

Guidance on the New Leases Standard

Banking & Capital Markets Sector

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Introduction

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

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

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

This publication reflects the implementation developments and provides guidance on the application of the new leasing standard (PSAK 73) specific for the Banking & Capital Markets sector.

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PSAK 73

Leases

Under the new standard on leasing, lessees will be required to bring substantially all leases onto their balance sheets. Some changes could also impact certain lessors. The new guidance will likely introduce some level of change for all entities that are party to a lease.

This supplement highlights some of the areas that could create the most significant challenges for entities in the Banking & Capital Markets sector as they transition to the new standard.

Banking & Capital Markets industry supplement

Overview

Leases are common in the Banking & Capital Markets sector. Entities are generally lessees (for example, of banking branches and IT equipment, and intercompany leases between operating companies and trading companies) and, at times, lessors of assets (for example, of aircraft and properties).

This supplement highlights some of the areas that could create the most significant challenges for entities in the Banking & Capital Markets sector as they transition to the new standard. Further guidance for lessors is included in our [“PSAK 73 – Leases, A new Era for Lease Accounting”](#) publication, which is a comprehensive analysis of the new standard.

Impact

Lessees

PSAK 73 requires lessees to capitalise (i.e., recognise a right-of-use asset and a lease liability) virtually for all leases; the only optional exemptions are for certain short-term leases and leases of low-value assets. Expense recognition will be similar to a finance lease today, (depreciation of the right-of-use asset and interest expense on the lease liability).

The financial reporting effects are just some of the most obvious of the impacts the new standard will have on companies in the Banking & Capital Markets sector. Banking & Capital Markets institutions will also need to analyse how the new model will affect current business activities, contract negotiations, budgeting, and key metrics. The identification of a complete lease arrangement, including embedded and intercompany leases, will be critical to effective capital planning.

Banking & Capital Markets institutions should be mindful of the impact of the new lease accounting on regulatory capital, such as the net open position, debt-to-equity ratio, the risk-based capital and weighted assets ratios, and should consider the view of OJK. For example, in Banking institutions, preliminary views given by OJK seemed to indicate that PSAK 73 lease liabilities do not represent Dana Pihak Ketiga (DPK) or third-party funds; and therefore, lease liabilities do not affect LPS premiums and GWM. Likewise, interest expense from lease liabilities does not affect net interest margin ratio (NIM) calculation. However, it's important to note that OJK has not issued any formal regulation on this matter to date. We encourage Banking & Capital Markets institutions to carefully evaluate this matter going forward.

For regulated banking institutions, the recognition of right-of-use assets on the balance sheet may impact the calculation of regulatory capital ratios by increasing the assets in the denominator of the risk-based capital ratios (risk-weighted assets) and leverage capital ratio (adjusted asset). All other things being equal, a higher denominator will result in lower capital ratios for the financial institution.

Financial institutions with a large portfolio of leases will need to evaluate their ability to gather the required information on existing leases, which will be critical to an orderly 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.

Overview (cont'd)

Lessors

The accounting model for lessors remains broadly consistent with existing PSAK, as lessors will classify leases as operating or financing based on the same guidance that is in PSAK 30 today. To the extent that financial institutions have arrangements with customers which contain lease and non-lease components, the lessor will need to consider the interaction of PSAK 73 with PSAK 72, which may result in certain components of the arrangement being accounted for as other revenue rather than as part of the lease.

The new rules may impact the financial metrics of customers and borrowers, causing some to re-evaluate whether to buy an asset instead of leasing it or to reconsider certain terms of a lease. For example, when underwriting new loans, bank personnel will need to understand the impact of the new accounting on the financial statements of potential borrowers, and will need to understand the impact the standard may have on how lending covenants have been traditionally structured.

Effective date and transition

The effective date is for annual reporting periods beginning on or after 1 January 2020. Early adoption is permitted for all entities as long as they have already adopted PSAK 72.

