THE IMPLEMENTATION OF PSAK 71, 72,73 & THEIR IMPACT ON COMPANY FINANCES

KADV RESEARCH

Elevating Knowledge

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Contents

PSAK 71

Financial Instruments: Recognitions & Measurements

- ❑ What is PSAK 71
- ❑ Why change is needed
- ❑ Recognitions in previous regulations
- ❑ Recognitions and influence of the regulations after PSAK 71

PSAK 71

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What is PSAK 71

- Regulating about the guidelines on **Financial Instruments: Recognitions & Measurements**
- **Refers to IFRS 9**
- **Replace** the previous standard that applies which is: PSAK 55

Why Change is Needed

- The previous applicable regulations were considered **too complex and inconsistent** with how the businesses manage risks
- The new regulations **provides room for companies to record existing risks before anything happens**, compared to the previous regulations that recorded losses when it already happened.
- **The existing regulations have been a subject of debate, but the economic crisis has made these regulations a priority.**

PSAK 71

Recognition in Previous Regulations

Rules in

PSAK 55

- ➔ The recognitions of financial institution's loss reserves is only done based on **incurred loss.**
- ➔ **Incurred Loss** within a financial institution can be recognized only when there are **indications/incidents** that causes **the risk of default from debtors.**
- ➔ This implementation provides flexibility to financial institutions to dynamically **allocate bank financial provisions (procyclical)**
- ➔ When the **economic conditions are improving**, companies are able to reduce their financial provisions of financial institutions, **allowing them to channel more credit.**
- ➔ In the other side, **procyclical could gives a negative effect when the economic condition is deteriorating**.
- ➔ **When deteriorating, financial institutions must set aside more financial provisions,** thus negatively impact the financial performance and also capital adequacy ratios.

PSAK 71

Recognitions and Influence of the Regulation after PSAK 71

- ➔ The recognition on loss reserves by financial institutions is only done based on **expected loss.**
- ➔ **Expected loss** within banks is recognized since the beginning of **credit formation** based on projection about the current asset condition, historical loss data, and future economic condition.
- ➔ **The implementation of expected loss is considered to be able to address the procyclical approach of financial institutions, because all provisions for financial instruments are reserved at the beginning of the period**. Financial institutions are better prepared when there are a disruptions causing debtors to have difficulty paying due to larger reserve amount.
- ➔ On the other hand, implementation of **expected loss** also **gives pressure to financial institutions due to the increase of company loss reserves**. The increasing amount of company loss reserves will lead to a decrease in the operating profit and a decline in capital coverage ratios.

Rules in

PSAK 71

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PSAK 72

Recognition of Revenue Contracts with Customers

- What is PSAK 72
- Why Change is Needed
- ❑ Recognitions in previous regulations
- ❑ Recognitions and influence of the regulations after PSAK 72

PSAK 72

What is PSAK 72

- Regulating on **Recognition of Revenue Contracts with Customer**
- Refers to **IFRS 15**
- **Replace** the previous standard that applies which is : **PSAK 34, PSAK 32, ISAK 10, ISAK 21, dan ISAK 27**

Why Change is Needed

- **There is a need for deeper clarification regarding the obligations that needed to fulfilled within the contract, as well as the role of each party** outlines in the employment contract.
- There is also a need to reiterate how the company recognized revenue from the employment contracts.
- Both point above **will clarify how the company allocate their expenses related to the contracts.**

PSAK 72

Recognition in Previous Regulation

Rules in the Previous PSAK

- ➔ The previous PSAK uses a **rule based approach.**
- ➔ **The previous PSAK divides the recognition of revenue and expenses based on the type of business**, either services or goods.
- ➔ Because the previous PSAK having more rules, **business owners are able to recognized their revenue according to their expertise.**
- ➔ However, the abundance of rules in the previous PSAK caused more **inconsistency when business conditions have become increasingly complex**. Therefore, the revenue and expenses recognitions became more difficult to align with evolving business models.

