

# PSAK 72 – Revenue from Contracts with Customers

**A comprehensive look at  
the new revenue model**



# At a glance

On 26 July 2017, the DSAK-IAI issued PSAK 72, a new standard for revenue recognition. PSAK 72 is adapted from IFRS 15 Revenue from Contracts with Customers. Almost all entities will be affected to some extent by the significant increase in required disclosures, but the changes extend beyond disclosures, and the effect on entities will vary depending on industry and current accounting practices. Entities will need to consider changes that might be necessary to information technology systems, processes, and internal controls to capture new data and address changes in financial reporting.

## Background

The objective of the revenue standard (PSAK 72) is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability within industries, across industries, and across capital markets.

The revenue standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognised. The underlying principle is that an entity will recognise revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services.

The revenue standard is effective for annual periods beginning on or after 1 January 2020. Early adoption is permitted.

This edition of In depth summarises the new revenue recognition model.

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# Key provisions

## Scope

The revenue standard applies to all contracts with customers, except for:

- lease contracts;
- insurance contracts;
- financial instruments and certain contractual rights or obligations within the scope of other standards;
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers; and
- certain guarantees within the scope of other standards (other than product or service warranties).

Revenue from a transaction or event that does not arise from a contract with a customer is not within the scope of the revenue standard and should continue to be accounted for in accordance with other standards. Such transactions or events include, but are not limited to: dividends; non-exchange-transactions; changes in the fair value of biological assets, investment properties and inventory of broker-traders.

Some contracts include components that are in the scope of the revenue standard and other components that are in the scope of other standards (for example, a contract that includes both a lease and maintenance services). An entity will apply the separation and/or measurement guidance in other standards first and then apply the guidance in the revenue standard. An entity will apply the revenue standard to separate and/or measure the components of the contract if other standards do not include separation or measurement guidance.

**PwC observation.** Management will need to evaluate arrangements with collaborators and partners to identify whether such arrangements or portions thereof are in the scope of the revenue standard. Arrangements where parties share risks and benefits are different from those where one entity obtains goods or services from the other.

For example, a biotechnology entity that has an agreement with a pharmaceutical entity to share equally in the development of a specific drug candidate is unlikely to be in the scope of the standard because the parties share the risks and benefits in developing the drug. The arrangement is likely to be in scope if the substance of the arrangement is that the biotechnology entity sells its compound to the pharmaceutical entity and/or provides research and development services. Management will also need to evaluate whether the arrangement contains elements of both collaboration with and a sale to a customer.

The revenue standard generally applies to an individual contract with a customer, and can be applied to a portfolio of contracts or performance obligations if the entity reasonably expects that the effect of applying a portfolio approach would not differ materially from considering each contract or performance obligation separately. Some entities enter into contracts with a large number of customers, all of which have the same or similar terms and conditions. It is appropriate in these situations to consider whether the revenue standard could be applied to a portfolio of contracts or performance obligations.

## The five-step approach

Entities will follow a five-step approach to apply the standard:

- Step 1: Identify the contract(s) with the customer
- Step 2: Identify the separate performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to separate performance obligations
- Step 5: Recognise revenue when (or as) each performance obligation is satisfied

### Step 1: Identify the contract(s) with the customer

A contract is an agreement between parties that creates enforceable rights and obligations. It can be written, oral, or implied by an entity's customary business practice. Generally, any agreement that creates enforceable rights and obligations will meet the definition of a contract. An entity will apply the revenue standard to each contract with a customer when all of the following criteria are met:

- a. The parties have approved the contract and intend to perform their respective obligations.
- b. Each party's rights regarding the goods or services to be transferred can be identified.
- c. The payment terms can be identified.
- d. The risk, timing, or amount of the entity's future cash flows are expected to change (that is, the contract has commercial substance).
- e. It is probable that the entity will collect the consideration to which it will be entitled in exchange for goods or services transferred.

An entity will reassess whether the criteria are met each reporting period to determine if the criteria are subsequently met if they are not met at contract inception. An entity that receives consideration from the customer when the criteria are not met will not recognise revenue until either:

- a. the entity has no remaining performance obligations and substantially all the consideration is received and non-refundable, or

- b. the contract is terminated and amounts received are non-refundable.

### Collectability

An entity will assess at the inception of the contract whether it is probable it will collect the transaction price. This assessment determines whether a contract exists for the purpose of applying the revenue standard.

The collectability assessment is based on the customer's ability and intent to pay as amounts become due, after considering any price concessions the entity expects to provide. An entity will consider credit risk, but not other uncertainties, such as those related to performance or measurement, as these are accounted for separately as part of determining the measurement and timing of revenue.

Credit losses arising from a contract whose collection was probable at inception will be recognised as an expense in the income statement. This expense will be measured in accordance with the relevant financial instrument standards. An entity will only reassess whether it is probable it will receive payment (and thus, whether a contract exists for the purpose of applying the revenue guidance) if there is an indication of a significant change in facts and circumstances, such as a significant deterioration in a customer's ability to pay for the remaining goods and services.

**PwC observation.** In most cases, an entity will not enter into a contract with a customer when there is significant credit risk without also having adequate economic protection. Judgement is required to determine the accounting when there is a significant deterioration in a customer's ability to pay after the inception of an arrangement. Management will have to assess whether the deterioration relates to performance obligations previously satisfied, performance obligations to be performed in the future, or both.

### **Contract combination**

Contracts will be combined and accounted for as a single contract only if they are entered into at or near the same time, with the same customer (or related parties), and one or more of the following criteria are met:

- a. The contracts achieve a single commercial objective and are negotiated as a package.
- b. The price or performance of one contract influences the amount of consideration to be paid in the other contract.
- c. The goods or services in the separate contracts represent a single performance obligation.

### **Contract modifications**

A contract modification occurs when the parties approve a change that either creates new or changes existing enforceable rights and obligations. Approval can be in writing, oral, or implied by customary business practice. Management will need to determine when a modification, such as a claim or unpriced change order, is approved and therefore creates enforceable rights and obligations. An entity will not account for a modification until it is approved; that is, it will continue to apply the revenue standard to the existing contract.