The new standard permits two transition methods. Acknowledging the potentially significant impact of the new lease standard on a lessee's financial statements, PSAK 73 does not require a full retrospective application in accordance with PSAK 25 but allows a 'simplified approach'. Full retrospective application is optional. If a lessee elects the 'simplified approach', it does not restate comparative information. Instead, the cumulative effect of applying the standard is recognised as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application. In addition, there are a number of practical expedients.



Identifying leases

Regardless of how an arrangement is structured, the lease accounting guidance in PSAK 73 applies to any arrangement that conveys *control* over an *identified* asset to another party. The arrangement or agreement does not need to be called a lease or be a lease in its entirety. An arrangement is a lease or contains a lease if (1) there is an explicitly or implicitly identified asset and (2) use of the asset is controlled by the customer (user of the asset or taker of the output from the asset).



Identified asset

An identified asset can be specified explicitly (e.g. a computer, by its serial number) or implicitly. However, in all cases, the asset is not identified if the supplier has a substantive contractual right to substitute such asset (e.g., if the server provider can substitute the server available to the bank). 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 asset from being considered 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). However, a capacity or other portion of an asset is an identified asset if (1) it is not physically distinct (e.g., an arrangement permits use of a portion of the capacity of a server); and (2) the customer does not have the right to substantially all of the economic benefits from the use of the asset (e.g., even though several parties share the use of the server, no customer has substantially all of the capacity).

Identifying leases (cont'd)

Example 1 –Whether a contract contains a lease: outsourced information technology function

Facts: Commercial Bank (“Customer”) enters into a 3-year IT contract with a service provider (“Supplier”) for IT related services. Under this arrangement, Supplier installs a dedicated server at Customer’s premises to be used by Customer during the term of the arrangement. The server is explicitly identified in the contract and Supplier is permitted to substitute the server only if it malfunctions. Customer decides which data to store on or delete from the server and how to integrate the server within its operations throughout the contract term. Supplier provides maintenance and other support services, such as nightly data back-up and software upgrades. The Supplier does not have any right to decide the deployment of the server during the term of the arrangement (it cannot make any decisions about the use of the server during the period of use, it does not have the right to decide how data is transported using the server, it cannot decide whether to reconfigure the server and it cannot decide whether to use the server for another purpose).

Question: Does the contract contain an identified asset?

Discussion: Based on the facts in this example, the contract contains a lease.

The contract explicitly identifies a server that Supplier can substitute only in the event of malfunction. Therefore, the arrangement contains identified property, plant, or equipment, i.e., the server. Since the contract has an identified asset, it is now necessary to determine who controls the use of that identified asset to determine whether the arrangement contains a lease.

Right to control the use of the identified asset

A customer controls the use of the identified asset by possessing (1) the right to obtain substantially all of the economic benefits (e.g., output) from the asset (“economics”) and (2) the right to direct the use of the identified asset throughout the period of the arrangement (“power”). The economics criterion may sound similar to today’s model under which an arrangement is deemed to meet the economics criterion if it is remote that any other party will take more than a minor amount of the output. However, under current guidance, if the customer has the right to substantially all of the output, there is a pricing exception that precludes the economics criterion from being met. That is, under current guidance, having substantially all of the output is not enough to satisfy the criterion if the price that the customer will pay for the output is either contractually fixed per unit or equal to the current market price per unit at the time of delivery.

A customer meets the “power” criterion if it holds the right to make decisions that have the most significant impact on the economic benefits derived from the use of the asset. In some cases, the use of the asset is predetermined in the contract (e.g., a piece of equipment). If decisions that have the most impact on the economic benefits to be derived from the use of the underlying asset are pre-determined, the customer may still have control if either (a) the customer has the right to

Identifying leases (cont'd)

direct the operations of the asset without the supplier having the right to change those operating instructions or (b) the customer has designed the asset (or specific aspects of the asset) in a manner that predetermines how and for what purpose the asset will be used. Sometimes there may be terms in the contract that are protective in nature that are included to protect the supplier's asset and supplier's personnel and comply with regulations. For example, a contract may restrict usage of a piece of equipment up to a maximum number of hours per period based on the piece of equipment'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.

