



**Indonesian Accounting Standards Board  
Indonesian Institute of Accountants**

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# **Accounting Treatment for Land (in Indonesia)**

Emerging Economies Group (EEG)  
International Accounting Standards Board



## ACCOUNTING TREATMENT FOR LAND (IN INDONESIA)

### I. BACKGROUND

As explained in the Agenda Consultation 2011 of the IASB, one of the five strategic areas driving the work of IASB is to improve consistency and quality of the application of IFRSs. This implementation issue is one key factor in ensuring the success of IFRSs convergence in different jurisdictions, each with its own sets of characteristics, local regulations, common practices, and problems.

Indonesia as the only G-20 member from the South East Asia region is fully aware of the importance in adopting or converging to IFRSs, as the recognized global sets of financial reporting standards. As it stands, Indonesia will be converged to IFRSs in 1 January 2012. During the convergence process, one major accounting issue related to accounting treatment of land has arose, leading to differences in accounting treatments used by the constituents in Indonesia due to multiple interpretations of the standards. Indonesian Accounting Standards Board – Indonesia Institute of Accountants (DSAK-IAI) as the national standard-setter in Indonesia believes that this inconsistency in interpretation and implementation of IFRSs-based standards need to be dealt with in an accurate, effective, and swift manner.

Indonesia has raised this issue in the Asian-Oceanian Standard-Setters Group (AOSSG) forum, specifically through the AOSSG Working Group on Leases. In essence, Indonesia and Pakistan argued that long-term leases of land should be allowed to be treated as in-substance purchases or sales. AOSSG WG on Leases in their submission requested IASB to consider expanding the criteria for in-substance purchases or sales to include the indicators so that certain long-term leases of land may qualify as in-substance purchases or sales. Otherwise, IASB would need to provide further guidance on the amortisation requirements for such leases. As it stands, IASB has unanimously affirmed on its 2 March 2011 meeting the decision to include long-term leases of land within the scope of the ED Leases standard.

The aim of this Issue Paper is to seek if similar problem also exists in other emerging countries, thus, Indonesia would like to propose that Accounting for Land (Right) should be discussed among emerging countries in the future IASB EEG Working Group meeting. If this issue is proven to be a common issue between EEG members Indonesia would like to propose an establishment of an EEG Working Group to further investigate the problem and how should we approach the solution. One of the possible options is to propose an extra guidance to the new ED Leases or to ask International Financial Reporting Interpretation Committee to develop an IFRIC for land (right).

This Issue Paper will analyze the relation between the related IFRSs, among others; The Conceptual Framework of Financial Reporting, IAS 16 *Property, Plant and Equipment*, IAS 17 *Leases*, where appropriate the new ED Leases, with the laws and regulations in Indonesia specifically related to land.

In regard to accounting for land in Indonesia, since 1998 Indonesia have a distinctive accounting standard for land (namely the Indonesian Financial Accounting Standards (PSAK) 47: *Accounting for Land*), which has recently been revoked by DSAK-IAI in 2011 as part of the IFRS convergence process in Indonesia. This PSAK 47 was the main reference used by constituents in Indonesia in

accounting for land (right), on how it should be accounted for, measured, and presented on the financial statements.

Upon the withdrawal of PSAK 47, starting 1 January 2012, the financial report preparers in Indonesia need to refer to other PSAK standards relevant to land (right), which are based from IAS 16 and IAS 17. Due to interaction between these standards and the land laws and regulations, there have been multiple interpretations among preparers on how to account for land.

As a measure to maintain consistency of accounting treatment used to account for land, DSAK-IAI as the national standard-setter recently issued a pronouncement, an Interpretation on the Accounting for Land. The purpose of this Interpretation is to provide guidance on how land should be accounted, based on the land laws and regulations in Indonesia. DSAK-IAI is fully aware that this pronouncement may be a divergence from IFRSs, thus, acknowledges the importance of bringing up this issue to IASB.