A contract modification is treated as a separate contract if the modification adds one or more distinct performance obligations to the contract and the price increases by an amount that reflects the stand-alone selling price of the additional distinct performance obligation(s). Otherwise, a modification is accounted for as an adjustment to the original contract, either prospectively or through a cumulative catch-up adjustment depending on whether the remaining goods or services in the contract are distinct.

An entity will account for a modification prospectively if the goods or services in the modification are distinct from those transferred before the modification. The remaining consideration in the original contract not yet recognised as revenue is combined with the additional consideration promised in the modification to create a new transaction price that is then allocated to all remaining performance obligations (that is, both those not yet completed in the original contract and those added through the modification). This effectively

accounts for the modification as a termination of the original contract and the inception of a new contract for all performance obligations that remain unperformed.

An entity will account for a modification through a cumulative catch-up adjustment if the goods or services in the modification are not distinct from those in the original contract and are thus part of a single performance obligation that is only partially satisfied. The measure of progress towards satisfying the performance obligation is updated to reflect performance completed and performance that remains.

A change to only the transaction price will be treated like any other contract modification. The change in price will be either accounted for prospectively or on a cumulative catch-up basis, depending on whether the remaining performance obligations are distinct.

**PwC observation.** Accounting guidance for contract modifications did not previously exist for most industries and arrangements. The new guidance therefore provides structure in an area where practice was previously mixed. Management will need to apply judgement when evaluating whether goods or services in a modification are distinct, and whether the price reflects the stand-alone selling price to determine the accounting. This might be more challenging in situations where there are multiple performance obligations in a contract, or when modifications occur frequently.

### ***Step 2: Identify the separate performance obligations in the contract***

A performance obligation is a promise to transfer a distinct good or service (or a series of distinct goods or services that are substantially the same and have the same pattern of transfer) to a customer. The promise can be explicit, implicit, or implied by an entity's customary business practice. The objective of identifying distinct performance obligations is to depict the transfer of goods or services to the customer. Identifying performance obligations is more challenging when there are multiple explicit or implicit promises in a contract.

Explicit and implicit promises in a contract to provide goods or services, including promises to provide goods or services that a customer can resell or provide to its customer (an ‘end customer’), are performance obligations, even if they are satisfied by another party.

Management will need to determine whether promises are distinct when there are multiple promises in a contract. This is important because distinct performance obligations are the units of account that determine when and how revenue is recognised.

A good or service is distinct only if:

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

A customer can benefit from a good or service on its own if it can be used, consumed, or sold to generate economic benefits. A good or service that cannot be used on its own, but can be used with readily available resources, is still distinct, as the entity has the ability to benefit from it. A readily available resource is one that is sold by the entity, by others in the market, or that a customer has already obtained from the entity.

Determining whether a good or service is distinct within the context of the contract requires assessment of the contract terms and the intent of the parties. Indicators include, but are not limited to:

- The entity does not provide a significant service of integrating the individual goods or services in the contract into a bundle that is the combined item the customer has contracted to receive.
- The good or service does not customise or significantly modify another contractually promised good or service.
- The good or service is not highly dependent on or highly interrelated with other goods or services in the contract; therefore, a customer’s decision to not purchase a good or service does not significantly affect the other promised goods or services in the contract.

**PwC observation.** The revenue standard provides indicators rather than criteria to determine when a good or service is distinct within the context of the contract. This allows management to apply judgement to determine the separate performance obligations that best reflect the economic substance of a transaction. All promises in an arrangement should be identified. Promises that are inconsequential or perfunctory need to be identified, even if they are not the ‘main’ deliverable in the arrangement, because all promises in a contract are goods or services that a customer expects to receive. An entity should assess whether inconsequential or perfunctory performance obligations are immaterial to the financial statements.

Goods or services that are not distinct should be combined with other goods or services until the entity identifies a bundle of goods or services that is distinct.

### **Step 3: Determine the transaction price**

The transaction price is the amount of consideration that an entity expects to be entitled to in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of a third party (for example, some sales taxes). Determining the transaction price is more complex if the arrangement involves a variable consideration, a significant financing component, a non-cash consideration, or a consideration payable to a customer.

#### **Variable consideration and the constraint on revenue recognition**

The transaction price might include an element of consideration that is variable or contingent on the outcome of future events, including (but not limited to) discounts, refunds, rebates, credits, incentives, performance bonuses, and royalties. A consideration can also vary if an entity’s ability to retain a fixed amount of the consideration is contingent upon a future event. An entity’s practices, policies, or statements might also result in a variable consideration, for example, if they indicate the entity will provide price concessions.

Variable considerations should be estimated using the more predicative of the following approaches: the expected value or the most likely amount. The expected-value approach represents the sum of probability-weighted amounts for various possible outcomes. The most likely amount represents the most likely amount in a range of possible amounts. The approach used is not a policy choice: management should use the approach that it expects will best predict the amount of consideration to which the entity will be entitled based on the terms of the contract and taking into account all reasonably available information. The approach used should also be applied consistently throughout the contract.

A variable consideration included in the transaction price is subject to a constraint. An entity should recognise revenue as performance obligations are satisfied only if it is highly probable that a change in the estimate of the variable consideration would not result in a significant reversal of the cumulative revenue recognised. This assessment will often require judgement.

The following indicators suggest that including an estimate of a variable consideration in the transaction price could result in a significant reversal of cumulative revenue:

- The amount of the consideration is highly susceptible to factors outside the entity's influence.
- Resolution of the uncertainty about the amount of the consideration is not expected for a long period of time.
- The entity has limited experience with similar types of contracts.
- The entity has a practice of offering a broad range of price concessions or changing payment terms and conditions in similar circumstances for similar contracts.
- There is a large number and broad range of possible outcomes.

Management will need to determine if there is a portion of the variable consideration (that is, some minimum amount) that should be included in the transaction price, even if the entire estimate of variable consideration is not included due to the constraint. Management's estimate of the transaction price will be reassessed each reporting period, including any estimated minimum variable consideration.