In the context of Example 1 above, the Customer has the right to control the use of the server because it has (a) the right to obtain all of the economic benefits from the use of the identified server based on its exclusive access and use of the server during the 3-year term; and (b) the right to direct the use of the identified server because of its ability to determine which data is stored, and the nature and timing of the content placed on the server. Maintenance and support activities ensure the server operates as it should, but do not impact how and for what purpose the server is used because they do not affect the economic benefits derived from use of the server.

PwC observation:

Financial institutions may have data for leases related to their Head Office and branch networks but ensuring a complete inventory of leases will mean evaluating all types of arrangements for embedded leases. For example, there has been a trend for many financial institutions to outsource business operations and support functions such as IT to leverage and drive expertise. Financial institutions will need to assess such contractual arrangements to determine if they contain embedded leases. Common examples of arrangements that might contain an embedded lease are the outsourcing of data centres and hosting arrangements. Banks may also have leases associated with their ATMs or other assets. Arrangements that are considered to be leases may or may not qualify for the exemption available for short-term leases.

Intercompany arrangements

Intercompany arrangements designed to allocate overhead and other costs, such as rent, to different business and legal entities are common in the financial services sector. Companies will need to analyse such arrangements to determine if they are leases or contain embedded leases. While these types of arrangements exist in many industries, the impact of the new leases standard may be significant to financial services companies because they tend to have a large number of subsidiaries and legal entities through which they conduct business that prepare standalone financial statements.

While intercompany leases would be eliminated for the purposes of consolidated reporting, some legal entities may be required to prepare standalone financial statements. The recording of a right-of-use asset and a lease liability in the standalone financial statements upon application of the new lease accounting model may impact a number of regulatory reporting and capital calculations for such entities.

Identifying leases (cont'd)

Under the new leases standard, a lessee may, by class of underlying asset, elect to not reflect a right-of-use asset and a lease liability on the lessee's balance sheet for leases with a term of 12 months or less ("short-term exemption"). The standard also stipulates that leases between related parties should be accounted for based on the enforceable terms and conditions of the lease.

It is common for an entity to enter into an agreement with its parent company or another member of the consolidated group under which the entity pays a fee in return for the use of space (e.g., a floor in the building), equipment, and other services, such as maintenance. These types of agreements may contain a lease. However, if the legally-enforceable term of such agreement is 12 months or less, the lessee entity could elect the short-term exemption and not reflect a right-of-use asset and a lease liability on its balance sheet.

Interpretation of "legally enforceable"

The question that arises is how "legally enforceable" should be interpreted in connection with related-party leases. Some related-party transactions may not be documented and/or the terms and conditions are not at arm's length. Therefore, in order to operationalise the short-term exemption, we believe a lessee should first focus on what the legally-enforceable lease term is based on the written agreement. However, if the economics of the written agreement do not align with the economics of other related transactions (e.g., the lease term is one year but the lessee is installing expensive leasehold improvements that have an economic life of greater than one year) or there is no written agreement, the lessee should determine if there is a binding oral agreement or understanding. The lessee may need to solicit input from legal counsel about whether the terms and conditions of the oral agreement or understanding are legally enforceable.

PwC observation:

Even though a lessee may, by class of underlying asset, elect to not reflect a right-of-use asset and a lease liability on its balance sheet for leases with a term of 12 months or less, entities are still subject to the disclosure requirements for related-party transactions under PSAK 7, *Related Party Disclosures*. This includes disclosing information necessary to understand the effects of the related-party transactions on the entity's financial statements, such as a description of the relationships and the transactions.

Components, contract consideration, and allocation

An arrangement may contain lease and non-lease components. Components are those items or activities in the arrangement that transfer a good or service to a customer/lessee (e.g. maintenance of bank branches provided by landlord of the shopping centre which the branch is located within). A right to use an underlying asset is a separate lease component from other lease components if (a) the lessee can benefit from the right-of-use either on its own or together with other resources that are readily available to the lessee, and (b) the right-of-use is neither highly dependent on nor highly interrelated with the other rights to use underlying assets in the contract.