Land in Indonesia is governed through laws and regulations (Government Decree) dated from 1960. These laws and regulations define the legal position, ownership, and rights over the land in Indonesia.

This Paper focuses on the two most common types of land rights in Indonesia:

1. **HGU** (right to cultivate) – Provides the right to exploit or cultivate land for agriculture or fishery purposes; and
2. **HGB** (right to build) – Provides the right to build upon the land.

The focus will be on the recognition and measurement of land, on the possibilities of accounting land as a fixed asset, intangible asset, or leased asset in a lease agreement. Related to this, this Paper will also take into consideration behind the decision to/not to amortize/depreciate the land (right).

## **II. THE BRIEF ON INDONESIA LAND LAWS AND REGULATIONS**

This section focuses on the analysis of the laws and regulation in Indonesia in regard to the land (right) and the related extension and renewal.

The laws and regulations in Indonesia do not permit corporations to own freehold title to land, therefore, the State grants HGU/HGB as a replacement. Only individual citizens and certain types of not-for-profit organizations have freehold title to land.

The two main laws and regulations that regulates land in Indonesia are Law Number 5 year 1960 about Basic Agrarian and Government Regulation Number 40 year 1996 about Right to Cultivate, Right to Build, and Right of Use Over Land (extracts on the related Articles are presented in Appendix A).

In essence, the laws and regulations on land in Indonesia stated that:

- The State has a control right. This right grant the State the authority to arrange and conduct the allocation of use of the land and to determine legal relations between land (right) holders and the actual land. In principle, the State does not have the authority to own the land.

Ownership of land in Indonesia falls to the natives unless it has been transferred to other (individual) parties through sale or other transactions.

- The State is bestowed with the power to revoke any land (right) that has been given to land (right) holders, only if it is for the sake of public interest (and/or change in allocation of use of the land). Should the State utilize this power adequate compensation based on the selling value of the tax object will be provided to the land (right) holders, where:
  - Full compensation will be provided if the land (right) is revoked during the leasehold period. Types of land or the length of the remaining leasehold period are relatively irrelevant in deciding the amount that will be provided as compensation;
  - Compensation for the assets (building, etc) will be provided if the land (right) is revoked when the leasehold period has ended/expired or if the application to extend or renew the right is declined by the State through the Indonesia National Land Agency. No compensation will be provided for the actual land; and
  - The State's authority to revoke the land right is limited only after obtaining approval from the House of Representatives which is assumed to represent the public, which is a long and comprehensive process.
- HGU – Right to Cultivate and HGB – Right to Build could be given for a defined period and could be extended for another period. There is no limitation on the number of renewals. So in theory, the renewal should not be limited. On expiration renewal might be granted for both HGU and HGB. In extending and/or renewing the rights, the land (right) holders must meet several requirements that have been required by the State. Essentially, the land (right) holders should have a legally protected right to obtain the extension/renewal provided all the legal and administrative requirements are met and the land is not claimed by the State through the Indonesia National Land Agency to be used for public purposes. There is no case of rejection by Indonesia National Land Agency as long as the application has fulfilled all the requirements.
- The costs related to the extension and renewal of both HGU and HGB are considered to be immaterial, where only a nominal amount of 0.2% of the land value + IDR100,000 (~USD\$11) required to be paid upon extension. The amount paid on renewal is 0.2% of the land value + IDR100,000 (~USD\$11) plus 5% of the average sale value of the tax object, which is considered to be a minor cost compared to the actual value of the land (as illustrated in Illustration A).
- Both the main land right available to corporations in Indonesia, namely HGU and HGB can be used as collateral of debts and can be transferred to another party through sale, exchange, in-kind capital contribution, grant or inheritance. If the HGU/HGB is transferred to an individual, the individual can directly convert it to a freehold right. Thus, it reiterates the facts that in essence control of the land has in fact been transferred to the land (right) holders.

Interpretation on these laws and regulations has been confirmed through formal communications and discussions between DSAK-IAI as the national standard-setter in Indonesia with the Indonesia National Land Agency as the representative of the Government.

