Guidance on the New Big-3 Standards

Retail and Consumer 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 elect the convergence approach instead of full adoption was based on the consideration of the potential interpretation and implementation issues.

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

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

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

Table of Contents

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 ‘Financial Instruments: Recognition and Measurement’. This includes amended guidance for the classification and measurement of financial assets by introducing a fair value through other comprehensive income category for certain debt instruments. It also contains a new impairment model, which will result in earlier recognition of losses.

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

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

Overview

PSAK 71 will affect the retail and consumer industry with an effective date of 1 January 2020.

Under PSAK 71, retail and consumer entities may 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 (debt and equity investments). All financial assets need to be carefully assessed to understand the classification and impairment implications.

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

"PSAK 71 – Financial Instruments: Understanding the Basics" provide a comprehensive analysis of the new standard. This publication discusses some of the more significant impacts on entities within the retail and consumer industry.

What to do now?

Retail and consumer to-do list:

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

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

A snapshot of the financial position of a retail and consumer company

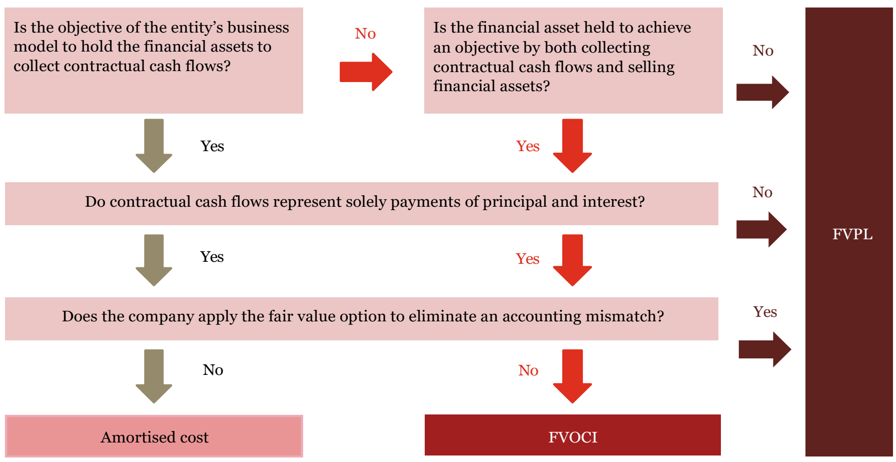
A typical balance sheet of a retail and consumer company might include the following financial instruments or receivables that fall under PSAK 71:

Current assets	Non-current assets	Current and non-current liabilities
• Trade receivables • Derivative financial assets	• Equity investment • Loan receivables, including intercompany loans	• Borrowings • Derivative financial liabilities • Lease payables • Contingent consideration from business combination

Classification and measurement – Business model assessment

Debt investments (including receivables)

Classification under PSAK 71 of debt investments 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). These considerations are represented in the following flow chart:



Business model assessment

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

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

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

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

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

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

Contractual cash flows analysis

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

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

- **Principal** is the fair value of the financial asset at initial recognition. However, that principal amount might change over the life of the financial asset (for example, if there are repayments of principal).
- **Interest** is typically the compensation for the time value of money and credit risk. However, interest can also include consideration for other basic lending risks (for example, liquidity risk) and costs (for example, servicing or administrative costs) associated with holding the financial asset for a period of time, as well as a profit margin.

Equity investments

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

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

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

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

What does this mean for the real retail and consumer industry?

Trade receivables	• Trade receivables in a retail and consumer entity will normally be of short-term nature and 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.
Equity investments	• Equity instruments are measured at fair value under all circumstances. An entity can make an irrevocable election to measure equity investments at FVOCI. There are additional disclosure requirements if this election is used. No ECL is recognised for equity investments.
Investments in bonds	• 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	• Derivatives remain classified at FVPL.
Contingent consideration	• 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 AFS will need to be reclassified to FVPL.

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, as shown in the diagram below.

Change in credit quality since initial recognition

Recognition of ECL		
12-month ECL	Lifetime ECL	Lifetime ECL
Interest revenue		
Effective interest on gross carrying amount	Effective interest on gross carrying amount	Effective interest on amortised cost carrying amount (that is, net of credit allowance)
Stage 1 *Performing* (Initial recognition)	**Stage 2** *Underperforming* (Assets with significant increase in credit risk since initial recognition)	**Stage 3** *Non-performing* (Credit-impaired assets)

- **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).

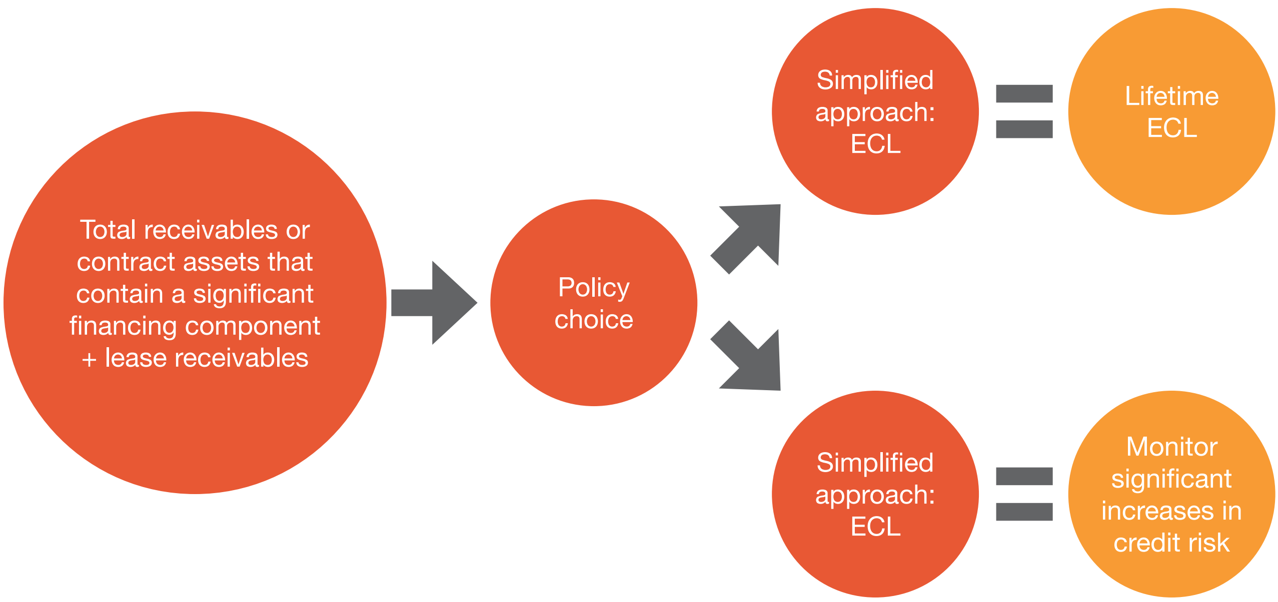
Impairment – Scope exception for trade receivables: The simplified approach

Whilst in most cases retail companies collect the transaction price immediately when a customer purchases the products and takes delivery in store, retailers may also have credit exposure to customers, including trade receivables.

The general impairment model under PSAK 71 includes some operational simplifications for trade receivables (as well as contract assets), because they are often held by entities that do not have sophisticated credit risk management systems. These simplifications eliminate the need to calculate 12-month ECL and to assess when a significant increase in credit risk has occurred.

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

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



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

What does this mean for the retail and consumer industry?

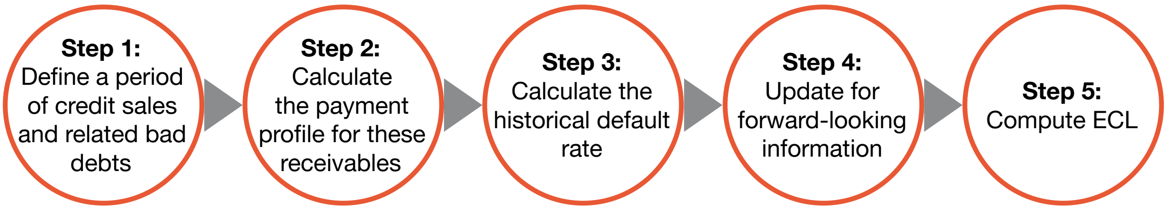
Short-term trade receivables	• A trade receivable with a maturity of less than one year will most likely qualify for the simplified model, since generally it will not contain a significant financing component. The entity will recognise lifetime ECL throughout the life of the receivable. Materially higher provisions might not arise for short-term trade receivables with customers with good collection history.
Long-term trade receivables and	• 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.
Financial investments in bonds	• For long-term investments, such as bonds, the entity will need to apply the full three-stage model.

Provision matrix

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

How does a provision matrix work?

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



Step 1

The first step, when using a provision matrix, is to define an appropriate period of time to analyse the proportion of 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 a period might mean that changes in market conditions or the customer base make the analysis 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

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

Total 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

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

For example, in the above information, CU300 out of the CU10,000 sales for the period 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 entity concludes that the defaulted receivables should be adjusted by CU100 to CU400 as a result of an economic slowdown affecting the retail and consumer industry. The entity also concludes that the payment profile and amount of revenue 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 scope for the accounting of intra-group loans and loans to joint ventures and associates (‘funding’) is not expected to change from the introduction of PSAK 71. Funding, previously within the scope of PSAK 55, ‘Financial instruments: Recognition and measurement’ will also be within the scope of PSAK 71.

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

Impairment of intra-group loans

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

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

What does this mean for the retail and consumer industry?

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

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

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

Cash advanced might not be fair value

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

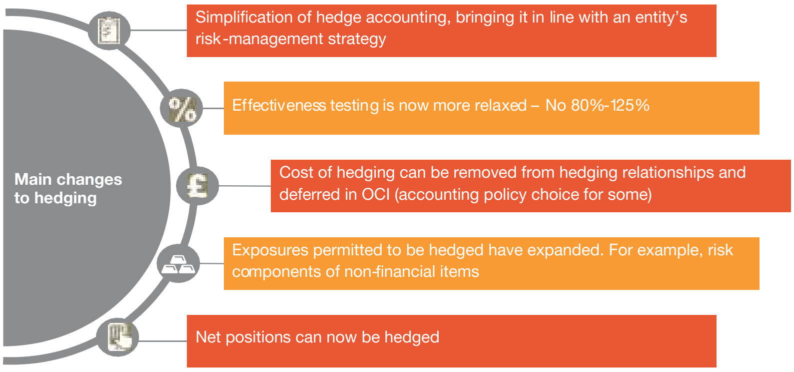
What does this mean for the retail and consumer industry?

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

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

Hedging

'Hedging' is a risk-management activity. More specifically, it is the process of using a financial instrument (usually a derivative) to mitigate all or some of the risk of a hedged item. 'Hedge accounting' changes the timing of recognition of gains and losses on either the hedged item or the hedging instrument so that both are recognised in profit or loss in the same accounting period in order to record the economic substance of the combination of the hedged item and hedging instrument. The diagram below sets out the main changes to hedging under PSAK 71.



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 retail and consumer industry?

Retail and consumer entities commonly hedge foreign exchange currency risks and interest rate risks by entering into foreign currency and interest rate 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% 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

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

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

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

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

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

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

PSAK 72

Revenue from contracts with customers

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

This publication reflects the implementation developments and highlights certain challenges specific to entities in the consumer markets industry.

