recorded to revenue.



3. Determine transaction price (cont'd)

Example 3(c) – Minimum purchase contract

Facts: A network provider enters into a contract with a communications company (its customer) to provide access to its network over a one-year period. The contract offers a discounted usage rate of \$0.05 per voice minute. The discounted rate is contingent on the customer's minimum monthly purchase commitment of 25 million minutes of network voice usage. If the customer is unable to meet the volume commitments, the usage rate increases to \$0.08 per voice minute, applied retroactively.

Question: How should the network provider determine the transaction price?

Analysis: The network provider should estimate the variable consideration to determine the transaction price. The network provider determines, based on its facts and circumstances, including the customer's usage history, that there is an 85% probability that the customer will meet the minimum monthly volume commitments for the contract period and a 15% probability the customer will not meet the minimum commitments. The network provider uses the most likely outcome method as it concludes it is the best prediction of the amount it expects to receive. It also determines that there is no amount in excess of \$0.05 per minute that is highly probable of not being reversed. Therefore, the network provider will recognise revenue based on a transaction price of \$0.05 per voice minute.





4. Allocate transaction price

Communications companies often provide multiple products and services to their customers as part of a bundled offering. These arrangements usually consist of the sale of telecom services and the sale of equipment (wireless handset, modem, etc.). Some communications companies also charge customers upfront activation fees. Most communications companies reporting under PSAK use either a residual method or apply a contingent revenue cap. The contingent revenue cap limits the amount of consideration allocated to the delivered item (e.g., a handset) to the amount that is not contingent on the delivery of additional items (e.g., the telecom services).

Under the new guidance, the transaction price in an arrangement must be allocated to each separate performance obligation based on the relative SSP of the goods or services being provided to the customer. The allocation could be affected by variable consideration or discounts.

The best evidence of SSP is the price a company charges for that good or service when the company sells it separately in similar circumstances to similar customers. However, goods or services are not always sold separately. The SSP needs to be estimated or derived by other means if the good or service is not sold separately.

New guidance	Current PSAK
<p>The transaction price is allocated to separate performance obligations in a contract based on relative SSP, as determined at contract inception.</p> <p>Companies will need to estimate the selling price if an SSP is not observable. In doing so, it should maximise the use of observable inputs.</p> <p>Possible estimation methods include:</p> <ul style="list-style-type: none"> • Expected cost plus a reasonable margin • Assessment of market price for similar goods or services • Residual approach (if certain criteria are met). <p>A residual approach may be used to estimate the SSP when the selling price of a good or service is highly variable or uncertain. A selling price is highly variable when a company sells the same good or service to different customers (at or near the same time) for a broad range of amounts.</p> <p>A selling price is uncertain when a company has not yet established a price for a good or service and the good or service has not previously been sold.</p>	<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 be exchanged or settled, between knowledgeable, willing parties in an arm's length transaction.</p> <p>PSAK does not mandate how consideration is allocated and permits the use of the residual method, in which the consideration for the undelivered element of the arrangement (normally service or tariff) is deferred until the service is provided, when this reflects the economics of the transaction. Any revenue allocated to the delivered items is recognised at the point of sale.</p>



4. Allocate transaction price (cont'd)

Potential impact:

Allocation requirements under PSAK 72 will have significant implications for the telecom industry. It requires the transaction price be allocated to each separate performance obligation in proportion to the SSP of the good or service. It therefore eliminates the contingent revenue cap. PSAK 72 also substantially reduces the circumstances when a residual approach can be applied. The residual approach is different from the residual method that is used today. Applying today's residual method results in the entire discount in an arrangement being allocated to the first item delivered under the contract. This will not be the case under PSAK 72.

Judgement will be needed to determine the SSP for each separate performance obligation (e.g., services, equipment, and material rights) in a customer contract. There is good visibility into the pricing of communications equipment and the associated telecom service in some markets. However, in many markets, communications companies charge customers little, if anything, for the equipment, and only sell equipment bundled with the telecom services. If communications companies do not equipment separately, management may have to use various estimation methods, including, but not limited to, a market assessment approach or a cost plus margin approach.

Determining the SSP of certain services may also present challenges. Historically, there was a reasonable level of consistency in the amounts charged for bundled services within operators and between operators. Today, there is increasing variability in the amounts charged for equivalent bundles of services. For example, the amount charged for services can vary depending on the number and mix of devices chosen by the customer, including "SIM-only" deals in which the monthly price for service is less when the customer does not take a subsidised device, or multi-line plans.

The revenue guidance will likely require companies to allocate more of the transaction price to the equipment than under the current guidance, and therefore, result in earlier recognition of revenue. Recognising more revenue than consideration received also results in the recognition of a contract asset, which will need to be monitored for impairment.

Companies will face practical challenges in allocating the transaction price for a large volume of customer contracts with varying configurations of equipment and service plans. The revenue guidance permits a company to apply the guidance to a portfolio of contracts (or performance obligations) with similar characteristics if it reasonably expects that the effects on the company's financial statements of doing so would not differ materially from the results of applying the guidance to individual contracts (or performance obligations). It is specifically acknowledged in the Basis for Conclusions to the standard that this approach may be particularly useful to companies in the telecommunications industry. Companies should be able to take a "reasonable approach" to identify portfolios for applying this guidance, as opposed to a quantitative evaluation. Companies choosing to apply a portfolio approach should consider the extent of variability in characteristics of portfolio groupings not only upon adoption, but also on an ongoing basis. Companies should consider whether they need to modify existing systems or develop new systems to gather information on customer contracts and to perform the required allocations of the transaction price between separate performance obligations.