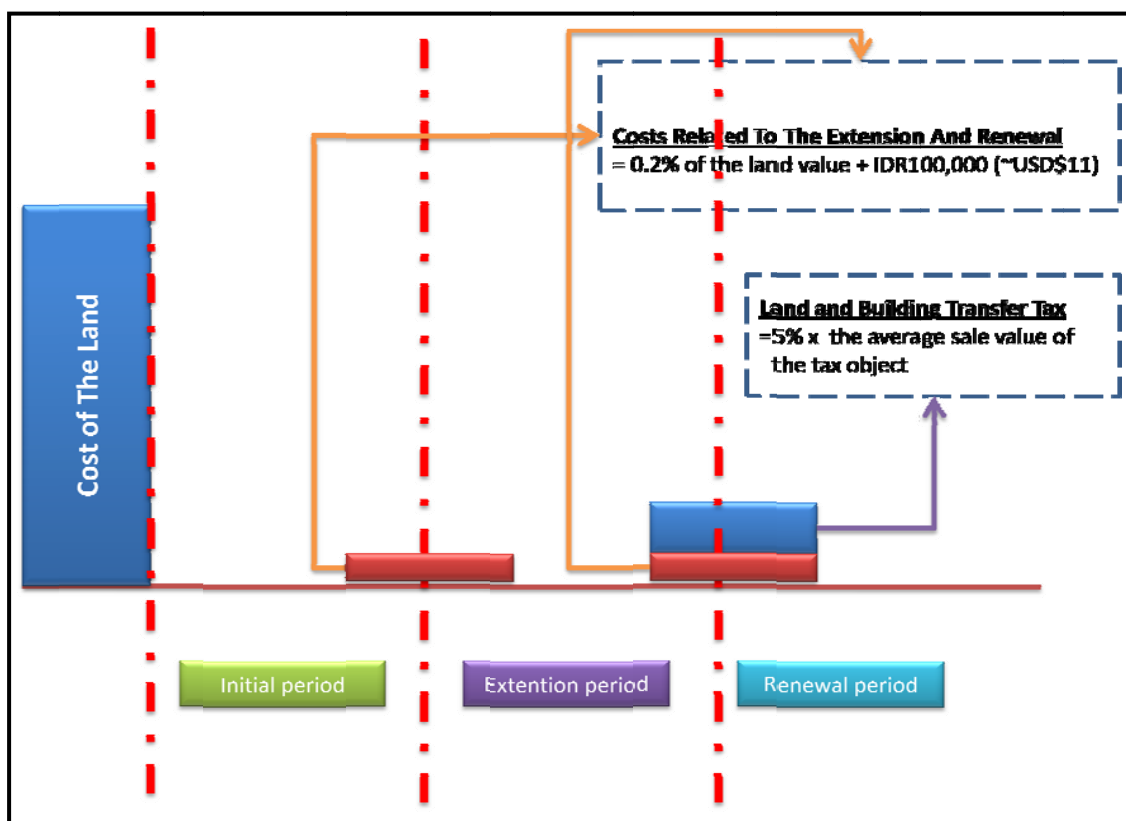


Illustration A – Extension and Renewal of Land (Right) in Indonesia

### III. MULTIPLE INTERPRETATIONS AMONG INDONESIAN REPORTING ENTITIES

Before the accounting standard for land was revoked, entities in Indonesia account land as PPE and the cost of land is recognised at the initial recognition of the land. The land is not depreciated unless the entity believes that the useful life of land becomes limited, as also stipulated in IAS 16.

However there have been different interpretations on how to account land in accordance with IFRS among the accounting firms in Indonesia. Many subsidiaries of European or Australian companies in Indonesia need to produce IFRS' based report since 2005 for their parents. In most cases, the parent required the subsidiary's financial statements to be audited. This multiple interpretations have developed tensions among entities with their auditor in regard to land accounting in accordance to IFRS and resulted to low comparability among reporting entities in Indonesia.