The constraint also applies to contracts with a fixed price if it is uncertain whether the entity will

be entitled to all of the consideration even after the performance obligation is satisfied. One example is an entity that enters into a contract with a customer to provide legal services in return for a fixed fee, but the entity will only be paid if the court rules in favour of the customer. The entity might not be able to recognise revenue until the court rules on the case, even though the legal services have been provided. However, if management considers it highly probable that the fee is not subject to significant reversal of cumulative revenue, the entity will recognise revenue prior to the court's ruling.

Performance-based incentive fees (for example, fees that vary based on the achievement of a contract milestone or an investment portfolio's performance) are also variable considerations and therefore subject to the constraint.

**PwC observation.** The reach of the variable-consideration guidance introduced in the revenue standard is broad and includes amounts that historically might not have been viewed as variable consideration. For example, fixed amounts that an entity is entitled to only upon the achievement of certain events are variable considerations under the revenue standard and included in the transaction price subject to the constraint. Management will need to think broadly about amounts, whether fixed or variable, that will be accounted for as variable considerations.

The evaluation of variable considerations will require judgement in many cases. Entities that defer revenue recognition under current guidance because the price is not reliably measurable could be significantly affected by the new standard. An example is a situation where the price is fixed, but the entity has a history of granting concessions. Entities could be required to recognise some minimum amount of revenue when control transfers as opposed to waiting until the extent of price concessions is resolved. This is because it is unlikely that an entity would be willing to grant a concession for 100% of the price.

New processes might be needed for making and monitoring estimates of variable considerations on an ongoing basis. Concurrent documentation of the judgements considered in making estimates will also be important.



The standard includes a narrow exception to the constraint on variable considerations for sales- or usage-based royalties on licences of intellectual property (IP). Royalties from licences of IP are not included in the transaction price until they are no longer variable (that is, when the customer's subsequent sales or usage occur). The exception is limited to sales- or usage-based licences of IP and will not apply to other royalty arrangements, and should not be applied by analogy.

**PwC observation.** Management will need to apply judgement to determine whether an arrangement qualifies for the exception to the overall variable-consideration constraint, given that neither 'intellectual property' nor 'royalty' are defined in IFAS. The boundaries for determining when the sales- and usage-based exception applies might be an area of the new standard that is subject to further clarification.

An outright sale of IP, for example, does not appear to qualify for the exception. It is unclear whether a perpetual licence, which is typically viewed as an in-substance sale, will qualify for the exception. The exception also does not appear to apply if the licence is not distinct from other promised goods or services in an arrangement. Even if the licence is distinct, it appears that the entity will need to conclude that the contingent consideration (that is, the sales- or usage-based royalty) relates specifically to the licence and not to other performance obligations in the arrangement for the exception to apply.

Certain fixed payments might be in-substance sales-based royalties and therefore subject to the exception. An example is an arrangement that requires a licensee to make a fixed payment that is subject to 'claw back' if the licensee does not meet certain sales or usage targets.

### *Significant financing component*

The transaction price should be adjusted for any significant financing component in the arrangement. A practical expedient allows entities to disregard the time value of money if the period between transfer of the goods or services and payment is less than one year, even if the contract itself is for more than one year. In assessing whether a contract contains a significant financing component, an entity should consider various factors, including:

- the length of time between when the entity transfers the goods or services to the customer and when the customer pays for them;
- whether the amount of consideration would substantially differ if the customer paid cash when the goods or services were transferred; and
- the interest rate in the contract and prevailing interest rates in the relevant market.

An entity that is paid in advance for goods or services need not reflect the effects of the time value of money when the timing of transfer of those goods or services is at the customer's discretion. For example, if a customer purchases a prepaid phone card from a telecom entity and uses the prepaid airtime at its discretion, the time value of money need not be considered. Another example is a customer-loyalty program where the customer can redeem the points awarded by the entity at its discretion. Those entities will not be required to account for time value of money even though there could be a significant timing difference between payment and performance.

There are two additional situations in which a significant financing component is not present. The first is when a substantial amount of the promised consideration is variable and the amount, or amount and timing, of payment varies due to factors outside the control of the entity or customer (for example, a sales-based royalty). The other is when the difference between the contractual consideration and the cash selling price arises for reasons other than the granting of finance to the entity or the customer (for example, protection against non-performance). The second situation allows entities to consider the intent of the parties when assessing whether a significant financing component is present.

The amount of revenue recognised will be different from the amount of cash received from the customer when an arrangement contains a significant financing component. Revenue recognised will be less than cash received when payments are made after performance, because the entity is providing the customer with financing. A portion of the consideration will be recognised as interest income. Revenue recognised will exceed the cash received for payments made in advance of performance, because the entity receives financing from the customer. The entity will recognise interest expense on the financing related to advance payments.

An entity needs to determine the discount rate to use when calculating the interest element of a significant financing component. The entity should use a discount rate that reflects what it would charge in a separate financing transaction with the customer, including consideration of any collateral or guarantees it would require. An entity receiving a significant financing benefit (for example, because it received an advance payment) should consider its incremental borrowing rate to determine the interest rate. The discount rate is not reassessed after inception of the contract.

**PwC observation.** Management will need to evaluate arrangements with customers to determine whether they include a significant financing component. The guidance related to a significant financing component is different than current guidance related to applying the time value of money.

In some cases it will be clear that a significant financing component exists due to the terms of the arrangement. In other cases it could be challenging to determine whether a significant financing component exists, especially in some long-term arrangements with multiple performance obligations if goods or services are delivered and cash payments received throughout the arrangement. The standard allows for some level of judgement by requiring entities to assess whether the substance of the payment arrangement is a financing.

For example, a software entity agrees to provide three years of post-contract customer support (PCS) for C600, which

the customer pays upfront and can renew for C200 annually after the initial three-year period. The entity will need to consider whether there is a significant financing component because the customer paid C600 in advance, but there is no discount for paying upfront as compared to the annual pricing (C200 per year). If the advance payment is required for reasons other than obtaining financing, such as for business purposes to obtain a longer-term contract, then the entity would conclude that a significant financing obligation does not exist.

An entity with contracts that include a significant financing component should consider any operational challenges relating to measuring and tracking the interest element of the arrangement. This could require additional information technology systems, processes, or internal controls to capture and measure such information.