4. Allocate transaction price (cont'd)

Example 4(a) – Allocating the transaction price

Facts: A wireless company enters into sales arrangements with two different customers: Customer A and Customer B. Each customer purchases or receives the same handset and selects the same monthly service plan. The SSP for the handset is C300 (it is purchased wholesale by the wireless company for C290) and the SSP of the telecom service plan is C40 per month.

Customer A purchases the handset for C300 and enters into a cancellable contract to receive telecom services for C40 per month.

Customer B enters into a 24 month-service contract for C40 per month and receives a discounted handset for C50.

<u>In summary:</u>	Customer A	Customer B
SSP of handset	C300	C300
SSP of services	C40	C960 (C 40 x 24 months)
Total	<u>C340</u>	<u>C1,260</u>
Cost equipment	C290	C290
Customer A transaction price	C340 (C300 handset + C40 for one month of service)	
Customer B transaction price	C1,010 (C960 services + C50 for handset)	

Question: How should the transaction price be allocated to the performance obligations in contracts with Customer A and B?

Analysis: The company needs to identify the separate performance obligations within the customer contracts. In this example, the sales of telecom services and handsets are separate performance obligations because they are distinct goods and services. Revenue is recognised when a promised good or service is transferred to the customer and the customer obtains control of that good or service. Revenue is recognised for the sale of the handset at delivery, when the communications company transfers control of the handset to the customer. Service revenue is recognised over the contract service period.

For simplicity, the example assumes the potential financing impact of transferring the handset to the customer at the initiation of the contract and collecting the customer's monthly payment over the 24-month contract period is insignificant.

The tables below compare the effect of applying the allocation guidance in the revenue guidance with that of the current guidance.



4. Allocate transaction price (cont'd)

Current guidance—existing PSAK guidance (residual method)

Customer	Day 1	Month 1	Month 2	Month 3
Customer A	C300 ^(a)	C 40	C 40	C 40
Customer B	C 50 ^(b)	C 40	C 40	C 40
Total	C350	C 80	C 80	C 80

(a) Under the residual method, the amount of consideration allocated to the delivered item (C300) equals the total arrangement consideration (C340) less the aggregate fair value of the undelivered item(s) (C40).

(b) Under the residual method, the amount of consideration allocated to the delivered item (C50) equals the total arrangement consideration (C1,010) less the aggregate fair value of the undelivered item(s) (C960).

New guidance—revenue recognised

Customer	Day 1	Month 1	Month 2	Month 3
Customer A	C300 ^(a)	C 40 ^(a)	C 40	C 40
Customer B	C240 ^(b)	C 32 ^(c)	C 32 ^(c)	C 32 ^(c)
Total	C540	C 72	C 72	C 72

(a) Handset: $C300 = (C300/C340) \times C340$; One month of service $C40 = (C40 / C340) \times C340$.

(b) Handset: $C240 = (C300/C1,260) \times C1,010$.

(c) Monthly service revenue: $C32 = (C960/C1,260) \times C1,010 = C770 / 24$ months.

In this example, the communications company recognises C190 more in equipment revenue under the new guidance compared to the current standard. The communications company will also recognise a net contract asset of C190 under the revenue guidance (C540 less C350 cash received), which should be amortised over the period that the related goods and services are transferred to the customers. Management needs to monitor the contract asset for impairment each reporting period. For example, the communications company may have to impair the asset if Customer B terminates the contract before the end of two years and it is unable to collect an early termination fee in excess of the contract asset balance.

This simple example does not address other complexities that companies will have to consider. For example, the company may charge an activation fee. The guidance states that activation services are an example of non-refundable upfront fees that do not result in the transfer of a good or service to the customer. Rather, the activation fee is an advance payment for future communications services. Additionally, if the company grants the customer an option to renew that provides a material right (e.g., an option to renew without requiring the customer to pay an additional activation fee), the amount allocated to the material right would likely be recognised over the customer relationship period.



5. Recognise revenue

A performance obligation is satisfied and revenue is recognised when control of the promised good or service is transferred to the customer. A customer obtains control of a good or service if they have the ability to (1) direct its use and (2) obtain substantially all of the remaining benefits from it. Directing the use of an asset refers to a customer's right to deploy the asset, allow another entity to deploy it, or restrict another company from using it.

Management should evaluate transfer of control primarily from the customer's perspective, which reduces the risk that revenue is recognised for activities that do not transfer control of a good or service to the customer.





Other considerations

Costs to obtain a contract

Communications companies often pay commissions to internal sales agents and third-party dealers for connecting new customers to their networks. Commissions paid for connecting new customers can vary depending on the length of the service contract and the type of service plan, including any enhanced services sold. The longer the service contract and the greater the monthly proceeds (e.g., service plans with relatively high or unlimited minutes of use), the greater the commission costs.

Some companies capitalise customer acquisition costs as an intangible asset, while other communications companies expense these costs as incurred. The new guidance requires communications companies to capitalise incremental costs of obtaining a contract if the costs are expected to be recovered. As a practical expedient, companies are permitted to expense these costs when incurred if the amortisation period would be less than one year.

Some wireless companies also provide free or heavily-discounted handsets to attract customers. Incentive programs will not be accounted for as costs to obtain a contract under the revenue guidance. A handset is a separate performance obligation, and the cost of the handset is recognised as an expense when the performance obligation is satisfied (i.e., when the handset is delivered to the customer). Communications companies offer a wide range of discounts and subsidies, using both their own and third-party dealer networks, and will have to assess the accounting for each different type of arrangement.

