

THE IMPACT OF OPERATING LEASE CAPITALIZATION ON FINANCIAL STATEMENTS IN INDONESIA

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INFO ARTIKEL	ABSTRACT
Diterima 2 Februari 2022 Direvisi 12 Februari 2022 Disetujui 20 Februari 2022	PSAK 73 is a new accounting standard that introduces a single accounting model for lessees, namely recording their rental activities as capital leases. This study aims to determine the impact of operating lease capitalization on financial statements. This research is a type of quantitative research using secondary data in the form of annual reports and company financial statements. The object of this research is a company listed on the Indonesia Stock Exchange for the period 2018-2019 which discloses the value of future minimum lease payments on operating leases in the financial statements. Data analysis methods include descriptive statistical testing and Wilcoxon signed-rank test. The results show that operating lease capitalization has a significant effect on unrecorded lease liability, unrecorded lease assets, equity, and financial ratios. Also, empirical evidence shows that there are tax savings from operating lease capitalization.
Keywords: PSAK 73, Operating Leases, Constructive Capitalization, Financial Statements	

Introduction

In the current era of globalization, competition in business is getting tougher. Not only survive, but the company must be able to compete to get a return on investment. Parameters for assessing the company's performance or the results of management activities can be seen from the company's financial information which is reflected in the form of financial statements. According to PSAK 1, financial statements provide entity information regarding assets, liabilities, equity, income and expenses, contributions from and distributions to owners in their capacity as owners, and cash flows. Based on this information, it is used to calculate financial ratios that help determine the company's financial position and success in that period. Furthermore, The adoption of PSAK 73 has an impact on the Company's statement of financial position because the

companies experienced an increase in asset and liability accounts (Saing & Firmansyah, 2021).

Improved company performance can be done by improving the company's operations, so that the organization runs efficiently and effectively. In helping smooth operations, companies need fixed assets that are used to produce goods and services, for administrative purposes, for rent, and so on. As stated by (Putri et al., 2020) that fixed assets can assist companies in carrying out operational activities to achieve company goals. The limited economic benefits of fixed assets require companies to replace old fixed assets with new ones. These fixed assets can be obtained through purchase, self-creation, through exchange, renting, or it can also be a capital deposit by the owner in the form of assets such as land, vehicles, buildings, and equipment.

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The relatively high value of fixed assets sometimes makes the company not have enough funds to carry out its own procurement, so that an alternative that can be used is procurement through a finance company engaged in leasing (Atstaja et al., 2022). Some of the advantages obtained if the company procures through leases, namely, financing by leasing is cheaper than other funding methods (such as buying assets or taking loans from banks), then avoiding obsolescence due to technological advances, and leasing can provide tax advantages because companies can utilize and depreciate leased assets to reduce taxable income (PKP).

Prior to 2020, in Indonesia, the recognition, measurement, presentation and disclosure of leases in the financial statements of go public companies was regulated in Statement of Financial Accounting Standards Number 30 (PSAK No. 30) on Leases. However, over time, these standards have begun to be criticized by users of financial statements (stakeholders) because they do not always accurately reflect the leasing transactions carried out by the company. The lease accounting model previously defined in this PSAK requires the lessee and the lessor to classify the lease as an operating lease or a capital lease and to record the two types of lease differently. According to PSAK 30, a finance lease (capital lease) occurs when there is a substantial transfer of the risks and rewards of the asset, and the entity recognizes and records it in the statement of financial position as a right-of-use asset and a lease liability. On the other hand, if substantially the risks and rewards incidental to ownership of the asset are not transferred, the lease is classified as an operating lease. The operating lease model does not require the lessee to recognize assets and liabilities arising from operating leases in the statement of financial position. Such conditions are known as off balance sheets, so that if a company applies this method, it will have an impact on

financial ratios, especially efficiency and leverage ratios that look better.

