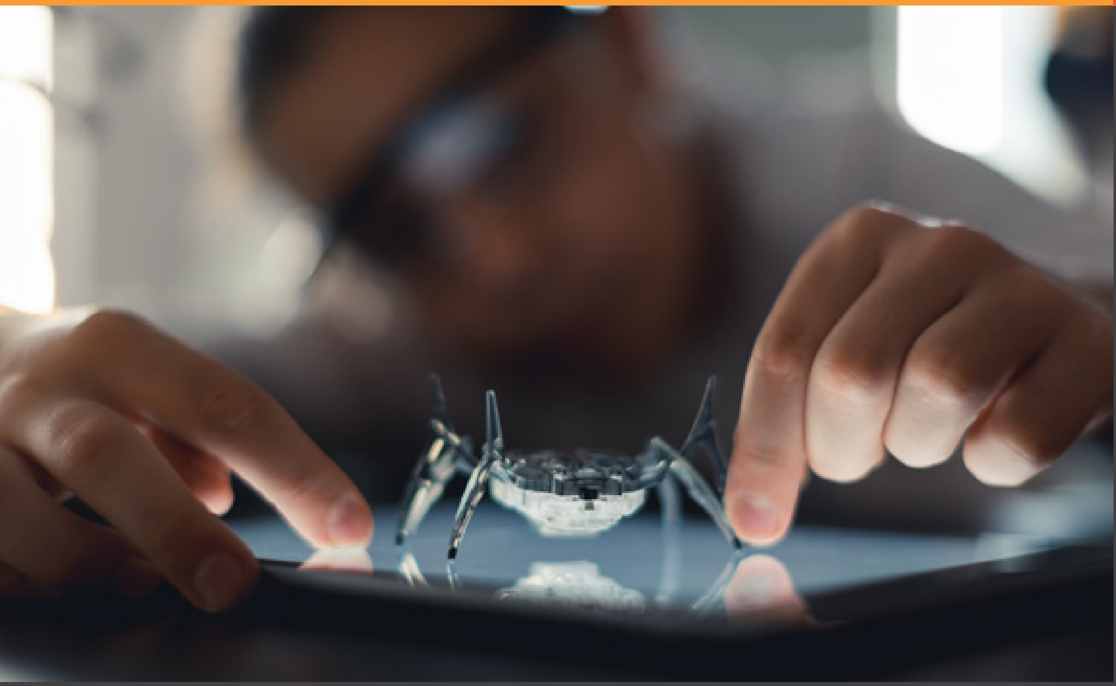
Guidance on the New Big-3 Standards

Technology Sector

October 2019



Introduction

Indonesia is committed to supporting International Financial Reporting Standards (IFRS) as the globally-accepted accounting standards, and to continuing with the IFRS convergence process, while further minimising the gap between Standar Akuntansi Keuangan (SAK) and IFRS. The decision to elect the convergence approach instead of a full adoption was based on the consideration of potential interpretation and implementation issues.

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

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

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

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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 another 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 credit risk in other comprehensive income for liabilities designated at fair value through the profit or loss.

PSAK 71 also includes the new hedging guidance.

These changes are likely to have a significant impact on entities that have significant financial assets.

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

PSAK 71 – Financial Instruments

Application in the technology industry

Overview

PSAK 71 will affect the technology industry with an effective date of 1 January 2020.

Technology entities hold a number of financial instruments arising from their core operations (contract assets and 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 it provides a new hedge accounting model.

"PSAK 71 – Financial Instruments: Understanding the Basics" provides a comprehensive analysis of the new standards. This publication discusses some of the more significant impacts on entities within the technology industry.

What to do now?

Technology to-do list

Here is your immediate to-do list for the implementation of PSAK 71:

1. **Equity investments** will all be held at fair value, even if they are unquoted. There is no cost exemption. An entity needs to decide if it will make an irrevocable election to hold any equity instruments at fair value through other comprehensive income. This can be done on an instrument-by-instrument basis. 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 technology company

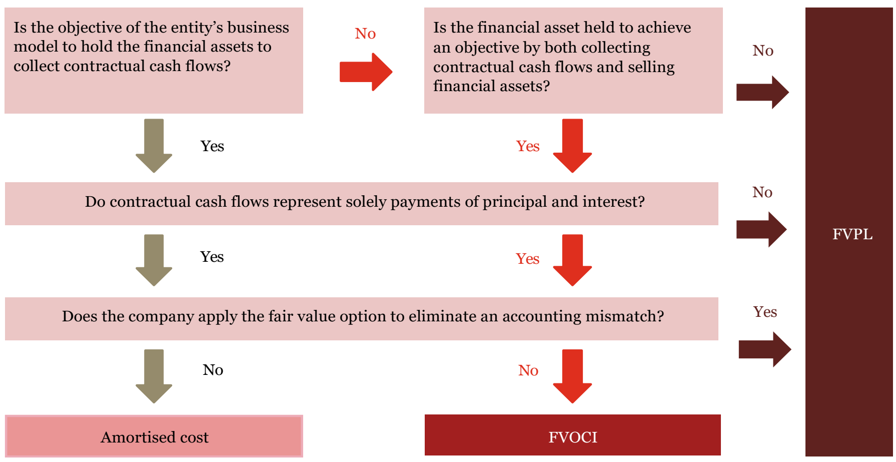
A typical balance sheet of a technology company might include the following financial instruments or receivables that fall under PSAK 71:

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

Classification and measurement – Business model assessment

Debt investments (including receivables)

Classification of debt investments under PSAK 71 is driven by the entity's business model for managing the financial assets and whether the contractual characteristics of the financial assets represent solely payments of principal and interest (SPPI).



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 a 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 a group of financial assets, to be classified at amortised cost or FVOCI. *Principal* and *interest* are defined as follows:

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

Equity investments

Investments in equity instruments (as defined in PSAK 50, from the perspective of the issuer) are always measured at fair value under PSAK 71. The cost exception under PSAK 55 has been removed even for unquoted investments. In limited circumstances, cost may be the appropriate estimate of fair value [PSAK 71 para PP.5.2.3].

Equity instruments that are held for trading are required to be classified at FVPL, with dividend income recognised in the 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 the profit or loss. Dividends are recognised in the 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 the profit or loss (for example, on the sale of an equity investment) and neither are there any impairment requirements. There are additional disclosure requirements if an entity elects to measure equity instruments at FVOCI. [PSAK 60 paras 11A 11B].

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

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

What does this mean for the technology industry?

Trade receivables	• Trade receivables in a technology entity will normally meet the hold to collect criterion. The payments would normally comprise solely the 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 fair value through OCI. 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, fair value through other comprehensive income or fair value through the profit or loss.
Derivatives	• Derivatives remain classified at fair value through profit or loss.
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 an available for sale (AFS) asset 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.

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).

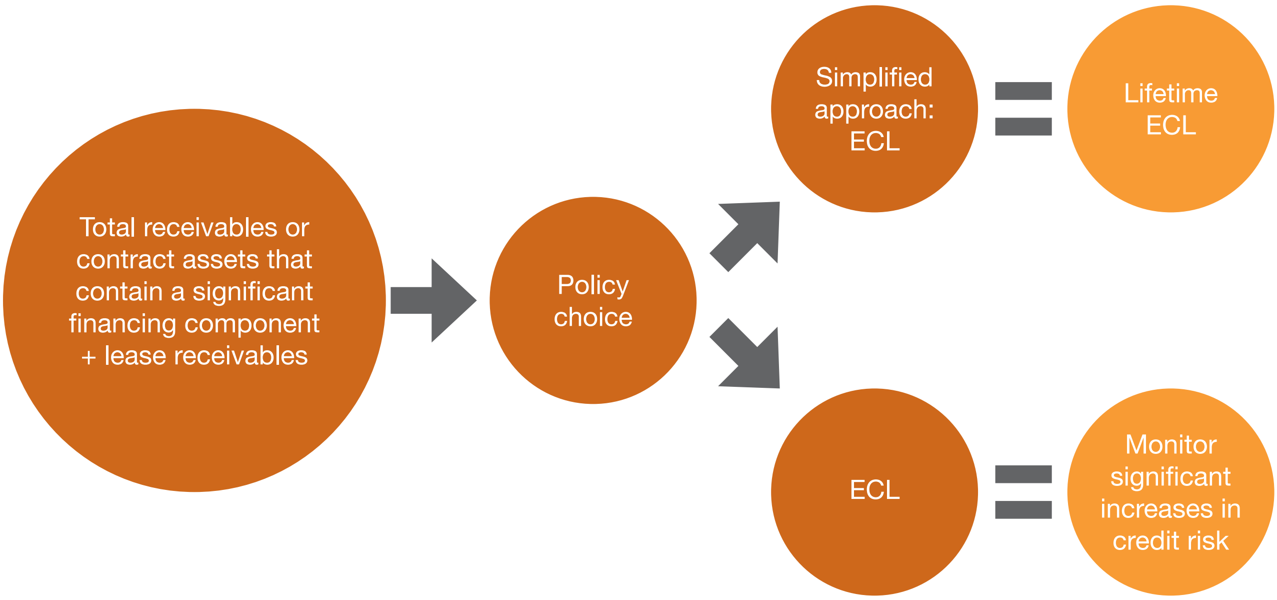
Impairment – Scope exception for trade receivables: The simplified approach

The general impairment model includes some operational simplifications for trade receivables, contract assets and lease receivables, because they are often held by entities that do not have sophisticated credit risk management systems.

These simplifications eliminate the need to calculate 12-month ECL and to assess when a significant increase in credit risk has occurred.

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

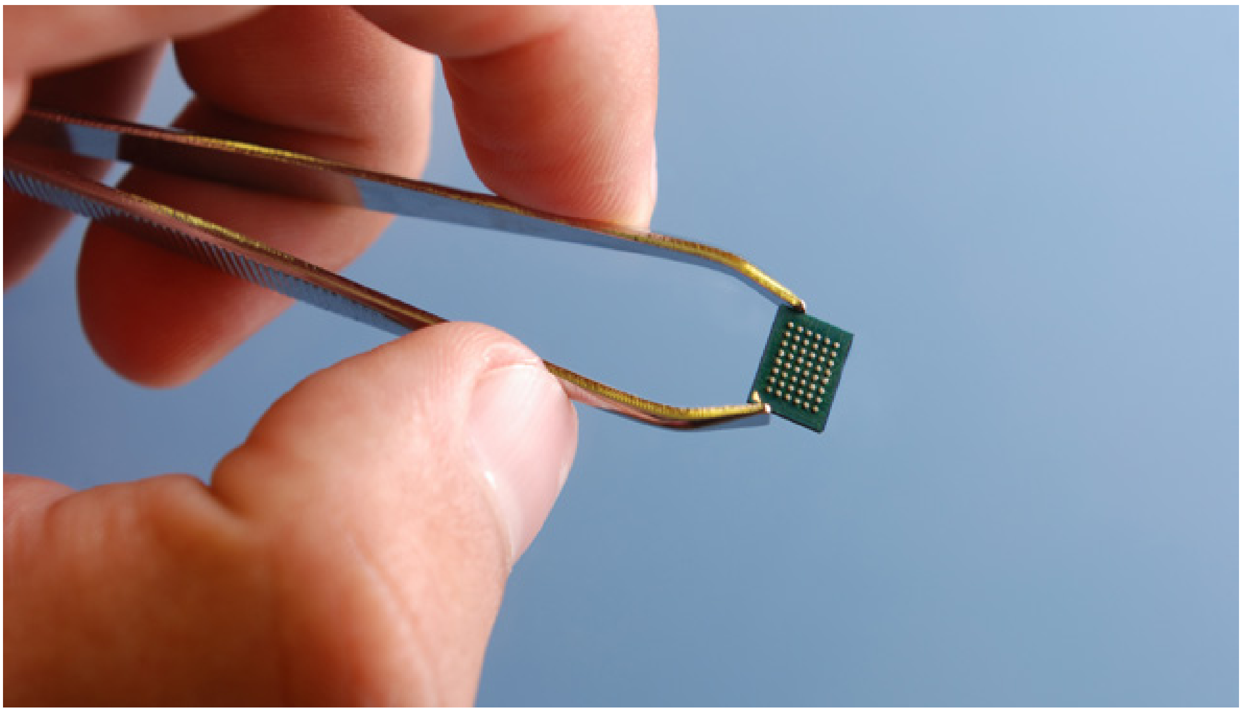
For trade receivables or contract assets that contain a significant financing component (in accordance with PSAK 72) and lease receivables, an entity has an accounting policy choice: either it can apply the simplified approach (that is, to measure the loss allowance at an amount equal to lifetime ECL 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.



