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Accounting Standard on Leases to be Revised

The Indonesian Institute of Accountants has recently released an Exposure Draft ("ED") to revise the existing accounting standard PSAK 30 – Accounting for Leases. The ED is based on International Accounting Standards ("IAS") 17 – Leases, with some modification to accommodate the unique social, legal and economic environment in Indonesia.

Salient points of the ED are discussed below

Classification of a lease
In accordance with the new ED, a lease may be classified either as a finance lease or an operating lease. A lease is classified as a finance lease if it transfers to the lessee substantially all of the risks and rewards incidental to ownership. All other leases are treated as operating leases. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the legal form of the contract.

Examples of situations in which a lease would be classified as a finance lease are: if there is transfer of ownership by the end of the lease term; if a bargain purchase option has been extended to the lessee; if the lease term is a major part of the useful life; if the present value of lease payments is substantially equal to the fair value of the leased asset; or if the leased assets are of such a specialised nature that only the lessee can use them without major modifications being made.

For sale and leaseback transactions resulting in a leaseback of a finance lease, any gain realised on the transaction is deferred and amortised through the income statement over the lease term. When the sale and leaseback is in the form of an operating lease, the recognition of resulting gains or losses will depend on whether the transaction is conducted at, below or above fair value.

Accounting by the lessee
A lessee in a finance lease records an asset and a liability in its financial statements and depreciates this asset in accordance with the lessee's normal depreciation policy for similar assets. The lessee in an operating lease records as expense the rental payments on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Accounting by the lessor
The lessor records an asset leased under a finance lease as a receivable at an amount equal to the net investment in the lease. Finance income is recognised based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.

The lessor records operating lease assets as property, plant and equipment and depreciates it on a basis consistent with the normal depreciation policy for similarly-owned assets. Rental income should be recognised on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern over which the benefit of the leased asset is diminished.

How the ED differs from the existing PSAK 30
One of the most significant differences between the ED and the existing PSAK 30 concerns the definition of a finance lease. The existing PSAK 30 classifies a lease

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as a finance lease if it meets all three of the following criteria:

- there is an option to buy the leased assets at a price agreed upon at the inception of the lease
- the minimum lease period is two years
- the lease payments are such that they cover the cost of the lease

Rather than setting forth a certain set of criteria that has to be met for a finance lease, the ED classifies a lease as a finance lease when substantially all of the risks and rewards relating to ownership are transferred to the lessee. In this regard the ED provides examples that can be used to determine whether the risks and rewards have been transferred. Consequently a lease that meets the definition of a finance lease under the existing PSAK 30 does not necessarily meet the criteria of a finance lease under the proposed revised PSAK 30 and vice versa.

How the ED differs from IAS 17

One of the main differences between the ED and IAS 17 relates to the treatment of land. Under IAS 17 a lease of land typically is treated as an operating lease when the title of the land is not expected to pass to the lessee at the end of the lease term. The reasoning is that when there is no transfer of title at the end of the lease term, the lessee normally does not receive substantially all of the risks and rewards of ownership in land, therefore such a lease is treated as an operating lease rather than a finance lease.

Considering the unique legal system in Indonesia - in particular on rights related to land (i.e a company may not have freehold title in Indonesia) - the ED proposes that land can still be capitalised when there are usage and building-related rights (*"Hak Guna Usaha"* and *"Hak Guna Bangunan"*) that are expected to be renewed practically indefinitely. Therefore it is still possible to capitalise lease of land under the ED even though under IAS such a lease would have been classified as an operating lease.

Comments deadline

Exposure Draft PSAK 30 (revised 2006) - Leases can be viewed in the September 2006 edition of Media Akuntansi Magazine. It will also be made available at IAI's website at www.akuntanpublik.org. Hard copies will be available to the general public within a few weeks.

If you would like to submit any comment on this ED, please contact IAI at iai-info@iaiglobal.or.id. The comment period ends on 16 October 2006. You are also welcome to discuss issues pertaining to the ED with your PricewaterhouseCoopers engagement team or Dudi Kurniawan of the PwC Technical Committee who can be contacted at 5289 0711 or at dudi.m.kurniawan@id.pwc.com

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