For some of the advantages that will be obtained when classifying their rental activities as operating leases, many managers try to arrange their leases so that they do not meet the criteria as a capital lease. As research conducted by (Nuryani et al., 2015) in their research concluded that operating lease activities cannot be explained by economic determinants, then there is a possibility that managers have the urge to use operating leases as an off balance sheet to hide company debt. This is like the case that happened to PT Garuda Indonesia. Reporting from the Kompas.com page written by Narita Indrastiti, PT Garuda did a large-scale purchase of aircraft using a lease scheme. The purchase of 90 new aircraft at the Paris Air Show, 80 percent of which used an operating lease scheme with a total purchase transaction value of US\$ 20 billion or equivalent to Rp 267 trillion. The explanation was delivered by the Finance Director of PT Garuda Indonesia Tbk. namely I Gusti Ngurah Askhara Danadiputra who was contacted by KONTAN, Wednesday (17/6/2015). This sale and lease back lease is provided by PT Garuda Indonesia, in which the airline sells the aircraft it has purchased and immediately leases it back from the lessor. That way, PT Garuda Indonesia does not need to record assets or lease liabilities for the procurement of assets in the statement of financial position, so that the company's financial ratios are maintained.

Obtained from the Kompas.com page, cases related to leases were also experienced by the airline PT Metro Batavia. The airline (Batavia Air) was declared bankrupt by the Central Jakarta Commercial Court on Wednesday (30/1/2013). This decision stems from a lawsuit by the aircraft leasing company International Lease Finance Corporation (ILFC) because Batavia Air has not paid its obligations. As for data, Batavia

Air's debt reached Rp 1.25 trillion, most of which was leased debt worth Rp 500 billion, the remaining Rp 95 billion owed to passengers and ticket-holding agents, Rp 230 billion bank debt, Rp 60 billion tax debt, and Rp 140 billion of employee debt. From this information, it can be seen that leasing may be one of the most widely used financing methods, especially for companies that require high-value assets in carrying out their operations, because leasing is expected to allow companies to allocate their funds for other operational activities.

The basis for revising PSAK 30 is a company leasing transaction that cannot show a proper representation of leasing activities and as a form of commitment to IFRS convergence, then on September 18, 2017 the Financial Accounting Standards Board of the Indonesian Institute of Accountants (DSAK IAI) ratified PSAK 73: Rent. This PSAK replaces the rental-related standards previously set in PSAK 30. PSAK 73 is effective on January 1, 2020, however, the Indonesian Institute of Accountants (IAI) allows early application provided that the entity has implemented PSAK 72: Revenue from Contracts with Customers. PSAK 73 on leases aims to introduce for the lessee a single accounting model, namely classifying the lease as a finance lease. There are two exceptions for the lessee to be able to categorize the lease agreement as an operating lease, namely if the lease term is less than 12 months or the underlying assets are of low value. If the underlying asset is normally of high value when new, it cannot be classified as a lease of a low value asset, such as a used car leased by the lessee. Examples of low-value underlying assets are laptops, office equipment, and telephones. Meanwhile, for the lessor, because there is no change in the rules, they still classify the lease as a finance lease or an operating lease.

The entry into force of PSAK 73 in 2020 will certainly have an impact on the

company's financial statements, because they are required to capitalize their operating lease commitments and report the lease on the statement of financial position as right of use asset and lease liability. The impact of operating lease capitalization has also been studied previously, by (Wong & Joshi, 2015), (Bennett & Bradbury, 2003), and (Öztürk, M., & Serçemeli, 2016) using the constructive capitalization method developed by (Imhoff, E. A., Lipe, R., & Wright, 1991). (Wong & Joshi, 2015) examined 107 companies listed on the Australian Stock Exchange with the aim of analyzing the impact of operating lease capitalization on financial statements and financial ratios. The results showed that there was a significant effect on the financial statement and financial ratio after the capitalization of the lease was carried out. The average DER increased by 0.258 or 31.69%, and the DAR increased by 0.046 or 10.11%. As for profitability, return on assets (ROA) fell sharply by 15.35% and ROE fell by 0.0033 or an average of 1.23%. (Bennett & Bradbury, 2003) conducted a study on the capitalization of operating leases with the title "Capitalizing Non-cancelable Operating leases" on 38 companies listed on the New Zealand Stock Exchange. The measurement uses the constructive capitalization model developed by (Imhoff, E. A., Lipe, R., & Wright, 1991). The results show that rental capitalization has a material impact on liabilities and financial ratios. The average unreported lease liability was 22.9% of total liabilities, and equity decreased by 3%. A similar study was also conducted by (Öztürk, M., & Serçemeli, 2016) on airlines in Turkey. The results show that the estimated number of lease liabilities that are not reported as a result of rental capitalization is 1,427,860,777, and the effect on the statement of financial position is that liabilities increased by 52.2%, equity decreased by 12.5%, while assets increased by 29.3%.

