KPMG

Accounting News Flash

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ED PSAK 73 Leases – Overhaul of Lease Accounting for Lessee

The Exposure Draft (ED) of PSAK 73 *Leases* was published at the end of April 2017. It adopts IFRS 16 *Leases*, one of the long awaited standards intended to improve the transparency of companies' assets and liabilities associated with lease transactions and improve comparability between companies that lease and those that borrow to buy.

In short, this ED will fundamentally change the accounting treatment of leases by lessees, in that it eliminates the current dual accounting model for lessees, which is distinguished between on-balance sheet finance leases and off-balance sheet operating leases. It is replaced with a single accounting model that is similar to current finance lease accounting under PSAK 30. For contracts that meet the definition of lease or that contains a lease, a lessee must:

a. recognize right-of-use assets ("ROU assets" as a separate line item or together with property, plant and equipment) and lease liabilities in the balance sheet;

b. recognize depreciation of the ROU assets and interest on lease liabilities in the income statement; and

c. present the amount of cash paid for the principal portion of the lease liability within financing activities, and the amount paid for the interest portion within either operating or financing activities, in the cash flow statement.

This ED includes two optional exemptions from recognizing assets and liabilities:

i. short-term leases (i.e. leases of 12 months or less), and

ii. leases of low-value items (e.g. personal computers).

If any of the exemptions are applied, then the operating lease accounting under the existing PSAK 30 is applied, such that rent expense is recognized in the income statement, on a straight line or another systematic basis.

Lessor accounting remains similar to current practice – i.e. lessors continue to classify leases as finance and operating leases. The existing lessor accounting model in PSAK 30 is retained because it is considered to be well understood by the users — unlike the previous accounting model for lessees that led users to adjust financial statement figures to account for the true effect of lease commitments — and the cost of substantially changing lessor accounting would outweigh the benefits. Nonetheless, this ED requires lessors to provide enhanced disclosures about their risk exposure, particularly on residual value risk.

This ED will supersede PSAK 30 and the following interpretations:

i. ISAK 8 *Determining whether an Arrangement contains a Lease;*

ii. ISAK 23 *Operating Leases — Incentives;*

iii. ISAK 24 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease;* and

iv. ISAK 25 *Land Rights*.

ISAK 25 will be revoked because IFRS 16 clarifies the notion of distinguishing a lease and sale or purchase of an asset — in determining whether a contract grants the rights that represents in-substance purchase of a property, plant or equipment — which is relevant for accounting issues on land rights (e.g. rights under general HGB title) in Indonesia. Such clarification is incorporated in the Basis for Conclusions of ED PSAK 73 and is intended to clarify the thought process of applying principles in this ED to account for land rights, in the absence of specific guidance that was previously included in ISAK 25. In addition, such revocation is also part of convergence initiatives of reducing differences between SAK and IFRS Standards with regard to locally developed standards or interpretations with no equivalent IFRSs.

This ED, once finalized and issued as the new lease standard, is expected to be effective for an annual period beginning on or after 1 January 2020, with permission for an early adoption for companies that had applied ED PSAK 72 *Revenue from Contracts with Customers*. In addition to regular retrospective application, this ED provides alternatives to apply a modified retrospective approach for initial adoption as well as various practical expedients for which companies need to assess and decide on the trade-off between cost of implementation and comparability of the resulting figures upon transition.

For companies that have material off-balance sheet leases, this ED is expected to result in an increase in lease assets and financial liabilities. It will result in a different total expense recognition pattern compared to PSAK 30, because interest expense is typically higher in the earlier years of a lease than in the later years. However, lessees typically hold a portfolio of leases, which generally neutralizes any significant effect on profit or loss when applying this ED compared to PSAK 30.

This ED will affect a wide variety of sectors. The larger the lease portfolio, the greater the impact on key reporting metrics. All companies will need to assess the extent of the standard's impacts in order to address wider business implications. Areas of focus may include effects on financial results, the costs of implementation, and proposed changes to business practices.

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