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

What does this mean for the technology 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 it will generally not contain a significant financing component. Under the simplified approach, 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 a 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: Define a period of credit sales and related bad debts

Step 2: Calculate the payment profile for these receivables

Step 3: Calculate the historical default rate

Step 4: Update for forward-looking information

Step 5: Compute the ECL

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 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 lease 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 (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 credit sales for that period. For example, in the above information, CU300 out of the CU10,000 lease income for the period, was written off.

Current sales – historical rate of default

Since all of the receivables relating to the sales made 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, GDP, employments 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 economic changes affecting the industry. The entity also concludes that the payment profile and amount of sales are the same. Each entity should make its own assumption of forward-looking information. The provision matrix should be updated accordingly.

The default rates are then recalculated for the various time buckets, based on the expected future losses.

	Current sales	Sales payments outstanding after 30 days	Sales payments outstanding after 60 days	Sales payments outstanding after 90 days
Ageing profile of sales (1)	10,000	8,000	4,500	1,500
Loss: (2)	400	400	400	400
Default rate: (2)/(1) (%)	**4**	**5**	**8.9**	**27**

Step 5

Finally, take the default rates from step 4 and apply them to the actual receivables, at the period end, for each of the time buckets. There is a credit loss of CU12 in the example illustrated.

	Total	Current (0-30 days)	30-60 days	60-90 days	After 90 days
Trade receivable balances at year end: (1)	140	50	40	30	20
Default rate: (2) (%)		4	5	8.9	27
Expected credit loss: (1)*(2)	**CU 12**	**CU 2**	**CU 2**	**CU 3**	**CU 5**

Intra-group loans

The 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 expected credit loss.

What does this mean for technology 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.

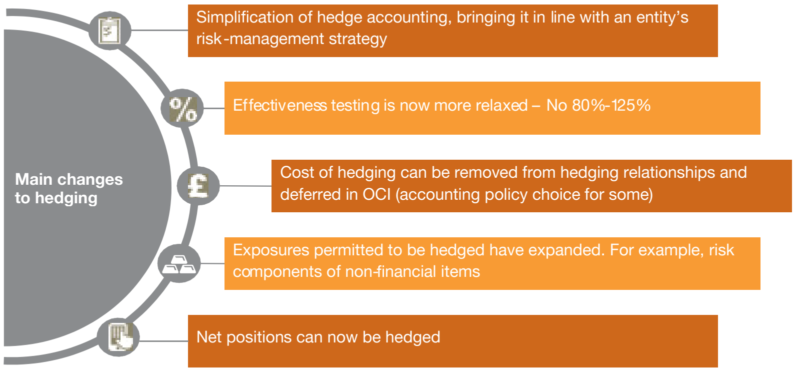
What does this mean for the technology industry?

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 one 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 the profit or loss in the same accounting period in order to record the economic substance of the combination of the hedged item and hedging instrument.



For a transaction to qualify for hedge accounting PSAK 71 includes the following requirements:

- An entity should formally designate and document the hedging relationship at the inception of the hedge. PSAK 71 requires additional documentation to show sources of ineffectiveness and how the hedge ratio is determined.
- There must be an economic relationship between the hedging instrument and the hedged item.
- Credit risk should not dominate value changes.
- The hedge ratio should be aligned with the economic hedging strategy (risk management strategy) of the entity.

What does this mean for technology industry?

Technology entities mostly hedge interest rate risks and, where relevant, foreign exchange currency risks, by entering into interest rate and foreign currency swaps, forwards and options.

Entities will need to update their hedging documentation and ensure that a qualitative assessment of effectiveness for each hedging relationship is performed.

There is no longer an 80-125% effectiveness 'bright line' effectiveness test. As such, a retrospective effectiveness test is no longer required to prove that the effectiveness was between 80 and 125%. However, all ineffectiveness should still be recorded in the income statement.

PSAK 71 gives companies a free choice over whether to adopt its new hedge accounting requirements when 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

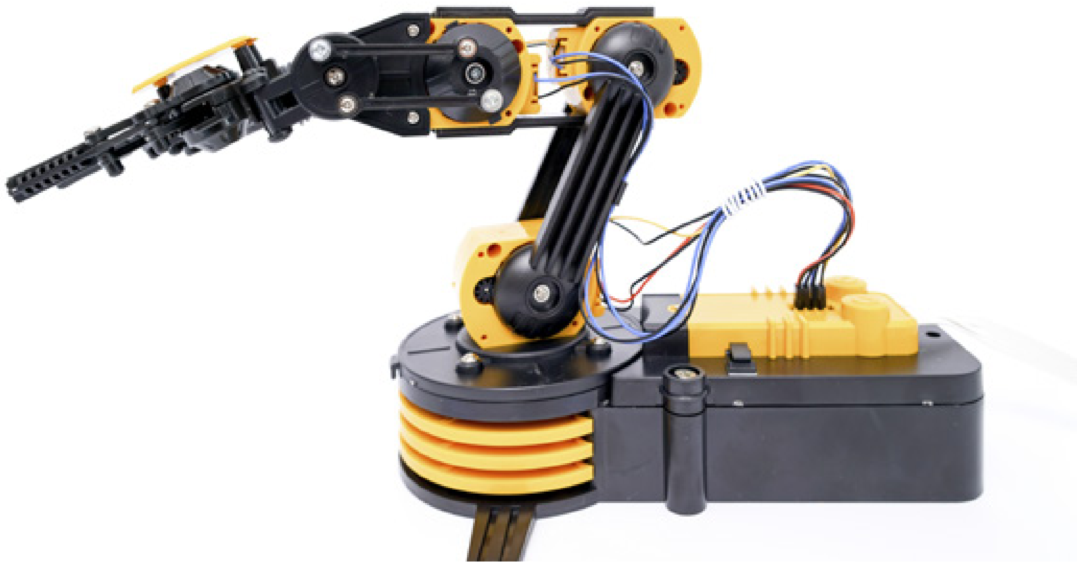
Technology entities might restructure borrowings with banks to adjust interest rates and maturity profiles and hence modify their debt.

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

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

This will 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 the 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.




Chocolate ice cream
7 dec.
Chokolate spread
7 dec.
Biscuits
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PSAK 72

Revenue from contracts with customers

Indonesian reporters must adopt the new revenue standard in 2020. Almost all entities will be affected to some extent by the new guidance, though the effect will vary depending on the industry and current accounting practices.

This publication reflects the implementation developments over the past few years and highlights certain challenges specific to entities in the technology industry.

Implementation in the technology sector

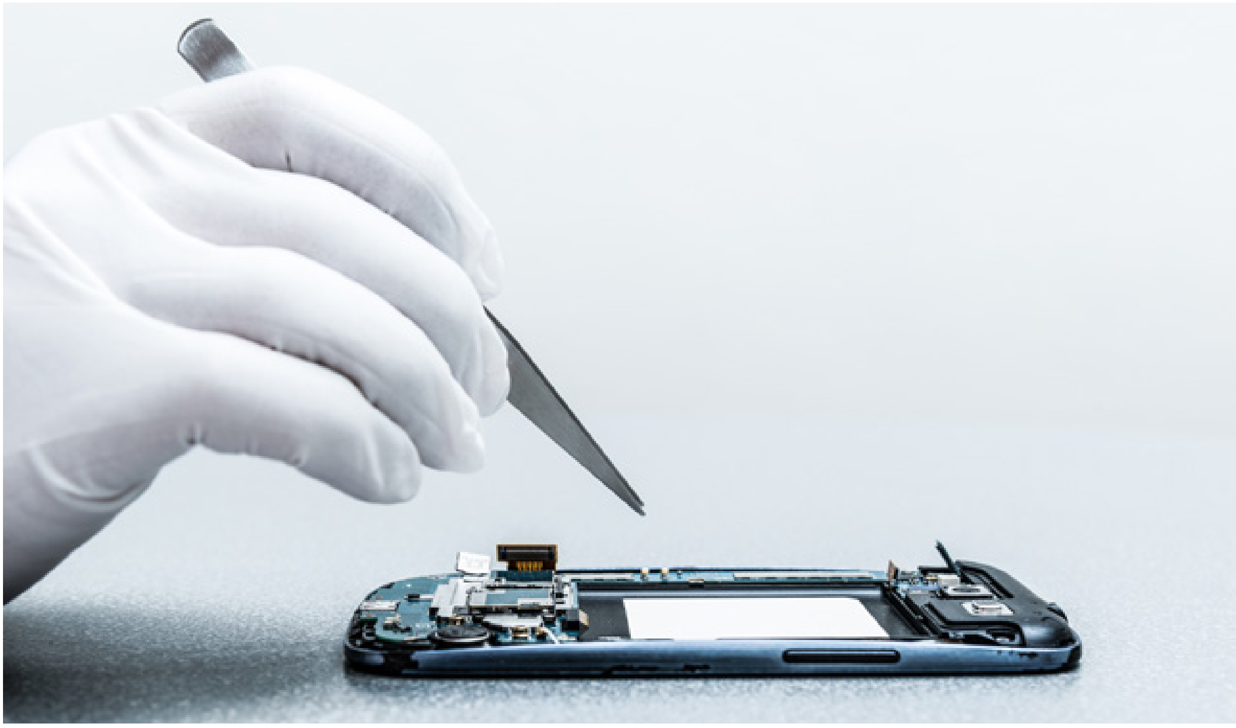
Overview

The technology industry comprises numerous subsectors, including, but not limited to, computers and networking, semiconductors, financial technology, software and internet, the internet of things, health technology, and clean technology. Each subsector has diverse product and service offerings and various revenue recognition issues. Determining how to allocate consideration among elements of an arrangement and when to recognise revenue can be extremely complex and, as a result, industry-specific revenue recognition models were previously developed. The new revenue standard replaces these multiple sets of guidance with a single revenue recognition model, regardless of the industry.

Whilst PSAK 72 includes a number of specific factors to consider, it is a principles-based standard. Accordingly, entities should ensure that revenue recognition is ultimately consistent with the substance of the arrangement.

This publication summarises some of the areas within the technology industry, broken down by step of the model that may be significantly affected by the new revenue standard. The content in this publication should be considered together with our "PSAK 72 – A Comprehensive Look at The New Revenue Model".

Entities that report under PSAK are required to apply PSAK 72 for annual reporting periods beginning on or after January 1, 2020, and early adoption is permitted.



(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Recognise revenue | Other consideration

1. Identify the contract

A contract can be written, orally discussed, or implied by an entity'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.

Technology companies should consider any history of entering into amendments or side agreements to a contract that either changes the terms of, or adds to, the rights and obligations of 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, entities 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 variable consideration (which affects the transaction price), rather than a factor to consider in assessing collectability.

New guidance	Current PSAK
An entity will account for a contract with a customer when: • the parties have approved the contract, • each party's rights to goods or services to be transferred can be identified, • the payment terms are defined, • the contract has commercial substance, and • it is probable the entity will collect substantially all of the consideration. The assessment of whether an amount is probable of being collected is made after considering any price concessions expected to be provided to the customer. Management should first determine whether it expects the entity to accept a lower amount of consideration from the customer than the customer is obligated to pay, then determine if the remaining amount is collectible. If management concludes collection is not probable, the arrangement is not accounted for using the five-step model. In that case, the entity will only recognise consideration received as revenue when one of the following events occurs: • There are no remaining obligations to transfer goods or services to the customer, and substantially all of the consideration has been received and is nonrefundable • The contract has been terminated, and the consideration received is non-refundable	An entity is required to consider the underlying substance and economics of an arrangement, not merely its legal form. An entity must establish that it is probable that the economic benefits of the transaction will flow to the entity before it can recognise revenue. A provision for bad debts (incurred losses on financial assets including accounts receivable) is recognised in a two-step process: (1) objective evidence of impairment must be present; then (2) the amount of the impairment is measured based on the present value of expected cash flows.