From this explanation, it can be seen that there are differences in the results of capitalization of operating leases, this arises due to differences in samples and assumptions used by each researcher. Regulations related to leases are not necessarily the same between countries, for example in the United States, the standard used is US GAAP and the tax rates used are different from those in Indonesia. Therefore, it is necessary to conduct research on companies in Indonesia because it may give different results. The researcher also wants to examine from another point of view, how is the effect of lease capitalization on tax savings that will be obtained by the entity if it applies a capital lease since the beginning of the lease term. Because in a capital lease, the entity can include depreciation expense and interest expense as a deduction from net income, in contrast to the operating lease which only includes the total rental payments as an expense in the current period.

Research Hypothesis

Operating Lease Capitalization and Unrecorded Lease Liability

Companies that categorize their leases as operating leases do not need to recognize the existence of a leased asset or liability in the statement of financial position. The rental expense paid by the company is fully recognized in the current year's income statement as a deduction from revenue. However, the capitalization of operating leases will result in the recognition of a lease liability. The liability is recognized at the present value of non-cancellable operating lease commitments.

Previous research has proven that lease capitalization has an effect on unrecorded lease liability (URL). The results of research conducted by (Bennett & Bradbury, 2003) on 38 companies listed on the New Zealand Stock Exchange showed that the average unreported lease liability was 22.9% of the

total liabilities. (Duke et al., 2009) found that the average unreported lease liability due to rental capitalization is 11% of total liabilities. Research on airlines in Turkey by (Öztürk, M., & Serçemeli, 2016) also proves that there is a fairly material amount of lease liability that is not reported by the company as a result of rental capitalization, which is 1,427,860,777 (52.2%). Based on this explanation, the following hypothesis is formulated.

H1: Capitalization of operating leases has an effect on unrecorded lease liability

Operating Lease Capitalization and Equity

Under operating leases, the rental expenses paid by the company are fully recognized in the current year's income statement as a deduction from revenue. Meanwhile, after the capitalization of the operating lease will result in the existence of a leased asset and a lease liability on the statement of financial position, and the company must depreciate the asset over the lease term. In addition to recognizing the depreciation expense on leased assets, the company also recognizes interest expense as a deduction from revenue. The recognition of these two expenses resulted in the expense recognized by the company during the year which was higher than when the lease was classified as an operating lease and caused a decrease in the company's equity value.

A study conducted by (Bennett & Bradbury, 2003) on 38 companies listed on the New Zealand Stock Exchange showed that equity decreased by 3% after the capitalization of the lease. Meanwhile, research by (Wong & Joshi, 2015) on 107 companies listed on the Australian Stock Exchange stated that equity decreased by \$9.568 billion (0.27%). While research on airlines in Turkey by (Öztürk, M., & Serçemeli, 2016) found that equity decreased by 12.5% after capitalization of leases. Based

on this explanation, the following hypothesis is formed.

H3: Capitalization of operating leases has an effect on equity

Operating Lease Capitalization and Financial Ratios

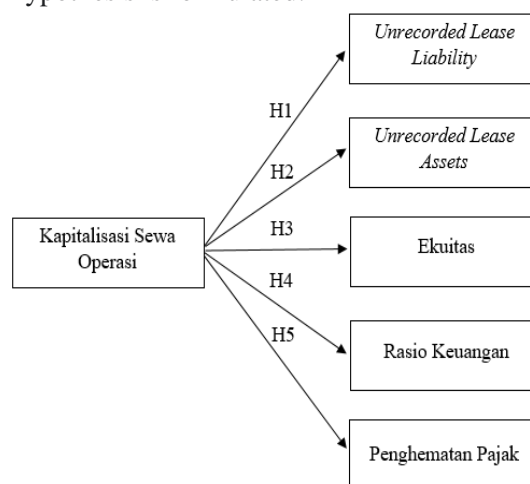
Financial ratios are measuring tools used in analyzing financial statements. That is, by comparing an account in the financial statements with other accounts. Changes in the balances of financial statement accounts, also result in changes in the company's financial ratios. As research conducted by (Nuryani et al., 2015), (Wong & Joshi, 2015), (Safitri et al., 2019), and (Öztürk, M., & Serçemeli, 2016) which stated that there were significant differences in financial ratios between before and after the capitalization of the lease. In this study, three financial ratios will be tested, namely the solvency ratio which is proxied using the Debt to Assets Ratio (DAR), and the Debt to Equity Ratio (DER), the profitability ratio is proxied using the Return on Assets Ratio (ROA), Return on Equity Ratio (ROE), and Net Profit Margin (NPM), and finally the activity ratio proxied using Total Asset Turnover (AT).