PSAK 72 - Revenue from contracts with customers

Overview

Historically, the accounting for revenue in the consumer markets sector has been governed by the revenue standard (PSAK 23, Revenue) and its related interpretations. The new revenue standard (PSAK 72, *Revenue from Contracts with Customers*) will replace substantially all existing revenue guidance under PSAK. The new standard introduces a new model for revenue recognition, and while it may not broadly change all aspects of the consumer markets industry, certain areas will be significantly affected.

Arrangements in the retail and consumer markets sector are often unique to the parties to a transaction and the specific facts and circumstances should be evaluated closely when applying the new standard.

This publication highlights certain challenges specific to entities in the retail and consumer industry. The content in this publication should be considered together with our "**PSAK 72 – A Comprehensive Look at The New Revenue Model**".

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. 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.

Retail and consumer markets companies should consider any history of entering into amendments or side agreements to a contract that either change the terms of, or add to, the rights and obligations of the parties to a contract. These can be verbal or written, and could include cancellation, termination or other provisions. They could also provide customers with options or discounts, or change the substance of the arrangement. All of these have implications for revenue recognition. Therefore, understanding the entire contract, including any amendments, is important to the accounting conclusion.

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. 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 collectibility (see further discussion in Step 3 – *Determine the transaction price* below).

New guidance	Current PSAK
A company accounts for a contract with a customer when: • The contract has been approved and the parties are committed • Each party's rights are identified • Payment terms are defined • The contract has commercial substance • Collection is probable In evaluating whether an amount is collectible, management should consider whether a customer has the ability and intention to pay the promised consideration when it is due. The amount of consideration to which the company will be entitled may be less than the price stated in the contract if the consideration is variable. For example, the company may offer the customer a price concession. When collectibility of the transaction price is not probable at inception, management should continue to assess the contract at each reporting period to determine if collectibility is probable. If collectibility of the transaction price is not probable and the company receives a consideration from the customer, it should recognise the consideration received as revenue only when one of the following events has occurred: • There are no remaining obligations to transfer goods or services to the customer, and substantially all of the consideration has been received and is non-refundable. • The contract has been terminated, and the consideration received is non-refundable.	A company is required to consider the underlying substance and economics of an arrangement, not merely its legal form. Management must establish that it is probable that economic benefits will flow before revenue can be recognised.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Determine transfer of control and recognise revenue | Other consideration

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

Potential impact:

The assessment of whether a contract with a customer exists under the new revenue guidance is driven less by the form of the arrangement and more by whether an agreement between two parties (either written, oral, or implied) creates legally enforceable rights and obligations between them.

The purpose of the collectibility assessment under the new guidance is to determine whether there is a substantive contract between the company and the customer. This differs from current guidance under both frameworks in which collectibility is a constraint on revenue recognition.

The new guidance eliminates the cash-basis method of revenue recognition that is often applied today if collectibility is not probable. Under the new standard, any cash received is recognised as a contract liability until either collectability of the transaction price is probable or one of the criteria for recognition is met. This could result in revenue being recorded later than under current guidance in some situations.

(1) Identify the contract | **(2) Identify performance obligation** | (3) Determine transaction price | (4) Allocate transaction price | (5) Determine transfer of control and recognise revenue | Other consideration

2. Identify performance obligations

Retail and consumer product companies often provide assets or services to retailers to aid in the sell-through of product to end customers, such as training the customer's sales employees, deploying their own employees to work on-site at the customer's retail location, providing gifts to be included with end customer purchases, and constructing assets at a customer's location (e.g., "shop-in-shop" or concession areas). There is currently some diversity in practice in the accounting for such assets or services. Under the new standard, these provisions may result in additional performance obligations, which can affect the timing of revenue recognition.

<table>
<tr><th>New guidance</th><th>Current PSAK</th></tr>
<tr><td>

<u>Performance obligations</u>

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.

A performance obligation is a promise in a contract to transfer a distinct good or service to a customer.
A good or service is distinct and is separated from other obligations in the contract if both:

the customer can benefit from the good or service separately or together with other resources that are readily available to the customer; and
the good or service is separately identifiable from the other goods or services in the contract.

Companies applying PSAK 72 should also consider the concept of materiality when identifying performance obligations in the context of the contract.

<u>Options to acquire additional goods or services</u>

An entity may grant a customer the option to acquire additional goods or services free of charge or at a discount. These options may include customer award credits or other sales incentives and discounts, such as a volume discount, that will give rise to a separate performance obligation if the option 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.

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.

</td><td>

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.
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.

The recognition criteria are usually applied separately to each transaction (that is, 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 identifiable components as a single transaction in order to reflect the substance of the transaction.

If an entity grants its customers, as part of a sales transaction, an option to receive a discounted good or service in the future, the entity 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.

</td></tr>
</table>

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

Potential impact:

Companies will need to identify the different performance obligations in each agreement and pinpoint when and how those obligations are fulfilled. Retailers often offer customers a right to purchase free or discounted goods or services in the future in connection with the sale of goods (e.g., coupons toward additional purchases). These arrangements typically create additional performance obligations.

Retail and consumer product companies will need to closely examine their contracts with customers to evaluate the promises in those arrangements, both verbal and implied, to determine if any meet the definition of a performance obligation. If a service provided by a retail and consumer product company to its customer is determined to be a performance obligation, the costs of fulfilling that service should be presented as cost of sales. Examples of promises that might warrant evaluation include training the customer's sales employees, deploying employees to work on-site at the customer's store location, and providing free or significantly discounted products to be provided with end customer purchases.

The accounting for the construction of assets in a customer's establishment (e.g., sales counters, permanent displays, "shop in shop" arrangements) should be carefully evaluated. First, the consumer product company should determine who legally owns the asset and whether control of the asset transfers to the customer. The evaluation may lead to the conclusion that there is a lease.

If control of the asset does not transfer to the customer, the company should consider whether the construction costs should be accounted for in accordance with other standards (e.g., fixed assets) or as costs to fulfil a contract under the new revenue standard. Any reimbursements received from the customer related to the constructed assets may be part of the transaction price of the underlying product sold to the customer and accounted for in accordance with the guidance on non-refundable upfront fees in the new revenue standard.

If control of the asset transfers to the customer, the company will need to consider whether there is a separate performance obligation. In situations when the consumer product company contributes to the cost of in-store assets that it does not own via a cash payment to the customer, such payments should be evaluated under the guidance addressing consideration payable to a customer in the new revenue standard.

Payments between the company and its customer related to the construction of assets require careful consideration.

(1) Identify the contract | **(2) Identify performance obligation** | (3) Determine transaction price | (4) Allocate transaction price | (5) Determine transfer of control and recognise revenue | Other consideration

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

Gift cards

The use of gift certificates and gift cards is common in the retail and consumer industry. The gift cards or certificates are typically sold for cash and may be used by customers to obtain products or services in the future up to a specified monetary value. The amount of gift certificates that are forfeited by customers is commonly referred to as breakage. Breakage will typically result in the recognition of income for a retailer; however, the timing of recognition depends on expected customer behaviour and the legal restrictions in the relevant jurisdiction.

New guidance	Current PSAK
When a customer purchases a gift card, it is pre-paying for goods or services to be delivered in the future. The vendor has an obligation to transfer, or stand ready to transfer, the goods or services in the future – creating a performance obligation. The vendor should recognise a contract liability for the amount of the prepayment and derecognise the liability (and recognise revenue) when it fulfils the performance obligation. Expected breakage (i.e., the customer's unexercised right) should be estimated and recognised as revenue in proportion to the pattern of rights exercised by the customer. The guidance for variable consideration is followed when estimating breakage. If the company is unable to estimate the breakage amount, revenue for the unused portion of the gift card is recognised when the likelihood of the customer exercising its remaining rights becomes remote. If a company is required to remit consideration associated with a customer's unclaimed rights to a third party, such as a government body responsible for unclaimed property, the company should not recognise revenue related to unexercised rights.	Payment received in advance of future performance is recognised as revenue only when the future performance to which it relates occurs. That is, revenue from the sale of a gift card or voucher is accounted for when the seller supplies the goods or services upon exercise of the gift card. PSAK does not provide any specific model for recognising breakage. However, there are three accounting models that are generally accepted by US Generally Accepted Accounting Principles (GAAP) for the recognition of breakage, depending on the features of the programme, legal requirements, and the vendor's ability to reliably estimate breakage. These models are as follows: • proportional model – recognise as redemptions occur • liability model – recognise when the right expires • remote model – recognise when it becomes remote that the holder of the rights will demand performance. The above models used under US GAAP are acceptable under PSAK.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Determine transfer of control and recognise revenue | Other consideration

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

Potential impact:

Similar to today's accounting models, companies will continue to recognise a contract liability for the obligation to deliver goods and services. Expected breakage should be estimated and recognised as revenue in proportion to the pattern of rights exercised by the customer. If the company does not expect to be entitled to a breakage amount, it will recognise breakage revenue when the likelihood of exercise becomes remote.

Example 2(a) – Gift cards/breakage

Facts: A customer buys a CU100 gift card from a retailer, which can be used for up to one year from the date of purchase. Using the guidance for variable consideration and its history of issuing gift cards, the retailer estimates that the customer will redeem CU90 of the gift card and that CU10 will expire unused (10% breakage). The company has no requirement to remit any unused funds to the customer or any third party when the gift card expires unused. A contract liability of CU100 is recorded upon sale of the gift card.

Question: How is revenue recognised when the gift card is redeemed?

Analysis: For every CU1 of gift card redemption, the retailer would recognise CU1.11 (CU1.00 x CU100/CU90) of revenue. If customer redeem CU50, the retailer would recognise revenue of CU55.55, reflecting the product's selling price of CU50 plus the estimated breakage of CU5.55.

3. Determine transaction price

Retail and consumer markets companies offer a wide array of customer incentives. Retailers commonly offer coupons, rebates issued at the point of sale, free products (“buy one get one free”), price protection, or price matching programmes to their customers. Retail and consumer product companies commonly provide vendor allowances, including volume rebates and cooperative advertising allowances, mark-down allowances (compensation for poor sales levels of vendor merchandise), and volume discounts to their customers. Various pieces of guidance apply today and there is some diversity in practice in accounting for such incentives.

Customer incentives can affect the amount and timing of revenue recognition in several ways. They can create additional performance obligations, which can affect the timing of revenue recognition, and they often introduce variability into the transaction price, which can affect the amount of revenue recognised. The new revenue standards include specific guidance addressing these areas. The guidance for variable consideration, in particular, will apply to a wide range of customer incentives and is different from the existing guidance under PSAK.

New guidance	Current PSAK
Consideration payable to a customer A company needs to determine the transaction price, which is the amount of consideration it expects to be entitled to in exchange for transferring promised goods or services to a customer. Consideration payable by a company to a customer is accounted for as a reduction of the transaction price unless the payment is for a distinct good or service that the customer transfers to the company and the payment does not exceed fair value of that good or service. **Variable consideration** The transaction price might include an element of consideration that is variable or contingent on the outcome of future events, including (but not limited to) discounts, rebates, price concessions, refunds, returns, credits, incentives, performance bonuses and royalties. Variable consideration is estimated using either an expected value or most likely outcome method, whichever provides the best estimate. Variable consideration is included in the transaction price to the extent it is highly probable that there will not be a significant reversal in the amount of cumulative revenue recognised when the uncertainty is resolved. Judgment will often be needed to determine whether it is highly probable there will not be a significant reversal in the amount of cumulative revenue. The revenue standard provides indicators that might suggest such a reversal would take place.	Sales incentives offered to customers are recorded as a reduction of revenue at the time of sale. Management uses its best estimate of incentives expected to be awarded to estimate the sales price. The potential impact of volume discounts is considered at the time of the original sale. Revenue from contracts that provide customers with volume discounts is measured by reference to the estimated volume of sales and the expected discounts. Revenue should not exceed the amount of consideration that would be received if the maximum discounts were taken if management cannot reliably estimate the expected discounts.