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

Potential impact:

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

The purpose of the collectability assessment under the new guidance is to determine whether there is a substantive contract between the entity and the customer, which differs from current guidance in which collectability is a constraint on revenue recognition.

The new guidance also eliminates the cash-basis method of revenue recognition that is often applied today if collection is not probable.

Entities that conclude collection is not probable under the new guidance cannot recognise revenue for cash received if (1) they have not collected substantially all of the consideration and (2) continue to transfer goods or services to the customer.

Example 1(a) – Assessing collectability for a portfolio of contracts

Facts: Wholesaler sells network routers to a large volume of customers under similar contracts. Before accepting a new customer, the wholesaler performs customer acceptance and credit check procedures designed to ensure that it is probable the customer will pay the amounts owed. The wholesaler will not accept a new customer that does not meet its customer acceptance criteria.

In January 20X0, the wholesaler delivers routers to multiple customers for consideration totalling CU100,000. The wholesaler concludes that control of the routers has transferred to the customers and there are no remaining performance obligations. The wholesaler concludes, based on its procedures, that collection is probable for each customer; however, the historical experience indicates that, on average, the wholesaler will collect only 95% of the amounts billed. The wholesaler believes its historical experience reflects its expectations about the future. The wholesaler intends to pursue a full payment from customers and does not expect to provide any price concessions.

Question: How much revenue should the wholesaler recognise?

Analysis: Because collection is probable for each customer, the wholesaler should recognise revenue of CU100,000 when it transfers control of the routers. The wholesaler's historical collection experience does not impact the transaction price because it concluded that the collectability threshold is met and it does not expect to provide any price concessions.

The wholesaler should also evaluate the related receivables for impairment.

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

Example 1(b) - Assessing collectability with a history of price concessions

Facts: Semiconductor Inc. enters into a contract to sell 100 chips to a Customer for a price of CU10 per unit. Therefore, the total price of the contract is CU1,000. Semiconductor Inc. has a history of providing price concessions to the Customer. Semiconductor Inc. estimates it will provide a price concession for 20% of the contract price, such that the total amount it expects to collect in the arrangement will be CU800. Based on its history with the Customer, Semiconductor Inc. concludes the CU800 is probable of being collected. Assume all other requirements for identifying a contract are met.

Question: Has Step 1 of the model been achieved, such that there is a valid contract?

Analysis: Yes. Because the transaction price for the contract is CU800 and Semiconductor Inc. has concluded that collection of the CU800 is probable, and the criteria for identifying a valid contract with a customer have been met. Semiconductor Inc. will continually reassess the estimated price concession (variable consideration) each reporting period and recognise changes to estimated price concessions as changes to the transaction price (revenue).

If the CU800 subsequently becomes uncollectible, Semiconductor Inc. should evaluate the related receivable for impairment.

Example 1(c) - Collection not probable

Facts: Equip Co. sells equipment to its customer with three years of maintenance for a total consideration of CU1,000, of which CU500 is due upfront and the remaining CU500 is due in instalments over the three-year term. At contract inception, Equip Co. determines that the customer does not have the ability to pay as amounts become due, and therefore collection of the consideration is not probable. Equip Co. intends to pursue payment and does not intend to provide a price concession. Equip Co. delivers the equipment at the inception of the contract. At the end of the first year, the customer makes a partial payment of CU400. Equip Co. continues to provide maintenance services, but concludes that collection of the remaining consideration is not probable.

Question: Can Equip Co. recognise revenue for the CU400 partial payment received?

Analysis: No, Equip Co. cannot recognise revenue for the partial payment received because it has concluded that collection is not probable. Therefore, Equip Co. cannot recognise revenue for cash received from the customer unless it terminates the contract or stops transferring goods or services to the customer. Equip Co. should continue to reassess collectability each reporting period. If Equip Co. subsequently determines that collection is probable, it will apply the five-step revenue model and recognise revenue accordingly.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Recognise revenue | Other consideration

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

Contract modifications

It is common for companies in the technology industry to modify contracts to provide additional goods or services, which may be priced at a discount. For example, a company may sell equipment and maintenance to a customer in an initial transaction and then modify the arrangement to extend the maintenance period. In general, any change to an existing contract is a modification per the guidance when the parties to the contract approve the modification either in writing, orally, or based on the parties' customary business practices. Also, a new contract entered into with an existing customer could be viewed as the modification of an existing contract depending on the facts and circumstances. This determination may require judgment.

The new standard provides specific guidance on the accounting for contract modifications. A modification is accounted for as either a separate contract or as part of the existing contract. This assessment is driven by (1) whether the modification adds distinct goods and services and (2) whether the distinct goods and services are priced at their standalone selling prices. PwC's Revenue guide includes more guidance on assessing whether contract modifications need to be accounted for as such under the new guidance.

When service contracts are modified to renew or extend the services being provided, the added services will often be distinct. The modification is accounted for as a separate contract if the services are distinct and the price of the added services reflects the standalone selling price, including appropriate adjustments to reflect the circumstances of the particular contract (e.g., a discount given because the company does not incur the selling-related costs it incurs for new customers).

The modification is accounted for prospectively if the services are distinct, but the price of the added services does not reflect standalone selling price; that is, any unrecognised revenue from the original contract and the additional consideration from the modification is combined and allocated to the remaining unsatisfied performance obligations under both the existing contract and modification.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Recognise revenue | Other consideration

2. Identify performance obligations

Many technology companies provide multiple products or services to their customers as part of a single arrangement. Hardware vendors sometimes sell extended maintenance contracts or other service elements with the hardware, and vendors of intellectual property (IP) licenses may provide professional services in addition to the license. Management must identify the separate performance obligations in an arrangement based on the terms of the contract and the entity's customary business practices. A bundle of goods and services might be accounted for as a single performance obligation in certain fact patterns.

<table>
<tr><th>New guidance</th><th>Current PSAK</th></tr>
<tr><td>A performance obligation is a promise in a contract to transfer to a customer either:

a good or service (or a bundle of goods or services) that is distinct; or
a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

A good or service is distinct if both of the following criteria are met:

The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (capable of being distinct).
The good or service is separately identifiable from other goods or services in the contract (distinct in the context of the contract).

Factors that indicate that two or more promises to transfer goods or services to a customer are not separately identifiable include (but are not limited to):
a. The entity provides a significant service of integrating the goods or services with other goods or services promised in the contract.
b. One or more of the goods or services significantly modifies or customises the other goods or services.
c. The goods or services are highly interdependent or highly interrelated.

Companies applying PSAK 72 should also consider the concept of materiality when identifying performance obligations in the context of the 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.</td></tr>
</table>

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Recognise revenue | Other consideration

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

Potential impact:

Assessing whether goods and services are capable of being distinct is similar to determining if deliverables are separate components under existing PSAKs, although the definition is not identical. Under the new guidance, management will assess if the customer can benefit from the good or service with "resources that are readily available to the customer," which could be a good or service sold separately by the company or another entity, or a good or service the customer has already obtained.

Entities will need to determine whether the nature of the promise, within the context of the contract, is to transfer each of those goods or services individually or, instead, to transfer a combined item(s) to which the promised goods or services are inputs. This will be a new assessment for companies as compared to today.

Example 2(a) - Sale of hardware and installation services - separate performance obligations

Facts: Vendor enters into a contract to provide hardware and installation services to the Customer. Vendor always sells the hardware with the installation service, but the installation is not so complex that the Customer could perform the installation on its own or use other third parties.

Question: Does the transaction consist of one or more performance obligations?

Analysis: The vendor should account for the hardware and installation services as separate performance obligations.

The vendor does not sell the hardware and installation services separately; therefore, management will need to evaluate whether the customer can benefit from the hardware on its own or together with readily available resources. Because the Customer can either perform the installation itself or use another third party, the Customer can benefit from (1) the hardware on its own and (2) the installation services in connection with the hardware already received. The installation service does not significantly integrate, modify, or customise the equipment; therefore, the Vendor's promise to transfer the equipment is separately identifiable from the Vendor's promise to perform the installation service. Accordingly, the equipment and the installation are distinct and accounted for as separate performance obligations.

The conclusion would not change if the Vendor contractually required the Customer to use the Vendor's installation services because absent the contractual requirements, the Customer could perform the installation itself or use another third party.

As discussed in step 5, the Vendor should recognise revenue allocated to the hardware when it transfers control of the hardware to the Customer. The Vendor should assess whether the performance obligation for installation services is satisfied over time or at a point time, and recognise the allocated revenue accordingly.

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

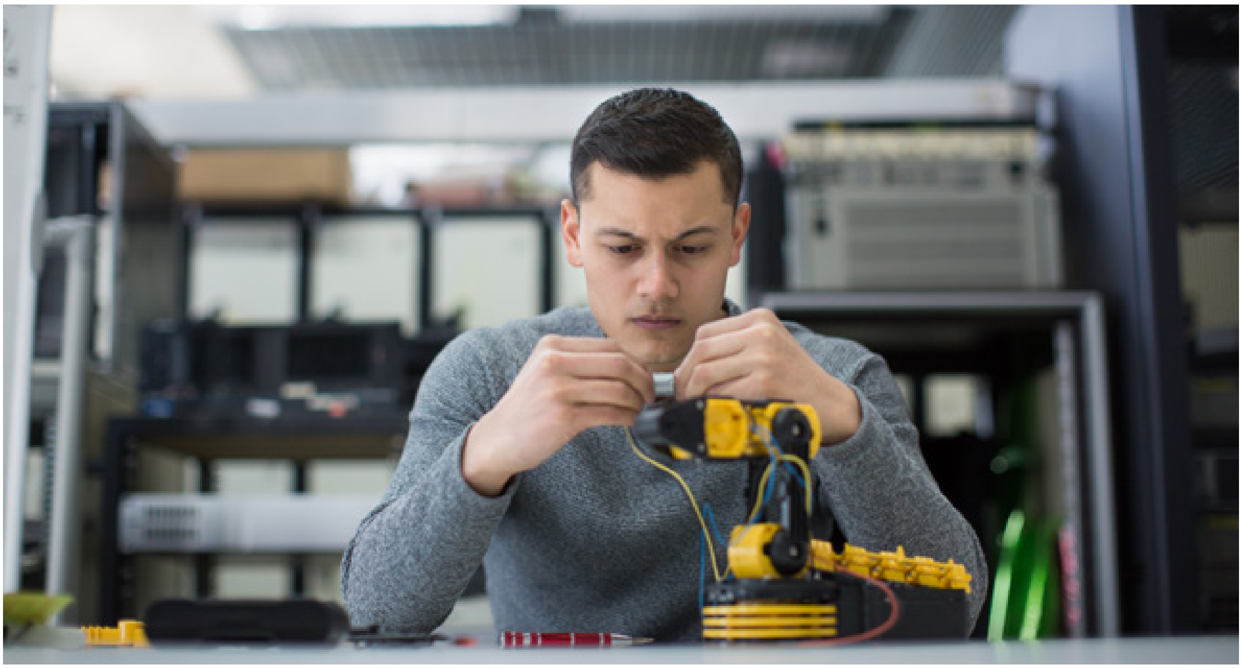
Example 2(b) - Sale of hardware and installation services - single performance obligation

Facts: A Vendor enters into a contract to provide hardware and installation services to the Customer. The Vendor also provides the customer with a license to software that is embedded on the hardware that is integral to the functionality of the hardware. The installation services significantly customise and integrate the hardware into the Customer's information technology environment. Only the Vendor can provide this customisation and integration service.

Question: Does the transaction consist of one or more performance obligations?

Analysis: The Vendor should account for the hardware with embedded software and installation services together as a single performance obligation.

The new guidance states that a license that (1) forms a component of a tangible good and (2) is integral to the functionality of the good is not distinct from the other promised goods or services in the contract. Therefore, the license to embedded software is not distinct from the hardware. The Vendor also provides a significant service of integrating the hardware and the installation services into the combined item in the contract (a customised hardware system). Therefore, the hardware with embedded software and the installation services are inputs into the combined item and are not separately identifiable.