The average stated that the solvency ratio experienced a significant increase due to the recognition of lease liabilities in the statement of financial position, while the profitability ratio decreased due to higher expense recognition which resulted in a decrease in net income. Research by (Wong & Joshi, 2015) on 107 companies listed on the Australian Stock Exchange stated that after capitalization the average DER increased by 0.258 or 31.69%, and DAR increased by 0.046 or 10.11%. As for profitability, return on assets (ROA) fell sharply by 15.35% and the average ROE decreased by 0.0033 or 1.23%. Based on this explanation, the following hypothesis is formulated.

H4: Capitalization of operating leases has an effect on financial ratios

Operating Lease Capitalization and Tax Savings

The excess of the cumulative cost of rent capitalization will result in cumulative tax savings. Tax gains occur at the beginning of the lease term when the capital lease reports a larger expense, which consists of interest expense and depreciation expense on the leased asset, than an operating lease which only reports lease payments as an expense for the current year. Research by (Duke et al., 2009) shows that there are tax savings due to capitalization of leases of \$61.17 million (18.55% of cash balance). From this explanation, the following hypothesis is formulated.



H5: Capitalization of operating leases has an effect on tax savings

Figure 1. Research Model

Source: Author's Results (2020)

Method

This research is a type of quantitative descriptive research (Creswell, 2017). The population in this study were all companies listed on the Indonesia Stock Exchange for the 2018-2019 period. The research sample was selected using a purposive sampling method, in which the company discloses its commitment to future minimum lease payments on operating leases in the notes to financial statements (CALK). The empirical

model in this study uses the constructive capitalization method developed by (Imhoff, E. A., Lipe, R., & Wright, 1991). Adopting from previous research (Bennett & Bradbury, 2003), due to the unavailability of information in the financial statements, to capitalize the lease, it is assumed that the maximum lease term is 10 years, the interest

rate is 10%, and 50% of the lease term has expired (used). In analyzing the data, among others, using descriptive statistical tests and different tests. The hypothesis was tested using paired sample t-test if the data were normally distributed or the Wilcoxon test if the data were not normally distributed.

Table 1
Wilcoxon test

Description	Year 2018	Year 2019	Total
Number of companies listed on the IDX	619	668	1.287
Companies that do not have/disclose operating lease commitments	(585)	(637)	(1.222)
Companies that disclose operating lease commitments	34	31	65

Source: Processed Data (2020)

The final sample was obtained as many as 65 companies consisting of 7 industrial sectors, including the Mining sector, Basic and Chemical Industry sector, Miscellaneous Industry sector, Consumer Goods Industry sector, Infrastructure sector, Utilities and Transportation, Finance sector, and the last is the Trade, Services sector. and Investment.

Results and Discussion

Hypothesis testing

This study aims to determine the impact of operating lease capitalization on financial statements. The results of the Normality Test showed that all variables were not normally distributed, so Wilcoxon's test was used, except for the tax saving variable which used a descriptive statistical approach

such as the previous research conducted by (Duke et al., 2009). Wilcoxon test results (Table 2) show a significance value of less than <0.05, so it can be concluded that the hypothesis H1, H2, H3, H4 is accepted, that is, there is a significant effect of operating lease capitalization. In the tax savings variable, it is seen how much influence the rental capitalization has on the total tax burden that must be borne by the company. Based on the calculations that have been made, it shows that on average there is a tax savings of 1.91% (Rp 42,847,436,598) from the average amount of cash and cash equivalents reported. So it can be concluded that the fifth hypothesis (H5) is accepted, namely the capitalization of operating leases has an effect on tax savings.