PSAK 72

Recognition and Influence of the Regulation after PSAK 72

- ➔ PSAK 72 used **principle based approach** on the recognition of revenue contracts with customers.
- ➔ **PSAK 72** divides revenue and expense recognition based on contract duration, which is:
  - ◆ Revenue recognized over the time
  - ◆ Revenue recognized at a point in time
- ➔ This PSAK provide a common ground and broader opportunity for business to recognize the arising revenue and expenses, as **recognition of revenue and expenses can be acknowledged using an adaptive framework of thinking**, rather than rigid regulations.
- ➔ However, the regulations from PSAK have **caused some types of business to face difficulties, especially in sectors involving long term risk transfer such as real estate.** For instance, revenue recognition from the real estate sector cannot be recognized if the handover process of the building has not been completed because it is deemed that there has been no substantial transfer between the seller and the buyer.

Rules in

PSAK 72

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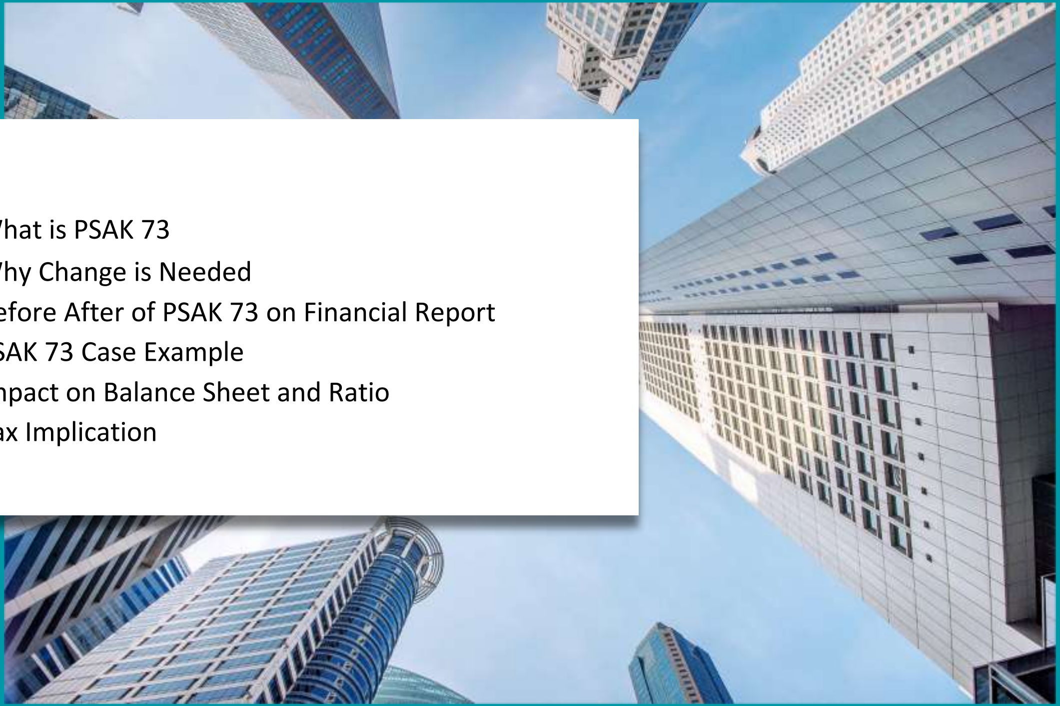
PSAK 73



Leasing

- What is PSAK 73
- Why Change is Needed
- Before After of PSAK 73 on Financial Report
- PSAK 73 Case Example
- Impact on Balance Sheet and Ratio
- Tax Implication

PSAK 73

What is PSAK 73

- Regulating **Leasing** activities conducted by companies
- Refers to **IFRS 16**
- **Replace** the previous standard that applies which is **: PSAK 30, ISAK 23 dan ISAK 25**