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

Series of distinct goods or services

The new standard includes "series" guidance that does not exist in today's revenue guidance. A contract is accounted for as a series of distinct goods or services if, at contract inception, the contract promises to transfer a series of distinct goods or services that (1) are substantially the same and (2) have the same pattern of a transfer to the customer. A series has the same pattern of transfer if:

- Each distinct good or service in the series would be a performance obligation satisfied over time, and
- The same method would be used to measure the entity's progress toward complete satisfaction of the performance obligation.

Judgment will be required to assess if the underlying goods or services meet these criteria. If the criteria are met, the goods or services are combined into a single performance obligation. However, management should consider each distinct good or service in the series, rather than the single performance obligation, when accounting for contract modifications and allocating variable consideration.

Example 2(c) - Accounting for a series - transaction processing

Facts: Transaction Inc. enters into a two-year contract with the Customer to process credit card transactions. The Customer is obligated to use Transaction Inc.'s system to process all of its transactions; however, the ultimate quantity of transactions is unknown. Transaction Inc. concludes that the nature of its promise is a series of distinct monthly processing services. Transaction Inc. charges the Customer a monthly fee calculated as CU0.03 per transaction processed. The fees charged by Transaction Inc. are priced consistently throughout the contract.

Question: How should Transaction Inc. account for the contract?

Analysis: Transaction Inc. should account for the contract as a series of distinct goods or services, and therefore, as a single performance obligation.

Transaction Inc. will stand ready to process transactions as they occur. The service of processing credit card transactions for the Customer each day is substantially similar since the Customer is receiving a consistent benefit on a daily basis.

As discussed in step 4, Transaction Inc. should allocate variable consideration to the distinct goods or services within the series if certain criteria are met. As discussed in step 5, Transaction Inc. would likely conclude it should recognise as revenue the variable monthly fee each month as the variable fee relates to the services performed in that period.

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

Customer options that provide a material rights

An option that provides a customer with free or discounted goods or services in the future might be a material right. A material right is a promise embedded in a current contract that should be accounted for as a separate performance obligation. If the option provides a material right to the customer, the customer, in effect, pays the entity in advance for future goods or services, and the entity recognises revenue when those future goods or services are transferred or when the option expires.

An option to purchase additional goods or services at their standalone selling prices is a marketing offer and therefore not a material right. This is true regardless of whether the customer obtained the option only as a result of entering into the current transaction. An option to purchase additional goods or services in the future at a current standalone selling price could be a material right if prices are expected to increase. This is because the customer is being offered a discount on future goods compared to what others would have to pay as a result of entering into the current transaction.

Example 2(d) – Customer options - discounts on additional servers

Facts: Technology Inc. enters into a contract for the sale of a server for CU1,000. Technology Inc. promises the customer a 30% discount off additional servers if those servers are purchased before the end of the year. Technology Inc. typically provides a 10% discount to all customers before the end of the year as a promotional offer to drive sales volume.

Question: Is the customer option a material right and a separate performance obligation?

Analysis: Technology Inc. should account for the promise to provide the incremental discount as a material right. As such, it is a separate performance obligation and Technology Inc. should allocate a portion of the transaction price to the material rights.

Because all customers will receive a 10% discount on servers during the same timeframe, the standalone selling price of the material rights should be based on the incremental 20% discount offered in the contract (i.e., 30% offered to this customer and 10% offered to other customers). Technology Inc. should also adjust the standalone selling price for the likelihood that the customer will exercise the option. The amount of the transaction price allocated to the material rights is recognised as revenue when the additional servers are purchased or when the option expires.

3. Determine transaction price

The transaction price is the consideration a vendor expects to be entitled to in exchange for satisfying its performance obligations in an arrangement. Determining the transaction price is straightforward when the contract price is fixed, but is more complex when the arrangement includes a variable amount of consideration. Consideration that is variable includes, but is not limited to, discounts, rebates, price concessions, refunds, credits, incentives, performance bonuses, and royalties. Additionally, as discussed in Step 1 (Identify the contract), management will need to use judgment to determine when amounts it will not collect from its customers are due to collectability issues (i.e., Step 1 of the model) or due to price concessions through variable consideration (i.e., Step 3 of the model). This will depend on the facts and circumstances of the arrangement.

To determine the transaction price, management will estimate the consideration to which it expects to be entitled. Variable consideration is only included in the estimate of the transaction price to the extent it is highly probable of not resulting in a significant reversal of cumulative revenue in the future. PSAK defines probable as 'more likely than not', which is greater than 50%. Consideration payable to a customer, rights of return, noncash consideration, and significant financing components are other important concepts to consider in determining the transaction price.

New guidance	Current PSAK
The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer. It includes an estimate of variable consideration based on the expected value or most likely amount approach (whichever is more predictive). Variable consideration included in the transaction price is subject to a constraint. The constraint limits revenue recognition as performance obligations are satisfied to the extent that a significant revenue reversal will not occur. An entity will meet this objective if it is highly probable that there will not be a significant downward adjustment of the cumulative amount of revenue recognised for that performance obligation in the future. Management will need to determine if there is a portion of the variable consideration (that is, a minimum amount) that would not result in a significant revenue reversal and include that amount in the transaction price. Management will have to reassess its estimate of the transaction price each reporting period, including any estimate of the minimum amount of variable consideration it expects to receive.	Revenue is measured at the fair value of the consideration received or receivable. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Trade discounts, volume rebates, and other incentives (such as cash settlement discounts) are taken into account in measuring the fair value of the consideration to be received. Revenue related to the variable consideration is recognised when it is probable that the economic benefits will flow to the entity and the amount is reliably measurable, assuming all other revenue recognition criteria are met.

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

Potential impact:

The guidance on variable consideration might significantly affect the timing of recognition compared to today. Technology companies often enter into arrangements with variable amounts, such as milestone payments, service level guarantees with penalties, and refund rights, due to their focus on customer adoption of cutting-edge products. Although judgment will be needed to determine the amount of variable consideration that should be included in the transaction price, technology companies might recognise revenue earlier than they do currently in many circumstances.

Example 3(a) – Variable consideration - performance bonus

Facts: The Contract Manufacturer enters into a contract with the Customer to build an asset for CU100,000. The contract also includes a CU50,000 performance bonus paid based on the timing of completion, with a 10% decrease in the bonus for every week that completion is delayed beyond the agreed-upon completion date. Management estimates a 60% likelihood of on-time completion, a 30% likelihood of the project being one week late, and a 10% likelihood that it will be two weeks late based on relevant experience with similar contracts.

Question: How much of the performance bonus should the Contract Manufacturer include in the transaction price?

Analysis: Management concludes that the most likely amount method is the most predictive approach for estimating the performance bonus. Management believes that CU45,000 (CU50,000 less 10%, the bonus that will be earned with a one-week delay) should be included in the transaction price as there is a 90% probability of achieving at least this amount. Therefore, it meets the criterion that it is highly probable that including this amount in the transaction price will not result in a significant revenue reversal. Management should update its estimate at each reporting date.

(1) Identify the contract | (2) Identify performance obligation | **(3) Determine transaction price** | (4) Allocate transaction price | (5) Recognise revenue | Other consideration

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

Consideration payable to a customer

An entity might pay, or expect to pay, consideration to its customer. The consideration paid can be cash, either in the form of rebates or upfront payments, or a credit or another incentive that reduces amounts owed to the entity by a customer. Payments to customers can also be in the form of equity.

Management should consider whether payments to customers are related to a revenue contract even if the timing of the payment is not concurrent with a revenue transaction. Such payments could nonetheless be economically linked to a revenue contract; for example, the payment could represent a modification to the transaction price in a contract with a customer. Management will therefore need to apply judgment to identify payments to customers that are economically linked to a revenue contract.

An important step in this analysis is identifying the customer in the arrangement. Management will need to account for payments made directly to its customer, payments to another party that purchases the entity's goods or services from its customer (that is, a customer's customer within the distribution chain), and payments to another party made on behalf of a customer pursuant to the arrangement between the entity and its customer.

Consideration payable to a customer is recorded as a reduction of the arrangement's transaction price, thereby reducing the amount of revenue recognised, unless the payment is for a distinct good or service received from the customer. If payment is for a distinct good or service, it would be accounted for in the same way as the entity accounts for other purchases from suppliers. Determining whether a payment is for a distinct good or service received from a customer requires judgment. An entity might be paying a customer for a distinct good or service if the entity is purchasing something from the customer that is normally sold by that customer.

Management also needs to assess whether the consideration it pays for distinct goods or services from its customer exceeds the fair value of those goods or services. Consideration paid in excess of fair value reduces the transaction price. It can be difficult to determine the fair value of the distinct goods or services received from the customer in some situations. An entity that is not able to determine the fair value of the goods or services received should account for all of the consideration paid or payable to the customer as a reduction of the transaction price since it is unable to determine the portion of the payment that is a discount provided to the customer.

Rights of return

Rights of return are considered a form of variable consideration, as they affect the total amount of fees that a customer will ultimately pay. Revenue recognition when there is a right of return is based on the variable consideration guidance, with revenue recognised to the extent it is highly probable that a significant reversal of cumulative revenue will not occur. Therefore, revenue is not recognised for products expected to be returned. A liability is recognised for the expected amount of refunds to customers, which is updated for changes in expected refunds.

An asset and corresponding adjustment to cost of sales is recognised for the rights to recover goods from customers on settling the refund liability, with the asset initially measured at the original cost of the goods (that is, the carrying amount in inventory), less any expected costs to recover those products. The asset is assessed for impairment if indicators of impairment exist.

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

Example 3(b) - Sale of product with a return right

Facts: Vendor sells and ships 10,000 gaming systems to the Customer, a reseller, on the same day. The Customer may return the gaming systems to Vendor within 12 months of the purchase. The Vendor has historically experienced a 10% return rate from the Customer.

Question: How should the Vendor account for the return rights?

Analysis: The Vendor should not record revenue for the gaming systems that are anticipated to be returned (10% of the systems, 1,000 systems). The Vendor should record a refund liability for 1,000 gaming systems and record an asset for the rights to the gaming system assets expected to be returned. The asset should be recorded at the original cost of the gaming systems. The Vendor will not derecognise the refund liability and related asset until the refund occurs or the refund right lapses (although the Vendor should adjust these amounts as it revises its estimate of returns over time). The asset will need to be assessed for impairment until derecognition.

The transaction price for the 9,000 gaming systems that the Vendor believes will not be returned is recorded as revenue when control transfers to the customer, assuming the Vendor concludes it is highly probable that a significant reversal of cumulative revenue will not occur.

Non-cash consideration

Any non-cash consideration received from a customer needs to be included in the transaction price and measured at fair value. PSAK 72 does not include specific guidance on the measurement date of non-cash consideration and, therefore, different approaches may be acceptable. Management should also consider the accounting guidance for derivative instruments to determine whether an arrangement with a right to non-cash consideration contains an embedded derivative.

Significant financing component

Technology companies should also be aware of the accounting impact of significant financing components, such as extended payment terms. If there is a difference between the timing of receiving consideration from the customer and the timing of the entity's performance, a significant financing component may exist in the arrangement.

The new standards require entities to impute interest income or expense and recognise it separately from revenue (as interest expense or interest income) when an arrangement includes a significant financing component. However, as a practical expedient, entities do not need to account for a significant financing component if the timing difference between payment and performance is less than one year.

Management should determine if payment terms are reflective of a significant financing component or if the difference in timing between payment and performance arises for reasons other financing. For example, the intent of the parties might be to secure the rights to a specific product or service, or to ensure that the seller performs as specified under the contract, rather than to provide financing.

4. Allocate transaction price

Technology companies often provide multiple products or services to their customers as part of a single arrangement. Under the new standard, they will need to allocate the transaction price to the separate performance obligations in one contract based on the relative standalone selling price of each separate performance obligation. There are certain exceptions when discounts or variable consideration relate specifically to one or more, but not all, of the performance obligations.