New guidance	Current PSAK
<p>Companies recognise as an asset the incremental costs of obtaining a contract with a customer if they expect to recover them.</p> <p>The incremental costs of obtaining a contract are those costs that a company would not have incurred if the contract had not been obtained. All other costs incurred regardless of whether a contract was obtained are recognised as an expense.</p> <p>The revenue standard permits companies to expense incremental costs of obtaining a contract when incurred if the amortisation period would be one year or less, as a practical expedient.</p> <p>Contract costs recognised as an asset are amortised on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates. In some cases, the asset might relate to goods or services to be provided in future anticipated contracts (e.g., service to be provided to a customer in the future if the customer chooses to renew an existing contract).</p> <p>An impairment loss is recognised if the carrying amount of an asset exceeds:</p> <ul style="list-style-type: none"> the amount of consideration to which a company expects to be entitled in exchange for the goods or services; less the remaining costs that relate directly to providing those goods or services. <p>Companies may reverse impairments when costs become recoverable; however, the reversal is limited to an amount that does not result in the carrying amount of the capitalised acquisition cost exceeding the depreciated historical cost.</p>	<p>Given the lack of definitive guidance under current PSAK, costs of acquiring customer contracts are capitalised by some communications companies as intangible assets and amortised over the customer contract period, while other communications companies expense the costs when incurred.</p>



Other considerations *(cont'd)*

Potential impact:

The revenue standards will have a significant impact on companies that do not currently capitalise costs to obtain contracts. Companies will likely have to develop systems, processes, and controls to identify and track incremental contract acquisition costs and to subsequently monitor the capitalised costs for impairment.

A communications company will capitalise costs to obtain a contract as an asset if the costs are recoverable, and amortise them consistent with the pattern of when goods or services to which the asset relates are transferred to the customer. Companies will need to use judgment to determine the amortisation period as the revenue standards require companies to consider periods beyond the initial contract period (e.g., the renewal of existing contracts and anticipated contracts). Therefore, the asset recognised from the cost to obtain the initial contract may be amortised over a period longer than the initial contract term, such as over the average customer life, which is based on the period of expected future cash flows to be received from the customer. However, there may be circumstances when the asset should be amortised over a period shorter than the average customer life, such as when the lifecycle of the goods or services to which the asset relates is shorter than the average customer life.

Amortising an asset over a longer period than the initial contract would not be appropriate when a company pays a commission on a contract renewal that is commensurate with the commission paid on the initial contract. It was clarified that the level of effort to obtain a contract or renewal should not be a factor in determining whether the commission paid on a contract renewal is commensurate with the initial commission. However, it may be reasonable for a company to conclude that a renewal commission is commensurate with an initial commission if the two commissions are reasonably proportionate to the respective contract value.

A company also has to develop a systematic approach, considering the number of customers and contract offerings, to test assets relating to contract acquisition costs for impairment (e.g., a portfolio approach) when the estimated amount of consideration to be received from customers might be less than the outstanding contract asset.

Spreading these costs over the amortisation period could significantly affect operating margins compared to the current accounting model. Wireless companies, for example, often incur significant contract acquisition costs during the holiday seasons as they sign up customers through significant promotional offers.

Example 6(a) – Contract acquisition costs, practical expedient

Facts: A communications company enters into a contract with a customer to provide telecom services. The transaction does not include the sale of a device. The company pays a third-party dealer a commission to connect the customer to its network. The customer signs an enforceable contract to receive telecom services for one year.

Question: How should the communications company account for the third-party dealer commission?

Analysis: The company identifies incremental contract acquisition costs and capitalise those costs that are recoverable.

The communications company may use the practical expedient and expense contract acquisition costs when incurred if the amortisation period would be one year or less. In this case, the company determines that the amortisation period is one year because no renewal is expected.



Other considerations *(cont'd)*

Example 6(b) – Contract acquisition costs, identifying incremental costs

Facts: A communications company sells wireless telecom service subscriptions (service plans) from a retail store in a shopping mall. Sales agents employed at the retail store sign 120 customers to two-year telecom service contracts in a particular month. The monthly rent for the store is C5,000. The communications company pays the sales agents' commissions for the sale of telecom service contracts, in addition to their normal wages. Wages paid to the sales agents during the month are C12,000 and commissions are C24,000.

The communications company also offers customers free, or significantly subsidised, handsets to create an incentive for them to enter into two-year contracts. The net subsidy (loss) on handsets sold to the 120 customers is C36,000 (measured on the basis of the cost of the handset compared to advertised price, and not as specified in the revenue standards). The retail store also incurs C2,000 in costs during the month to advertise in the local journals.

Question: How much should the communications company recognise as a contract acquisition asset?

Analysis: The communications company is required to capitalise incremental costs to acquire contracts, which are those costs it would not have incurred unless it acquired the contracts. The practical expedient is not available as the amortisation period is greater than a year. In this example, the only costs that qualify as incremental contract acquisition costs are the C24,000 commissions paid to the sales agents.

All other costs are expensed when incurred. The store rent of C5,000, the sales agents' wages of C12,000, and advertising expenses of C2,000 are all expenses the communications company would have incurred regardless of acquiring the customer contracts.

Although the company might internally regard the handset losses as marketing incentives or incidental goods or services, the sale of the handsets are performance obligations, and the costs of the handsets are recognised (as cost of goods sold) as the goods are delivered.

Companies should be aware that subtle differences in arrangements could have a substantial impact on the accounting for subsidies and discounts under the revenue guidance. For example, another communications company might pay third-party dealers greater commissions to allow those dealers to offer similar incentives (i.e., offer significantly-discounted handsets at a dealer's discretion). Payments to dealers that are in-substance commissions should be treated as contract acquisition costs.