Why Change is Needed

- There are more than 1.25 Trillion US dollars stated as **off balance sheets.**
- This raises **concerns** from the International Accounting Standard Board (IASB) regarding **the transparency of information to investors regarding leasing.**
- **The incomplete informations prevent investors from comparing existing companies without prior adjustments.**

Before After PSAK 73

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Position in the Balance Sheet	Previous PSAK		PSAK 73
	Finance Lease	Operating Lease	All Lease
Assets	Assets in a form of finance lease are recorded		All assets ownership in all forms of leasing are recorded in the financial statements
Liabilities	The remaining amount of the existing leasing is recorded as a liability		All liabilities ownership in all forms of leasing are recorded in the financial statements
Off Balance Sheets / Obligations		All ownership of assets and liabilities in the form of operating leases are recorded outside the financial statements and disclosed in the notes	

Before After PSAK 73

Position in the Profit and Loss Statement	Previous PSAK		PSAK 73
	Finance Lease	Operating Lease	All Lease
Operating Expenses		The amount needed to be paid each month is recorded as operating expenses	
Depreciation and Amortization	The amount of leasing is reduced through depreciation		The amount of leasing is reduce through depreciation
Financial Expenses	The interest from leasing is recorded as financial expenses		Interest from leasing is recorded as financial expenses

PSAK 73 Case Example

Company X enters a lease contract for equipment for a duration of 3 years. The annual lease payments are 20 million, 24 million, and 28 million. There are no purchase option and other incentives in the contract. The implicit interest rate is 4.235%, resulting in a present value of 66 million. Depreciation is calculated using the straight line method.

PSAK 73 Case Example

Position in the Balance Sheet	Previous PSAK	PSAK 73
	Operating Lease	Operating Lease
Assets		(+) Leasing Asset 66 Million; (-) The reduction each year through depreciation based on the straight line method: **Year 1 – 3 = 66 Million/3 Years**
Total Assets		**+ 66 Million**
Liabilities		(+) Liabilities Leasing 66 Juta + Total Leasing Interest (-) Each year will decrease in line with the specified payments: **Year 1 : 20 Million, Year 2 : 24 Million, Year 3 : 28 Million**
Total Liabilities		**+ 66 Million and Leasing Interest**
Off Balance Sheets / Obligations	Ownership of assets and liabilities in the form of operating lease are recorded outside the financial statements and disclosed in the notes. **(+) Leasing Asset and Leasing Liabilities 66 Million**	