New guidance	Current PSAK
The transaction price is allocated to separate performance obligations based on the relative standalone selling price of the performance obligations in the contract. Entities will need to estimate the standalone selling price for items not sold separately. A residual approach may be used as a method to estimate the standalone selling price when the selling price for a good or service is highly variable or uncertain. Variable consideration or discounts might relate only to one or more, but not all, performance obligations in the contract. Variable consideration is allocated to specific performance obligations if both of the following criteria are met: • the terms of the variable consideration relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service) • the outcome is consistent with the allocation objective. A discount is allocated to a specific performance obligation if all of the following criteria are met: • the entity regularly sells each distinct good or service on a standalone basis. • the entity regularly sells, on a standalone basis, a bundle of some of those distinct goods or services at a discount. • the discount attributable to the bundle of distinct goods or services is substantially the same as the discount in the contract and observable evidence supports the discount belonging to that performance obligation.	Consideration is generally allocated to the separate components in the arrangement based on a relative fair value or cost plus a reasonable margin approach. A residual or reverse residual method may also be used.

Potential impact:

The basic allocation principle has not changed under the new guidance; however, there are three specific differences that could affect allocation:

- An entity will allocate discounts and variable consideration amounts to specific performance obligations if certain criteria are met.
- Under the new standard, the residual approach should only be used when the selling price of a good or service is highly variable or uncertain. Before utilising this approach, management should first consider whether another method provides a reasonable basis for estimating the standalone selling price.

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

Example 4(a) - Allocation of transaction price

Facts: Technology Inc. enters into an arrangement with a customer, Network Co., for a fixed fee of CU10 million, which includes separate performance obligations for 100 servers (delivered at the same time), network monitoring software, installation services, and post-contract support (PCS). Technology Inc. can earn an additional CU500,000 per year for the next two years if it achieves specified performance bonuses related to the performance of the servers, which it expects to achieve based on history with similar arrangements. This type of bonus is common in Technology Inc.'s other server-only transactions. Technology Inc. has concluded its standalone selling prices for the performance obligations are as follows:

Performance obligation	Standalone price
100 servers	CU10 million
Installation	CU500,000
Software license	CU2.5 million
PCS	CU1.125 million
Total	**CU14.125 million**

Question: How should Technology Inc. allocate the transaction price to each performance obligation?

Analysis: The total transaction price includes the fixed consideration of CU10 million plus the estimated variable consideration of CU1 million for a total of CU11 million. Technology Inc. allocates the CU10 million fixed consideration to all of the performance obligations based on the relative standalone selling price.

The variable consideration, however, relates solely to the performance of the servers and management has concluded that allocating the variable consideration directly to the servers is consistent with the standard's allocation objective (that is, the variable consideration allocated directly to the servers depicts the amount of consideration that Technology Inc. expects to be entitled to in exchange for transferring the servers to the customer). Therefore, CU8.08M ((CU10,000,000 * 70.8%) + CU1,000,000) will be allocated to the servers, CU350K will be allocated to the installation, CU1.77M will be allocated to the software license and CU800K will be allocated to the PCS.

If the criteria to allocate variable consideration to only one performance obligation were not met (i.e., if the terms did not relate specifically to that performance obligation or the outcome was not consistent with the allocation objective), the estimated transaction price of CU11 million would be allocated to all performance obligations on a relative basis.

5. Recognise revenue

Technology companies often have contracts that include a service (installation or customisation) with the sale of goods (software or hardware products). The software, hardware, and services may be delivered over multiple periods ranging from several months to several years. A performance obligation is satisfied and revenue is recognised when “control” of the promised good or service is transferred to the customer. A customer obtains control of a good or service if it has the ability to (1) direct its use and (2) obtain substantially all of the remaining benefits from it. Directing the use of an asset refers to a customer’s rights to deploy the asset, allow another entity to deploy it, or restrict another entity from using it. Management should evaluate transfer of control primarily from the customer’s perspective, which reduces the risk that revenue is recognised for activities that do not transfer control of a good or service to the customer.

New guidance	Current PSAK
Over time revenue recognition An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met: a. The customer simultaneously receives the benefits provided by the entity’s performance as the entity performs. b. The entity’s performance creates or enhances an asset that the customer controls as the asset is created. c. The entity’s performance does not create an asset with an alternative use, and the entity has an enforceable right to payment for performance completed to date. **Point in time revenue recognition** A performance obligation is satisfied at a point in time if none of the criteria for satisfying a performance obligation over time are met. If the performance obligation is satisfied at a point in time, indicators of the transfer of control include: • The entity has a right to payment for the asset. • The customer has a legal title to the asset.	Revenue recognition occurs at the time of delivery, when the following conditions are satisfied: • The risks and rewards of ownership have been 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.

Potential impact:

Entities that manufacture customised products and recognise revenue at a point in time under current guidance will need to assess the new criteria, including whether the product has no alternative use and whether they have a right to payment for performance completed to date. These entities could potentially change from point-in-time recognition under current guidance to over time recognition if the criteria are met.

The timing of revenue recognition for point-in-time arrangements could change (and be accelerated) for some entities compared to current guidance, which is more focused on the transfer of risks and rewards than the transfer of control. The transfer of risks and rewards is an indicator of whether control has transferred under the new guidance, but entities will also need to consider the other indicators.

5. Recognise revenue *(cont'd)*

Sales to distributors

Under current guidance, the "sell-through approach" is common in arrangements that include dealers or distributors in which revenue is recognised once the risks and rewards of ownership have transferred to the end consumer. The effect of the new standard on the sell-through approach will depend on the terms of the arrangement and why sell-through accounting was applied historically. Technology companies that apply the sell-through approach today should re-evaluate the appropriateness of this approach under the new revenue recognition criteria.

Revenue is recognised under the new standard when a customer obtains control of the product, even if the terms include a right of return or other price protection features. The transfer of risks and rewards is an indicator of whether control has transferred, but entities need to consider additional indicators. Therefore, revenue could be recognised earlier under the new standard. For example, if a distributor has physical possession of the product, can direct the use of the product, and is obligated to pay the seller for the product, control of the product may have transferred to the distributor even when the seller retains some risks and rewards or the final price is uncertain. If the entity is able to require the distributor to return the product (that is, it has a call right), control likely has not been transferred to the distributor.

Since many distributors are thinly capitalised, an entity will also need to consider the impact of the requirement to assess whether collection is probable (in step 1).

Example 5(a) – Sale of a product to a distributor with ongoing involvement

Facts: The Manufacturer uses a distributor network to supply its product to final customers. The distributor takes title to the product, but may return unsold products at the end of the contract term. Once the products are sold to the end customer, the Manufacturer has no further obligations related to the product, and the distributor has no further return rights. Because of the complexity of the products and the varied nature of how end users may incorporate them into their final products, the Manufacturer supports the distributor with technical sales support, including sending engineers on sales calls with the distributor.

Question: When should the Manufacturer recognise revenue?

Analysis: The Manufacturer should recognise revenue upon the transfer of control of the product to its customer, the distributor. Therefore, the Manufacturer should assess the point in time that control transfers based on the indicators, including transfer of title, risks and rewards, etc.

The Manufacturer should also consider whether there is a separate performance obligation to provide sales support. Assuming the sale of the product and the sales support are separate performance obligations, The Manufacturer should:

- recognise revenue allocated to the products when control of the goods transfers to the distributor, subject to any anticipated returns, and provided collection of the consideration is probable
- recognise revenue allocated to the support obligation over time as the support is provided.

5. Recognise revenue *(cont'd)*

Example 5(b) – Sale of product to a distributor with a price protection clause

Facts: The Manufacturer sells products into its distribution channel. In its contracts with the distributors, the Manufacturer provides price protection by reimbursing its distribution partner for any difference between the price charged to the distributor and the lowest price offered to any customer during the following six months.

Question: When should the Manufacturer recognise revenue?

Analysis: The Manufacturer should recognise revenue upon the transfer of control of the product to the distributor. The price protection clause creates variable consideration. The Manufacturer should estimate the transaction price using either the expected value approach or the most likely amount, whichever is more predictive.

As discussed in step 3, the estimate of variable consideration is constrained to the amount that is highly probable of not reversing. The Manufacturer will need to determine if there is a portion of the variable consideration (that is, a minimum amount) that would not result in a significant revenue reversal. Relevant experience with similar arrangements that allow the Manufacturer to estimate the transaction price, taking into account the expected effect of the price protection provision, could result in earlier revenue recognition as compared to the current practice.

"Right to invoice" practical expedient

As a practical expedient, management can elect to recognise revenue based on the amount invoiced to the customer if that amount corresponds directly with the value to the customer of the entity's performance completed to date. Such an assessment will require judgment; management should not presume that a negotiated payment schedule automatically implies that the invoiced amounts represent the value transferred to the customer. Entities can look to the market prices or standalone selling prices of the goods or services as evidence of the value to the customer; however, other evidence could also be used to demonstrate that the amount invoiced corresponds directly with the value transferred to the customer.

The right to invoice practical expedient is described as a measure of progress, but it effectively allows entities to bypass significant portions of the revenue recognition model. If an entity elects the practical expedient, it typically does not need to determine the transaction price, allocate the transaction price, or select a measure of progress. Entities electing the right to invoice practical expedient can also elect to exclude certain disclosures about the remaining performance obligations in the contract.

5. Recognise revenue *(cont'd)*

Example 5(c) – Right to invoice practical expedient

Facts: Technology Inc. enters into a contract with a customer to provide hosting services for a three-year period. The rates in the contract increase over time by an amount that is commensurate with future market prices for hosting services at contract inception.

Question: Would it be appropriate for Technology Inc. to apply the right to invoice practical expedient?

Analysis: Technology Inc. could apply the right to invoice practical expedient if it concludes that the rates charged in each billing period correspond directly with the value to the customer of the entity's performance. This conclusion would likely be supported by the fact that the rates increase at an amount commensurate with future market prices. Additionally, an increase in the rates over time due to an increase in the number of users or amount of data hosted may also provide evidence that the rates charged correspond directly with the value to the customer.

Example 5(d) – Right to invoice the practical expedient

Facts: Payroll Co. enters into a contract with a customer to provide monthly payroll services over a five-year period. The billing schedule in the contract requires lower monthly payments in the first part of the contract, with higher payments later in the contract. The billing schedule escalates to provide the customer with more liquidity in the early part of the contract because the customer has current cash flow limitations. Payroll Co. provides the same service over the entire contract and market prices of the service are not expected to increase in line with the escalating billing schedule.

Question: Would it be appropriate for Payroll Co. to apply the right to invoice the practical expedient?

Analysis: No, it would not be appropriate to apply the right to invoice practical expedient because the amounts billed do not directly correspond to the value to the customer of the entity's performance. The rising rates in the contract were negotiated to provide the customer with more liquidity, which is not related to the value to the customer of the entity's performance.

Consulting and manufacturing service contracts

Many technology companies provide consulting and manufacturing services, including business strategy services, supply-chain management, system implementation, outsourcing services, and control and system reliance. Technology service contracts are typically customer-specific, and revenue recognition is therefore dependent on the facts and circumstances of each arrangement.

Accounting for service revenues may change under the new standard as management must determine whether the performance obligation is satisfied at a point in time or over time. We do not expect a significant change in practice for many services; however, some products recognised at a point in time on final delivery today could be recognised over time under the new standards. Management will need to apply judgment to assess whether the asset has an alternative use and whether contract terms provide the rights to payment for the performance completed to date.

For performance obligations satisfied over time, entities will use the method to measure progress that best depicts the transfer of control to the customer, which could be an output or an input method.

5. Recognise revenue *(cont'd)*

Example 5(e) – Consulting services – the performance obligation satisfied over time

Facts: The Computer Consultant enters into a three-month, fixed-price contract to track the Customer's software usage to help the Customer decide which software packages best meet its needs. The Computer Consultant will share findings on a monthly basis, or more frequently if requested, and provide a summary report of the findings at the end of three months. The Customer will pay the Computer Consultant CU2,000 per month, and the Customer can direct the Computer Consultant to focus on the usage of any systems it wishes to throughout the contract.

Question: How should the Computer Consultant recognise revenue in the transaction?

Analysis: The Computer Consultant should recognise revenue over time as it performs the services. The Customer simultaneously receives a benefit from the consulting services as they are performed during the three-month contract because the customer is able to receive findings at any time when requested. Another vendor would not have to substantially reperform the work completed to date to satisfy the remaining obligations.