Table 2
Wilcoxon Test Results

Variabel	Mean Pre	Mean Post	Change	Percentage of Change	z-value	Sig.
Liability	Rp19.480.549.419.417	Rp20.339.753.279.618	Rp859.203.860.201	4,41%	-7,009	0,000
Assets	Rp31.068.915.011.623	Rp31.799.576.562.030	Rp730.661.550.407	2,35%	-7,009	0,000
Equity	Rp11.242.606.238.359	Rp11.114.063.928.566	-Rp128.542.309.794	-1,14%	-7,009	0,000
DAR	0,6914	0,7108	0,0194	2,81%	-6,414	0,000
DER	2,0241	2,2584	0,2342	11,57%	-6,983	0,000
ROA	0,0535	0,0471	-0,0064	-11,93%	-6,564	0,000
ROE	0,1006	0,0758	-0,0248	-24,69%	-6,865	0,000
NPM	0,0529	0,0430	-0,0099	-18,70%	-7,009	0,000
AT	1,0187	0,9855	-0,0333	-3,27%	-7,009	0,000

Source: Processed Data (2020)

Discussion

Based on the results of the Wilcoxon test (Table 2), it shows that the capitalization of operating leases has a significant effect on the financial statements. The company's assets and liabilities experienced a significant increase due to the recognition of right-of-use assets and lease liabilities after capitalization of the lease, while equity decreased significantly due to the recognition of a larger expense. Expenses under the capital lease method include depreciation expense on leased assets and unpaid interest expense on lease liabilities, while in operating leases only lease payments are recognized as current period expenses in the income statement (Duke et al., 2009). Changes in the elements of the financial statements also resulted in an increase in the solvency ratio and a decrease in the profitability ratio and activity ratio. A larger recognition of expenses results in a decrease in net income so that tax savings are obtained if the company categorizes its operating lease activities as capital leases.

In agency theory, an agent is a party who is given the trust and flexibility by the company owner (principal) to manage the company (Cuevas - Rodríguez et al., 2012). However, all his actions must be based on the interests of the company. The existence of information asymmetry between the two parties is sometimes used by agents to maximize their own profits or in other words not for the benefit of the company. The agent always strives to be able to show the best performance as a form of accountability to the owner of the company. This is what sometimes makes agents to justify any means so that their performance looks in accordance with the wishes of the owner of the company. Based on the hypothesis test, it shows that rental capitalization has a significant positive effect on unrecorded lease liability (URL). This shows that there is an indication that the management prefers to use an operating lease scheme to hide the company's debts, because

high liabilities can increase the solvency ratio and reduce the profitability ratio and activities, which means it worsens the company's performance. The results of this study are in line with previous research conducted by (Beattie et al., 1998), (Bennett & Bradbury, 2003), (Duke et al., 2009), (Wong & Joshi, 2015), (Öztürk, M., & Serçemeli, 2016), (Safitri et al., 2019), (Alabood et al., 2019), and (Mashuri, 2021), but there are slight differences with the research conducted by (Nuryani et al., 2015) which states that there is no significant difference in the Return on Equity Ratio (ROE).

Table 3
Analysis by Sectors

No	Sektor	URL	URA	Equity	DAR	DER	ROA	ROE	NPM	AT	Tax Savings
1	Basic and Chemical Industry	1,19%	0,47%	-0,15%	0,82%	1,16%	-1,32%	-1,08%	-1,56%	-	0,39%
2	Consumer Goods Industry	2,36%	0,78%	-0,23%	1,30%	2,38%	-1,64%	-0,37%	-1,06%	-	0,28%
3	Finance	0,21%	0,15%	-0,16%	0,35%	0,69%	-2,34%	-2,52%	-2,44%	-	0,57%
4	Infrastructure, Utilities and Transportation	11,92%	4,98%	-1,85%	5,18%	9,47%	-	-60,38%	-32,47%	-	4,46%
5	Mining	3,32%	1,93%	-1,08%	1,58%	25,25%	-7,26%	-27,80%	-17,95%	-	0,83%
6	Various Industries	1,27%	1,49%	-0,70%	0,00%	10,80%	-	-11,10%	-11,98%	-	1,04%
7	Trade, Services and Investment	7,31%	3,20%	-1,16%	6,70%	11,27%	-	-58,28%	-92,72%	-	1,56%
	Average	4,41%	2,38%	-1,14%	2,81%	11,87%	-	-24,69%	-18,76%	-	1,91%
							11,93%				3,27%