PSAK 73 Case Example

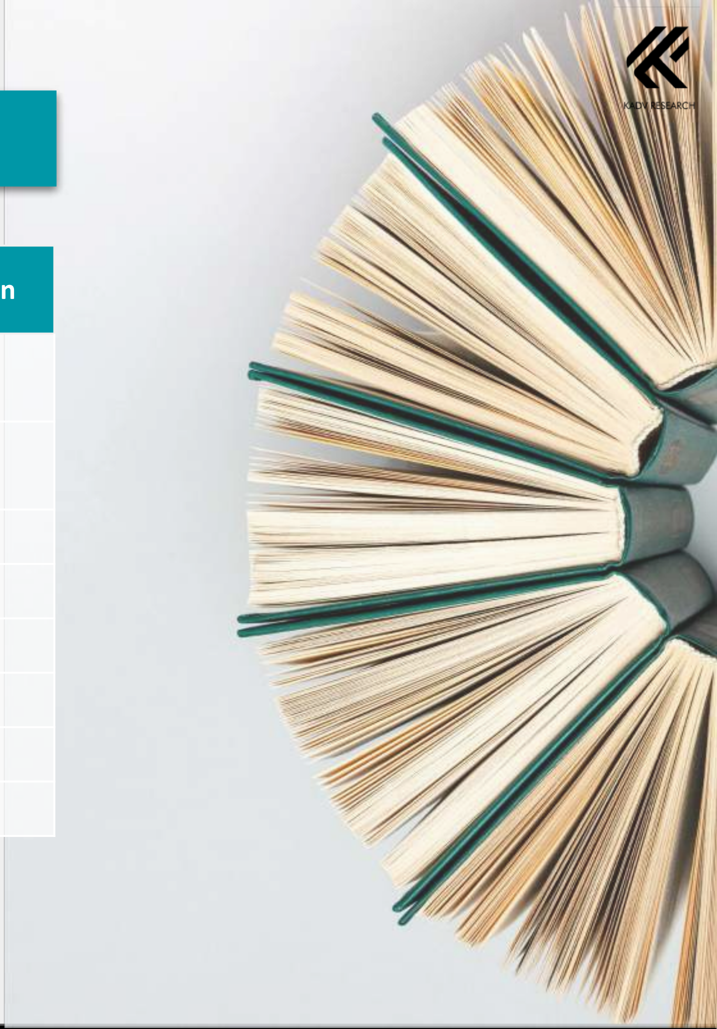
Position in the Profit and Loss Statement	Previous PSAK	PSAK 73
	Operating Lease	Operating Lease
Operating Expenses	Total that needed to be paid: **Year 1 =20 Million, Year 2 = 24 Million, Year 3 = 28 Million**	
Depreciation and Amortization		(+)Depreciation based on the straight line method: **Year 1 – 3 = 66 Million/3 Year**
Financial Expenses		(+) The interest expenses is calculated based on the Present Value of the Leasing x Interest Rate (4,235%): **Year 1 = 2,8 Million; Year 2 = 2,07 Million; and Year 3 = 1,13 Million**

Important Point of the PSAK 73 Case Example

- With the implementation of PSAK 73, **entities engaging in a leasing are required to record the amount of leasing liabilities arising from lessors in the balance sheet, and there are slight changes in the recognition of profit and loss.**
- This can result in **changes to the composition of the balance sheets, especially in assets and liabilities, which become larger compared than before.**
- **The difference in recognition in the profit and loss statement also have some significant implications for the company's performance.**
- The recognition of depreciation causes the company's **EBITDA to appear larger** than the previous recognitions.
- However, due to the recognition of leasing interest**, the company's financial expenses will increase.**

Impact on Balance Sheet and Ratio

	Previous PSAK	PSAK 73 Implementation
Return on Assets (ROA)	Higher ↑	Lower ↓
Interest Coverage Ratio	Higher ↑	Lower ↓
Debt to Equity (DER)	Lower ↓	Higher ↑
EBITDA Margin	Lower ↓	Higher ↑
Net Income Margin	Same	Same
Operating Margin	Lower ↓	Higher ↑
Total Liabilitas	Lower ↓	Higher ↑
Total Asset	Lower ↓	Higher ↑



Tax Implication

1

Until now, Tax regulation regarding leasing are regulated in Decision of the Minister of Finance of the Republic of Indonesia Number: 1169/KMK.01/1991

2

In Article 2, it stated that lease activities are divided into 2: **finance lease and operating lease.**

3

In Article 3, the definition of finance lease with a option which is finance lease, as follow:

- The total lease payment during the initial lease term, plus the residual value of the leased asset, must be sufficient to cover the cost of acquiring the asset and the lessor's profit.
- The lease term is determined to be at least 2 years for Class I assets, 3 years for Class II and Class III assets, and 7 years for buildings.
- The lease agreement includes provisions regarding options for the lessee.

4

On the other hand, Article 4 stated that the definition of an operating lease as follow:

- The total lease payments during initial lease term cannot cover the acquisition cost of the leased asset plus the profit calculated by the lessor.
- The lease agreement does not include provisions regarding options for the lessee.

5

With this rules, it can be concluded that even though PSAK 73 provides different recognition**, from a tax perspective, the treatment of lease agreement by companies still refers to the previous PSAK,** following the statutory regulations until changes are made.

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