Example 5(f) – Sale of specialised equipment - performance obligation satisfied over time

Facts: A Contract Manufacturer enters into a six-month, fixed-price contract with the Customer for the production of highly customised equipment. The title to the equipment is transferred to the Customer at the end of the six-month contract term. If the Customer terminates the contract for reasons other than the Contract Manufacturer's non-performance, the Contract Manufacturer is entitled to payment for costs plus a margin for any work in process to date.

Question: How should the Contract Manufacturer recognise revenue in the transaction?

Analysis: The Contract Manufacturer should recognise revenue over time as it manufactures the equipment. Given the highly customised nature of the equipment, the Contract Manufacturer's performance does not create an asset with an alternative use to the Contract Manufacturer. Also, the Contract Manufacturer has an enforceable right to payment from the Customer for the performance completed to date. The performance obligation, therefore, meets the criteria for recognition over time.

5. Recognise revenue *(cont'd)*

Intellectual property licenses

Licenses of intellectual property (IP) include, among others: software and technology; media and entertainment rights; franchises; patents; trademarks; and copyrights. These arrangements also frequently include other obligations, such as ongoing support, professional services, etc. Licenses can include various features and economic characteristics, which can lead to significant differences in the rights provided by a license. The terms might be perpetual or for a defined period of time.

An entity should first consider the guidance for identifying performance obligations to determine if the license is distinct from other goods or services in the arrangement. For licenses that are not distinct, an entity will combine the license with other goods and services in the contract and recognise revenue when it satisfies the combined performance obligation.

Under PSAK, the nature of a license and, accordingly the timing of revenue recognition, is determined by whether the entity's activities significantly change the IP.

PSAK 72 includes an exception for the recognition of sales- or usage-based royalties from licenses of IP. Revenue from the sales- or usage-based royalty is not recognised until the later of when (1) the customer's subsequent sales or usages occur 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 to both a license of IP and other goods and services, and the license is the "predominant" item to which the royalty relates. However, the exception does not apply to an outright sale of IP.

New guidance	Current PSAK
When a license is distinct, an entity must consider the nature of the license to determine when to recognise revenue. The new standard identifies two types of licenses of IP: (1) a right to access IP and (2) a right to use IP. ***Right to use IP*** Licenses that provide a right to use IP are performance obligations satisfied at a point in time. ***Right to access IP*** Licenses that provide a right to access an entity's IP are performance obligations satisfied over time.	Fees and royalties paid for the use of an entity's assets are recognised in accordance with the substance of the agreement. This might be on a straight-line basis over the life of the agreement, for example, when a licensee has the rights to use certain technology for a specified period of time. Revenue may also be recognised upfront if the substance is similar to a sale. An assignment of rights for a fixed fee or a non-refundable guarantee under a non-cancellable contract that permits the licensee to exploit those rights freely when the licensor has no remaining obligations to perform is, in substance, a sale.

5. Recognise revenue *(cont'd)*

Potential impact:

The new standard provides specific guidance for determining whether to recognise revenue from a license at a point in time or over time. Whether the license is a perpetual license or a term license does not impact the conclusion. Thus, the analysis under the new standard could result in a different timing of revenue recognition as compared to today, depending on the entity's current accounting conclusions.

For licenses of IP with fees in the form of sales- or usage-based royalties, the exception provided in the new guidance may result in a similar accounting outcome to today since entities typically do not recognise revenue until royalties are received. However, the new guidance specifies that the period of recognition should be the period the sales or usage occurs. As a result, if information from customers is received on a lag basis, entities may need to estimate sales or usage prior to receiving this data from the customer.

Example 5(g) – License to IP with a sales-based royalty

Facts: Vendor licenses its patented technology to customers for no upfront fee and 1% of future product sales that incorporate the technology. The license term is equal to the remaining patent term of three years.

Question: How should the Vendor recognise revenue in the transaction?

Analysis: Sales-based royalties from licenses of IP cannot be recognised until the customer's subsequent sales or usages occur. Therefore, the Vendor will recognise revenue in the period that the customer's sales occur. The Vendor may need to estimate sales in each reporting period if the customer does not report sales until a later period.

Example 5(h) – License to IP with a sales-based royalty and guaranteed minimum

Facts: The Vendor licenses its patented technology to customers for no upfront fee and 1% of future product sales that incorporate the technology. The license term is equal to the remaining patent term of three years. The Vendor is entitled to a minimum payment of CU5 million at the end of each year, regardless of the actual sales. The Vendor has concluded that control of the license transfers at a point in time when the license period commences. The Vendor has also concluded that it is probable it will collect the consideration to which it is entitled, and there are no further obligations remaining after the license is transferred.

Question: How should the Vendor recognise revenue in the transaction?

Analysis: Since the Vendor is entitled to a minimum payment of CU5 million at the end of each year, this amount of the consideration is not variable and should be recognised as revenue when control of the license transfers to the customer (at the beginning of the license period). The Vendor should also evaluate whether the arrangement contains a significant financing component since the minimum payments are received over a three-year period. Any consideration from royalties in excess of the minimum in a given year will be recognised in the period that the customer's sales occur.

Other considerations

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 entity 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.

This assessment is often required in technology industry arrangements. Common examples include internet advertising, internet sales, sales of virtual goods and mobile applications/games, sales through a travel or ticket agency, sales in which subcontractors fulfil some or all of the contractual obligations, and sales of services provided by a third-party service provider.

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 entity obtains control of the specified good or service. The revenue standard provides indicators to help management make this assessment.

New guidance	Current PSAK
An entity is the principal and should present revenue on a gross basis if it controls the specified good or service before it is transferred to the customer. Indicators to assist entities in determining whether it controls the good or service before it is transferred to the customer are: a. The entity is primarily responsible for fulfilling the promise b. The entity has inventory risk c. The entity has discretion in establishing price Under the new standard, no single indicator is determinative or weighted more heavily than other indicators. However, some indicators may provide stronger evidence than others, depending on the circumstances.	An entity presents revenue gross if the gross economic benefit from the business activity results in an increase in the entity's equity. Alternatively, the entity presents revenue net if the gross economic inflows include amounts collected on behalf of the principal. An entity is acting as the principal when it is exposed to the overall risks and rewards of the transaction. The following are indicators to assess in determining whether gross or net revenue presentation is appropriate: a. Primary responsibility for providing the goods or services b. Inventory risk c. Latitude in establishing price d. Credit risk

Other considerations *(cont'd)*

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 an entity 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 entity 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 the current guidance.

Example 6(a) – Principal vs agent: Online bookstore

Facts: WebCo operates a website that sells books. WebCo enters into a contract with Bookstore to sell Bookstore's books online. WebCo's website facilitates payments between Bookstore and the customer. The sales price is established by Bookstore, and WebCo earns a commission equal to 5% of the sales price. Bookstore ships the books directly to the customer; however, the customer returns the books to WebCo if they are dissatisfied. WebCo has the rights to return books to Bookstore without a penalty if they are returned by the customer.

Question: Is WebCo the principal or agent for the sale of books to the customer?

Analysis: WebCo is acting as the agent of the Bookstore and should recognise the commission revenue for the sales made on Bookstore's behalf; that is, it should recognise revenue on a net basis.

The specified good or service in this arrangement is a book purchased by the customer. WebCo does not control the books before they are transferred to the customer. WebCo does not have the ability to direct the use of the goods transferred to customers and does not control Bookstore's inventory of goods. WebCo is also not responsible for the fulfilment of orders and does not have discretion in establishing prices of the books.

Although customers return books to WebCo, WebCo has the right to return the books to Bookstore and therefore does not have substantive inventory risk. The indicators therefore support that WebCo is not the principal for the sale of Bookstore's books. Accordingly, WebCo should recognise commission revenue when it satisfies its promise to facilitate a sale (that is, when the books are purchased by a customer).

Other considerations *(cont'd)*

Example 6(b) – Principal vs agent: Cloud computing

Facts: CloudCo provides its customers with a package of cloud services, including access to a software-as-a-service (SaaS) platform owned and operated by a third party. CloudCo contracts directly with the third party for the rights to access the SaaS platform as part of its service offering to its customers. CloudCo determines that it is providing a significant service of integrating the various services into a combined package to meet the customer's specifications. Therefore, access to the SaaS platform and the related services performed by CloudCo are not separately identifiable; the contract contains a single performance obligation.

Question: Is CloudCo the principal or agent for the package of cloud services?

Analysis: CloudCo is the principal and should recognise revenue for the gross fee charged to customers. Access to the SaaS platform is an input into the package of cloud services (the specified good or service). CloudCo obtains control of the inputs, including access to the SaaS platform, and directs their use to create the combined output for which the customer has contracted.

The conclusion could differ if CloudCo determines that access to the SaaS platform and the related services performed by CloudCo are each distinct (and therefore, separate performance obligations). In that case, CloudCo would determine whether it is the principal or agent separately for each distinct good or service.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Recognise revenue | Other consideration

Other considerations *(cont'd)*

Product warranties

It is common for technology companies to provide a product warranty in connection with the sale of a product. The nature of a product warranty can vary from contract to contract. Some warranties provide a customer with assurance that the related product complies with agreed-upon specifications (assurance-type or standard warranties). Other warranties provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

The new 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) and product warranties that the customer cannot purchase separately. Management will need to exercise judgment to determine if a warranty includes a service component that is not sold separately and should be accounted for as a separate performance obligation.

New guidance	Current PSAK
An entity should account for a warranty that the customer has the option to purchase separately as a separate performance obligation that is satisfied over the warranty period. A warranty that the customer does not have the option to purchase separately should be accounted for in accordance with existing guidance on product warranties. A warranty, or part of it, that is not sold separately but that provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications, creates a performance obligation for the promised service. An entity that cannot reasonably separate the service component from a standard warranty should account for both together as a single performance obligation.	Warranties that a customer can purchase separately are typically similar to extended warranty contracts. Revenue from extended warranties is deferred and recognised over the life of the contract. Warranties that are not sold separately are accounted for in accordance with provisions guidance, resulting in recognition of an expense and a warranty liability when the good is sold.

Potential impact:

Similar to existing guidance, warranties sold separately give rise to a separate performance obligation under the new standard and, therefore, revenue is recognised over the warranty period. Warranties that are separately priced may be affected, as the arrangement consideration will be allocated based on the relative standalone selling price under the new standard.

Product warranties that are not sold separately and provide for defects that exist when a product is shipped will result in a cost accrual similar to today's guidance. Entities will have to assess whether warranties that are not sold separately also provide the customer with a service. This assessment will require judgment and is based on factors such as the nature of the tasks the entity will perform and the length of the warranty coverage period.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Recognise revenue | **Other consideration**

Other considerations *(cont'd)*

Example 6(c) – Product sale with optional warranty

Facts: Vendor sells a hard drive, keyboard, monitor, and a 12-month warranty that the customer elected, but was not required, to purchase.

Question: How should the Vendor account for the warranty?

Analysis: The new standard requires the Vendor to account for the 12-month optional warranty as a separate performance obligation because the customer can purchase the warranty separately from the related goods. The fact that it is sold separately indicates that a service is being provided beyond ensuring that the product will function as intended.

The Vendor allocates a portion of the transaction price to the warranty based on its relative standalone selling price. The amount of revenue allocated to the warranty could therefore differ from the stated price of the warranty in the contract. The Vendor will need to assess the best measure of progress for the promise to provide the warranty to determine when the revenue allocated to the warranty is recognised (that is, rateably over the warranty period or some other pattern).

If the 12-month warranty were not optional, the vendor would assess whether the warranty only provides the customer with assurance that the related product complies with agreed-upon specifications or provides a service that is a separate performance obligation.

Other considerations *(cont'd)*

Contract costs

Technology companies often pay commissions to internal sales agents, other employees, and third-party dealers. Commission plans can often be complex and involve a number of different employees. Some entities capitalise customer acquisition costs as an asset today, while other entities expense these costs as incurred. The new standard requires entities to capitalise incremental costs of obtaining a contract if the costs are expected to be recovered.