### **Non-cash consideration**

An entity will measure any non-cash consideration exchanged in the transaction (including equity of the customer) at its fair value to determine the transaction price. An entity will measure the consideration indirectly by reference to the stand-alone selling price of the goods or services promised in the arrangement if it cannot reasonably estimate the fair value of the non-cash consideration.

An entity could have a customer that contributes goods or services (for example, materials or labour) to facilitate the fulfilment of a contract. The entity will need to assess whether it obtains control of those contributed goods or services to determine whether they are non-cash consideration and therefore revenue to the entity.

### **Consideration payable to a customer**

A consideration paid (or expected to be paid) to a customer or to a customer's customer reduces the transaction price unless the payment is made in exchange for a distinct good or service that the customer transfers to the entity. The definition of 'distinct' is consistent with the guidance in step 2 for identifying performance obligations (see

page 6). An entity will recognise the reduction of revenue in the later of:

- the period the entity recognises revenue for the transfer of the promised goods or services; or
- the period the entity pays or promises to pay the consideration (even if the payment is conditional on a future event).

A consideration paid or payable to a customer (or to other parties that purchase the entity's goods or services from the customer) includes cash, credits, or other items that can be applied to amounts owed to the entity. For example, a coupon or voucher that an end customer can redeem to reduce the purchase price of the entity's goods sold through a distributor is a consideration payable to a customer.

A consideration that is a payment for a distinct good or service is accounted for consistently with how an entity accounts for other purchases from suppliers. If a consideration paid for distinct goods or services is above the fair value of those goods or services, any excess is recorded as a reduction of the transaction price.

#### **Step 4: Allocate the transaction price to separate performance obligations**

The transaction price is allocated to the separate performance obligations in a contract based on the relative stand-alone selling prices of the goods or services promised. This allocation is made at contract inception and not adjusted to reflect subsequent changes in the stand-alone selling prices of those goods or services.

The best evidence of stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately. Management will need to estimate the selling price of goods or services that do not have an observable stand-alone selling price, and should maximise the use of observable inputs when making that estimate. Possible estimation methods include, but are not limited to:

- expected cost plus an appropriate margin;
- assessment of market prices for similar goods or services adjusted for entity-specific costs and margins; and
- residual approach, in limited circumstances.

**PwC observation.** The revenue standard requires entities to allocate the transaction price to each separate performance obligation. Under current guidance, entities generally allocate the consideration to individual components or deliverables in an arrangement.

#### **Residual approach**

A residual approach can only be used to calculate the stand-alone selling price of a distinct good or service if the selling price is highly variable or uncertain. It can be applied regardless of whether that good or service is delivered at the beginning or at the end of the contract.

A selling price is highly variable when an entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts. A selling price is uncertain when an entity has not yet established a price for a good or service and it has not been sold previously.

The residual approach requires that an entity first determine if any discounts need to be allocated to specific performance obligations in accordance with the guidance in the next paragraph ('allocating discounts and variable consideration') prior to using the residual approach to determine the stand-alone selling price of the remaining item(s). If the discount is not allocated to specific performance obligations, management will allocate the discount proportionately to all performance obligations in the contract. When a residual approach is used, judgement will be needed to determine if the amount allocated to the item faithfully depicts the amount of consideration to which the entity expects to be entitled. The residual approach cannot be used, for example, if it results in a very low amount or no consideration allocated to an item.

**PwC observation.** The residual approach is different from the residual method that is used by some entities today (for example, software companies). Applying today's residual method results in the entire discount in an arrangement being allocated to the first item delivered under the contract. This will not be the case under the new guidance because discounts will typically be allocated proportionately to all items.

Use of the residual approach should be limited and it will be used less frequently than the residual method is used today. An entity that applies the residual method today should not presume it will be able to use a residual approach to estimate selling price under the new standard, and should not expect the residual method and the residual approach to have identical results.

### **Allocating discounts and variable consideration**

Discounts and variable considerations will typically be allocated proportionately to all of the performance obligations in the contract. If certain conditions are met, a discount or variable consideration can be allocated to one or more separate performance obligations, rather than to all performance obligations in the arrangement.

An entity should allocate a discount entirely to one or more performance obligation(s) if all of the following criteria are met:

- The entity regularly sells each distinct good or service (or each bundle of distinct goods or services) on a stand-alone basis.
- The entity regularly sells, on a stand-alone basis, a bundle of some of those goods or services at a discount to the stand-alone selling prices of the goods or services in that bundle.
- The discount attributable to the bundle of goods or services is substantially the same as the discount in the contract.

**PwC observation.** An arrangement will need to include at least three performance obligations to apply this guidance, as the entity will need to sell at least two performance obligations together regularly to evidence that a subset of the arrangement is separately sold at the discount. The revenue standard includes multiple examples to illustrate how an entity will allocate discounts and variable consideration.

Changes in the estimate of a variable consideration should be allocated entirely to a performance obligation, or to a distinct good or service that forms part of a single performance obligation, if both of the following criteria are met:

- The variable payment relates to a specific performance obligation or outcome from satisfying that performance obligation.
- Allocating the variable amount of the consideration entirely to the separate performance obligation is consistent with the amount of consideration that the entity expects to be entitled to for satisfying that performance obligation after considering all other performance obligations and payment terms in the contract.

### ***Step 5: Recognise revenue when (or as) each performance obligation is satisfied***

The final step in the model is recognising revenue. An entity will recognise revenue when (or as) a good or service is transferred to the customer and the customer obtains control of that good or service. Control of an asset refers to an entity's ability to direct the use of and obtain substantially all of the remaining benefits (that is, the potential cash inflows or savings in outflows) from the asset. Directing use of an asset refers to a customer's right to deploy that asset, to allow another entity to deploy that asset in its activities, or to restrict another entity from deploying that asset.

**PwC observation.** The standard requires management to determine when control of a good or service has transferred to the customer. The timing of revenue recognition could change for some transactions compared to current guidance, which is more focused on the transfer of risks and rewards. The transfer of risks and rewards is an indicator of whether control has transferred, but additional indicators will also need to be considered. For example, an entity that transfers control of a good to a customer but retains some economic risks might need to record revenue when the good transfers, while under existing guidance revenue recognition might be delayed until all of the economic risks have also transferred.