The different interpretations among IFRS-based entities are as follows:

1. Land is recognised as a purchase of PPE and the cost is not depreciated.
2. The purchase of land is recognised as a finance lease and the cost of land subject to depreciation over the life of the land right. The support of this argument is that the State through the Indonesia National Land Agency still have the final discretion on the extension of the land right, thus, the useful life of land is arguably limited.

3. The purchase of land is recognised as the purchase of indefinite intangible asset, and is not amortised. The argument based on the actual asset being purchased is the right to use of land and not the physical land itself. Thus, intangible asset classification is more appropriate.
4. The land is recognised as an operating lease. The initial payment was recognised as deferred payment. The argument based on that the term of land right given by the Government are a lot shorter than the economic useful life of the land. Although it can be renewed and extended indefinitely and there has been no rejection from the Government to the renewal and extension submission, there is always inherent risk that the Government may deny the submission.

Observing different multiple interpretations may cause lack of comparability. DSAK-IAI issued an interpretation in 2011 which mainly decided that land is considered as PPE and not depreciated. The land starts to be amortised if the entity believes that the useful life of the land becomes limited. While Indonesia awaits the new ED Leases to be ratified and to be adopted, the interpretation is needed to minimise confusion during the transition period.

#### **IV. QUESTION AND ANALYSIS**

To provide better understanding on the issue, this Paper will present the issue in a Question and Answer Analysis format.

##### **A. Can HGU/HGB be Accounted as Purchase/Sale Transaction of PPE?**

We believe that the nature of HGU/HGB in Indonesia is closer to the purchase/sale transaction. The main evidence of this is the fair value of land does not influence by the remaining years of the HGU/HGB land right. When the entity purchases a land, even if the remaining years of the HGU/HGB is only less than three years, it does not influence the land price. There is no limitation on the number of renewals. So in theory, the renewal should not be limited. There is no case of rejection by Indonesia National Land Agency as long as the application has fulfilled all the requirements. This may be different in other countries where the land market price is significantly lower when the remaining years of the land (right) is shorter.

The second evidence is that HGU/HGB can be put as bank collateral for loan and can be transferred to another party through sale, exchange, in-kind capital contribution, grant or inheritance. If the HGU/HGB is transferred to an individual, the individual can directly convert it to freehold. Thus, reiterating the facts that in essence control of the land has in fact been transferred to the land (right) holders.

The third reason is the compensation to the entity stipulated by the law if the State deny the renewal or the extension of the HGU/HGB. If the State decides to use the land for public welfare or social purposes, by law a fair amount of compensation need to be paid to the holder of HGU/HGB. This reiterates the fact that the benefit and reward have been transferred to the HGU/HGB (right) holders. The holders bear no risk to lose the initial cost of land should the State does not grant their HGU/HGB renewal or extension.

Thus, many stakeholders in Indonesia support the argument that HGU/HGB should be accounted using IAS 16 PPE. However, some argued that land should be accounted using IAS 17 Leases accounting standard instead of IAS 16 PPE because HGU/HGB are not a freehold land. Indonesia

does not allowed corporations to have freehold land, however freehold title to land is available for individuals, non-government organisations, and some not-for-profit organisations. So, the opponents of this view argued that IAS 16 PPE should only be used if the land is freehold and not if the land right with some limited time, even with the high probability of uncontested renewal or extension of the right.

Indonesia would like to identify if there are any emerging economy countries with similar legal framework that classify the purchase of land (right) as purchase/sale agreements of PPE (apply IAS 16) instead of accounting it as a land lease (apply IAS 17).

#### **B. Can HGU/HGB be Accounted for as a Finance Lease under IAS 17?**

Before 1 January 2010, the position of IASB is suggesting that the lease of land is an operating lease. However in the annual improvement of 2009, IASB deleted paragraph 14 that suggest such position and IAS 17 became silent about land lease ever since. Although IASB made a suggestion in their basis for conclusion that land lease may be classified as finance lease, the example of 999 year of lease term (like Hong Kong case) as suggested in the BC would be very unlikely to occur again in this modern world.