Entities should amortise any asset recognised from capitalising costs to obtain or fulfil a contract (including capitalised sales commissions) on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. Determining the amortisation period requires judgment and is similar to estimating the amortisation or depreciation period for other assets (such as a customer relationship acquired in a business combination). Amortising an asset over a longer period than the initial contract may be necessary if an entity expects a customer to renew the contract and does not pay commissions on contract renewals that are commensurate with the commission paid on the initial contract. The level of effort to obtain a contract or renewal should not be a factor in determining whether the commission paid on a contract renewal is commensurate with the initial commission. Rather, entities should assess whether the initial commission and renewal commission are reasonably proportional to the respective contract values.

New guidance	Current PSAK
Entities will recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs. All other contract acquisition costs that are incurred regardless of whether a contract was obtained (e.g., employee salaries and legal fees) are recognised as an expense. As a practical expedient, the revenue standard permits entities to expense incremental costs of obtaining a contract when incurred if the amortisation period of the asset would be one year or less. Contract costs recognised as an asset are amortised on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates. In some cases, the asset might relate to goods or services to be provided in future anticipated contracts (for example, service to be provided to a customer in the future if the customer chooses to renew an existing contract). Entities will have to recognise an impairment loss if the carrying amount of an asset exceeds: 1. The amount of consideration to which an entity expects to be entitled in exchange for the goods or services to which the asset relates; less 2. The remaining costs that relate directly to providing those goods or services.	Given the lack of definitive guidance, some entities capitalise costs of acquiring customer contracts as intangible assets and amortise them over the customer contract period, while other entities expense the costs when incurred.

(1) Identify the contract | (2) Identify performance obligation | (3) Determine transaction price | (4) Allocate transaction price | (5) Recognise revenue | Other consideration

Other considerations *(cont'd)*

Potential impact:

Under the new standard, entities no longer have the option to capitalise costs to obtain a contract. All incremental costs must be capitalised if the entity expects to recover the costs. Incremental costs could include amounts paid not just to a single salesperson, but amounts paid to multiple employees (e.g., a salesperson, manager, and regional manager) if the payment would not have been incurred if the contract had not been obtained. Entities will have to apply judgment to identify all costs that are incremental and to determine the amortisation period of the resulting asset.

Entities may reverse impairments when costs become recoverable; however, the reversal is limited to an amount that does not result in the carrying amount of the capitalised acquisition cost exceeding the depreciated historical cost.

Example 6(d) - Incremental costs to obtain a contract

Facts: A company's vice president of sales receives a quarterly bonus, which is partially based on total new bookings during the year. The bonus is also based on other factors, including individual performance. The compensation committee has the discretion to determine the final amount of the bonus payment and may decide not to pay any bonus.

Question: Is the quarterly bonus considered an incremental cost to obtain a contract?

Analysis: No, the payment is based on factors other than obtaining new contracts; therefore, it would not be considered an incremental cost.

Example 6(e) – Amortisation of initial commission

Facts: A sales employee is paid a CU500 commission for each initial annual SaaS contract obtained with a customer and CU250 for each annual renewal of the contract thereafter. The company expects one customer to renew, and concludes that the renewal commission is not commensurate with the initial commission. The average customer life is five years.

Question: What is the amortisation period for the initial commission and renewal commission for the contract with this customer?

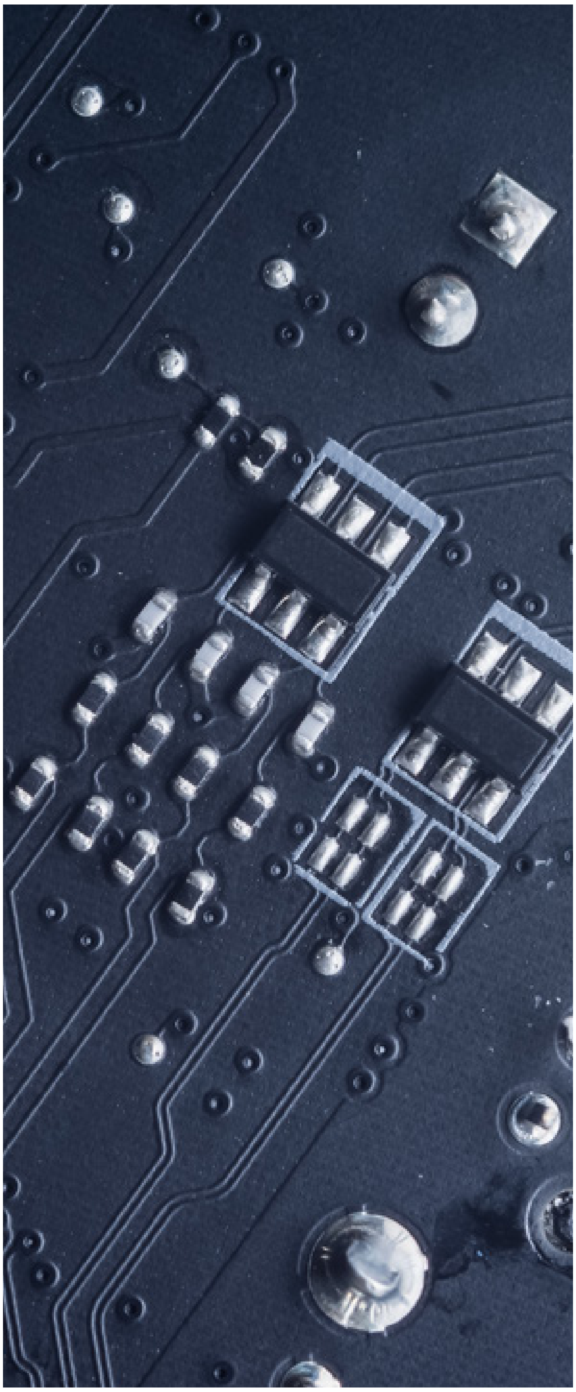
Analysis: Since the renewal commission is not commensurate with the initial commission and the company expects the customer to renew, the company should amortise the initial commission over a period longer than the initial contract term, say the average customer life of five years. As a result, the company could amortise the initial CU500 commission over five years, or it could separate the initial commission of CU500 into two components, and amortise CU250 over the initial contract term of one year and the remaining CU250 over the five-year average customer life.

PSAK 73

Leases

In 2017, the DSAK-IAI issued PSAK 73 which supersedes PSAK 30 Leases, ISAK 8 Determining whether an Arrangement Contains a Lease, ISAK 23 Operating Leases - Incentives, ISAK 24 Evaluating the Substance of Transactions Involving the Legal Form of a Lease and ISAK 25 Land Rights. For lessors, the accounting remains largely unchanged; however, the accounting for lessees will change significantly, with almost all leases being recognised on the balance sheet. This and other provisions will likely introduce some level of change for all entities that are a party to a lease.

Overview



Entities in the technology sector are generally frequent lessees and, at times, lessors of assets. Lease accounting literature and related interpretations under PSAK have sometimes presented challenges for lessees and can result in different financial reporting outcomes for economically similar transactions based solely on the nuanced terms of particular leasing transactions. PSAK 73, 'Leases', requires that lease accounting guidance is applied to any arrangement that conveys control over an identified asset to another party. The DSAK-IAI's objectives for the new standard were increased transparency and comparability across organisations.

PSAK 73 requires lessees to capitalise all leases with a term of more than one year. Almost all leases will be recognised on the balance sheet, with a right of use asset and financial liability that recognise more expenses in the profit or loss during the earlier life of a lease. This will have an associated impact on key accounting metrics of lessees, and clear communication will be required to explain the impact of changes to the stakeholders.

Guidance for lessors remains substantially unchanged from PSAK 30. Lessors are still required to classify leases as either finance or operating, and the indicators used to make that distinction are again unchanged from PSAK 30. For a finance lease, the lessor recognises a receivable at an amount equal to the net investment in the lease; this is the present value of the aggregate of lease payments receivable by the lessor and any unguaranteed residual value. For an operating lease, the lessor continues to recognise the underlying asset on its balance sheet.

Our "PSAK 73 – Leases, A new Era for Lease Accounting" publication provides a comprehensive analysis of the new standard from the perspective of both lessee and lessor. This guide summarises the main aspects of the standard that the technology sector might face, focusing on some key challenges and questions management should ask as they prepare for transition.

Overview *(cont'd)*

Effective date and transition

The new standard is effective for annual reporting periods beginning on or after 1 January 2020. Early adoption is permitted, but only in conjunction with earlier application of PSAK 72, 'Revenue from Contracts with Customers'. This means that an entity is not allowed to apply PSAK 73 before applying PSAK 72.

In order to facilitate transition, entities can choose a 'simplified approach' that includes certain reliefs related to the measurement of the right-of-use asset and the lease liability, rather than full retrospective application; furthermore, the 'simplified approach' does not require a restatement of comparatives. Any adjustment will have impact on Retained Earnings 1 January 2020 (Date of Initial Application). In addition, as a practical expedient, entities are not required to reassess whether an existing contract is, or contains, a lease at the date of initial application (i.e. such contracts are "grandfathered") but can apply the guidance regarding the definition of a lease only to contracts entered into (or changed) on or after the date of initial application. This applies to both contracts that were not previously identified as containing a lease applying PSAK 30/ISAK 8 and those that were previously identified as leases in PSAK 30/ISAK 8. If the entity chooses this expedient, it shall be applied to all contracts.

Except for re-assessment of operating subleases ongoing at the date of initial application of PSAK 73, a lessor is not required to make any adjustments on transition.

Impact

PSAK 73 will apply to all categories of contracts in the technology sector, except for licences of intellectual property granted by a lessor that are within the scope of PSAK 72, Revenue from Contracts with Customers. Other scope exceptions include rights held by a lessee under licensing agreements (such as motion picture films, video recordings, plays, manuscripts, patents and copyrights), leases of biological assets, service concession agreements and leases to explore for or use mineral and other non-regenerative resources. There is an optional scope exemption for lessees of intangible assets other than the licences mentioned above.

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

Embedded leases

Technology companies often enter into arrangements that include a variety of products or services and that may include a lease. For example, hardware vendors sometimes offer commercial equipment leases together with service add-ons or vendors of IP licenses may sell subscriptions to a cloud based storage solution in addition to the license. They may also use a data storage centre owned or managed by a third-party hosting company. Regardless of how an arrangement is structured, lease accounting guidance applies to any arrangement that conveys control over an identified asset to another party.

An arrangement is a lease or contains a lease if an underlying asset is explicitly or implicitly identified and use of the asset is controlled by the customer.

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

An identified asset must be physically distinct. A physically-distinct asset may be an entire asset or a portion of an asset. For example, a building is generally considered physically distinct, but one floor within the building may also be considered physically distinct if it can be used independent of the other floors (e.g., point of entry or exit, access to lavatories, etc.). A capacity or a portion of an asset is not an identified asset if (1) the asset is not physically distinct (e.g., the arrangement permits use of a portion of the capacity of a data storage centre) and (2) a customer does not have the rights to substantially all of the economic benefits from the use of the asset (e.g., several customers share a storage centre and no single customer has substantially all of the capacity).

A customer controls the use of the identified asset by possessing the rights to (1) obtain substantially all of the economic benefits from the use of such asset ("benefits" element); and (2) direct the use of the identified asset throughout the period of use ("power" element). A customer meets the "power" element if it holds the rights to make decisions that have the most significant impact on the economic benefits derived from the use of the asset. If these decisions are pre¬determined in the contract, for the arrangement to be a lease, the customer must have the rights to direct the operations of the asset without the supplier having the rights to change those operating instructions throughout the period of use or has designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used.

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

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

Embedded leases *(cont'd)*

PwC observation

Some contracts that may contain a lease are the result of specific negotiations covering a variety of goods and services, and 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 may not be obvious and may require significant judgment. Careful assessment of the facts and circumstances, considering all relevant rights will be required.

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

Example 1 – Whether an arrangement contains a lease: data centre arrangement

Facts: Technology Corp ("Customer") enters into a two-year Service Level Agreement (SLA) with the Data Centre Corp ("Supplier") under which the Customer will place its servers and related equipment in a locked wire cage in 10,000 square feet of the Supplier's 120,000 square foot multi-user data centre. There is no other data centre available that is suitable to meet the Customer's requirements. The space in the data centre can be divided into separate units by placing removable cages. The Supplier has the right to move the Customer's servers and related equipment to a cage in another location in the data centre provided there is no disruption to the Customer's operations. The Supplier's cost to move the Customer's servers and related equipment to another cage is minimal. The Customer will control access to its designated cage and the Customer's employees will operate the servers and related equipment. The Supplier can only enter the cage for maintenance and monitoring purposes and to move the servers and related equipment to another cage in the data centre. In addition to providing the data centre infrastructure (e.g., HVAC, UPS, high speed Internet), the Supplier will also provide security and monitoring services. Any infrastructure related outages above the agreed thresholds will require the Supplier to pay a significant penalty to the Customer.