Other considerations *(cont'd)*

Example 6(c) – Contract acquisition costs, amortisation period for prepaid services

Facts: A communications company sells wireless services to a customer under a prepaid, unlimited monthly plan. The communications company pays commissions to sales agents when they activate a customer on a prepaid wireless service plan. While the stated contract term is one month, the communications company expects the customer, based on the customer’s demographics (e.g., geography, type of plan, and age), to renew for six additional months.

Question: What period should the communications company use to amortise the contract acquisition costs (i.e., the commission costs)?

Analysis: The company could use the practical expedient to expense the costs as incurred. If the company chooses to capitalise the costs, it will use judgment to determine an amortisation period that represents the period during which the company transfers the telecom services. In this example, the company determines an amortisation period of seven months based on anticipated renewals.

Fulfilment costs

Companies that provide long-term network outsourcing services sometimes defer set-up costs because they are necessary investments to support the ongoing delivery of the contract.

Costs to fulfil contracts are capitalised in accordance with other standards (e.g., inventory, property, plant and equipment, or intangible assets) or, if not within the scope of other guidance and they meet specific requirements, are capitalised under the revenue guidance. Companies need to review their cost capitalisation policies to understand the potential effect of these changes.

New guidance	Current PSAK
<p>Direct costs incurred to fulfil a contract are first assessed to determine if they are within the scope of other standards, in which case the company accounts for them in accordance with those standards.</p> <p>Costs that are not in the scope of another standard are evaluated under the revenue guidance. A company recognises an asset only if the costs:</p> <ul style="list-style-type: none"> relate directly to a contract; generate or enhance resources that will be used in satisfying future performance obligations (i.e., they relate to future performance); and are expected to be recovered. <p>These costs are then amortised as control of the goods or services to which the asset relates is transferred to the customer.</p>	<p>Costs incurred to install services at the origination of a customer contract are either expensed as incurred or recognised as an asset and charged to expense in proportion to the revenue recognised, depending on the nature of the costs.</p> <p>In particular, direct, incremental, set-up costs on long term network outsourcing contracts may be deferred if they are “costs that relate to future activity on the contract.”</p> <p>In addition, many of the costs of connecting customers form part of the operator’s network, and the costs are capitalised as property, plant and equipment.</p>



Other considerations *(cont'd)*

Potential impact

Communications companies that currently expense all contract fulfilment costs as incurred might be affected by the revenue standard since costs are required to be capitalised when the criteria are met. Fulfilment costs that are likely to be in the scope of this guidance include, among others, set-up costs for service providers.



Interaction between PSAK 71 and PSAK 72

Trade receivables arising from sales with contracts with customers in the scope of PSAK 72, 'Revenue from contracts with customers,' are within the scope of PSAK 71. There might be additional complexity where the sale has a significant financing component, which creates an accounting impact in both the PSAK 71 and PSAK 72 measurement of the sale and the corresponding receivable.

This results in a 'double hit' in the income statement.

Example – Measurement of receivables including a significant financing component

The telco sells handsets with its service contracts in country X.

The telco has historically experienced long delays in payments for sales in this country, due to slow economic growth and high consumer debt levels.

Under the terms of the sales contract, handsets are paid for over 24 months, in equal monthly instalments. The telco has an unconditional right to receive payment.

The telco currently has outstanding receivables from handset sales, but continues to enter into handset/service contracts at its normal market price. The telco has not entered into any factoring arrangements for these receivables.

The criteria for recognition of revenue in accordance with paragraph 9 of PSAK 72 have been met. The entity has also concluded that the arrangements contain a significant financing component in accordance with paragraph 60 of PSAK 72. The telco's accounting policy is to apply the simplified approach when determining ECLs for trade receivables with a significant financing component. The ECL is calculated using a probability weighted approach, considering scenarios where the government will and will not pay the amount due.

The following financial information has been extracted from the telco's records in relation to the sales in country X:

Handset sales during 20X1 – Before discounting for financing element under PSAK 72	CU50m
Handset sales during 20X1 – After discounting for financing element under PSAK 72	CU45m
Lifetime expected losses as calculated using a provision matrix approach	CU 8m

The sales are performed in the telco's functional currency.

How should the telco account for the receivables from the governmental entity?

Interaction between PSAK 71 and PSAK 72 *(cont'd)*

Solution

The telco recognises revenue when the handsets are transferred to the customer because it is probable that it will collect the consideration that it is entitled to. However, the revenue and receivable will need to be discounted at initial recognition, because there is a significant financing component, due to the 24 month term over which payments are received.

The journal entry to record under would be:

Receivables	DR CU45m
Sales	CR CU45m

The telco will also need to apply the provisions of PSAK 71 and recognise impairment on initial recognition of the receivables. The ECL will also need to be discounted from the expected payment date to the due date.

The telco applies the simplified approach, and it recognises lifetime ECLs on the receivable. This results into a 'double' hit on the income statement: the discounting element on the recognition of the financing component, and the ECLs. This might appear counterintuitive given that the discount rate used under PSAK 72 for contracts containing significant financing components already incorporates the customer's credit risk. [PSAK 72 para 64].

Impairment losses (P&L)	DR CU8m
Receivables	CR CU8m

PSAK 73

Leases

In 2017, the DSAK-IAI issued PSAK 73 which supersedes PSAK 30 Leases, ISAK 8 Determining whether an Arrangement Contains a Lease, ISAK 23 Operating Leases - Incentives, ISAK 24 Evaluating the Substance of Transactions Involving the Legal Form of a Lease and ISAK 25 Land Rights. 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. This and other provisions will likely introduce some level of change for all entities that are a party to a lease.