An entity should determine at contract inception whether control of a good or service is transferred over time or at a point in time. This determination should depict the transfer of benefits to the customer and should be evaluated from the customer's perspective. An entity should first assess whether the performance obligation is satisfied over time. If not, the good or service transfers at a point in time.

#### **Performance obligations satisfied over time**

An entity will recognise revenue over time if any of the following criteria are met:

- The customer concurrently receives and consumes the benefits provided by the entity's performance as the entity performs.
- The entity's performance creates or enhances a customer-controlled asset.
- The entity's performance does not create an asset with an alternative use and the entity has a right to payment for performance completed to date.

The first criterion generally addresses service contracts where no asset is created and the customer consumes the services as they are provided. The performance obligation is satisfied over time if another entity would not have to substantially re-perform the work completed to date to fulfil the remaining obligation to the customer. For example, a contract with a customer to provide daily cleaning services of an office building would meet this criterion. Contractual or practical limitations that prevent an entity from

transferring a remaining performance obligation to another entity are not considered in this evaluation.

The second criterion addresses transactions where an asset is created or enhanced and the customer controls that asset as it is created. This applies in situations where the customer controls the work-in-progress as the entity manufactures goods. For example, it is common in transactions with a government that the government entity (the customer) controls any work-in-progress or other output of the contract. Management should apply the guidance on transfer of control to determine whether the customer obtains control of the asset as it is created.

The last criterion addresses situations where the customer does not control an asset as it is created, or no asset is created by the entity's performance. Management will need to consider whether the asset being created has an alternative use to the entity (if an asset is created) and whether the entity has an enforceable right to payment for performance to date.

The assessment of whether an asset has an alternative use should be made at contract inception, and not reassessed. Management should consider its ability to redirect a product that is partially completed to another customer, considering both contractual and practical limitations. A substantive contractual restriction that limits management's ability to redirect the asset could indicate the asset has no alternative use. Practical limitations, such as significant costs required to rework the asset so it could be directed to another customer, could also indicate that the asset has no alternative use.

A right to payment exists if an entity is entitled to payment for performance completed to date if the customer terminates the contract for reasons other than the entity's non-performance. A specified payment schedule does not, by itself, indicate the entity has a right to payment for performance to date. The assessment of the enforceability of the right to payment should include consideration of the contract terms and any legal precedent that could override the contract terms.

The right to payment should compensate the entity at an amount that reflects the selling price of the goods or services provided to date, rather than provide compensation for only costs incurred to date or the entity's potential loss of profit if the contract is terminated. This would be an amount that covers an entity's cost plus a reasonable profit margin for work completed.

**PwC observation.** Management will need to apply judgement to assess the criteria for performance obligations satisfied over time, especially when assessing whether assets have an alternative use and whether the entity has a right to payment for performance completed to date. For example, management will need to assess whether there is a substantive reason for restrictions on transfer of the asset(s) to another party in a contract to determine whether assets have an alternative use.

Manufacturers of large volumes of homogeneous goods produced to a customer's specification might be surprised to find that they could meet the criteria for performance obligations satisfied over time. This is because (1) such goods often have no alternative use to the entity given their customisation or contractual restrictions, and (2) the payment terms in these arrangements might include a protective clause that provides for payment for performance to date in the event the contract is cancelled.

Entities that manufacture these types of goods could be required to recognise revenue as the goods are produced, rather than when they are delivered to the customer. Differences in payment terms could result in the goods being treated as a performance obligation satisfied over time in one case and as inventory transferred at a point in time in another. The 'right to payment' criterion might not be satisfied if the customer only provides reimbursement for the cost of units in production.

### **Performance obligations satisfied at a point in time**

An entity will recognise revenue at a point in time (when control transfers) for performance obligations that do not meet the criteria for recognition of revenue over time.

To determine when a customer obtains control and an entity satisfies a performance obligation, the entity should consider the definition of transfer of control on pages 11-12 and the following indicators:

- The entity has a present right to payment for the asset.

- The entity has transferred legal title to the asset.
- The entity has transferred physical possession of the asset.
- The entity has transferred the significant risk and rewards of ownership to the customer.
- The customer has accepted the asset.

**PwC observation.** All of the indicators above do not need to be satisfied for revenue to be recognised at a point in time. The standard does not place more weight on one indicator over another. An entity will need to consider all indicators, not just whether significant risk and rewards have transferred, to determine when revenue should be recognised.

### **Measuring progress toward satisfying a performance obligation**

For a performance obligation satisfied over time, the objective is to recognise revenue in a manner that depicts the transfer of control of the promised goods or services to the customer. Methods for measuring progress include:

- output methods, such as units produced or delivered, contract milestones, or surveys of work performed; and
- input methods, such as costs incurred, labour hours expended, time elapsed, or machine hours used.

Entities using an input method to measure progress should exclude the effects of inputs that do not depict the transfer of control to the customer. An entity sometimes receives materials that a customer controls prior to when those materials are used in the good or service the entity is providing (uninstalled materials). An entity might also incur costs that are attributable to significant inefficiencies in the entity's performance that were not considered in determining the contract price. These situations can create challenges if an entity is using an input method to measure progress. The measure of progress should be adjusted to ensure that it depicts the entity's performance. The standard includes an example that illustrates how management will recognise revenue when significant materials are delivered prior to installation.

Revenue should only be recognised for a performance obligation satisfied over time if the entity can reasonably measure its progress toward complete satisfaction. An entity must have reliable information that can be applied to an appropriate method of measuring progress to meet this objective. An entity that cannot reasonably measure the outcome of a performance obligation, but expects to recover the costs incurred, should recognise revenue only to the extent of the costs until a reliable measure of progress can be made.

### **Other considerations**

Several issues exist beyond applying the five steps of the model. The revenue standard provides guidance in the following areas to assist entities in applying the model.