Source: Processed Data (2020)

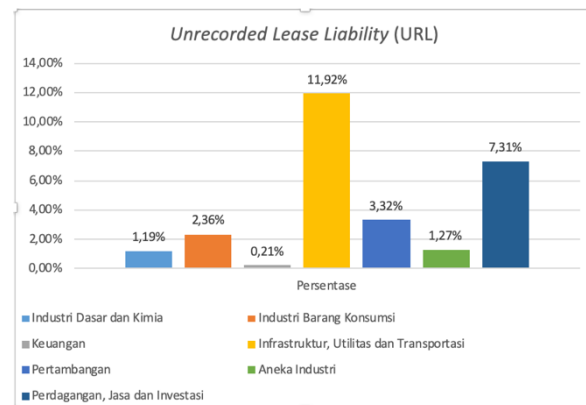


Figure 2. Graph of the Impact of Lease Capitalization on URLs

Source: Processed Data (2020)

After the Infrastructure, Utilities and Transport sectors, the sectors most affected are Trade, Services and Investment. Companies engaged in trading or retail do a lot of renting land and buildings. The rental of

these assets is needed by the company to market its products to reach many areas. As by PT. Graha Layar Prima Tbk. which is engaged in the film industry or which is one of the Trade, Services and Investment sectors. The company entered into a cinema room rental agreement with a total present value of operating leases reaching Rp 527,346,449,790 or 78.30% of the total liabilities presented in the statement of financial position. The results of this study are supported by previous research conducted by (Safitri et al., 2019) which examines the impact of rental capitalization on service, manufacturing and mining companies. The study stated that services were the largest sector that experienced the impact of rental capitalization, because the service industry carried out many operating leases on shops or buildings to run their business.

The third most affected sector is the mining sector. This finding is also similar to (Safitri et al., 2019), which states that after the service sector, the mining sector is the most affected by rental capitalization. In his research, it is stated that the sector carries out operating lease activities for production activities and coal loading and unloading operations. Of all mining sectors, in this study the company most affected was PT Energi Mega Persada with a total URL of 23.86% of the total reported liabilities. This company has a rental commitment related to heavy equipment used to support the company's operations. For this reason, due to the high price, the company uses operating leases as one of the assets procurement. This is followed by the Consumer Goods Industry sector, the Miscellaneous Industry sector, the Basic and Chemical Industry sector, and the last is the Finance sector.

Conclusion

Effectively entry into force of PSAK 73 on January 1, 2020, substantially changes the accounting for leases for the lessee. The

standard introduces a single accounting model for the lessee, namely recording the lease activity as a capital lease. Based on this, this study was conducted with the aim of knowing whether the capitalization of operating leases has an influence on the financial statements.

Based on the hypothesis test conducted using the Wilcoxon Test, it can be concluded that operating lease capitalization has a significant positive effect on unrecorded lease liability (URL). This is due to the recognition of lease liabilities that were not previously presented when the company classified its rental activities as operating leases.

Operating lease capitalization has a significant positive effect on unrecorded lease assets (URA). Right of use assets will appear on the statement of financial position, resulting in an increase in the company's total assets.

Capitalization of operating leases has a significant negative effect on equity. The recognition of greater expenses causes a decrease in the company's retained earnings.

Capitalization of operating leases has a significant effect on financial ratios. Changes in the elements of the financial statements result in changes in the company's financial ratios.

Capitalization of operating leases has an effect on tax savings. The recognition of a larger expense due to the capitalization of leases, causes a decrease in the tax burden that must be borne by the company.

Thus, there is a significant influence from the capitalization of operating leases, it is hoped that this research can be used by management and accounting practitioners in planning and formulating strategies so that they are not too affected by important changes in leasing. And, for the public and other stakeholders as external users of financial statements, it is hoped that this research will be able to provide knowledge on how to interpret information in financial statements after the implementation of the

new financial accounting standard, namely PSAK 73. It should be remembered, the size of the impact of rental capitalization cannot be generalized, because each company has different conditions. Suggestions for further researchers are expected to use this research as a reference and develop research related to operating lease capitalization and the application of PSAK 73: Leases, because in this study there are still some limitations related to the use of assumptions about the lease term and interest rates.

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