Non-lease components are subject to other GAAP outside of the new leases standard (for example, non-lease components may be lessor performance obligations under the new revenue standard). Property taxes and insurance that do not represent separate goods or services are not components. Any fixed payments by the lessee for these items are considered part of overall contract consideration to be allocated among the lease and non-lease components.

Maintenance costs, on the other hand, involve delivery of a separate service, and are therefore considered a non-lease component if provided by the lessor to the lessee. In leases containing land, the land is a separate lease component unless the accounting effect of separately accounting for the land component is insignificant (for example, the amount recognized for the land lease component would be insignificant or separating the land lease component would not impact the lease classification of any lease component). Once the lease and non-lease components are identified, contract consideration is allocated to each component.

A lessee should allocate the contract consideration to each lease and non-lease component based on its relative standalone price. Any variable payments that are not based on a rate or an index are excluded from the calculation of the overall contract consideration. The standard provides a practical expedient under which a lessee may, as an accounting policy election by class of underlying asset, choose to not separate non-lease components from the associated lease component and instead account for them all together as part of the applicable lease component.

The impact of property taxes and insurance paid by the lessee depends on whether they are fixed or variable. If a lessee pays the actual amount of property taxes and insurance that are not in substance fixed and the payments are not based on an index or a rate, they should be accounted for similar to other variable lease payments—i.e., excluded from contract consideration and excluded from lease payments used for classification and initial measurement—by both the lessee and the lessor. On the other hand, if a lessee pays a fixed amount of property taxes and insurance as part of rent payments, such payments should be included in contract consideration and allocated to the lease and non-lease components by the lessee and lessor. The effect of doing so, consistent with the notion that property taxes and insurance are not separate goods that are transferred, is that such payments are subject to allocation to the components and the amounts allocated to the lease component are included in the classification and measurement of the lease. Lessor accounting is discussed on page 14.

Lessee accounting model

Lessees will be required to recognise a right-of-use asset and liability for virtually all of their leases (other than short-term leases or leases of low value assets). For income statement purposes, leases will produce a front-loaded expense pattern (similar to current finance leases), where a higher interest expense is recognised in earlier reporting periods. Depreciation of the right-of-use asset is on a straight line basis (similar to current finance lease expense recognition).

Example 2 – Lessee accounting - initial and subsequent measurement

Facts: Commercial Bank enters into a lease of equipment with Lessor Corp. The following is a summary of information about the lease and the leased asset.

Lease commencement date	January 1, 20x1
Lease term	5 years with no renewal option
Remaining economic life of the equipment	6 years
Purchase option	None
Annual lease payments	\$525,000
Payment date	Annually in advance on January 1 (first lease payment is due on lease commencement date)
Fair value of the equipment at lease commencement date	\$2,500,000
Commercial Bank's incremental borrowing rate	5%
Residual value guarantee	None
Initial direct costs	None

Other information

- The interest rate implicit in the lease that Lessor Corp charges Commercial Bank is not readily determinable by Commercial Bank
- Title to the equipment remains with Lessor Corp throughout the period of the lease and upon lease expiration
- Commercial Bank does not guarantee the residual value of the equipment
- Commercial Bank pays for insurance and maintenance of the equipment separate from lease payments
- The lease commencement date does not fall at or near the end of the economic life of the equipment
- The right-of-use asset is not impaired

Question 1: How should Commercial Bank account for the lease at lease commencement date?

Discussion: Commercial Bank should measure the lease liability by calculating the present value of the unpaid annual fixed lease payments of \$525,000 discounted at Commercial Bank's incremental borrowing rate of 5% (\$1,861,625). The right-of-use asset would be equal to the lease liability, plus \$525,000 rent paid on lease commencement date (\$2,386,625).

Although not included in the example, the right-of-use asset would be reduced by any lease incentives received from Commercial Bank on or before the lease commencement date and increased by initial direct costs incurred by Commercial Bank or lease payments made to Lessor Corp before the commencement date.

Lessee accounting model (cont'd)

Question 2: How should Commercial Bank subsequently measure the right-of-use asset and lease liability during the lease term?