#### **Licences**

A licence establishes a customer's rights related to an entity's IP and the entity's obligations related to those rights. Licences of IP include, among others: software and technology rights; media and entertainment rights; franchises; patents; trademarks; and copyrights. Licences can vary significantly and include different features and economic characteristics, which can lead to significant differences in the rights provided.

An entity should first consider the guidance for distinct performance obligations to determine if a licence is distinct from other goods or services in an arrangement. An entity will combine licences that are not distinct with other goods and services in the contract and recognise revenue when it satisfies the combined performance obligation. Examples of licences that are not distinct include a licence that is integral to the functionality of a tangible good (such as software included on a hardware device) or a licence that the customer can benefit from only in conjunction with a related service (such as access to online internet content).

The nature of the rights provided in some licence arrangements is to allow access to the entity's IP as it exists throughout the licence period. Licences that provide access are performance obligations satisfied over time and, therefore, revenue is recognised over time. The nature of the rights in other transactions is to provide a right to use the entity's IP as it exists at the point in time the licence is granted. Licences that provide a right to use an entity's IP are performance obligations satisfied at a point in time, with revenue recognised when control transfers to the licensee and the licence period begins.

Distinct licences that meet all of the following three criteria provide access to IP (and, thus, revenue is recognised over time):

- The licensor will undertake (either contractually or based on customary business practices) activities that significantly affect the IP to which the customer has rights.
- The licensor's activities do not otherwise transfer a good or service to the customer as they occur.
- The rights granted by the licence directly expose the customer to any effects (both positive and negative) of those activities on the IP and the customer entered into the contract with the intent of being exposed to those effects.

The first criterion requires an assessment of whether a licensor might undertake activities that significantly affect the IP. These activities might result from published policies or customary practices, or they might be the result of the existence of a shared economic interest between the licensor and customer.

The second criterion requires that the activities that might affect the IP are not additional performance obligations in the contract. Activities are not performance obligations if they do not directly transfer goods or services to a customer. A customer might be affected by the activities because they affect the IP; however, this effect could be either positive or negative.

The third criterion requires that the effects (positive or negative) of any activities identified in the first criterion impact the customer. Activities that do not affect what the licence provides to the customer or what the customer controls do not meet this criterion.

**PwC observation.** The revenue standard includes a number of examples that illustrate how an entity should apply the criteria to different licence arrangements. Applying these criteria could be challenging and will require judgement, especially to determine what constitutes an activity rather than a separate performance obligation. Different accounting conclusions might be reached for arrangements that appear to be similar, which could make comparability across entities and industries more challenging.

### Contract costs

An entity should recognise an asset for the incremental costs to obtain a contract if management expects to recover those costs. Incremental costs of obtaining a contract are costs the entity would not have incurred if the contract had not been obtained (for example, sales commissions). Costs that the entity would have incurred if the contract had not been obtained, such as facilities costs and sales force salaries, are not capitalised. An entity can elect to expense the cost of obtaining a contract if the amortisation period would be one year or less.

An entity will recognise an asset for costs to fulfil a contract if those costs:

- relate directly to a contract or anticipated contract that the entity can specifically identify;
- generate or enhance the entity's resources that will be used to satisfy future performance obligations; and
- are expected to be recovered.

Management will need to consider whether costs to fulfil a contract should be accounted for in accordance with other standards (for example, inventory, fixed assets, or intangible assets) before applying the revenue standard. Costs that relate to satisfied performance obligations are expensed as incurred.

**PwC observation.** The guidance on contract costs is expected to result in the recognition of more assets than under current practice. Entities that expense sales commissions as paid and set-up costs as incurred could now be required to capitalise and amortise these costs if they are recoverable.

An asset recognised for the costs to obtain or fulfil a contract will be amortised on a systematic basis as the goods or services to which the assets relate are transferred to the customer. The asset will also be assessed for impairment each reporting period.

### Repurchase agreements

An entity that has an obligation or right to repurchase an asset (a forward or a call option) has not transferred control of the asset to the

customer because the customer is limited in its ability to direct the use of and obtain substantially all of the remaining benefit from the asset. An entity will account for the contract as a lease if the entity can or must repurchase the asset for a price that is less than the original selling price, unless the contract is part of a sale-leaseback transaction. An entity will account for a contract as financing if it can or must repurchase the asset for a price that is equal to or greater than the original selling price of the asset. When comparing the repurchase price to the selling price an entity should consider the time value of money.

An arrangement where a customer has the right to require the entity to repurchase an asset (a put option) at a repurchase price less than the original selling price will be accounted for as a lease if the arrangement provides the customer a significant economic incentive to exercise that right, unless the contract is part of a sale-leaseback transaction. The arrangement is a financing if the repurchase price of the asset is equal to or exceeds the original selling price and is more than the expected market value of the asset.

An arrangement is a sale of a product with a right of return, as discussed in paragraph 91, if the customer has a repurchase right at an amount less than the original selling price (or greater than or equal to the original selling price but less than the expected market value), but does not have a significant economic incentive to exercise that right.

### Principal versus agent

Entities often involve third parties when providing goods and services to their customers. Management needs to assess, for each performance obligation in a contract, whether the entity is acting as the principal or as an agent in such arrangements. An entity recognises revenue on a gross basis if it is the principal in the arrangement, and on a net basis (that is, equal to the fee or commission received) if it is acting as an agent.

An entity is the principal in an arrangement if it obtains control of the goods or services of another party in advance of transferring control of those goods or services to a customer. The entity is an agent if its performance obligation is to arrange for another party to provide the goods or services. An entity will need to evaluate if and when it obtains



control. If an entity obtains legal title to a product only momentarily before the title is transferred to the customer, this does not necessarily indicate that the entity is acting as the principal in the arrangement.

Indicators that the entity is an agent include:

- Fulfilment - The entity does not have primary responsibility for fulfilment of the contract.
- Inventory risk - The entity does not have inventory risk at any point during the transaction (that is, before the order, during shipment, or upon return).
- Pricing - The entity does not have discretion in establishing prices for the other party's good or service.
- Credit risk - The entity does not have customer credit risk for the amount of the receivable.
- Commission - The entity's consideration is in the form of a commission.