Scenario 1: The Supplier currently uses 80,000 of the remaining 110,000 square feet for an SLA with another customer.

Question: Does the arrangement contain a lease?

Embedded leases *(cont'd)*

Discussion: No, the arrangement does not contain a lease.

Although the amount of space the Customer uses is specified in the contract (10,000 square feet), there is no identified asset. This space can change at the discretion of the Supplier, who has the substantive rights to substitute the space for the Customer's SLA because:

a. The Supplier has the practical ability to change the space used by the Customer throughout the period of use due to (1) the Supplier's legally enforceable right to move the Customer's server and related equipment to another cage in the data centre at any time during the term of the arrangement without the Customer's approval and (2) additional space (30,000 square feet) being available for the Supplier to move the Customer's equipment during the term of the arrangement; and

b. The space can be easily re-configured with minimal additional cost. The Supplier would derive an economic benefit from being able to make the most effective use of the data centre space to accommodate more customers or to configure space more efficiently or accommodate a request for additional space from an existing customer.

Scenario 2: The Supplier currently uses all of the remaining 110,000 square feet for an SLA with another customer. There are three years remaining under that arrangement, which is non-cancellable.

Question: Does the arrangement contain a lease?

Discussion: Yes, the arrangement contains a lease.

The Supplier's substitution right is not substantive because alternative space is not readily available in the data centre due to an existing non-cancellable agreement between the Supplier and its other customer. Since the Supplier does not have practical ability to substitute the space, the contract is dependent on the identified space.

The Customer has the right to control the use of the space throughout the period of use because:

a. The Customer has the right to obtain substantially all of the economic benefits from use of the space used for its servers and related equipment throughout the period of use, and

b. The Customer makes the relevant decisions about how and for what purpose the space is used by determining how its servers and related equipment will be operated by its employees during the period of use.

Embedded leases *(cont'd)*

Example 2 – Whether an arrangement contains a lease: cloud computing arrangement

Facts: Cloud Services Corp ("Supplier") provides cloud based computing services to customers. Its key offering is 'Software as a Service' cloud computing contract in which the customer contracts to pay a fee in exchange for a right to receive access to the supplier's application software for a specified period. The infrastructure and any associated software are provided and operated by the supplier, for example, it is within the power of the supplier to determine how and when to update or reconfigure the software, or decide on what infrastructure is required for the software to run effectively. Customers access the software as necessary online or via a dedicated line. The contract also does not convey to the customer any rights over tangible assets.

Question: Does the contract contain a software lease?

Discussion: No, the arrangement does not contain a software lease.

This matter was considered by the IFRS Interpretation Committee and, in the March 2019 Rejection, the Interpretations Committee noted that such cloud based computing arrangement does not provide the customer with a right to direct the use of an asset in the context of the new leasing standard. When assessing whether the customer has the right to direct the use of the identified asset, the key question is which party (that is, the customer or the supplier) has the right to direct how and for what purpose the identified asset is used throughout the period of use. However, the Supplier retained the relevant decision-making rights, for example, when and whether to update or reconfigure the software or determining the level of capacity required for connections and data storage throughout the contract period.

Accordingly, the customer only receives the right to access the supplier's software.

Example 3 – Whether an arrangement contains a lease: warehouse space contract

Facts: The Warehousing Corp ("Supplier") owns a large warehouse and provides third-party logistics services to large companies. The warehouse can be subdivided into numerous subsections by inserting removable walls. It makes available different portions of storage space to its customers based on their respective needs. XYZ Corp ("Customer") contracts with the Supplier to reserve 1,000 square feet of space to store its products for a three-year period. The contract specifies that the Customer's inventory will be stored in a specified location in the warehouse. However, the Supplier has the legal right to move the Customer's inventory to another location within its warehouse at its discretion, subject to the requirement to provide 1,000 square feet for the three-year period. The Supplier frequently reorganises its space to meet the needs of new contracts and has sufficient alternative space to fulfil Customer's requirements. The cost of reallocating space is low compared to the benefits of being able to accommodate as many customers as possible in the warehouse.

Question: Does the contract contain a lease?

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

The asset is not identified because the Supplier has substantive substitution rights. The Supplier has agreed to provide a specific level of capacity within its warehouse but has the unilateral right to relocate the Customer's inventory and can do so without significant cost.

Components, contract consideration, and allocation

A contract may contain lease and non-lease components. Only lease components are subject to the balance sheet recognition guidance in the new lease standard. Components within an arrangement are those items or activities that transfer a good or service to the customer.

A right to use an asset is a separate lease component if the lessee can benefit from the asset on its own (or together with readily available resources) and the asset is neither interdependent nor highly correlated with any other underlying asset in the contract. For example, if a lessee pays for the right to use an asset and also for administrative tasks, which do not transfer a good or service to the lessee, the administrative tasks are not a separate non-lease component. The amount due for administrative tasks will be considered as part of the total consideration that is allocated to the separately identified lease and non-lease components of the contract.

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

PwC observation

In addition to typical real estate leases and equipment leases, technology companies often enter into a variety of arrangements, such as outsourcing and supply agreements that may contain leases. Technology companies will need to put processes in place to identify embedded leases and then identify the lease and non-lease components. A process will also be needed to allocate contract consideration to each component (absent the lessee making a policy election to not separate a non-lease component from the associated lease component).

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

Example 4 – Identifying components within an arrangement: data centre

Facts: Colocation Corp ("Lessor") and Tech Company ("Lessee") enter into a lease of an entire data centre, which grants the Lessee exclusive rights to use the data centre for a five-year period. The Lessee will occupy the data centre and use its own resources and personnel to operate it. The monthly payment to Lessor includes: (a) fixed rent for the data centre; (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 data centre.

Question1: What are the components in the lease?

Discussion: The lease component in the arrangement is the data centre and, additionally, the contract includes two non-lease components - maintenance service and utilities. The fixed payments for property taxes and building insurance that Lessee will make during the five-year lease term do not transfer a good or service to the lessee, so they cannot be identified as separate components. They would instead be included in the measurement of the transaction consideration to be allocated to the separately identified components of the contract.

Security and cleaning services involve the provision of separate services to Lessee, and they are considered as separate non-lease components. The Lessee 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 Lessee 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. Lessee should allocate the contract consideration to the separate lease and non-lease components, based on their relative stand-alone prices.

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

PwC observation

A lessee might elect to apply the practical expedient of accounting for a lease and the associated non-lease component as a single lease component. If the practical expedient is applied, the cash flows associated with the non-lease component will increase the liability and right-of-use asset recognised on the balance sheet. This is an election by asset class. Technology companies are likely to consider the significance of the increase in the right-of-use asset and liability relative to the effort and complexity required to obtain reliable information to separately account for the lease and non-lease components. Technology sector lessees with material leases will need additional processes, controls and documentation to ensure appropriate and consistent application of the guidance. For example, the guidance requires an appropriate allocation based on relative stand-alone prices that maximises the use of observable prices.

Lessee accounting model

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

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

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

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

PwC observation

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

Lessee accounting model *(cont'd)*

Technology companies often sublease excess space. When a lessee subleases an asset, the lessee (now a sub-lessor) should account for a head lease and sublease as two separate contracts unless the sub-lessor is relieved of its primary obligation under the head lease. The sub-lessor should determine the classification of the sublease based on the underlying asset in the head lease, rather than on the sub-lessor's rights-of-use.

PwC observation

Classification guidance requires treating a lease as a finance lease if it transfers all risks and rewards incidental to ownership of the underlying the asset. Where the underlying asset is so specialised that only the lessee can use it without major modifications, the sublease contract would normally be classified as a finance lease. We do not expect that this indicator will have a significant impact on lease classification for most technology companies. This is because, in such cases, the lessor would likely have either (a) priced the lease such that the present value of lease payments is substantially all of the fair value of the asset or (b) set the lease term to be equal to a major part of the asset's remaining economic life, causing the lease to be classified as financing (capital) already.

Example 5 – Lessee model, initial and subsequent measurement

Facts: Technology Corp ("Lessee") rents an office building from Landlord Corp ("Lessor") that qualifies as a lease. The following is a summary of information about the lease and the leased asset.

Lease term	Eight years with three three-year renewal options
Remaining economic life of the leased asset	25 years
Purchase option	None
Annual lease payments	C25,000
Payment date	Annually on December 31
Initial direct costs	CU10,000
Lessee's incremental borrowing rate	6.00%

Other information
- The rate implicit in the lease that the Lessor charges the Lessee is not readily determinable by the Lessee
- Title to the asset remains with the Lessor upon lease expiration
- The Lessee does not guarantee the residual value of the office building at the end of the lease term
- The Lessee is responsible for maintaining the asset
- Exercise of the renewal option by the Lessee is not reasonably certain

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

Lessee accounting model *(cont'd)*

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

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

Question: How would the Lessee subsequently measure the rights-of-use asset and lease liability over the lease term?

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

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

	Lease Liability				Right-of-use of Asset	
	Payment	**Principal**	**Interest**	**Lease Liability**	**Amortisation**	**Right-of use Asset**
Commencement	$10,000	-	-	$155,245		$165,245
Year 1	25,000	$15,685	$9,315	139,560	20,656	144,589
Year 2	25,000	16,626	8,374	122,934	20,656	123,933
Year 3	25,000	17,624	7,376	105,310	20,656	103,277
Year 4	25,000	18,681	6,319	86,629	20,656	82,621
Year 5	25,000	19,802	5,198	66,827	20,656	61,965
Year 6	25,000	20,990	4,010	45,837	20,656	41,309
Year 7	25,000	22,250	2,750	23,587	20,656	20,653
Year 8	25,000	23,587	1,413	-	20,653	-
	$210,000	**$155,245**	**$44,755**		**$165,245**	

Lease modification and reassessment (lessee)

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

A modification is accounted for as a contract separate from the original lease if the modification grants the lessee an additional right of use not included in the original lease and the additional right of use is priced consistent with its standalone value. When 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.

In contrast, when a lease is modified and the modification is not recognised as a separate lease, the lessee must remeasure and reallocate all of the remaining contract consideration from both lease and non-lease components based on the modified contract and remeasure the lease liability and adjust the rights-of-use asset using assumptions as of the effective date of the modification (e.g., discount rate and remaining economic life).

PwC observation

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

It will be important for companies to have processes and controls in place to identify and monitor triggering events that would require the reassessment of a lease.

Even when a lease is not modified, there are circumstances when a lessee will also be required to remeasure the right-of-use asset and lease liability. The table below lists these circumstances and the related impact on the lessee's accounting.

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

Sale and leaseback arrangements

Existing sale-leaseback guidance in PSAK 30 is replaced with a new model applicable to both lessees and lessors. The accounting for sale and leaseback transactions under PSAK 30 mainly depended on whether the leaseback was classified as a finance or an operating lease. Under PSAK 73, the determining factor is whether the transfer of the asset qualifies as a sale in accordance with PSAK 72. Technology companies should apply the requirements for determining when a performance obligation is satisfied in PSAK 72, to make this assessment.

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

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

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

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

PwC observation

Judgment will be required to determine whether the sale criteria in PSAK 72 have been met and the conclusion will depend on the specific facts and circumstances of the transaction. Not all of the indicators need to be met to conclude that control has transferred from the seller-lessee to the buyer-lessor. In the revenue standard, sale recognition is precluded when the party that would be the seller-lessee has a substantive repurchase right (a call option) or obligation (a forward) with respect to the underlying asset.

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
ISAK	*Interpretasi Standar Akuntansi Keuangan* or "Interpretation of Financial Accounting Standards"
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


09:41
smart home
DEVICE
GROUP
SCENE
add new
preferences
LIGHT
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lights
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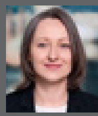

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