This would make any entities applying IAS 17 exercise their professional judgment in classifying land lease as a finance lease or operating lease using the criteria in the standard. With the case of HGU/HGB in Indonesia, we argued that the land right can be classified as finance lease based on the table of criteria shown on Illustration B.

CRITERIA	EVALUATION
<p>a. <i>the lease transfers ownership of the asset to the lessee by the end of the lease term</i></p>	<p>Arguably met. In substance, the HGU/HGB holder owns the land. But in order for them to use their land, they need to apply for continuous renewal and extension to the Government.</p>
<p>b. <i>the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised</i></p>	<p>Not applicable for Land Lease</p>
<p>c. <i>the lease term is for the major part of the economic life of the asset even if title is not transferred</i></p>	<p>1. Criteria Met, based on the definition of lease term as follows:</p> <p><i>“The lease term is the non-cancellable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.”</i></p> <p>2. The land right holder will certainly request for an extension of the land right and the request can be granted provided the land right holder met the requirements. There is a big disincentive if the land right holder will not comply with the requirements that would result in the request for extension being denied. This in effect is equivalent to having an option to continue to lease the asset and it is reasonably certain the lessee will continue to lease the asset</p> <p>3. The lease period is therefore the initial 30 years (non-cancellable period) and the further extensions which may last for several decades as long as the land right is not sold or appropriated by the government for public use.</p>
<p>d. <i>at the inception of the lease the present value of the minimum lease payments amounts to at</i></p>	<p>Criteria Met. Land rights are ordinarily acquired at market value plus legal</p>



<i>least substantially all of the fair value of the leased asset; and</i>	processing cost.
<i>e. the leased assets are of such a specialized nature that only the lessee can use them without major modifications</i>	Not Applicable

Illustration B – Finance Lease Criteria

To classify HGU/HGB to the operating lease as IAS 17 suggested just does not fit with the real economic condition in Indonesia where land is sold and purchase like a piece of property and the HGU/HGB holder may put the HGU/HGB as a debt collateral and HGU/HGB can be transferred to another party through sale, exchange, in-kind capital contribution, grant or inheritance

Indonesia would like to know the current practices in other emerging economy countries regarding this issue. If there are any countries have similar legal framework with Indonesia, we would like to know how the entities classify land lease and what the supporting arguments for such classification are. Indonesia would also like to know the classification of long term leased asset, whether it is under PPE or intangible asset.

### **C. Can HGU/HGB Satisfy the Criteria of a Lease Under the New ED on Leases?**

In the ED of IAS 17, IASB decided to distinguish lease in to two categories: Lease and Short-term Lease. Thus the confusing criteria between finance lease and operating lease in regard with land can be avoided. IASB in their meeting on 2 March 2011, also, tentatively decided to include long term land lease in the scope of standard allowing users to apply IAS 17 to account long term land lease.

IASB on their meeting on 13 June 2011 meeting tentatively defined short term lease as **“as a lease that, at the date of commencement of the lease, has a maximum possible term, including any options to renew, of 12 months or less.”** With this tentative definition of short term lease, long term land lease will not be able to satisfy the definition of short term lease as HGU/HGB term are always more than 12 months.

Thus if the HGU/HGB in Indonesia is lease transaction rather than sales/purchase transaction, HGU/HGB satisfies the criteria of a lease under the new ED of IAS 17. This would bring us to the next question regarding the subsequent measurement of long term land lease under the ED of IAS 17. The two accounting options for subsequent measurement in the ED is to amortise the “right-to-use” asset over their lease term or applying revaluation model for all items in the class of asset. The lessee should also apply IAS 36 Impairment of Assets for the “right-to-use” asset

As far as our understanding, the never entertain the possibility of a long term land lease not as subject of depreciation/amortisation in their deliberation.