**PwC observation.** The indicators in the revenue standard are similar to the current standard. However, the specific requirement for the entity to obtain control differs from current guidance. The revenue standard does not weigh any of the indicators more heavily than others. New and evolving business models, especially related to internet transactions, have resulted in an increased focus in this area. We expect that entities will continue to apply judgement to assess whether to recognise revenue on a gross or net basis for many of these transactions, similar to today.

### Options to acquire additional goods or services

Entities often grant customers the option to acquire additional goods or services free of charge or at a discount. These options might include customer award credits or other sales incentives and discounts, such as volume discounts. An option gives rise to a separate performance obligation if it provides a material right to the customer that the customer would not receive without entering into the contract. The entity will recognise revenue allocated to an option when the

additional goods or services are transferred to the customer, or the option expires.

An example of a material right is a discount that is incremental to the range of discounts typically given to a similar class of customers in the same market. The customer is effectively paying in advance for future goods or services and therefore revenue is recognised when those future goods or services are transferred.

Management will need to determine the stand-alone selling price for the option. Often the option will not have a directly observable selling price; therefore, management will need to estimate the stand-alone selling price. This estimate is adjusted for any discount the customer would receive without exercising the option and the likelihood that the customer will exercise the option. The revenue standard includes several examples related to customer options as well as the treatment of unexercised rights.

**PwC observation.** The guidance related to options that provide the customer with a material right could have a significant effect on entities in a number of industries. For example, entities within the retail and consumer industry that provide customers with a loyalty program will need to consider whether the rewards issued by the program provide a material right. A portion of the transaction price will be allocated to the reward if it is a material right and a distinct performance obligation.

### Rights of return

An entity will account for the sale of goods with a right of return by recognising revenue for the consideration it expects to be entitled to (considering the products expected to be returned) and a liability for the refund it expects to pay to customers, similar to current accounting under IFAS. Amounts are updated for changes in expected returns each reporting period. Exchanges by customers for products of the same type, quality, condition, and price are not considered returns.

The entity will recognise an asset and corresponding adjustment to cost of sales for the right to recover goods from customers. The

asset is initially measured at the original cost of the goods less any expected costs to recover those goods. Impairment is assessed at each reporting date. The entity should present the asset separately from the refund liability (that is, the entity should not present a net balance in the financial statements). The revenue standard includes an example that illustrates the journal entries that an entity would record to account for estimated product returns.

### **Warranties**

An entity accounts for a warranty as a separate performance obligation if the customer has the option to purchase the warranty separately. An entity accounts for a warranty as a cost accrual if it is not sold separately, unless the warranty is to provide the customer with a service in addition to assurance that the product complies with agreed-upon specifications.

An entity should consider factors such as whether the warranty is required by law, the length of the warranty period, and the nature of the tasks the entity has promised to perform as part of the warranty to determine whether the warranty provides the customer with an additional service. Judgement will be required in this assessment. The portion of a warranty that provides a service in addition to assurance that the product complies with specifications is accounted for as a separate performance obligation. An entity that cannot reasonably separate the obligation to provide an additional service from the rest of the warranty should account for both together as a single performance obligation providing a service.

**PwC observation.** The guidance on accounting for warranties is generally consistent with the current standard. However, it might be challenging to separate a single warranty that provides both a standard warranty and an additional service in some arrangements. Management will have to develop processes to estimate stand-alone selling prices and allocate the transaction price between the performance obligations in the arrangement when such services are not sold separately.

### **Non-refundable upfront fees**

Some entities charge a customer a non-refundable fee at the beginning of an arrangement. Examples include set-up fees, activation fees, and joining fees. Management needs to determine whether a non-refundable upfront fee relates to the transfer of a promised good or service to a customer.

A non-refundable upfront fee might relate to an activity undertaken at or near contract inception. Similar to current accounting under IFAS, the activity does not result in the transfer of a promised good or service to the customer unless the entity has satisfied a separate performance obligation. The upfront fee is recognised as revenue when goods or services are provided to the customer in the future. Depending on the nature of the fee, the period of revenue recognition could extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right.

### **Bill-and-hold arrangements**

In a bill-and-hold arrangement, an entity bills a customer for a product but retains physical possession of the product until a later date. Revenue is recognised upon transfer of control of the goods to the customer (that is, the customer has the ability to direct the use of and obtain substantially all of the remaining benefits from the asset). In addition to applying the control guidance in the standard, all of the following requirements must be met to recognise revenue in a bill-and-hold arrangement:

- The reason for the customer requesting the bill-and-hold arrangement is substantive.
- The product is ready for physical transfer to the customer and separately identified as the customer's product.
- The entity cannot use the product or direct the product to another customer.

An entity will need to consider whether it is providing custodial services to the customer that might be a separate performance obligation if the bill-and-hold criteria are met. Custodial services that are a separate performance obligation will result in a portion of the transaction price being allocated to that service.

**PwC observation.** The list of indicators for bill-and-hold transactions is generally consistent with the current guidance under IFAS.

### **Transfers of assets that are not an output of an entity's ordinary activities**

The revenue standard also amends existing requirements for gain or loss recognition on the transfer of certain non-financial assets that are not the output of an entity's ordinary activities. Specifically, PSAK 16, Property, Plant and Equipment, PSAK 19, Intangible Assets, and PSAK 13, Investment Property, were modified. Entities will apply the concepts related to control and measurement to these arrangements. The revenue standard will be applied to determine when the asset should be de-recognised and determine the consideration to be included in the net gain or loss recognised on transfer of these assets.

### **Consignment arrangements**

It is common in certain industries for entities to transfer goods to dealers or distributors on a consignment basis. The transferor typically owns the inventory until a specified event occurs, such as the sale of the product to an end customer. Revenue should not be recognised in a consignment arrangement until the transferor no longer controls the asset.

Management should consider the following common characteristics to determine if an arrangement is a consignment arrangement:

- The entity holding the goods does not have an unconditional obligation to pay for the goods.
- The entity can require return of the product or transfer to another distributor (which indicates that control has not transferred to the distributor).
- The goods are controlled by the entity until a specified event occurs.