Overview

'The new lease accounting standard will fundamentally change the accounting for lease transactions and is likely to have significant business implications. PSAK 73 covers every lease except for rights to explore non-regenerative resources, rights held under certain licencing arrangements, leases of biological assets and service concession arrangements.

Almost all leases will be recognised on the balance sheet, with a right of use asset and financial liability that recognise more expenses in profit or loss during the earlier life of a lease.

This will have an associated impact on key accounting metrics, and clear communication will be required to explain to the impact of changes to stakeholders.

Our '[PSAK 73 – Leases, A new Era for Lease Accounting](#)' publication provides a comprehensive analysis of the new standard. This guide summarises the main aspects of the standard, highlighting some key challenges and questions management should ask as they prepare for transition.



Overview (cont'd)

Effective date and transition

The new standard is effective 1 January 2020 and includes pre-existing leases (however, there are some reliefs on transition).

Early adoption is permitted for all entities, but only in conjunction with PSAK 72. This means that an entity is not allowed to apply PSAK 73 before applying PSAK 72.

The new standard can be adopted using a 'grandfathering' approach, which means that entities are not required to reassess existing lease contracts but can elect to apply the guidance regarding the definition of a lease only to contracts entered into (or changed) on or after the date of initial application. This applies to both contracts that were not previously identified as containing a lease applying PSAK 30/ISAK 8 and those that were previously identified as leases in PSAK 30/ISAK 8. If the entity chooses this expedient, it shall be applied to all contracts.

Acknowledging the potentially significant impact of the new lease standard on a lessee's financial statements, PSAK 73 does not require a full retrospective application in accordance with PSAK 25 but allows a 'simplified approach'. Full retrospective approach is optional. To reduce some of the burden of adoption, there are further practical expedients, available to lessees.

Lessor accounting stays largely the same as under PSAK 30 and, except for re-assessment of operating subleases ongoing at the date of initial application of PSAK 73, a lessor is not required to make any adjustments on transition.

Impact

The new standard will have a significant impact on telecommunications companies, in particular how they identify embedded leases, allocate contract consideration to components, and the impact of reflecting leases on a lessee's balance sheet. However, the accounting changes are just the most obvious impact the new standard will have on telecommunications companies. Companies will need to analyse how the new model will affect current business activities, contract negotiations, budgeting, key metrics, systems and data requirements, and business processes and controls.

Embedded leases

Telecommunications companies often enter into arrangements that include a variety of goods and services and that may include a lease. For example, telecommunications companies may enter into an infeasible right of use, backhaul, interconnection, or other network capacity arrangement that may include equipment, fibre, or other assets. They may also use third-party owned networks or transmission capacity provided by other telecommunications companies rather than building and owning this infrastructure.

Regardless of how an arrangement is structured, lease accounting guidance applies to any arrangement that conveys control over an identified asset to another party. An arrangement is a lease or contains a lease if an underlying asset is explicitly or implicitly identified and use of the asset is controlled by the customer.

If an arrangement explicitly identifies the asset to be used, but the supplier has a substantive contractual right to substitute such asset, then the arrangement does not contain an identified asset. A substitution right is substantive if the supplier can (a) practically use another asset to fulfil the arrangement throughout the term of the arrangement, and (b) it is economically beneficial for the supplier to do so. The supplier's right or obligation to substitute an asset for repairs, maintenance, malfunction, or technical upgrade does not preclude the customer from having the right to use an identified asset.

An identified asset must be physically distinct. A physically distinct asset may be an entire asset or a portion of an asset. For example, a building is generally considered physically distinct but one floor within the building may also be considered physically distinct if it can be used independent of the other floors (e.g., point of entry or exit, access to lavatories). Capacity or a portion of an asset is not an identified asset if (1) the asset is not physically distinct (e.g., the arrangement permits use of a portion of the capacity of a fibre optic cable); and (2) a customer does not have the right to substantially all of the economic benefits from the use of the asset (e.g., several customers share a fibre optic cable and no one customer has substantially all of the capacity). A customer controls the use of the identified asset by possessing the right to (1) obtain substantially all of the economic benefits from the use of such asset ("benefits" element); and (2) direct the use of the identified asset throughout the period of use ("power" element). A customer has the "power" element if they hold the right to make decisions that have the most significant impact on the economic benefits derived from the use of the asset. If these decisions are predetermined in the contract, the contract is a lease if the customer either (a) has the right to direct the operations of the asset without the supplier having the right to change those operating instructions or (b) has designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used.

Sometimes there may be terms in the contract that are included to protect the supplier's asset and supplier's personnel. For example, a contract may require the asset to be used in a manner that complies with regulations or may restrict usage of the asset up to a maximum capacity based on the asset's design constraints. The existence of such protective rights in and of itself does not prevent a customer from having the right to direct the use of an asset.

The new model differs in certain respects from today's risks and rewards model. Under current lessee guidance, embedded leases are often off-balance-sheet operating leases and, as such, application of lease accounting may not have had a material impact. Determining whether to apply lease accounting to an arrangement under the new guidance is likely to be more important since virtually all leases will result in recognition of a right-of-use-asset and lease liability by the lessee.

Embedded leases *(cont'd)*

PwC observation

Some contracts that may contain a lease are the result of specific negotiations covering a variety of goods and services, and often involve extensive collaboration between the parties before and during the term of the arrangement. In some cases, the factors that indicate that control has passed to the customer may not be obvious and may require significant judgment. Careful assessment of the facts and circumstances, considering all relevant rights will be required.