Discussion: Commercial Bank would subsequently account for the lease liability and right-of-use asset as follows. The right-of-use asset would be amortized on a straight-line basis over the lease term because the remaining economic life of the leased equipment is greater than the lease term consistent with the principles in IAS 16, *Property, Plant and Equipment*.

	Payment	Principal*	Interest expense**	Lease liability	Right-of-use asset amortisation	Right-of use asset
Commencement	\$525,000***	\$525,000		\$1,861,625		\$2,386,625
Year 1	\$525,000	\$431,919	\$93,081	\$1,429,706	\$477,325	\$1,909,300
Year 2	\$525,000	\$453,515	\$71,485	\$976,191	\$477,325	\$1,431,975
Year 3	\$525,000	\$476,190	\$48,810	\$500,001	\$477,325	\$954,650
Year 4	\$525,000	\$500,001	\$24,999	\$ -	\$477,325	\$477,325
Year 5	\$ -	\$ -	\$ -	\$ -	\$477,325	\$ -
	\$2,625,000	\$1,861,625	\$238,375	\$ -	\$2,386,625	\$ -

* This would be classified as a financing outflow on the statement of cash flows.

** This would be classified as an operating or financing outflow on the statement of cash flow.

*** Initial payment was due at lease commencement date; therefore, the entire payment is a reduction of principal.

PwC observation:

The incremental borrowing rate is the rate of interest that a lessee would have to pay to borrow, over a similar term and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. When calculating the incremental borrowing rate, a lessee should consider the following:

- The rate calculated should be the rate at which the entity could borrow. The rate should not reflect the cost of equity finance and, as such, it would be inappropriate to use a WACC (or any other rate including a component 'cost of capital' alongside the cost of debt). Similarly, it would be inappropriate to use a transfer pricing rate (used for tax transfer pricing adjustments) because these are typically 'risk-free'. However, there might be scenarios in which these rates can be used as a starting point, provided that appropriate adjustments are made.
- The rate should reflect the amount that the entity could borrow over the term of the lease. It should be the rate at which an entity would borrow to acquire an asset of similar value to the right-of-use asset, rather than to acquire the entire underlying asset. An exception would be where the lease term is for substantially all of the life of the underlying asset.
- The rate should reflect that of a secured borrowing for a similar asset (being the right-of-use asset, not the underlying asset), rather than an unsecured borrowing or general line of credit.
- The rate should reflect the credit standing of the entity and the rate at which it would borrow in a similar economic environment. For example, if a company has GBP functional currency and typically borrows in GBP, but it enters into a US dollar lease, the incremental borrowing rate will reflect the cost of borrowing US dollars.

Lessee accounting model (cont'd)

Example 3 – Lease of space for installation of ATMs

Facts: Commercial Bank has automated teller machines (ATMs) for purposes of providing a self-service option to its depositors and customers. While Commercial Bank places many of its ATMs at its branches, it also enters into leases with third parties to place its ATMs in shopping centres and other strategic locations. The ATMs are built securely into the premises. The leases for space often have a non-cancellable term of 12 months with a 1-year renewal option. The rent during the renewal period would be the market rent at the time of exercise of the renewal option by Commercial Bank. Commercial Bank has exercised its renewal option for a majority of such leases in the past.

Question: How should Commercial Bank determine the lease term?

Discussion: In PSAK 73, a lessee may elect to not apply the recognition requirements of the standard to short-term leases (i.e., a lease that, at the commencement date, has a lease term of 12 months or less). This election should be made by class of underlying asset. If a lessee elects this short-term lease exemption, it should recognize the lease payments in net income on a straight-line basis over the lease term along with appropriate disclosures.

In evaluating whether or not the lease would be considered short term, at lease commencement date, Commercial Bank should consider the factors that create an economic incentive for exercise of the renewal option, including contract, asset, entity, or market-based factors. Commercial Bank should compare the renewal rents with the expected market rents for equivalent property under similar terms and conditions. In general, a renewal option with renewal rents that are equal to or greater than the rents in the initial lease term is not considered to be reasonably certain of exercise; however, this presumption could be overcome if the economic penalties the lessee would suffer by not exercising the renewal option are significant. For example, if Commercial Bank determines that there would be significant economic losses incurred if a lease is not renewed, such as the costs to relocate the ATM to another location (since it would be costly to uninstall a built-in ATM and re-install it another location) or lost economic benefits due to losing a strategic ATM location, Commercial Bank may conclude that exercise of the renewal option is reasonably certain. Although not determinative in isolation, the historical pattern of renewing its leases may indicate that there are factors that would commercially compel Commercial Bank to renew the lease.