3. Determine transaction price *(cont'd)*

Potential impact:

Companies that defer revenue recognition under current guidance because the price is not reliably measurable might be significantly affected by the revenue standard. In a situation when the price is fixed, but the company has a history of granting concessions, companies would be required to recognise the minimum amount of revenue they expect to be entitled to when control transfers as long as it is highly probable that there will not be a significant reversal of cumulative revenue recognised when the uncertainty is resolved.

The evaluation of variable consideration will require judgment in many cases. Some companies will need to recognise revenue before all contingencies are resolved, which might be earlier than under current practice. Management might need to put into place new processes to monitor estimates on an ongoing basis as more experience is obtained.

Although prospective volume discounts and volume rebates may offer customers similar economic incentives, the accounting and disclosure requirements under the new standards will be different due to different guidance for material rights (prospective volume discounts) and variable consideration (volume rebates).

- Volume rebates are a sales incentive programme under which the entity makes a cash payment to its customer once the customer reaches a specified cumulative level of purchases.
- Prospective volume discounts are a sales incentive programme that provides the customer with an option for free or discounted goods or services in the future.

The two incentive programmes differ because volume rebates are not an option to purchase future free or discounted goods or services, and therefore not considered to be material rights. Under the new standards, the promise of a cash rebate affects the estimate of transaction price. The cash rebates expected to be paid to a customer are a variable consideration as they would reduce the amount the customer pays, and should be estimated at contract inception to determine the transaction price. In comparison, volume discount arrangements that include a material right affect the timing of revenue recognition as revenue is allocated to the performance obligation (i.e., the right) and recognised when the free or discounted goods or services are provided or when the right expires.

When a retail and consumer product entity accounts for consideration payable to a customer as a reduction to the transaction price, a liability will be recorded on the balance sheet until the related payments to the customer are made. Generally, this liability will not meet the definition of a contract liability because it does not obligate the company to transfer future goods or services to the customer. Therefore, the liability should be presented separate from any contract liabilities and would not be subject to the new disclosure requirements for contract balances.

3. Determine transaction price *(cont'd)*

Example 3(a) – Retailer-issued coupons

Facts: A retailer sells goods to a customer for CU100,000 and at the same time provides a coupon for a 60% discount off a future purchase during the next 90 days. The retailer intends to offer a 10% discount on all sales as part of a promotional campaign during the same period. Management estimates that 75% of customers that receive the coupon will exercise the option for the purchase of, on average, CU40,000 of discounted additional product.

Question: How should the retailer account for the option provided by the coupon?

Analysis: The retailer should account for the option as a separate performance obligation, as the discount represents a material right. It is a material right because it is incremental to the discount offered to a similar class of customers during the period (only a 10% discount is offered more widely). The standalone selling price of the option is CU15,000, calculated as the estimated average purchase price of additional products (CU40,000) multiplied by the incremental discount (50%) multiplied by the likelihood of exercise (75%). The transaction price allocated to the discount, based on its relative standalone selling price, would be recognised upon exercise (that is, upon purchase of the additional product) or expiry.

A company should generally assume 100% redemption of the options if it does not have sufficient history to estimate the extent of redemption.

Example 3(b) – Manufacturer-issued coupon

Facts: A manufacturer sells 1,000 boxes of laundry detergent to a retailer for CU10 per box. Control transfers when the product is delivered to the retailer. There are no return, price protection, stock rotation, or similar rights. The retailer sells the laundry detergent to end customers for CU12 per box. The manufacturer simultaneously issues coupons directly to end customers via newspapers, which are valid for the next six months and provide a CU1 discount on each box of detergent purchased. The coupons are presented by the end customer to the retailer upon purchase of the detergent. The retailer submits coupons to the manufacturer and is compensated for the face value of the coupons (CU1). Using the expected value method (which the manufacturer believes is most predictive of the consideration it will be entitled to), the manufacturer estimated that 400 coupons will be redeemed. The manufacturer has recent experience with similar promotions involving similar pricing and discounting levels. Therefore, it concludes it is highly probable that the actual number of coupons redeemed will not result in a significant reversal of the cumulative revenue recognised.

Question: How much revenue should the manufacturer and retailer recognise?

Analysis: The manufacturer would recognise CU9,600 of revenue (CU10,000 less estimated coupon redemptions of CU400) for detergent sold to the retailer. While the retailer's accounting in this scenario is not specifically addressed by the new standards, we generally believe the additional consideration paid by the manufacturer is revenue to the retailer, as the fair value of the total consideration received by the retailer is CU12. Following this logic, the retailer would recognise revenue of CU12 and cost of sales of CU10 for each box upon sale to the end customer, whether or not they present a coupon. Cost of sales would remain as the original amount paid by the retailer to the manufacturer.

3. Determine transaction price *(cont'd)*

Example 3(c) – Free product rebate

Facts: A vendor is running a promotion whereby an end customer who purchases three boxes of golf balls at CU20 per box in a single transaction receives an offer for one free box of golf balls if the customer fills out a request form and mails it to the vendor before a set expiration date (a mail-in rebate). The vendor estimates, based on recent experience with similar promotions, that 80% of the customers will complete the mail-in rebate required to receive the free box of golf balls.

Question: How should the consideration be allocated to the various deliverables in the arrangement?

Analysis: The purchase of three boxes of golf balls gives the customer the right to the fourth box for free. This is a material right, which is accounted for as a separate performance obligation. The transaction price would be allocated to the right using relative standalone selling price, which considers estimated redemptions. Therefore, the value of the option would be CU16 (CU20 x 100% discount x 80% expected redemption). Management would allocate CU12.63 (CU60 x (CU16 / (CU16 + CU60))) of the transaction price to the mail-in rebate. The vendor would recognise revenue of CU47.37 when control of the three boxes of golf balls transfers, and recognise a liability for CU12.63 until the rebate is redeemed or expires unredeemed. If the vendor is unable to determine the number of mail-in rebates that will be used, management should assume 100% redemption. Management would allocate CU15 (CU60 x (CU20 / (CU20 + CU60))) to the undelivered box and recognise revenue on delivery following redemption, expiration of the rebate, or until it is able to make an estimate. As the fourth box is a performance obligation, the cost of the fourth box should be presented as cost of sales.

Example 3(e) – Price protection

Facts: A retailer sells a product to a customer for CU100 on January 1 and agrees to reimburse the customer for the difference between the purchase price and any lower price offered by a certain direct competitor during the three-month period following the sale. The retailer has recent experience with similar promotions of similar products. On a probability-weighted basis, the retailer estimates it will reimburse the customer CU5.

Question: How should the retailer account for the potential refund?

Analysis: The consideration expected to be repaid to the customer should be excluded from revenue and recorded as a liability at the time of sale. Assuming management concludes, based on its recent experience, that it is probable (or highly probable) that recognising CU95 would not result in significant reversal of cumulative revenue upon resolution of the uncertainty, the retailer would recognise revenue of CU95 and a refund liability of CU5.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Determine transfer of control and recognise revenue | Other consideration

3. Determine transaction price *(cont'd)*

Example 3(d) – Slotting fees

Facts: A manufacturer sells products to a retailer for CU8 million. The manufacturer also makes a CU1 million non-refundable upfront payment to the retailer for favourable product placement.

Question: How should the manufacturer and retailer account for the upfront payment?

Analysis: The product placement services cannot be sold separately. The service is not distinct because the manufacturer would not obtain any rights or receive any benefit without selling products to the retailer. The manufacturer should recognise a reduction in the transaction price of CU1 million and recognise CU7 million in revenue when control of the products transfers to the retailer.

From the retailer's perspective, the CU1 million upfront payment for product placement services is not a payment for satisfying a distinct performance obligation and should be recognised as a reduction of cost of goods sold.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | **(4) Allocate transaction price** | (5) Determine transfer of control and recognise revenue | Other consideration

4. Allocate transaction price

Under the new revenue guidance, the transaction price in an arrangement is allocated to each separate performance obligation based on the relative standalone selling prices of the goods or services being provided to the customer. That allocation may need to be adjusted if variable consideration or discounts apply exclusively to only certain performance obligations.

Loyalty programmes should be considered when allocating the transaction price. Retailers often use customer loyalty programmes to build brand loyalty and increase sales volume by providing customers with incentives to buy their products. Each time a customer buys goods or services, the retailer grants the customer award credits. The customer can redeem the credits for awards such as free or discounted goods or services. The award credits are a separate performance obligation to which consideration is allocated.

New guidance	Current PSAK
An option to acquire additional goods or services gives rise to a separate performance obligation if the option provides a material right that the customer would not receive without entering into that contract. The revenue standard requires management to estimate the transaction price to be allocated to the separate performance obligations and to recognise a contract liability for the performance obligations that will be satisfied in the future. The customer is paying for the future goods or services to be received when the award credits are issued in conjunction with a current sale. The company recognises revenue for the option when those future goods or services are transferred to the customer or when the option expires.	Customer loyalty programmes are accounted for as multiple-element arrangements. Consideration is allocated to the award credits based on their fair values, typically using the residual method, although the guidance also permits relative fair values. This amount is deferred and recognised as revenue when the award credits are redeemed or expire. The fair value of the award credits is adjusted for discounts available to other buyers absent entering into the initial purchase transaction and for expected forfeitures (breakage).

Potential impact:

The revenue standard is consistent with the multiple-element model currently required under PSAK. The transaction price is allocated between the product and the loyalty reward performance obligations based on relative standalone selling price. The amount allocated to the loyalty rewards is recognised as a contract liability and revenue is recognised when the rewards are redeemed or expire.

Companies will need to account for points issued and rights earned under these programmes as separate performance obligations, which could involve developing more robust valuation models to enable management to comply with the new revenue standard. Specifically, companies will need to thoroughly consider concepts such as redemption curves, breakage estimates, and the value of the loyalty award.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Determine transfer of control and recognise revenue | Other consideration

4. Allocate transaction price *(cont'd)*

Example 4(a) – Loyalty points

Facts: A retailer has a loyalty programme that rewards customers one point per CU1 spent. Points are redeemable for CU0.10 off future purchases (but not redeemable for cash). A customer purchases CU1,000 of product at the normal selling price and earns 1,000 points redeemable for CU100 off future purchases of goods or services. The retailer expects redemption of 950 points (that is, 5% of points will expire unredeemed). The retailer therefore estimates a standalone selling price for the incentive of CU0.095 per point based on the likelihood of redemption (CU0.10 less 5%).

Question: How is the consideration allocated between the points and the product?

Analysis: The retailer would allocate the transaction price of CU1,000 between the product and points based on the relative standalone selling prices of CU1,000 for the product and CU95 for the loyalty reward as follows:

Product	CU913 (CU1,000 x CU1,000/CU1,095)
Points	CU 87 (CU1,000 x CU95/CU1,095)

The revenue allocated to the product is recognised upon transfer of control of the product and the revenue allocated to the points is recognised upon the earlier of the redemption or expiration of the points. The estimate of the number of awards that will expire unredeemed is updated at each period end and the contract liability adjusted accordingly.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Determine transfer of control and recognise revenue | Other consideration

5. Determine transfer of control and recognise revenue

Retail and consumer markets companies distribute their products to customers in a variety of different ways. For certain distribution channels, such as retail point of sale, the timing of revenue recognition is straightforward and not expected to change. For other distribution channels, retail and consumer markets companies will need to apply judgment when evaluating when control transfers to ultimately determine the timing of revenue recognition, which may be different than under current guidance.