A thorough understanding of the facts and circumstances is important to the assessment of a potential embedded lease, particularly as it relates to evaluating control when an identified asset is present. The financial reporting function may need to engage engineers and the broader commercial team to fully understand the relevant facts and circumstances associated with arrangements that may be unique to the telecommunications industry.

Example 1 – Whether an arrangement contains a lease: Network bandwidth arrangement.

Example 1(a)

Facts: Customer enters into a 15-year indefeasible right of use (“IRU”) contract with a telecommunications company (“Supplier”) for 30% capacity across Supplier’s fixed-line network. Customer makes the decision about what, when and how much data will be transmitted across Supplier’s network. Supplier is not contractually required to use a specified cable or fibre strand to provide the service to Customer. Supplier has discretion over how to provide the capacity. Given the nature of the network, there are no technical or economic barriers to Supplier in substituting alternative infrastructure to provide the capacity required by Customer and it is economically beneficial for Supplier to do so for network efficiency or to ease network congestion.

Question: Does the contract contain a lease?

Analysis: Based on the facts in this example, the contract does not contain a lease.

Supplier has agreed to provide use of only a portion (30%) of the network capacity, which is not physically distinct from the remaining capacity of the network and does not represent substantially all of the capacity of the network. Therefore, Customer does not have the right to use an identified asset.

Embedded leases (cont'd)

Example 1(b)

Facts: Assume the same facts as Example 1(a), except that a dark fibre strand in the fixed-line network is specifically identified in the IRU contract. The dark fibre strand will be wholly dedicated for this IRU contract and Supplier cannot use other infrastructure to meet Customer's bandwidth needs except due to repairs and maintenance. Customer will decide when, what and how much data to transmit across the dark fibre strand.

Question: Does the contract contain a lease?

Analysis: Based on the facts in this example, the contract contains a lease.

The dark fibre strand is explicitly identified in the contract. Supplier does not have a legally enforceable right to substitute the identified asset throughout the period of use except for repairs and maintenance, which does not preclude the arrangement from containing an identified asset.

Customer has the right to control the use of the dark fibre strand throughout the period of use because:

- (a) Customer has the right to obtain substantially all of the economic benefits from the use of the dark fibre strand over the period of use, i.e., the dark fibre strand is dedicated for this IRU contract and no other party will use it throughout the contract period.
- (b) Customer has the right to direct the use of the dark fibre strand because Customer makes the relevant decisions about how and for what purpose the dark fibre strand will be used by deciding when and whether to light the fibre and what data and how much data the dark fibre strand will transmit.



Separating components of a contract

Telecommunications companies enter into a variety of arrangements that are leases (or may contain embedded leases) with lease and non-lease components. For example, the lease of an industrial area might contain the lease of land, buildings and equipment, or a contract for a car lease might be combined with maintenance. Both lessors and lessees are required to determine if a right to use an underlying asset is a separate lease component. A right to use an asset is a separate lease component if the lessee can benefit from the asset on its own (or together with readily available resources) and the asset is neither interdependent nor highly correlated with any other underlying asset in the contract. It is important to properly identify and measure the lease and non-lease components as they are subject to different accounting models.

Components are those items or activities that transfer a good or service to the lessee. For example, if a lessee pays for the right to use an asset and also for administrative tasks, which do not transfer a good or service to the lessee, the administrative tasks are not a separate non-lease component. The amount due for administrative tasks will be considered as part of the total consideration that is allocated to the separately identified lease and nonlease components of the contract.

Once the lease and non-lease components are identified, contract consideration is allocated to each component:

- Lessee: the lessee should allocate the contract consideration to the separate lease and non-lease components based on their relative standalone prices. If observable standalone prices are not readily available, the lessee shall estimate the prices, and should maximise the use of observable information. As a practical expedient, a lessee may, as an accounting policy election by class of underlying asset, choose to not separate non-lease components from the associated lease component and instead account for them as a single lease component.
- Lessor: the lessor should allocate contract consideration to the separate lease and non-lease components in accordance with the transaction price allocation guidance in PSAK 72 (that is, on the basis of relative stand-alone selling prices). The practical expedient available to a lessee for lease and non-lease components is not available to a lessor.

PwC observation

It is common in the industry for a lease agreement to contain non-lease components, such as maintenance or other services. Lessees may find estimating standalone price to be challenging depending upon the nature of the arrangement. As an alternative to estimating standalone prices of non-lease components, a lessee may elect the practical expedient to not separate non-lease components from their associated lease components and instead consider them as part of the applicable lease component. Before electing the practical expedient, it will be prudent for lessees to consider the impact that this might have on lease classification and the extent of the increased gross up on the balance sheet due to a larger right-of-use asset and lease liability. Differences in accounting policy elections may reduce comparability between companies.

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

Example 2(a) – Separating lease components

Facts: Company A enters into a 15-year contract for the right to use three specified, physically distinct dark fibers within a larger cable connecting Hong Kong to Tokyo and maintenance services. The entity makes all of the decisions about the use of the fibers by connecting each end of the fibers to its electronics equipment (i.e. Company A ‘lights’ the fibers). The entity concluded that the contract contains a lease.

Question: How to separate lease and non-lease components?

Discussion: The agreement consist of the lease of three dark fibers and maintenance services. The observable standalone prices can be determined based on the amounts for similar lease contracts and maintenance contracts entered into separately. If no observable inputs are available, Company A has to estimate the standalone prices of both components.

Example 2(b) – Allocation of components within an arrangement: Device and service arrangement

Facts: A telecommunication company enters into a contract under which it agrees to lease a device to a subscriber customer, as well as provide service (i.e., talk, text and data) to the subscriber. The arrangement requires the subscriber to pay a fixed monthly amount for the use of the device and the service.