If Commercial Bank is reasonably certain to exercise the renewal option, then the lease term is 24 months (the initial lease term plus the 1-year renewal option term) and consequently the exemption for short-term leases cannot be applied.

PwC observation:

Short-term leases are leases with a lease term of 12 months or less. The lease term also includes periods covered by an option to extend, or an option to terminate, if the lessee is reasonably certain to exercise the extension or to exercise the termination option. A lease that contains a purchase option is not a short-term lease. The exemption for short-term leases must be applied by class of underlying asset.

Lessee accounting model (cont'd)

Example 4 – Lease of computers and photocopiers

Facts: Commercial Bank leases desktop and laptop computers from IQ Technologies for a period of three years, for staff to use in the Head Office and branches. The desktop computers have an average value of £1,500 and the laptop computers have an average value of £2,000.

IQ Technologies also leases photocopier machines for a period of 5 years to Commercial Bank which are also used in the Head Office. The photocopiers have an average value of £800. The photocopiers which also have in-built fax machines have an average value of £1,000.

Question: Can Commercial Bank apply the low-value exemption to these leases?

Discussion: The analysis of low-value leases does not require the lessee to determine whether low-value assets in aggregate are material. The exemption is still available, even if the aggregate value of low-value leases is material to the lessee; i.e. Commercial Bank can assess the value of the desktop computers (£1,500), laptop computers (£2,000) and photocopiers (£800, £1,000) individually, rather than the total value of each of those portfolios which could be material to Commercial Bank.

The standard does not define the term 'low value', but its Basis for Conclusions of IFRS 16 explain that the IASB had in mind assets of a value of US\$5,000 or less when new. The amount of US\$5,000 is not a quantitative threshold but an example that the IASB has used to illustrate a general principle. PSAK also does not define the term 'low value' or provide any illustrative examples using a certain threshold.

Commercial Bank can apply the low-value asset exemption to the leased desktop computers, laptop computers and photocopiers. The desktop computers, laptop computers and photocopiers are not highly dependent on, or highly interrelated with, each other. Although, in practice, some of the desktop computers/laptop computers/photocopiers are used together within the Head Office/branches, Commercial Bank could remove one of the items from the Head Office/branches and still operate the Head Office/branches. Furthermore, the Commercial Bank can benefit from each of the leased assets on their own.

PwC observation:

The low-value exemption allows lessees to recognise the associated lease payments as an expense on either a straight-line basis over the lease term or another systematic basis. The lessee shall apply another systematic basis if that basis is more representative of the pattern of the lessee's benefit. Appropriate disclosure should be made if the exemption is taken.

In order to assess whether a leased asset qualifies for the low-value asset exemption, an entity should focus on the nature of the asset. Examples of assets of low value can include certain IT equipment (tablets and standard personal computers), office furniture, or telephones. Cars would not qualify as low-value assets, because a new car would typically not be of low value. The types of asset that qualify for the low-value asset exemption might change over time if, due to technological or market developments, the price of a particular type of asset changes. A change in the US dollar foreign currency exchange rate or the inflation rate does not, by itself, affect whether an asset is within the scope of the exemption.

A lease does not qualify as a lease of a low-value asset if a lessee sub-leases, or expects to sub-lease, the leased asset.

Initial direct costs

Initial direct costs are incremental costs of obtaining a lease that would not have been incurred had the lease not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease. For example, when a lessee and lessor execute a legally-binding lease commitment prior to drafting the lease agreement, incremental legal fees for drafting the legally-binding lease commitment may qualify as initial direct costs. However, incremental external legal fees would be excluded from the initial direct costs if the lessee would be required to pay its attorneys for negotiating the lease even if the lease were not executed.