New guidance	Current PSAK
Revenue should be recognised when control of the goods or services is transferred to the customer. A company transfers a good or service when the customer obtains control of that good or service. A customer obtains control of a good or service if it has the ability to direct the use of and receive the benefit from the goods or service. Indicators that the customer has obtained control of the goods or service include: • The company has a present right to payment for the asset. • The customer has legal title to the asset. • The company has transferred physical possession of the asset. • The customer has the significant risk and rewards of ownership. • The customer has accepted the asset. A product is held on consignment if the buyer has physical possession of a good, but has not obtained control. An entity should not recognise revenue for products held by its customers on consignment. Indicators that there is a consignment arrangement include: • The product is controlled by the seller until a specified event, such as a sale to an end customer. • The company is able to require the return or transfer of the product to a third party. • The dealer does not have an unconditional obligation to pay for the product.	A contract for the sale of goods normally gives rise to revenue recognition at the time of delivery, when the following conditions are satisfied: • The risks and rewards of ownership have transferred. • The seller does not retain managerial involvement to the extent normally associated with ownership and does not retain effective control. • The amount of revenue can be reliably measured. • It is probable that the economic benefit will flow to the customer. • The costs incurred can be measured reliably. Revenue is recognised once the risks and rewards of ownership have transferred to the customer. Revenue is not recognised on consignment sales until performance has taken place. If the purchaser of goods on consignment has undertaken to sell the items on the seller's behalf, then revenue should not be recognised by the seller until the goods are sold to a third party.

5. Determine transfer of control and recognise revenue *(cont'd)*

Potential impact:

The effect of the revenue standard on retail and consumer markets distribution arrangements will depend on the terms of the contract. The new revenue standard requires management to determine when control of the product has transferred to the customer. Revenue is recognised when the customer or distributor has control of the product, even if the terms include a right of return (i.e., not when the product is transferred to the end customer).

Expected returns or price concessions affect the amount of revenue, but not when revenue is recognised. Revenue could therefore be recognised earlier under the new revenue standards.

The main reason that timing of revenue recognition could change for some companies is because current guidance is focused on the transfer of risks and rewards rather than the transfer of control. The transfer of risks and rewards is an indicator of whether control has transferred under the new revenue standard, but additional indicators will also need to be considered. Control could transfer before all of the risks and rewards transfer.

If the company can require the customer or distributor to return the product (that is, it has a call option), control has not transferred to the customer.

Example 5(a) – Sale of products to a distributor with a right of return

Facts: A consumer products company uses a distributor network to supply its product to the end customer. The distributor receives legal title and is required to pay for the products upon receipt, but may return unsold product at the end of the contract term. Once the products are sold to the end customer, the consumer products company has no further obligations with regard to the product and the distributor has no further return rights.

Question: When does the consumer products company recognise revenue?

Analysis: Revenue is recognised once control of the product has transferred, which requires an analysis of the indicators of the transfer of control. The distributor has physical possession, legal title, a present obligation to pay for the asset, and the right to determine whether the goods are returned, which are all indicators that control transferred when the goods were delivered to the distributor. As control has transferred to the distributor and revenue is recognised, the consumer products company would recognise a liability for expected returns (discussed in further detail below).

Note: In instances when control transfers to the retailer and revenue is recognised but the consideration the company receives is dependent on the sell-through price to the end customer (or on the extent of any returns), the guidance for variable consideration would be applied to determine the transaction price.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Determine transfer of control and recognise revenue | Other consideration

5. Determine transfer of control and recognise revenue *(cont'd)*

Example 5(b) – Sale of products on consignment

Facts: A manufacturer provides household goods to a retailer on a consignment basis (scan-based trading). The manufacturer retains title to the products until they are scanned at the register. The retailer does not have an obligation to pay the manufacturer until a sale occurs and any unsold products may be returned to the manufacturer. The manufacturer also retains the right to call back or transfer unsold products to another retailer. Once the retailer sells the products to the end customer, the manufacturer has no further obligations with regard to the products, and the retailer has no further return rights.

Question: When does the manufacturer company recognise revenue?

Analysis: The manufacturer should recognise revenue when control has passed to the retailer, which requires an analysis of the indicators of the transfer of control. Although the retailer has physical possession of the products, it does not take title or have an unconditional obligation to pay the manufacturer, and the manufacturer maintains a right to call the products. Therefore, control does not transfer and revenue is not recognised until the product is sold to the end customer.

Shipments to customers with a common carrier, including e-Commerce

Retail and consumer product companies often use common carriers to ship products to customers. Retailers also commonly use common carriers to deliver products to their e-Commerce customers. These companies often have a customary practice of replacing or crediting lost or damaged goods even when sales contain "free on board" (FOB) shipping point terms, and the customer obtains control at the time of shipment. In such instances, the customer is in the same position as if the shipping terms were FOB destination. Revenue would likely be recognised when the product is received by the customer under today's guidance because the risks and rewards of ownership have not been substantively transferred to the customer at the point of shipment. Under the new standard, transferring the risks and rewards of ownership is only one of the five indicators that a customer has obtained control of the asset. Not transferring the risks and rewards of ownership does not automatically preclude revenue recognition under the new standards as it does today. As a result, the timing of revenue recognition for certain contracts might change as retail and consumer markets companies apply the new standard's control-based model.

New guidance	Current PSAK 23 and other relevant interpretations
Revenue should be recognised when control of the goods or service is transferred to the customer, as described in the section above.	A contract for the sale of goods normally gives rise to revenue recognition at the time of delivery, as described above.
Situations when a company transfers control of a good but retains the risk of loss or damage based on shipping terms could indicate that an additional performance obligation to cover any losses exists that has not yet been fulfilled.	Revenue is typically recognised once the goods reach the buyer. This would be the case when there are synthetic FOB destination terms, as risks and rewards of ownership typically transfer at that time.

5. Determine transfer of control and recognise revenue *(cont'd)*

Potential impact:

The timing of revenue recognition could change under the new revenue standard as the transfer of risks and rewards is no longer a requirement for revenue recognition, but an indicator of when control of the goods transfers to the customer. All of the indicators of whether control has transferred would need to be assessed based on facts and circumstances. For example, a good may be shipped under FOB destination terms. However, control may transfer upon shipment if the customer has the ability to sell the good and re-direct delivery to its own customers while in transit.

Management will also need to assess whether the shipping terms create additional performance obligations when control transfers on shipment. Examples of this could be shipping and in-transit risk of loss coverage. Control of the underlying goods could be transferred and revenue recognised when the product leaves the seller's location, based on legal title transfer, the entity's right to receive payment, or the customer's ability to redirect and sell the goods, but there might be additional performance obligations for shipping and in-transit risk of loss. Management will need to allocate the transaction price to each of the performance obligations, and recognise revenue when each performance obligation is satisfied, which might be at different times. Management should consider the effect of these arrangements based on the facts and circumstances of each transaction.

Example 5(c) – Shipments to customers with a common carrier

Facts: An electronics manufacturer enters into a contract to sell flat screen televisions to a retailer. The delivery terms are FOB shipping point (legal title passes to the retailer when the televisions are handed over to the carrier). A third-party carrier is used to deliver the televisions. The manufacturer has a past business practice of providing replacements to the retailer, at no additional cost, if the televisions are damaged during transit.

The retailer does not have physical possession of the televisions during transit, but has legal title at shipment and therefore can redirect the televisions to another party. The manufacturer is also precluded from selling the televisions to another customer while in transit.

Question: When does control of the televisions transfer?

Analysis: The manufacturer would assess the indicators of transfer of control and recognise revenue when control transfers to the retailer. Though the risks and rewards of ownership have not transferred, the retailer has legal title and can direct the televisions to another party during transit. The manufacturer would likely conclude that control transfers and revenue should be recognised at shipping point. The manufacturer should consider whether additional performance obligations exist relating to in-transit risk of loss coverage based on its past business practice.

5. Determine transfer of control and recognise revenue *(cont'd)*

Bill-and-hold arrangements

Retail and consumer product manufacturing entities may have bill-and-hold arrangements with their customers whereby the companies bill customers for goods, but do not deliver those goods until a later date. Retailers may have similar arrangements whereby customers are offered layaway services. Companies can currently recognise revenue when product is billed (rather than on delivery) if the arrangement meets certain criteria.

New guidance	Current PSAK 23 and other relevant interpretations
The new revenue standard focuses on when control of the goods transfer to the customer to determine when revenue is recognised. A customer may obtain control of a product even though that product remains in the vendor's physical possession in some circumstances. A customer has control when it has the ability to direct the use of, and obtain the remaining benefits from, the product, even if it does not have physical possession of the product. For a customer to have obtained control of a product in a bill-and-hold arrangement, the following criteria must be met: (1) the reason for the arrangement is substantive; (2) the product has been identified separately as belonging to the customer; (3) the product is ready for delivery in accordance with the terms of the arrangement; and (4) the vendor does not have the ability to use the product or sell the product to another customer.	Revenue is recognised in bill-and-hold transactions when the buyer takes title, provided: (1) it is probable that delivery will be made, (2) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised, (3) the buyer specifically acknowledges the deferred delivery instructions, and (4) the usual payment terms apply.

Potential impact:

Companies will need to consider the facts and circumstances of their arrangements to determine whether control of the product has transferred to the customer prior to delivery.

A company that has transferred control of the goods to recognise revenue needs to consider whether it is providing custodial services in addition to providing the goods and whether those custodial services are a performance obligation. If so, a portion of the transaction price should be allocated to each of the separate performance obligations (that is, the goods and the custodial service).

5. Determine transfer of control and recognise revenue *(cont'd)*

Example 5(d) – Bill-and-hold arrangement

Facts: A video game company enters into a contract to supply 100,000 video game consoles to a retailer. The contract contains specific instructions from the retailer about where the consoles should be delivered. The video game company must deliver the consoles in the next year at a date to be specified by the retailer. The retailer expects to have sufficient shelf space at the time of delivery. As of the year-end, the video game company has inventory of 120,000 game consoles, including the 100,000 relating to the contract with the retailer. The 100,000 consoles are stored with the other 20,000 game consoles, which are all interchangeable products; however, the video game company will not deplete its inventory below 100,000 units.

Question: When should the video game company recognise revenue for the 100,000 units to be delivered to the retailer?

Analysis: The video game company should not recognise revenue until the bill-and-hold criteria are met and control is transferred to the customer. Although the reason for entering into a bill-and-hold transaction is substantive (lack of shelf space), the other criteria are not met as the game consoles produced for the retailer are not separated from other products.

Intellectual property (IP) licences and franchise agreements

Licences are common in the retail and consumer markets sector. Many products include a licensed image or name. Retail and consumer markets entities may license their trade names or grant franchise rights to others. Additionally, these arrangements may also include other obligations, such as ongoing support, additional services, etc. Licences can include various features and economic characteristics, which can lead to significant differences in the rights provided by a licence. The terms might be perpetual or for a defined period of time. Accounting for licences and franchise rights under the revenue standard may be different compared to today.

A company should first consider the guidance for identifying performance obligations to determine if the licence is distinct from other goods or services in the arrangement. For licences that are not distinct, a company will combine the licence with other goods and services in the contract and recognise revenue when it satisfies the combined performance obligation.

Under PSAK 72, whether revenue is recognised at a point in time or over time depends on the nature of the licence and whether the company's activities significantly change the IP.

