

An update on bad debt provision calculation for financial institutions <sup>P1</sup>

## An update on bad debt provision calculation for financial institutions

On 18 October 2024, the Minister of Finance (“MoF”) issued PMK-74<sup>1</sup> to update previous regulations<sup>2</sup> regarding the rules on deductible bad debt provision for certain financial institutions, which is applicable starting Fiscal Year (“FY”) 2024. The scope of the changes covers only the rules for banks and other financing companies, finance lease companies with option rights, consumer financing companies and factoring companies, as listed in the table below. The rules for insurance companies, Deposit Insurance Agency, mining companies, forestry companies, and industrial waste provisions still follow the previous regulations.

The general rule to determine the fiscal adjustment related to bad debt provision for these financial institutions remains the same. PMK-74 modifies the rules to calculate the allowable bad debt provision and provides more elaboration on several aspects. Below are the key changes in the regulation.

### Limits applicable to calculate bad debt provision balance

Under PMK-74, the allowable limits for bad debt provision balances can be calculated based on the Staging method (good, not good, poor) or the Collectability method (current, special mention, substandard, doubtful, loss).

The percentage for each eligible financial institution is as follows:

Financial Institution	Staging method			Collectability method				
	Good	Not good	Poor	Current	Special mention	Sub Standard	Doubtful	Loss
Banks								
Finance lease with option								
Consumer finance								
Factoring								
PT Perusahaan Pengelola Aset (“PPA”)	1.4%	23%	71%					
Financing								
Venture capital								
Infrastructure financing								

<sup>1</sup> MoF Regulation No.74 Year 2024 (“PMK-74”) dated and effective from 18 October 2024

<sup>2</sup> MoF Regulation No.81/PMK.03/2009 as lastly amended by MoF Regulation No.219/PMK.01/2012

Financial Institution	Staging method			Collectability method				
	Good	Not good	Poor	Current	Special mention	Sub Standard	Doubtful	Loss
<i>PT Permodalan Nasional Madani</i> ("PNM")	1.4%	23%	71%					
<i>PT Sarana Multi Infrastruktur</i> ("SMI")								
<i>Lembaga Pembiayaan Ekspor Indonesia</i> ("LPEI")								
<i>PT Sarana Multigriya Finansial</i> ("SMF")								
<i>Perusahaan Pergadaian</i>								
Micro Financial Institution				1%	5%*	15%*	50%*	100%*
<i>Bank Perekonomian Rakyat</i>				0.5%	3%*	10%*	50%*	100%*
<i>Koperasi Simpan Pinjam</i>				0.5%		10%*	50%*	100%*
Banks - Sharia				1%	5%*	15%*	50%*	100%*
LPEI - Sharia								
Finance lease with option - Sharia								
Consumer finance - Sharia								
Factoring - Sharia								
Financing - Sharia				1%*	5%*	15%*	50%*	100%*
Venture capital - Sharia								
Infrastructure financing - Sharia								
PNM - Sharia								
SMI - Sharia								
SMF - Sharia				0%	5%*	15%*	50%*	100%*

\* After deducting collateral

The followings are several noteworthy changes with regards to the calculation basis:

- The basis for the calculation amount is now the loan amount that is recorded in the financial statement. Previously, it was based on the outstanding principal of the loan provided by the financial institution, which could be different from the amount recorded in the financial statement based on the prevailing accounting standard.
- The collateral (when applicable) is now set at 100% for liquid assets and 75% for other assets based on taxpayer's assessment. If the taxpayer has collateral reporting obligation to the Financial Services Authority (*Otoritas Jasa Keuangan*/"OJK"), the value will be based on the OJK report. Previously, the percentage served as a maximum amount and the value assessment was based on the collateral value (which is not clear from which assessment) or based on valuation amount from an appraisal company.
- The regulation also set out the types of collateral that fall under each category, namely:
  - ✓ Liquid asset
    - Savings, time deposit, checking account, security deposit, foreign banknotes;
    - Bank Indonesia ("BI") Certificates and government bonds, including sharia-based and all securities issued by BI or government;
    - Investment grade government securities (from Indonesia or foreign countries);
    - Precious metal.
  - ✓ Other asset
    - Listed securities or investment grade securities based on securities rating agency that is registered at OJK;
    - Land and/or building with ownership certificate (including customary land acknowledgment letter);
    - Machinery or electronics;
    - Aircraft or ship with a size above 20m<sup>3</sup>;
    - Motor vehicle, heavy equipment, or inventory;
    - Warehouse receipt.

## Calculation for fiscal adjustment purposes

Based on the Income Tax Law, certain financial institutions (including sharia-based) are allowed to claim deductible bad debt provision expenses based on a certain limit governed under an implementing MoF Regulation (*Peraturan Menteri Keuangan*/"PMK").

As with previous regulations, the PMK will provide the allowable limit to calculate the beginning and ending balances of the bad debt provision for tax purposes. The movement (increase/decrease) of these balances, after taking into account the actual (qualifying) bad debt write-off incurred, will constitute the allowable bad debt provision expense. The difference between this amount and the commercial bad debt provision expense amount will result in a positive or negative fiscal adjustment.

Under PMK-74, the allowable bad debt provision limit for tax purposes is the **lower** of the commercial provision or the tax limit based on each sub-category under the applicable method. For example:

Loan category based on staging method	Loan recorded amount (in IDR mn)	Commercial provision (in IDR mn)	Tax limit		Allowable provision for tax purposes (in IDR mn)
			%	Amount (in IDR mn)	
Good	745,000	<b>3,700</b>	1.4%	10,430	3,700
Not good	87,000	23,000	23%	<b>20,010</b>	20,010
Poor	23,000	<b>11,500</b>	71%	16,330	11,500
				Total	<b>35,210</b>

PMK-74 also provides confirmation that write-offs that do not fulfil the deductibility requirements cannot be used to deduct the basis in calculating the beginning balance of the provision and can no longer be used as a basis in calculating the ending balance of the provision.

## Transitional provisions

The existing Bank Perkreditan Rakyat and Bank Pembiayaan Rakyat Syariah that have not been converted into BPR and BPR Syariah can calculate their bad debt provision using this regulation.

Specifically, for FY24 provision calculation:

- Both the beginning and ending balances of the bad debt provision are calculated using this regulation.
- The difference between FY24 beginning balance calculated using this regulation and FY23 ending balance calculated using previous regulation, will be treated as follows:
  - ✓ If FY24 beginning balance is higher than FY23 ending balance, the difference will be added as a deductible expense in FY24 and/or FY25.
  - ✓ If FY24 beginning balance is lower than FY23 ending balance, the difference will be added as taxable income in FY24.

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