**D. If HGU/HGB has an Indefinite Life, Should it be Depreciated?**

Either under the current IAS 17 or the ED of new IAS 17, the question of amortisation is relevant to rise. The possibility of not amortising land is evident under IFRS as IAS 16 Paragraph 58 stated that:

*“Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, **land has an unlimited useful life and therefore is not depreciated.** Buildings have a limited useful life and therefore are depreciable assets. **An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.**”*

We assumed that what IAS 16 meant of land is freehold land not the long term land lease. However if the nature of long term land lease is very close to freehold land, which is the case of Indonesia, is it possible that the HGU/HGB is not depreciated?

One may argue that the revaluation model allowed in the ED of new IAS 17 may suffice to reflect the real economic condition that the price of land in Indonesia are always increasing. However, revaluation model also requires entity to amortise the asset between the revaluation tests. The argument in this discussion is not whether IAS 17 is capable of portraying the fair value of the land, but whether the depreciation is appropriate to be applied for HGU/HGB.

As the HGU/HGB can be extended and renewed indefinitely (arguably more than 999 years), we argued that HGU/HGB should not be depreciated unless entities believes that the useful life of land right become definite (e.g. there is an indication that the land will be used by State for public welfare purpose). This concept is similar with indefinite intangible asset in IAS 38.

However, the leased intangible asset is scoped out in the ED of new IAS 17. Moreover IASB on their meeting on 20 July 2011 tentatively decided that it is not necessary to clarify if “right-to-use” asset is classified in the intangible or intangible asset in the presentation. In the presentation section, the ED of new IAS 17 only suggests to classify “right-to-use” asset as PPE or investment property.

If Indonesia believes that HGU/HGB should not be depreciated/amortised, there are two options that could be considered: either to use IAS 16 PPE or IAS 38 Intangible Assets to account the land I Indonesia. We are not quite sure if IAS 17 allows “right-to-use” asset to be classified as an indefinite, thus, it should not be depreciated.

Indonesia would like the view of other emerging economy countries regarding this issue.

\*\*\* The End of Issue Paper\*\*\*

## **APPENDIX A**

### **Law Number 5 year 1960 about Basic Agrarian**

#### **Article 2**

*“...Earth, water and space, including natural resources contained therein is **controlled by the State....**”*

*“Control rights of the State **give the authority to the State to:***

- a) Arrange and conduct the allocation, use and maintenance of the earth, the water and the space;*
- b) Determine and regulate the legal relations between people and the earth, the water and the space; and*
- c) Determine and regulate the legal relations between people and legal actions concerning the earth, the water and the space.”*

#### **Article 18**

*“**For the sake of public interest**, including the interests of the nation and the state and the interests of the people, the rights over the land **can be revoked by giving adequate compensation** in accordance to the applicable laws and regulations.”*

### **Government Regulation Number 40 year 1996 about Right to Cultivate, Right to Build, and Right of Use over Land**

#### **Article 8**

*“The HGU could be given for a period of 35 years and **could be extended** for a period of 25 years. After a period of the HGU (including its extension period) expires, the holders **might be granted renewal** of the HGU on the same land.”*

#### **Article 9**

*“HGU could be extended or renewed at the request of the right holders, if they **meet several requirements** as follows:*

- The land is still being used properly in accordance with circumstances, the nature and purpose of granting such rights;*
- conditions of the entitlement are met by the right holders, and*

*Right holders still qualify as right holders.”*

#### **Article 15**

*“HGU **can be used as collateral** of debts...”*

#### **Article 25**

*“The HGB could be given for a period of 30 years and **could be extended** for a period of 20 years. After a period of the HGB (including its extension period) expires, the holders **might be granted renewal** of the HGB on the same land.”*

**Article 26**

*“HGU could be extended or renewed at the request of the right holders, if they **meet several requirements** as follows:*

- *The land is still being used properly in accordance with circumstances, the nature and purpose of granting such rights;*
- *conditions of the entitlement are met by the right holders, and*
- *Right holders still qualify as right holders.*
- *The land is still being used in accordance with the regional spatial plan.”*

**Article 33**

*“HGB can be used as collateral of debts...”*