Question: How should the telecommunication company allocate contract consideration among the lease and non-lease components in the arrangement?

Discussion: If it is determined that there are two components in the arrangement (i.e., the lease of the device and the provision of service), the telecommunication company should allocate the consideration in the contract to the lease component for the device and the non-lease component for the service in accordance with the new revenue standard. The amount allocable to the lease component would be accounted for under the new lease standard. The amount allocable to the non-lease component would be accounted for under the revenue standard.

Lessee accounting model

Lessees will be required to recognise a right-of-use asset and liability for virtually all leases (other than short-term leases or leases of low-valued assets for which they elect to apply an exemption). There will be no distinction between finance and operating leases for lessee accounting, as is the case under PSAK 30.

Lessees should initially recognise a right-of-use asset and lease liability based on the discounted payments required under the lease, taking into account the lease term as determined under the new standard. Determining the lease term will require judgment. Initial direct costs and restoration costs are also included.

The key elements of the new standards and the effect on financial statements are as follows:

- A right-of-use model replaces the risks and rewards model. Lessees are required to recognise an asset and liability at the inception of a lease.
- All lease liabilities are to be measured with reference to an estimate of the lease term, which includes optional lease periods when an entity is reasonably certain to exercise an option to extend (or not to terminate) a lease.
- The lessee subsequently measures the lease liability using the effective interest rate method. It remeasures the carrying amount to reflect any re-assessment, lease modification, or revised in-substance fixed lease payments.
- Contingent rentals or variable lease payments will need to be included in the measurement of lease assets and liabilities when these depend on an index or a rate or where in substance they are fixed payments. A lessee should reassess variable lease payments that depend on an index or a rate when the lessee remeasures the lease liability for other reasons (for example, because of a reassessment of the lease term) and when there is a change in the cash flows resulting from a change in the reference index or rate (that is, when an adjustment to the lease payments takes effects).
- Lessees should reassess the lease term only upon the occurrence of a significant event or a significant change in circumstances that are within the control of the lessee.
- The right-of-use asset is depreciated over the shorter of the lease term and the useful life of the right-of-use asset, unless there is a transfer of ownership or purchase option which is reasonably certain to be exercised at the end of the lease term. If there is a transfer of ownership or purchase option which is reasonably certain to be exercised at the end of the lease term, the lessee depreciates the right-of-use asset over the useful life of the underlying asset.
- The lessee applies the impairment requirements in PSAK 48, 'Impairment of assets', to the right-of-use asset.

PwC observation

The ability to gather the required information for existing leases and capture data for new leases (e.g., renewal terms, discount rates, and embedded lease terms) will be critical to an effective transition to the new standard. This may result in the need for new systems, controls and processes, which will take time to identify, design, implement and test.

Lessee accounting model (cont'd)

Example 3- Lessee model

Facts: A telecommunications company (“Lessee”) enters into a “site license” with Lessor Corporation (“Lessor”) for space on a cell tower that qualifies as a lease. Lessee is not the only customer of the cell tower and has concluded that its shared use of the underlying land does not represent an additional lease component. The following is a summary of information about the lease and the leased cell tower space.

Lease term	8 years with three 3-year renewal options
Purchase option	None
Annual lease payments	C25,000
Payment date	Annually in arrears on December 31
Initial direct costs	C10,000
Lessee Corp’s incremental borrowing rate	6%

Other information

- The rate implicit in the lease that the Lessor charges the Lessee is not readily determinable by the Lessee.
- Title to the cell tower space remains with the Lessor throughout the period of the lease and upon lease expiration.
- The Lessee does not guarantee the residual value of the cell tower space at the end of the lease term.
- The Lessee pays for maintenance of the cell tower space separately from the lease.
- Exercise of renewal options is not reasonably certain.

Question1: How should the Lessee measure and record the lease at the lease commencement date?

Discussion: The Lessee should measure the lease liability by calculating the present value of the unpaid annual fixed lease payments of C25,000 discounted at the Lessee’s incremental borrowing rate of 6% (C155,245).

The right-of-use asset would be equal to the sum of the lease liability and the initial direct costs paid by the Lessee, which is C165,245 (C155,245 + C10,000). Although not mentioned in this example, the right-of-use asset would be adjusted for any lease payments made to the Lessor on or before the commencement date, and lease incentives received from the Lessor on or before the lease commencement date.

Lessee accounting model (cont'd)

Example 3– Lessee model (cont'd)

Question 2: How should the Lessee subsequently measure the right-of-use asset and lease liability during the lease term?

Discussion: The Lessee would calculate the total lease cost equal to C25,000 rent payments per year for eight years plus C10,000 initial direct costs (C210,000). The straight line lease expense recorded each period would be the total lease cost divided by the total number of periods, which is C26,250.

Interest expense on the lease liability would be calculated using a rate of 6%, the same discount rate used to initially measure the lease liability. The lease liability would be amortised based on the effective interest method and thus reduced by the principal component each year. The Lessee would calculate the amortisation of the right-of-use asset in accordance with PSAK 16 over the shorter of the lease term and the useful life of the right-of-use asset. In this example, the lease term is shorter than the useful life of the right-of-use asset, therefore, it is amortised for eight years using the straight line method.