The new revenue standard includes an exception relating to variable consideration for the recognition of sales- or usage-based royalties from licences of IP. Revenue from a sales- or usage-based royalty is not recognised until the later of when (1) the customer's subsequent sales or usage occurs or (2) the performance obligation to which some or all of the sales- or usage-based royalty has been allocated is satisfied or partially satisfied. The exception would also apply when a contract includes a royalty, a licence of IP and other goods and services, and the licence is the "predominant" item to which the royalty relates. However, the exception does not apply to an outright sale of IP.

5. Determine transfer of control and recognise revenue *(cont'd)*

New guidance	Current PSAK 23 and other relevant interpretations
When a licence is distinct, a company must consider the nature of the licence to determine when to recognise revenue. The revenue standard includes specific implementation guidance for accounting for licences of IP and distinguishes between a licence that provides a right to access IP and a licence that provides a right to use IP: **Right to use IP** Licences that provide a right to use IP are performance obligations satisfied at a point in time. **Right to access IP** Licences that provide a right to access a company's IP are performance obligations satisfied over time. The licences guidance in PSAK 72 is based on the extent to which an entity's activities affect the intellectual property because they either change its form or functionality or because the customer's ability to benefit from the IP is derived from those activities.	Revenue is not recognised under licensing and franchise agreements until performance occurs and the revenue is earned. The assignment of rights for a non-refundable amount under a non-cancellable contract permits the licensee to use those rights freely. When the licensor has no remaining obligations to perform, the assignment is, in substance, a sale. A fixed licence term is an indicator that the revenue should be recognised over the period because the fixed term suggests that the licence's risks and rewards have not been transferred to the customer. Royalties are recognised on an accrual basis in accordance with the relevant agreement's substance.

Potential impact:

Companies will need to consider the facts and circumstances of their arrangements to determine The new guidance for licences is different from today's models, so the timing of revenue recognition might change depending on the model currently followed.

A company should first consider the guidance for distinct performance obligations to determine if the licence is distinct from other goods or services in the arrangement. Licences that are not distinct are combined with other goods and services in the contract to identify a distinct performance obligation. Revenue is recognised when that performance obligation is satisfied. Complex arrangements, which include licences and other performance obligations, will require careful consideration to determine whether the licence should be accounted for separately.

The next step for distinct licences is to determine the nature of the promise in granting the licence, which will determine whether revenue is recognised at a point in time or over time. Licensors may have to perform a much more detailed assessment than previously to determine the nature of the licence and when revenue is recognised.

Common licensing scenarios for retail and consumer product manufacturers, such as trademarks and tradenames, should be carefully considered to determine the nature of these licences. Under PSAK 72, the determination of whether an entity's promise to grant a licence provides a right to access IP or a right to use IP is based on whether the IP is significantly affected by the entity's activities. Most trademark and tradename licences will be right of access licences under PSAK 72.

Other arrangements, such as the licensing of a patent, product formula, or recipe, will likely be considered as right to use IP under PSAK.

5. Determine transfer of control and recognise revenue *(cont'd)*

Intellectual property (IP) licences and franchise agreements

Franchise arrangements often involve the right to access IP as well as other goods and services, such as point-of-sale systems, equipment, signage, and layouts. Companies that grant franchise rights to third parties will apply the principles for licence agreements described above.

Companies should evaluate the different promises (explicit and implicit) within a franchise arrangement to determine whether there are multiple performance obligations. For example, equipment provided upfront may be a separate performance obligation from the licensed franchise right.

The provisions of the contract will need to be assessed against the criteria in PSAK 72 to determine whether they are right to access or right to use licences. Franchise arrangements will typically be right to access licences under PSAK.

Licences of IP that involve variable consideration due to sales- or usage-based royalties are subject to specific guidance on revenue recognition. The application of this guidance is not optional. Therefore, companies will need to carefully consider whether their licence arrangements fall within this guidance.

Variable consideration from the licence of IP that is based on a sales- or usage-based royalty is excluded from the transaction price until the sale or usage occurs. Therefore, because royalties should be recognised in the period the sale or usage occurs (assuming the performance obligation has been satisfied), it may be necessary for management to estimate sales or usage that have occurred, but have not yet been reported by the customer. In other words, recognising royalty revenue on a lag basis is not permitted under the new standard.

Minimum guarantees are common in licence arrangements in which the consideration is in the form of a sales-based or usage-based royalty. Questions arise in practice when determining whether and how the minimum guarantee impacts the application of the recognition constraint for sales-based or usage-based royalties for licences of IP. Any fixed, non-contingent fees, such as minimum royalty payments or minimum guarantees, are not subject to the sales- or usage-based royalty exception. Thus, if a contract includes a sales-based royalty with a minimum royalty guarantee that is binding and not contingent on the occurrence or non-occurrence of a future event, the minimum (fixed fee) would be recognised as revenue when control of the licence transfers. The variable consideration (i.e., the amount above the fixed minimum) should be recognised in accordance with the sales- or usage-based royalty exception.

For licences in which revenue is recognised over time, there are three acceptable approaches to the sales-based or usage-based exception for licences with right to access that include a minimum guarantee:

- Recognise revenue as the royalties occur if the licensor expects the total royalties to exceed the minimum guarantee.
- Estimate the total transaction price (including fixed and variable consideration) that will be earned over the term of the licence. Using an appropriate measure of progress, recognise revenue subject to the royalty constraint.
- Recognise the minimum guarantee (fixed consideration) using an appropriate measure of progress, and recognise royalties only when cumulative royalties exceed the minimum guarantee.

Since the new revenue standard does not prescribe a single approach that must be followed, judgment must be applied when selecting a methodology used to measure progress. We believe any of the three views are reasonable under PSAK 72, although companies should select the method that best depicts the transfer of goods and services to customers. Companies should also consider the nature of these arrangements and ensure that the measure of progress does not conflict with the core principles of the new revenue standard. Companies should also disclose their judgments in this area, if material. Other methodologies not described above may also be appropriate if they meet the core objective of the new revenue standard.

5. Determine transfer of control and recognise revenue *(cont'd)*

Example 5(e) – Licences

Facts: A designer of jeans has a worldwide recognised brand. A global manufacturer of dolls contracts with the designer for the right to use its brand name on the dolls' clothes. The terms of the agreement provide the doll manufacturer with rights to use the brand name on the dolls' clothes for two years. The designer will receive CU1 million upfront and 12% of all proceeds from the sales of the dolls that include branded jeans. The doll manufacturer will provide updated sales estimates on a quarterly basis and actual sales data on a monthly basis.

Question: When does the designer recognise revenue?

Analysis: Revenue will be recognised over time. The licence is a distinct performance obligation and the nature of the entity's promise is to provide a right to access the entity's IP.

The upfront payment of CU1 million is recognised over time using an appropriate measure of progress. The variable consideration to be received by the designer depends on the level of sales of dolls and is a sales-based royalty. Therefore, the royalty component of the consideration is excluded from the transaction price until the sales have occurred, following the sales-based or usage-based royalty constraint.

Example 5(f) – Franchise agreement

Facts: An entity grants a franchisee the right to operate a restaurant in a specific market using the entity's brand name, concept and menu for a period of ten years. The entity has granted others similar rights to operate this restaurant concept in other markets. The entity commonly conducts national advertising campaigns, promoting the brand name, and restaurant concept generally. The franchisee will also purchase kitchen equipment from the entity. The entity will receive CU950,000 upfront (CU50,000 for the kitchen equipment and CU900,000 for the franchise right) plus a royalty, paid quarterly, based on 4% of the franchisee's sales over the life of the contract.

Question: When should the company recognise revenue?

Analysis: The franchise right is a distinct performance obligation and the nature of the company's promise is to provide a right to access the company's IP. Revenue should be recognised over time.

The kitchen equipment is a distinct performance obligation. The company will satisfy this performance obligation upon transfer of the equipment. If CU900,000 and CU50,000 reflect the standalone selling prices of the franchise right and kitchen equipment, respectively, then the company would recognise CU50,000 of the upfront fee upon transfer of the equipment.

The remaining upfront payment of CU900,000 would be recognised over time (ten years in this example). The variable consideration (i.e., the 4% royalty) to be received by the restaurant company would be included in the transaction price only when the subsequent sales have occurred in accordance with the exception for sales-based royalties. The sales-based royalty should be allocated entirely to the franchise licence because the variable consideration relates entirely to the company's promise to grant the franchise licence. In addition, allocating CU50,000 to the equipment and allocating the sales-based royalty to the franchise licence would be consistent with an allocation based on the company's relative standalone selling prices in similar contracts.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Determine transfer of control and recognise revenue | **Other consideration**

Right of return

Return rights are commonly granted in the retail and consumer markets industry and may take the form of product obsolescence protection, stock rotation, trade-in agreements, or the right to return all products upon termination of an agreement. Some of these rights may be articulated in contracts with customers or distributors, while others are implied during the sales process, or based on historical practice.

New guidance	Current PSAK 23 and other relevant interpretations
Revenue should not be recognised for goods expected to be returned, and a liability should be recognised for expected refunds to customers. The refund liability should be updated each reporting period for changes in expected refunds. An asset and corresponding adjustment to cost of sales should be recognised for the right to recover goods from customers on settling the refund liability. The asset will be initially measured at the cost of inventory sold less any expected costs to recover the goods and the impact of any reduction in the value of those goods. At the end of each reporting period, the asset should be re-measured (if necessary) based on changes in expectations. The guidance for variable consideration is applied to determine how much revenue to recognise. Entities will recognise the amount of revenue they expect to be entitled to when control transfers to the extent it is highly probable that significant reversal will not occur in the future. Exchanges of products for another of the same type, quality, condition, and price are not considered returns. Defective product exchanges should be considered in accordance with the guidance on warranties.	Revenue is typically recognised net of a provision for the expected level of returns, provided that the seller can reliably estimate the level of returns based on an established historical record and other relevant evidence. The current PSAK does not specify the balance sheet accounting for expected returns.

Potential impact:

The accounting for product returns under the new revenue standard will be largely unchanged from current guidance under PSAK. There might be some retail and consumer markets entities that are deferring revenue today because they are unable to reliably estimate returns. The new guidance requires that the impact of returns be estimated using a probability-weighted approach or most likely outcome, whichever is most predictive. Consideration received is included in revenue to the extent that it is highly probable that there will be no significant reversal when the uncertainty is resolved. This could result in revenue being recognised earlier than under today's guidance.

There is diversity in existing practice in the balance sheet presentation of expected returns. The revenue standard specifies that the balance sheet should reflect both the refund obligation and the asset for the right to the returned goods on a gross basis, which should eliminate the current diversity in presentation.

We expect that in most circumstances, a refund liability will not meet the definition of a contract liability because the refund liability does not obligate the entity to transfer future goods or services to the customer. Therefore, the refund liability should be presented separately from any contract liabilities and would not be subject to the related disclosure requirements.