## **Disclosures**

The revenue standard requires a number of disclosures intended to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and the related cash flows. The disclosures include qualitative and quantitative information about contracts with customers, significant judgements made in applying the revenue guidance, and assets recognised from the costs to obtain or fulfil a contract.

The disclosures are required for each period a statement of comprehensive income is presented and as of each period a statement of financial position is presented. See the Appendix for a listing of these required disclosures.

**PwC observation.** The disclosure requirements are significantly greater than existing disclosure requirements for revenue under IFAS. The revenue standard could add significant disclosures for interim financial statements as well. This could require new systems, processes, and internal controls to capture information that has historically not been needed for financial reporting purposes, particularly in interim financial statements. The standard includes several examples that illustrate specific aspects of the disclosure requirements. However, entities will need to tailor the sample disclosures for their specific facts and circumstances.

# What's next

Entities will apply the revenue standard in the first interim period within annual reporting periods beginning on or after 1 January 2020.

An entity can apply the revenue standard retrospectively to each prior reporting period presented (full retrospective method) or retrospectively with the cumulative effect of initially applying the standard recognised at the date of initial application in retained earnings (simplified transition method).

An entity that elects to apply the standard using the full retrospective method can apply certain practical expedients:

- For completed contracts, an entity need not restate contracts that begin and end within the same annual reporting period.
- For completed contracts that have variable consideration, an entity can use hindsight and use the transaction price at the date the contract was completed.
- For all reporting periods presented before the date of initial application (for example, 1 January 2020 for an entity with a 31 December year-end), an entity is not required to disclose the amount of transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue.

An entity that elects to use the simplified transition method must disclose this fact in its financial statements. An entity applying this method may also use the practical expedient either (a) for all contract modifications that occur before the beginning of the earliest period presented, or (b) for all contract modifications that occur before the date of initial application. An entity using this method can elect to apply the revenue standard only to contracts that are not completed (that is, the entity has not transferred all of the goods or services promised in the contract) as of the date of initial application.

Entities are also required to disclose the amount by which each financial statement line item is affected by the adoption in the year of initial application.

**PwC observation.** The simplified transition method is intended to reduce the transition time and effort for preparers that choose this option. The requirement for entities to disclose the impact to each financial statement line item will effectively result in an entity applying both the new revenue standard and the previous revenue guidance in the year of initial application.

The boards provided a longer than typical period of time for transition because of the pervasiveness of the standard and the importance of reporting revenue. It is intended to ensure that there is sufficient time for entities that want to use the full retrospective method as well as for those that use the simplified transition method, given the concerns of preparers about the amount of effort adopting the standard might require. Full retrospective application provides stronger trend information that some entities might prefer to provide to investors, so it was important to provide sufficient time for these preparers to transition.

# Appendix: Disclosure requirements

Disclosure type	Disclosure requirement
<b><i>Disaggregation of revenue</i></b>	Disclose disaggregated revenue information in categories (such as type of good or service, geography, market, type of contract, etc.) that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. Provide sufficient disclosure to enable a user to understand the relationship between the disaggregated information and the revenue information disclosed for each reportable segment (PSAK 5).
<b><i>Reconciliation of contract balances</i></b>	<ul style="list-style-type: none"> <li>• Disclose opening and closing balances of contract assets and liabilities and provide a qualitative and quantitative description of significant changes in these amounts.</li> <li>• Disclose the amount of revenue recognised that was included in the contract liability balance at the beginning of the period.</li> <li>• Disclose the amount of revenue recognised in the current period relating to performance obligations satisfied in a prior period (such as from contracts with variable consideration).</li> <li>• Disclose how the timing of the satisfaction of a performance obligation relates to the timing of payment. Discuss the effect on the contract asset and liability balances related to any timing difference.</li> </ul>
<b><i>Performance obligations</i></b>	Disclose information about performance obligations, including: <ul style="list-style-type: none"> <li>• When performance obligations are typically satisfied.</li> <li>• Significant payment terms.</li> <li>• Nature of the goods or services promised to be transferred.</li> <li>• Obligations for returns, refunds, or other similar obligations.</li> <li>• Types of warranties and related obligations.</li> </ul>
<b><i>Remaining performance obligations</i></b>	<ul style="list-style-type: none"> <li>• Disclose the amount of the transaction price allocated to any remaining performance obligations not subject to significant revenue reversal.</li> <li>• Disclose when the entity expects to recognise revenue associated with the transaction price allocated to the remaining performance obligations.</li> <li>• Qualitatively describe any significant contract renewal and variable consideration not included within the transaction price.</li> </ul>
<b><i>Cost to obtain or fulfil contract</i></b>	<ul style="list-style-type: none"> <li>• Disclose disaggregated revenue information in categories (Disclose the closing balances, by main category of asset, of capitalised costs to obtain and fulfil a contract and the amount of amortisation in the period.</li> <li>• Disclose the method used to determine the amount of costs incurred and the amortisation for each reporting period.</li> </ul>

Disclosure type	Disclosure requirement
<b><i>Other qualitative disclosures</i></b>	<ul style="list-style-type: none"> <li>• Disclose significant judgements and changes in judgements that affect the amount and timing of revenue, including: <ul style="list-style-type: none"> <li>– timing of satisfaction of performance obligations; and</li> <li>– transaction price and amount allocated to performance obligations.</li> </ul> </li> <li>• For performance obligations satisfied over time disclose: <ul style="list-style-type: none"> <li>– methods used to recognise revenue (output or input method used and how applied); and</li> <li>– why method used faithfully depicts transfer of goods or services.</li> </ul> </li> <li>• For performance obligations satisfied at a point in time disclose significant judgements made in evaluating when customer obtains control.</li> <li>• Disclose information about the inputs, methods, and assumptions used to determine the transaction price, assess whether variable consideration is constrained, allocate transaction price, and determine the stand-alone selling price.</li> <li>• Disclose how management determines the minimum amount of revenue not subject to the variable consideration constraint.</li> <li>• Describe the practical expedients, including those for transition, used in an entity's revenue accounting policies.</li> </ul>
<b><i>Interim period disclosures</i></b>	Entities are required to only include the disclosures related to disaggregation of revenue.

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