	Lease Liability				Right-of-use of Asset	
	Payment (C)	Principal (C)	Interest (C)	Lease Liability (C)	Amortisation (C)	Right-of use Asset (C)
Commencement	10,000	-	-	155,245		165,245
Year 1	25,000	15,685	9,315	139,560	20,656	144,589
Year 2	25,000	16,626	8,374	122,934	20,656	123,933
Year 3	25,000	17,624	7,376	105,310	20,656	103,277
Year 4	25,000	18,681	6,319	86,629	20,656	82,621
Year 5	25,000	19,802	5,198	66,827	20,656	61,965
Year 6	25,000	20,990	4,010	45,837	20,656	41,309
Year 7	25,000	22,250	2,750	23,587	20,656	20,653
Year 8	25,000	23,587	1,413	-	20,653	-
	C210,000	C155,245	C44,755		C165,245	

Lease modification and reassessment (lessee)

A lease modification is any change to the terms and conditions of a contract that results in a change in the scope of a lease, or the consideration for the lease, that was not part of the original terms and conditions of the lease. Any change that is triggered by a clause that is already part of the original lease contract (including changes due to a market rent review clause or the exercise of an extension option) is not regarded as a modification.

A modification is accounted for as a contract separate from the original lease if the modification grants the lessee an additional right of use not included in the original lease and the additional right of use is priced consistent with its standalone price. When a modification is a separate lease, the accounting for the original lease is unchanged and the new lease components should be accounted for at commencement like any other new lease.

In contrast, when a lease is modified and the modification is not accounted for as a separate lease, the lessee must remeasure and reallocate all of the remaining contract consideration to both lease and non-lease components based on the modified contract. The lease liability and right-of-use asset should be remeasured using assumptions (e.g., discount rate and remaining economic life) as of the effective date of the modification. Any initial direct costs, lease incentives, or other payments by the lessee or lessor should be accounted for by the lessee similar to the accounting for those items in a new lease.

Even when a lease is not modified, there are circumstances when a lessee will be required to remeasure the right-of-use asset and lease liability.

The following table lists these circumstances and the related impact on the lessee's accounting.

	Reallocate contract consideration and remeasure the lease	Update discount rate
An event occurs that gives the lessee a significant economic incentive to exercise/not exercise a renewal or termination option	√	√
An event occurs that gives the lessee a significant economic incentive to exercise/not exercise a purchase option	√	√
A change in future lease payments occurs resulting from a change in an index or a rate used to determine those payments	√	
Amounts due under a residual value guarantee become probable of being owed	√	

Lease modification and reassessment (lessee) *(cont'd)*

PwC observation

For a re-assessment of either the lease term or the likelihood of exercise of a purchase option, the triggering event must be within the control of the lessee (if not, the event will not require a re-assessment). A change in market-based factors will not, in isolation, trigger a re-assessment of the lease term or the incentives related to the exercise of a purchase option. For example, a re-assessment would not be triggered if a lessee is leasing network infrastructure equipment and current market conditions change such that lease payments that the lessee will be required to make in the extension period are now considered below market. On the other hand, a lessee making significant investments in the network infrastructure with significant value beyond the initial lease term would require a re-assessment to determine whether this improvement now results in renewal being considered reasonably certain.

It will be important for a company to ensure it has processes and controls in place to identify and monitor triggering events that would require the re-assessment of a lease.



Sale and leaseback arrangements

Existing sale-leaseback guidance in PSAK 30 is replaced with a new model applicable to both lessees and lessors. 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. Telecommunication companies should apply the requirements for determining when a performance obligation is satisfied in PSAK 72, to make this assessment.

When the criteria are met, control has passed to the buyer-lessor and the buyer-lessor should recognise a purchase of the asset applying the applicable PSAK and the lease applying the lessor accounting. The seller-lessee should measure the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller-lessee. Accordingly, the seller-lessee shall recognise only the amount of any gain or loss that relates to the rights transferred to the buyer-lessor (adjusted for off-market terms).

If the transaction does not qualify as a sale, the seller-lessee would not derecognise the transferred asset and would reflect the proceeds from the sale-leaseback transaction as a financial liability. The buyer-lessor would reflect its cash payment as a financial asset accounted for in accordance with PSAK 71.

The five indicators (not all-inclusive) included in the new revenue recognition standard to determine whether a customer has obtained control of an asset are:

- The seller-lessee has a present right to payment
- The buyer-lessor has legal title
- The buyer-lessor has physical possession
- The buyer-lessor has the significant risks and rewards of ownership
- The buyer-lessor has accepted the asset.

PwC observation

Judgment will be required to determine whether the sale criteria in PSAK 72 have been met and the conclusion will depend on the specific facts and circumstances of the transaction. Not all of the indicators need to be met to conclude that control has transferred from seller-lessee to buyer-lessor.

In the revenue standard, sale recognition is however precluded when the party that would be the seller-lessee has a substantive repurchase right (a call option) option or obligation (a forward) with respect to the underlying asset. Despite this prohibition in the revenue guidance, the existence of a repurchase option does not always preclude recognition of a sale-leaseback when the underlying asset is equipment readily available in the market and the option is at the then-fair market value. However, because real estate is unique, it is difficult to envision a scenario when a reporting entity could assert that an alternative real estate asset is substantially the same as the underlying real estate asset.

Glossary

AFS	Available for sale
DSAK-IAI	<i>Dewan Standar Akuntansi Keuangan – Ikatan Akuntan Indonesia</i> or “Financial Accounting Standards Board – Indonesian Institute of Accountants”
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
IFRS	International Financial Reporting Standards
IP	Intellectual Property
ISAK	<i>Interpretasi Standar Akuntansi Keuangan</i> or “Interpretation of Financial Accounting Standards”
OCI	<i>Other comprehensive income</i>
PSAK	<i>Pernyataan Standar Akuntansi Keuangan</i> or “Statement of Financial Accounting Standards”
SAK	<i>Standar Akuntansi Keuangan</i> or “Financial Accounting Standards”
SPPI	Solely Payments of Principal and Interest



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