(1) Identify the contract
(2) Identify performance obligation
(3) Determine transaction price
(4) Allocate transaction price
(5) Determine transfer of control and recognise revenue
Other consideration

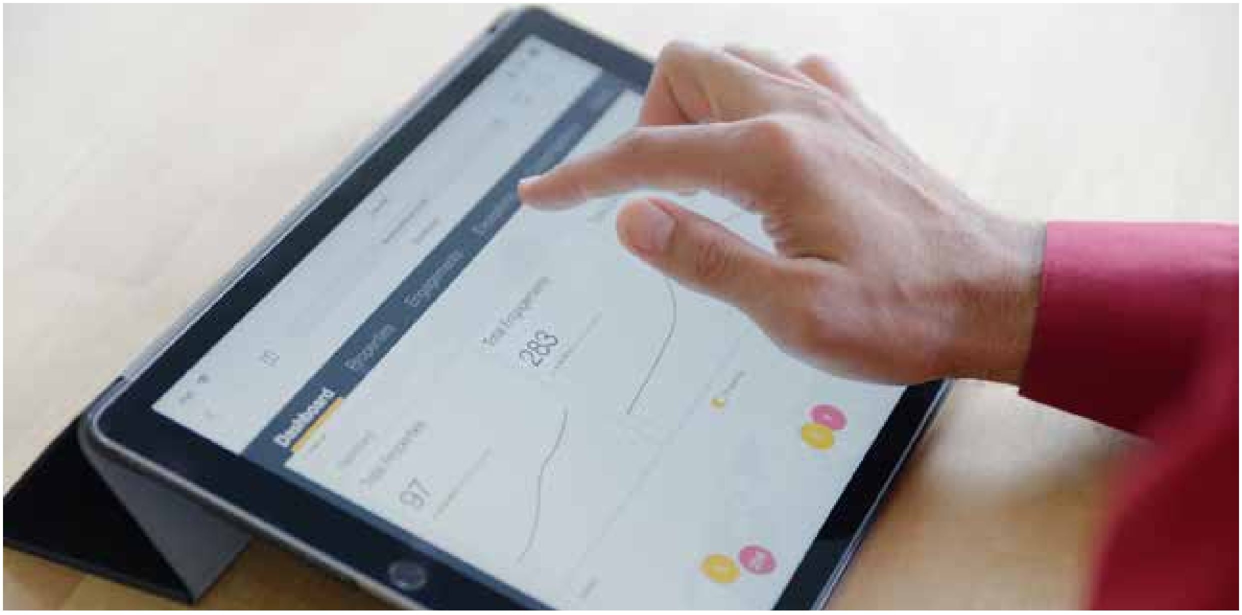
Right of return *(cont'd)*

Example 6(a) – Right of return

Facts: A retailer sells 100 mobile phones for CU100 each. The mobile phones cost CU50 and the terms of sale include a return right for 180 days. The retailer estimates that 10 mobile phones will be returned based on historical sales patterns. In establishing this estimate, the retailer uses an expected value method and estimates a 40% probability that eight mobile phones will be returned, a 45% probability that nine mobile phones will be returned, and a 15% probability that 18 mobile phones will be returned. The retailer also concludes it is highly probable that there will not be a significant reversal of revenue recognised based on this estimate when the uncertainty is resolved (i.e., once the return period has expired).

Question: How should the retailer record the revenue and expected returns related to this transaction?

Analysis: At the point of sale, CU9,000 of revenue (CU100 x 90 mobile phones) and cost of sales of CU4,500 (CU50 x 90 mobile phones) would be recognised. An asset of CU500 (cost of CU50 x 10 mobile phones) would be recognised for the anticipated return of the mobile phones (assuming they are expected to be returned in a re-saleable condition), and a liability of CU1,000 (CU100 x 10 mobile phones) is recognised for the refund obligation. The probability of return is evaluated at each subsequent reporting date. Any changes in estimates are adjusted against the asset and liability, with adjustments to the liability recorded to revenue and adjustments to the asset recorded against cost of sales.



Warranties

Products are often sold with standard warranties that provide protection to the end customer that the product will work as advertised or intended for a fixed period of time. Many companies also offer extended warranties that cover defects that arise after the initial warranty period has expired. Standard warranties have historically been accounted for as a cost accrual while extended warranties result in the deferral of revenue. The revenue standard draws a distinction between product warranties that the customer has the option to purchase separately (for example, warranties that are negotiated or priced separately, such as an extended warranty) and product warranties that the customer does not have the option to purchase separately (for example, a standard warranty). Management will need to exercise judgment when assessing a warranty that is not sold separately to determine if there is a service component embedded in the warranty that should be accounted for as a separate performance obligation.

New guidance	Current PSAK 23 and other relevant interpretations
A warranty that can be purchased separately should be accounted for as a separate performance obligation because the company promises a service to the customer in addition to the product. Warranties that provide assurance that a product will function as expected and in accordance with certain specifications are not separate performance obligations. Such warranties are accounted for in accordance with other guidance if the customer does not have the option to purchase the warranty separately. A promised warranty, or a part of the promised warranty, which is not sold separately but provides the customer with a service in addition to the assurance that the product complies with agreed specifications, creates a performance obligation for the promised service. A company that cannot reasonably separate the service component from a standard warranty should account for both together as a separate performance obligation.	Management must determine if the warranty obligation is a separate element in the contract. When a warranty is not a separate element, and it represents an insignificant part of the transaction, the seller has completed substantially all of the required performance and can recognise the consideration received as revenue at the time of sale. The expected future cost relating to the warranty is recorded as a cost of sale, as the warranty does not represent a return of a portion of the sales price. Expected warranty costs are determined at the time of sale, and a provision is recognised. If the cost of providing the warranty service cannot be measured reliably, no revenue is recognised prior to the expiration of the warranty obligation. The consideration for sale of extended warranties is deferred and recognised over the period covered by the warranty. When the extended warranty is an integral component of the sale (that is, bundled into a single transaction), management ascribes a relative fair value to each component of the bundle.

Potential impact:

Product warranties that are not sold separately and that provide only for defects at the time a product is shipped will result in a cost accrual similar to current guidance.

Extended warranties create separate performance obligations under the new revenue standard. Therefore, revenue is recognised over the warranty period. This is similar to existing guidance.

Warranties that are separately priced might be affected as the transaction price will be allocated based on relative standalone selling prices rather than at the contract price. It may be difficult to separate standard warranties from those that also provide a service in some situations. Determining the estimated standalone selling price for the latter category when such warranties are not sold separately could also be challenging.

Warranties *(cont'd)*

Example 6(b) – Warranty, cost accrual

Facts: A manufacturer sells stereo equipment. The manufacturer also provides a 60-day warranty that covers certain components of the stereo equipment. The warranty is not sold separately by the company and is designed to provide assurance that the product will function as expected.

Question: How should the manufacturer account for the warranty?

Analysis: The manufacturer should accrue the cost it expects to incur to satisfy the warranty similar to existing provisions guidance in PSAK.

Example 6(c) – Warranty, separate performance obligation

Facts: A manufacturer sells stereo equipment. A customer has elected to also purchase the optional 12-month extended warranty.

Question: How should the manufacturer account for the warranty?

Analysis: The manufacturer should treat the 12-month warranty as a separate performance obligation. A portion of the transaction price is allocated to the warranty based on its relative standalone selling price and recognised as revenue when the warranty obligation is satisfied, typically after the standard "manufacturer's" warranty has expired. The manufacturer will need to assess the pattern of warranty satisfaction to determine when revenue should be recognised (that is, rateably or some other pattern).

Consumer markets companies often offer customers other after-sales services, in addition to warranties, in conjunction with products and will need to evaluate whether those services represent a separate performance obligation. Examples of other after-sales services can include installation, product protection, and service plans.

Principal versus agent (Gross versus net)

Some arrangements involve two or more unrelated parties that contribute to providing a specified good or service to a customer. In these instances, management will need to determine whether the company has promised to provide the specified good or service itself (as a principal) or to arrange for those specified goods or services to be provided by another party (as an agent). This determination often requires judgment, and different conclusions can significantly impact the amount and timing of revenue recognition.

Retailer arrangements that will require evaluation might include: service offerings (e.g., an electronics retailer selling third-party cellular service plans), extended warranties, product protection plans, installation services, and third-party gift card sales. Retail and consumer product arrangements that will require evaluation might include direct shipments from suppliers or contract manufacturers to third-party distributors, retailer customers, or end customers. Other types of arrangements frequently involve more than two unrelated parties, and must be assessed to determine whether a company is the principal or an agent in the arrangement.

Management should first obtain an understanding of the relationships and contractual arrangements among the various parties. This includes identifying the specified good or service being provided to the end customer and determining whether the entity controls that good or service before it is transferred to the end customer. It is not always clear whether the company obtains control of the specified good or service. The revenue standards provide indicators to help management make this assessment.

New guidance	Current PSAK 23 and other relevant interpretations
A company is the principal and should report revenue on a gross basis if it controls the specified good or service before that good or service is transferred to the customer. Indicators that assist entities in determining whether it controls the good or service before it is transferred to the customer are: • The company has primary responsibility for fulfilment of the contract. • The company has inventory risk. • The company has discretion in establishing the price. Obtaining title momentarily before transferring a specified good or service to a customer does not necessarily constitute control. The company is an agent if its performance obligation is to arrange for another party to provide the specified goods or services. An agent does not control the specified good or service provided by another party before that service is transferred to the customer.	A company is a principal if it is exposed to risks and rewards when selling goods or providing services. Indicators that a company is acting as a principal in an arrangement are: • The company is the primary obligor • The company has inventory risk • The company has pricing latitude • The company has credit risk An indicator that a company is an agent is if the company earns a pre-determined fee.

Potential impact:

Although the indicators in the new standard are similar to those in the current guidance, the purpose of the indicators is different. The new standard requires a company to assess whether it controls the specified good or service, and the indicators are intended to support the control assessment. In contrast, the current guidance is focused on assessing whether the company has the risks and rewards of a principal. Entities will therefore need to reassess their arrangements through the lens of the control principle.

The new standard also provides more guidance on the unit of account that should be used in the gross versus net assessment, which could result in changes to the assessment as compared to current guidance.

Amounts collected on behalf of third parties

Companies often collect amounts from customers that must be remitted to a third party (for example, collecting and remitting taxes to a governmental agency). Taxes collected from customers could include sales, use, value-added, and some excise taxes. Amounts collected on behalf of third parties, such as certain sales taxes, are not included in the transaction price as they are collected from the customer on behalf of a third party, such as the government. Taxes that are based on production, rather than sales, are typically imposed on the seller, not the customer. A company that is obligated to pay taxes based on production is the principal for those taxes, which are recognised in operating expense with no effect on revenue.

New guidance	Current PSAK 23 and other relevant interpretations
The transaction price is defined to exclude amounts collected on behalf of third parties, such as certain sales taxes. A company will need to assess each type of tax, on a jurisdiction-by-jurisdiction basis, to determine which amounts to present as revenue on a gross basis (when the company is determined to be the principal) and which amounts to exclude from revenue as amounts collected on behalf of third parties (when the company is determined to be the agent).	PSAK 23 explains that revenue includes only the economic benefits that are received or receivable by the entity on its own account. It excludes amounts collected by the entity, such as sales taxes, that the company collects on behalf of the third party. There is no specific guidance on excise or use taxes.

Potential impact:

The requirement to evaluate each type of tax on a jurisdiction-by-jurisdiction basis, to determine which amounts should be reported gross and which should be reported net, could be a significant undertaking for some companies, particularly those that operate in numerous tax jurisdictions with different tax regimes.

The name of the tax (for example, sales tax or excise tax) is not always determinative when assessing whether the company is the principal or an agent for the tax. Management needs to look to the underlying characteristics of the tax and the tax laws in the relevant jurisdiction to determine whether the company is primarily obligated to pay the tax or whether the tax is levied on the customer.

PSAK 73

Leases

The new lease accounting standard, PSAK 73, 'Leases', will fundamentally change the accounting for lease transactions for lessees, and it is likely to have significant business implications. DSAK-IAI issued the standard in September 2017.

Almost all leases will be recognised on the balance sheet for a lessee, with a right-of-use asset and a lease liability that recognise more expenses in profit or loss earlier during the life of a lease. This will have an associated impact on key accounting metrics, and clear communication to stakeholders will be required to explain the impact of changes.