The definition of initial direct costs has narrowed under the new leases standard compared to the definition under today's guidance. The new definition may not align with practices today or with similar definitions used in other areas of PSAK, such as transaction costs under PSAK 71, Financial Instruments. Under the new standard, only incremental direct costs associated with executing the lease, such as broker commissions, would be deferred. Payroll costs would generally not qualify for deferral.

Many banks are evaluated on their cost: income ratio, which compares expenses to income and is a measure of cost containment. Under PSAK 30, payroll costs for originating a lease may be deferred by a lessor, included in the yield calculation of a finance lease, and recognized as a reduction of return over its lease term. Under the new model, such costs are no longer deferred, but will need to be expensed as incurred directly through non-interest expense. In some cases, this may impact the bank's cost: income ratio. This will also have the effect of increasing net interest income over future periods for lessor portfolios.

Accounting for initial direct costs in a failed sale and leaseback transaction

An example of a sale and leaseback arrangement for a bank may be that a company sells an asset (such as a vehicle or aircraft) to the bank, and then the bank leases that asset back to the seller. Under the new sale and leaseback model applicable to both lessees and lessors, a sale and leaseback transaction will qualify as a sale only if control of the asset sold has transferred to the buyer, per the guidance in PSAK 72. For example, if the seller-lessee has a repurchase option then the PSAK 72 guidance on repurchase agreements will have to be applied to decide whether control of the asset has transferred to the buyer-lessor.

If a transaction does not qualify as a sale, (1) the seller-lessee would not derecognize the transferred asset and would reflect the proceeds from the sale and leaseback transaction as a borrowing and (2) the buyer-lessor (the bank) would reflect its cash payment as a loan and apply the general loan guidance under PSAK 71 which would then allow the broader definition of transaction costs to be used.

PwC observation

Lessors should assess how application of the new standard will impact line items such as interest income and non-interest expense when evaluating profitability and other metrics. They should also assess the impact the narrowing of the definition of initial direct costs may have on the cost income ratio.

Lessor accounting model

The accounting for leases by lessors has not significantly changed under PSAK 73; as under the current guidance, lessors will continue to determine whether a lease is a finance or operating lease.

PSAK 73 has clarified how lessors should account for lease agreements which have lease and non-lease components. Further details about components can be found on page 9. Contracts often combine different kinds of obligations of the supplier, which might be a combination of lease components or a combination of lease and non-lease components. For example, the lease of a property may contain the lease of a property and the provision of maintenance services. In a multi-element arrangement, an entity has to identify each separate lease component (based on the guidance on the definition of a lease) and account for it separately.

A lessor should allocate the contract consideration to each lease and non-lease component in accordance with the transaction price allocation guidance in the new revenue standard (PSAK 72). Any variable payments not based on an index or rate (or which are not in substance fixed) that relate to a lease component are excluded from the calculation of the overall contract consideration. This includes elements of variable consideration that would otherwise be included under the new revenue standard. The practical expedient available to a lessee for lease and non-lease components is not available to a lessor.



Glossary

DPK	<i>Dana Pihak Ketiga</i> or “third-party funds”
DSAK-IAI	<i>Dewan Standar Akuntansi Keuangan – Ikatan Akuntan Indonesia</i> or “Financial Accounting Standards Board – Indonesian Institute of Accountants”
IASB	International Accounting Standards Board
IFAS	Indonesian Financial Accounting Standards
IFRS	International Financial Reporting Standards
GAAP	Generally Accepted Accounting Principles
GWM	<i>Giro Wajib Minimum</i> or “Minimum Statutory Reserves”
LPS	<i>Lembaga Penjamin Simpanan</i>
NIM	Net Interest Margin
OJK	<i>Otoritas Jasa Keuangan</i> or “Financial Service Authority”
PSAK	<i>Pernyataan Standar Akuntansi Keuangan</i> or “Statement of Financial Accounting Standards”
SAK	<i>Standar Akuntansi Keuangan</i> or “Financial Accounting Standards”
WACC	Weighted Average Cost of Capital



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