PSAK 73 – Leases

At a glance

'A study on the impact of lease capitalisation', issued by the International Accounting Standards Board in February 2016, identified that the retail and consumer industry is one of the most heavily impacted industries, and that it would see a median increase in debt of almost 100% and in Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) of 41%. 35% of entities would have an increase in debt of over 25%. This might be the case in Indonesia. This supplement highlights some of the areas that could create the most significant challenges for lessees in the retail and consumer sector as they transition to the new standard. These include:

- Determining whether renewal options should be considered in the initial measurement;
- Treatment of variable lease payments; and
- Identification of triggering events that might require reassessment of the lease.

Areas of focus for retailers include arrangements with variable lease payments, assessing right of use and perpetual lease contracts, and treatment of payments to previous lessees ('key money').

The majority of retailers are most significantly affected by the guidance for lessees. Further guidance for lessors is included in our '*PSAK 73 – Leases, A new Era for Lease Accounting*' publication, which is a comprehensive analysis of the new standard.

Overview

Entities in the retail and consumer sectors are generally prolific lessees and, at times, lessors of assets. PSAK 73 requires lessees to capitalise all leases, except for short-term leases and leases of low-value assets. This is a significant change from PSAK 30, where operating leases were off balance sheet.

The accounting model for lessors is substantially the same as under the existing PSAK. Lessors will classify leases as operating or financing. A lease that transfers substantially all risks and rewards incidental to ownership is classified as a finance lease. All other leases are classified as operating leases.

Effective date and transition

The new standard is effective for annual reporting periods beginning on or after 1 January 2020.

Earlier application is permitted, but only in conjunction with adopting PSAK 72, 'Revenue from contracts with customers'. This means that an entity is not allowed to apply PSAK 73 before applying PSAK 72. The date of initial application is the beginning of the annual reporting period in which an entity first applies PSAK 73.

The new standard is required to be adopted using either a full retrospective approach under PSAK 25, 'Accounting policies, changes in accounting estimates and errors', or a simplified approach. Under the simplified approach, lessees do not need to restate comparative information, but they should instead recognise the cumulative effect of applying the standard as an adjustment to the opening retained earnings at the date of initial application. The simplified approach provides various practical expedients, including being allowed to use hindsight.

Impact

The accounting changes are the most obvious impact that the new standard will have on retail and consumer companies. Companies will also 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.

For retail and consumer companies with a significant portfolio of leases, the ability to gather the required information on existing leases, and to capture data on new leases at the outset, will be critical to an orderly and smooth transition to the new standard. This might result in the need for new systems, controls and processes, which will take time to identify, design, implement and test. Furthermore, recognition of right-of-use assets and associated liabilities will profoundly change the balance sheet for retail and consumer companies. This, in turn, might affect loan covenants, credit ratings and other external measures of financial performance.

Is the contract a lease?

Lease accounting guidance applies to any arrangement that conveys control over an identified asset to another party. Retail and consumer companies often enter into arrangements that might clearly contain leases (for example, high street premises), or they might leave residual elements of control with the landlord (for example, airport coffee shop concessions).

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 the asset, the arrangement does not contain an identified asset. A substitution right is substantive if (a) the supplier can 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 might 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 might also be considered physically distinct if it can be used independently of the other floors (for instance, with its own point of entry or exit, access to lavatories, etc.). A capacity portion of an asset is not an identified asset if (1) the asset is not physically distinct (for example, the arrangement permits the lessor to allocate a different space to the lessee), and (2) a customer does not have the right to substantially all of the economic benefits from the use of the asset.

A customer controls the use of the identified asset by possessing the right (1) to obtain substantially all of the economic benefits from the use of such asset ('economics' criterion), and (2) to direct the use of the identified asset throughout the period of use ('power' criterion). A customer meets the 'power' criterion if it holds the right to make decisions that have the most significant impact on the economic benefits derived from the use of the asset. In a retail and consumer environment, these decisions would include what is sold, for how much and how it is displayed. If these decisions are predetermined in the contract, the customer must have the right to direct the operations of the asset without the supplier having the right to change those operating instructions, or must have designed the asset in a way that predetermines how, and for what purpose, the asset will be used throughout the period of use, in order for the contract to be a lease.

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

PwC observation

Contracts that might contain a lease are often the result of specific negotiations covering a variety of goods and services, and they 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 might not be obvious and might require significant judgement. Careful assessment of the facts and circumstances, considering all relevant rights, will be required.

Is the contract a lease? *(cont'd)*

Example 1 – Retail unit with substitution rights

A customer enters into a contract that conveys the right to use an explicitly specified retail unit for a period of five years. The property owner can require the customer to move into another retail unit; there are several retail units of similar quality and specification available.

Because the property owner has to pay for any relocation costs, it can benefit economically from relocating the customer only if there is a new lessee that wants to occupy a large amount of retail space at a rate that is sufficient to cover the relocation costs. Those circumstances might arise, but they are not considered likely to occur.

The contract requires the customer to sell his goods during the opening hours of the larger retail space. The customer decides on the mix of goods sold, the pricing of the goods sold and the quantities of inventory held. He further controls physical access to the retail unit throughout the five-year period of use.

The rent that the customer has to pay includes a fixed amount plus a percentage of the sales from the retail unit.

Question: Does the contract contain a lease?

Analysis: Is there an identified asset? The retail unit is explicitly specified in the contract. The property owner has a right to substitute the asset; however, the substitution right is not substantive, because the property owner would benefit from the exercise of the right only under certain circumstances that are not considered likely to occur. The retail unit is an identified asset.

Does the customer have the right to obtain substantially all of the economic benefits from the use of the retail unit? The customer has the exclusive use of the retail unit throughout the period of use. The fact that a part of the cash flows received from the use are passed to the property owner as consideration does not prevent the customer from having the right to substantially all of the economic benefits from the use of the retail unit.

Does the customer have the right to direct the use of the retail unit? During the period of use, all decisions on how, and for what purpose, the retail unit is used are made by the customer. The restriction that goods can only be sold during the opening hours of the larger retail space defines the scope of the contract, but it does not limit the customer's right to direct the use of the retail unit.

The contract contains a lease of a retail unit.

Is the contract a lease? *(cont'd)*

Example 2 – Coffee kiosk with substitution rights

A coffee vendor enters into a contract that conveys the right to 10 square metres of retail space within an airport terminal for a period of one year, with an option to renew indefinitely. There is no specific location cited in the contract – it is stipulated by the contract that the airport operator can require the coffee vendor to move to any location next to, or near to, different boarding gates. The coffee vendor can easily move its kiosk, and the airport operator has minimal costs to relocate the coffee vendor. The contract requires the outlet to be open between 5.30am and 10pm.

Question: Does the contract contain a lease?

Analysis: Is there an identified asset? The contract is for 10 square metres of retail space, but the location within the airport is not explicitly specified in the contract and the airport operator has a right to substitute the space at any time. The substitution right is substantive because:

(a) the airport operator has a practical ability to change the space used – it can choose between alternative locations near different boarding gates; and

(b) the airport operator would benefit economically from substituting the space – there are minimal costs to move the kiosk and, over time, the operator could benefit from using space differently to meet changing circumstances.

In this instance, there is no lease, because there is no identified asset and the arrangement is an executory contract.

Components, contract consideration and allocation

An arrangement might contain lease and non-lease components that are subject to different accounting models. Components are those items or activities that transfer a good or service to the lessee. Arrangements might also contain multiple lease components. The right to use an underlying asset is a separate lease (from other leases within the contract) where the lessee can benefit from using the underlying asset on its own, or together with resources readily available to the lessee, and the underlying asset is not highly dependent on, or highly interrelated with, other underlying assets in the contract.

Example 3 – Identifying components within an arrangement: rental unit

Facts: A retail company leases a retail unit within a shopping mall together with shop fixtures and a storage bay. The monthly payment to the lessor includes: (a) fixed rent for the retail unit, fixtures and loading/storage bay; (b) a fixed amount for property taxes and insurance; (c) a fixed amount for security and cleaning; and (d) a fixed amount relating to the maintenance of the retail unit.

Question: What are the components in this arrangement?

Discussion: The lease components in the arrangement are the retail unit with the loading/storage bay and the fixtures. The non-lease components are the security and cleaning and the maintenance services.

The fixed payments relating to property taxes and insurance do not transfer a good or service to the lessee, so they cannot be identified as separate components. They are instead considered as part of the total consideration allocated to the separately identified components of the contract.

The fixtures are considered a separate lease component, since they are neither dependent on, nor highly interrelated with, the retail unit or loading/storage bay, because they can be sourced from other providers and be used in other boutiques. Accordingly, the right to use the fixtures is a separate lease component.

Security and cleaning services involve the provision of separate services to the retail company, and they are considered as separate non-lease components. The retail company can either:

1) separate the lease from the non-lease components, and allocate consideration to each component; or
2) apply the practical expedient, and account for both the lease and the associated non-lease component as a single, combined lease component.

Due to the significance of the maintenance services, the retail company elects not to apply the practical expedient of combining the non-lease components with the associated lease components.

Once the lease and non-lease components are identified, contract consideration is allocated to each component. A lessee should allocate the contract consideration to the separate lease and non-lease components, based on their relative stand-alone prices.

A lessor should allocate the contract consideration to the separate lease and non-lease components in accordance with the transaction price allocation guidance in PSAK 72. The practical expedient available to a lessee, for lease and non-lease components, is not available to a lessor.

The guidance specifies that amounts payable by the lessee for activities and costs that do not transfer a good or service to the lessee (for example, property taxes and insurance) are not separate components of the contract, but they are considered as part of the total consideration allocated to the separately identified components of the contract.

Components, contract consideration and allocation *(cont'd)*

PwC observation

Contracts that might contain a lease are often the result of specific negotiations covering a variety of goods and services, and they 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 might not be obvious and might require significant judgement. Careful assessment of the facts and circumstances, considering all relevant rights, will be required.

Initial direct costs

Initial direct costs are incremental costs of a lease that would not have been incurred if the lease had not been executed. Any costs that would have been incurred even if the lease were not executed are not incremental costs, and they should be excluded from initial direct costs. For example, external legal fees are excluded from initial direct costs, assuming that the lessee would be required to pay its lawyers for preliminary work performed before a potential lessee was found. However, where a lessee and lessor execute a legally binding lease commitment prior to drafting the lease agreement, legal fees for drafting might be incremental costs that can be accounted for as initial direct costs. Initial direct costs are capitalised as part of the right-of-use asset and amortised over the lease term.

Retail and consumer companies often enter into multi-year arrangements, and they might incur significant initial direct costs in the form of payments paid to ensure access to a key location. Some contracts require the lessor, new lessee or old lessee to make payments when entering into a lease contract or during the lease term. Accounting for these payments might differ, depending on the contractual arrangements and on the substance of the transaction. The following table sets out the principles of lease accounting for payments between these parties:

	Lessor	New lessee	Old lessee
Lessor pays sums to:		Payments made to a new lessee at the inception of the lease are accounted for as a lease incentive.	This is a cost associated with cancelling the old lease, so it is generally expensed by the lessor. The old lessee should recognise the receipt as income (assuming that all conditions for receipt have been met).
New lessee pays sums to:	The payment is accounted for as a prepayment of rentals under the lease.		This might be a premium paid by the new lessee to gain access to a property located in a specific location. These payments, often called key money, might qualify as initial direct costs. The old lessee should recognise the receipt as income (assuming that all conditions for receipt have been met).
Old lessee pays sums to:	This is income arising from the old lease, so it should be recognised as income by the lessor. This is a cost of exiting the old lease, and it should be expensed by the old lessee.	This is a cost of exiting the lease for the old lessee, and it should be expensed. From the perspective of the new lessee, it is analogous to a lease incentive.	

Lease classification and initial measurement

Lessees will recognise a right-of-use asset and lease liability for virtually all of their 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. However, lessors will continue to classify leases as operating or finance leases.

Short-term leases are leases with a lease term of 12 months or less. The lease term also includes periods covered by an option to extend, or an option to terminate, if the lessee is reasonably certain to exercise the extension option, or not to exercise the termination option. A lease that contains a purchase option is not a short-term lease. Short-term leases for retail premises potentially exist in certain jurisdictions where notice periods are less than 12 months and there is no expiry date. In such circumstances, the guidance on lease renewal options should be considered (see below).

The guidance around lease portfolios is available for use by retailers. Both a lessee and a lessor can apply PSAK 73 to a portfolio of leases with similar characteristics if they reasonably expect that the resulting effect will not be materially different from applying the standard on a lease-by-lease basis. Care should be taken over judging whether characteristics are similar – boutiques in shopping malls are unlikely to share the same characteristics as luxury high street locations. Similarly, since property leases are often territory-specific, a country-by-country portfolio specification is most likely to be seen in practice.

At the commencement date, the lessee measures the lease liability at an amount equal to the present value of the lease payments during the lease term that are not paid at that date. Lease payments consist of the following components:

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

Variable lease payments which depend on turnover or footfall/passengers, rather than an index or a rate, are a frequent feature of retail leases, and they are recognised in the income statement when the event or condition that triggers those payments occurs.

The lessee might be obliged to return the underlying asset to the lessor in a specific condition or to restore the site on which the underlying asset has been located. The accounting for these obligations is comparable to the current accounting. The lessee continues to recognise a provision in accordance with PSAK 57, ‘Provisions, contingent liabilities and contingent assets’, to reflect this obligation. The initial carrying amount of any provision is included in the measurement of the right-of-use asset. Obligations incurred during the term of the lease (such as wear and tear) are recognised as an expense as incurred.

The existence of renewal options or lessee rights to extend are a common feature of leases on retail premises. Periods covered by an option to extend the lease term are included in the lease term if the lessee is reasonably certain to exercise that option. Hence, at initial recognition, retailers should include lease payments in future periods if the lessee is ‘reasonably certain’ to exercise the extension option.

Lease classification and initial measurement *(cont'd)*

PSAK 73 lists various factors to consider, but it does not prescribe how to weight the individual factors when determining whether it is 'reasonably certain' that a lessee will exercise an option. For example, consider a flagship store in a prime and much sought-after location. A number of factors should be considered to assess if it is reasonably certain that the lessee will renew the store lease, such as the lease term, geographical location of the store, termination penalties and, most importantly, the magnitude and expected useful life of leasehold improvements. It is likely that a retailer will be reasonably certain to extend the lease at a flagship store if the initial lease period is relatively short.

Non-monetary aspects are included in the analysis, provided that they reflect economic incentives and not irrational behaviour. Examples of non-monetary aspects include the time and business disruption to find a replacement asset and to enter into a new contract and move locations, and the prestige of the location.

A lessee's past practice might provide information that is helpful in assessing whether the lessee is reasonably certain to exercise, or not to exercise, an option. It is, however, key to understand the economic reasons for that past practice. Those economic reasons, if any, must be taken into account in the lease term assessment.

Example 4 – How are lease payments determined if there are extension options at market rates?

On 1 January 20X1, entity A (lessee) enters into a lease of retail space. The non-cancellable lease term is seven years. The annual lease payment is CU10,000 in the first year, with a 5% increase in every following year, and CU10,000 reflects the market rent at the commencement date. Entity A has the option to extend the lease term for another five-year period. At the commencement date, it concludes that it is reasonably certain to exercise the extension option.

How does entity A determine the lease payments that are included in the lease liability in the scenarios below?

Scenario A

The revised rent for the extension period will be agreed by the lessor and the lessee at the date when the option is exercised, based on the market rent at that time. The revised rent will, however, be no more than 105% of the rent at the end of the preceding period.

Since entity A is reasonably certain to exercise the extension option, the lease term is 12 years. All lease payments within that period are included in the lease liability.

Because both the lessor and lessee have to agree to the revised rent for the extension period, it can be assumed that the rent will be the market rent at that time. Variable lease payments that depend on an index or a rate, such as payments that vary to reflect changes in market rental rates, are initially measured using the index or rate as at the commencement date. [PSAK 73 para 27]. The lease payments for the extension period that are included in the initial measurement of the lease liability are therefore CU10,000 (market rent at the commencement date) for each year of the renewal period.

	1	2	3	4	5	6	7	8–12
Lease payment [CU]	10,000	10,500	11,025	11,577	12,155	12,763	13,401	10,000

When the entity agrees the amount of the first lease payment of the extension period (that is, the payment for year 8), it remeasures the lease liability to reflect the market rent at that time.

Lease classification and initial measurement *(cont'd)*

Scenario B

The revised rent for the extension period will be agreed by the lessor and the lessee at the date when the option is exercised, based on the market rent at that time. There is, however, a cap and a floor such that the revised rent cannot be below 85% or higher than 115% of the rent at the end of the preceding period. The lease payment throughout the extension period is therefore at least (CU10,000 × (1.05)6) × 0.85 = CU11,391.

In scenario B, the payments throughout the extension period are not fully variable but floored. Since the floor of CU11,391 is higher than the market rental rate at commencement date (CU10,000), the amount that is included in the initial measurement of the lease liability for years 8–12 is CU11,391.

	1	2	3	4	5	6	7	8–12
Lease payment [CU]	10,000	10,500	11,025	11,577	12,155	12,763	13,401	11,391

When the entity agrees the amount for the first lease payment of the extension period (that is, the payment for year 8), it remeasures the lease liability to reflect the market rent at that time.

Scenario C

The revised rent for the extension period is the higher of (i) the rent paid in year 7 (CU13,401) and (ii) the current market rent at the date of the commencement of the extension period (either to be agreed by the lessor and the lessee, or determined by an independent surveyor).

Similar to scenario B, the payments throughout the extension period are not fully variable but floored. In scenario C, the floor is the lease payment made in year 7 (CU13,401). Since the floor of CU13,401 is higher than the market rental rate at commencement date (CU10,000), the amount that is included in the initial measurement of the lease liability for years 8–12 is CU13,401.

	1	2	3	4	5	6	7	8–12
Lease payment [CU]	10,000	10,500	11,025	11,577	12,155	12,763	13,401	13,401

When the entity agrees the amount of the first lease payment of the extension period (that is, the payment for year 8), it remeasures the lease liability to reflect the market rent at that time if that is higher than CU13,401.

Lease modifications and reassessments

Lease modifications

A lease modification is any change to the terms and conditions of a contract that results in a change in the scope of, or the consideration for, the use of an underlying asset.

A modification is only accounted for as a separate lease if (i) the modification increases the scope of the lease by adding the right to use one or more assets, and (ii) the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope.

Where a modification is a separate lease, the accounting for the original lease is unchanged, and the new lease component(s) should be accounted for at commencement, like any other new lease.

Lease reassessments

A reassessment of the lease liability takes place if the cash flows change based on the original terms and conditions of the lease (that is, there is no change to the lease contract).

If a lessee has an extension option, with unchanged conditions, which it was initially not reasonably certain to extend, so the extension period was not included in the lease term, but it later does exercise the extension option, the lease liability would be reassessed to reflect the extended lease term. The lessee accounts for the remeasurement in a similar way to a modification, but whether or not it revises the discount rate depends on the reason for the reassessment. For example, when the lease term changes it uses a revised discount rate, whereas when the lease payments increase with inflation it does not revise the discount rate.

PwC observation

Reassessment of the likelihood of exercise of extension, termination or purchase options, and consequent reassessment of the lease term, is required when a triggering event occurs which is within the control of the lessee and was not previously included in the determination of the lease term. A change in market-based factors will not, in isolation, trigger a reassessment of options.

For example, a reassessment would not be triggered if a lessee is leasing retail space and current market conditions for the office space location change, resulting in lease payments that the lessee will be required to make in the extension period now being considered below market. A reassessment would be triggered if a lessee invests in significant lease improvements near the end of the original lease term, because the investment is within the lessee's control.

Retail companies have large portfolios of leased assets, and the likelihood of extending will change over time as a result of changes in general macro-economic conditions or company-specific factors (such as customer trends, store location, etc). It will be important for a company to ensure that it has processes and controls in place to identify and monitor triggering events that would require the remeasurement of a lease.

Lease payments which change with inflation or a rent review, which was foreseen in the original contract, are also situations where the lessee will reassess its liability. The original discount rate is still used, unless the change in payments is due to a change in interest rates.

Transition provisions

Lessees can choose between a full retrospective application in accordance with PSAK 25, 'Accounting policies, changes in accounting estimates and errors', and a 'simplified approach'. For more explanation of the two approaches, see 'PSAK 73 – Leases, A new Era for Lease Accounting'.

Comparative information is not restated under the 'simplified approach', which causes a lack of comparability for users of the accounts. This lack of comparability, and the significant magnitude of the change, is causing some retailers to elect the more costly full retrospective application.

If a lessee chooses the 'simplified approach', for its leases that are currently classified as operating leases it can choose whether to recognise the right-of-use assets retrospectively or based on the lease liability on transition. Right-of-use assets based on the lease liability will typically be larger than those calculated retrospectively, resulting in more depreciation and reduced profitability in future. Retailers with material long-term leases wanting to maximise reported profits are likely to choose right-of-use assets calculated retrospectively.

Lessees calculating right-of-use assets retrospectively under the 'simplified approach' have a choice of using hindsight (which is not available under the full retrospective application). Hindsight relates to areas of estimation and judgment (for example, whether the lessee was reasonably certain to extend a lease). Hindsight should not be applied to areas that do not involve judgment or estimation (for example, leases that have been modified or would have been reassessed – see the previous section).

All lessees calculating a right-of-use asset retrospectively (under either transition approach) will have to retrospectively calculate how the right-of-use asset would have changed each time there was a modification (such as a renegotiation) or a reassessment (such as a market rent review or inflationary increase). This will be particularly onerous for retailers with large long-term lease portfolios.

Glossary

AFS	Available for sale
DSAK-IAI	*Dewan Standar Akuntansi Keuangan – Ikatan Akuntan Indonesia* 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
OCI	Other comprehensive income
PSAK	*Pernyataan Standar Akuntansi Keuangan* or “Statement of Financial Accounting Standards”
SAK	*Standar Akuntansi Keuangan* or “Financial Accounting Standards”
SPPI	Solely Payments of Principal and Interest

PwC Indonesia contacts

For further help, please contact:

Jumadi
Partner
jumadi.anggana@id.pwc.com

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

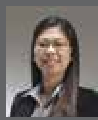
Irwan Lau
Director
irwan.lau@id.pwc.com

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

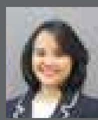
Lukmanul Arsyad
Partner
lukmanul.arsyad@id.pwc.com

Ely Kwan
Director
ely.kwan@id.pwc.com

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



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



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

PwC Indonesia

Jakarta
WTC 3
Jl. Jend. Sudirman Kav. 29-31
Jakarta 12920 - INDONESIA
T: +62 21 5099 2901 / 3119 2901
F: +62 21 52905555 / 52905050
www.pwc.com/id

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