

Evaluation of the Classification of Liabilities or Equity on Convertible Bond Issuance Transactions at PT ABC

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Abstract. This research aims to evaluate the implementation of PSAK 50 (2014) in determining the classification of liabilities or equity on convertible bond issuance transactions at PT ABC. PT ABC is a start-up company with a status as a foreign investment company effective since third quarter 2020, which then issued convertible bonds in the fourth quarter 2020 which were entirely absorbed by only one party, XYZ. The convertible bond was issued as a payment instrument for the acquisition of 100% ownership in KLM, an overseas entity. This case study research uses qualitative descriptive analysis based on data analysis techniques, data reduction, data presentation, and conclusion drawing using text-based content analysis. The study demonstrates that it is important to consider a number of qualitative factors to ensure the true substance of the transaction is properly reflected in accordance with PSAK 50 (2014), and that the classification of an instrument as a liability or equity is heavily dependent on the specific facts and circumstances of the transaction. In this case, the results showed that the convertible bond instrument at PT ABC should be classified as equity rather than a liability. This conclusion is obtained by considering the substance of the transaction, including the fact that the convertible bonds have no contractual redemption or repayment obligations and are in substance mandatorily convertible into equity.

Keywords: Convertible Bond; PSAK 50 (2014); Classification; Liabilities; Equity; Substance Over the Form

I. Introduction

In 2021 the debate over the proper classification of convertible instruments between liabilities and equity in the United States came to a head, where at least 340 special purpose acquisition companies ("SPACs") made improvements and or restatements to their previously issued financial statements after the Securities and Exchange Commission ("SEC") finally provided clarification that deals sweeteners in the form of warrants provided to sponsors of the SPAC should be recorded as liabilities and not as equity. This clarification by the SEC has significant consequences. Over the years, SPACs have treated warrant instruments that allow investors to buy shares at a specific price in the future as equity. As a result of the SEC guidance, almost all SPACs were forced to reassess the accounting treatment they had applied, and ultimately conclude that the classification in their balance sheets was wrong. Meanwhile, auditors, lawyers, and consultants rushed behind the scenes to deal with what felt like an overnight change in practice (White, 2021). Some other research also finds that for the finance professionals, getting the classification right is not as important as not getting it wrong because they rely on the instrument's underlying features to make their decisions. In contrast, finance professionals differ in their opinion on which individual characteristics are most critical to determining the difference between both liabilities and equity (Clor-Proell et al., 2016); in the other case, the classification decision will impact the firm, as after the prerequisite that firms classify the mandatory conversion preferred stock hybrid instrument as a liability, the share of issuer firms' new financing declined (Levi & Segal, 2015).

Those are examples of the consequences of incorrect classification of financial instruments between liabilities and equity, which has broader implications than only SPAC transactions or transactions in the United States.

In practice, the classification of a financial instrument between liabilities and equity is not always straightforward. PSAK 50 (2014) (Ikatan Akuntan Indonesia, 2014) paragraph 18 emphasizes that the substance of a transaction is the basis for classification and not simply its legal form.

Considering the above, using the case study method, this study analyzes the classification of a financial instrument in the form of a convertible bond between liabilities and equity by taking an actual transaction that occurred at PT ABC ("ABC") in 2020. ABC is a holding investment company officially established as a Foreign Investment ("PMA") company in Indonesia in 2020. ABC, as a parent investment company, was established with the primary purpose of acquiring companies in Indonesia with an excellent operational track record, but was also affected by the Covid-19 pandemic and required assistance from outside investors to be able to continue operating during the Covid-19 pandemic.

In the 2020 financial statements (unaudited), ABC's total equity is IDR 1.4 trillion. However, of the total equity, the total issued and fully paid-up authorized capital was only IDR 1 billion, with a total equity deficit

of IDR 800 million. At the same time, the remaining balance was recorded as the "equity component in convertible bonds" of IDR 1.4 trillion.

The equity component of this convertible bond itself, when viewed in the notes to the financial statements, is described as a convertible bond issued by ABC as the issuing party and owned by XYZ Pte. Ltd ("XYZ") as the holder, a company incorporated and operating in Hong Kong, which is also a related party of ABC.

The convertible bond was issued as a payment instrument with a value of IDR 1.4 trillion to purchase shares of KLM Limited ("KLM"), a company established and operating in Macau – China. The classification of the convertible bond as equity in the 2020 financial statements was challenged by the external auditor during the financial statement audit process, based on the auditor's preliminary view the convertible bond may need to be classified as a liability.

This study, therefore, analyzes the substance of the terms of the convertible bond issued by PT ABC to determine whether based on PSAK 50 (2014) the bond should be classified as a liability or equity. This study is limited to an analysis of the classification of the convertible bond as a liability or equity in PT ABC's 2020 Financial Statements based on PSAK 50 (2014). The research method employed is qualitative, with a case study approach. The data used are the unaudited 2020 financial statements of PT ABC and the convertible bonds agreement which was analyzed using the content analysis method.

II. Literature Review

Although the International Accounting Standards Board ("IASB") and the Financial Accounting Standards Board ("FASB") have for many years discussed new concepts for distinguishing liabilities and equities, given traditional dichotomies and classifications have not always resulted in a 'correct' classification, the standard-setters (such as the IASB and FASB) still seem reluctant to change this conventional classification of liabilities and equity. Instead, exceptions to the standards have been applied in practice to overcome the dynamics of change in the business world, rather than undertaking a full reassessment of the standards for the classification of liabilities and equities at a conceptual level. In these circumstances, the conventional classification approach cannot accurately depict the desired actual transaction (Schmidt, 2013). This situation also gives rise to difficulty in applying the standards and results in different approaches among entities.

The reporting standards referred to above are the *International Financial Reporting Standards* ("IFRS") and more specifically the standards related to the classification between liabilities and equity, that is International Accounting Standards 32 – Financial Instruments: Presentation (International Accounting Standards Board, 2014), ("IAS 32"), which was later adopted in full in Indonesia in Statement of Financial Accounting Standards 50 – Financial Instruments: Presentation ("PSAK 50 (2014)") which was ratified on April 29, 2014 (Ikatan Akuntan Indonesia, 2014).

A number of studies have been conducted on the topic of the proper classification of financial instruments between liabilities and equity, using both United States Generally Accepted Accounting Principles ("US GAAP") and IFRS.

US GAAP uses an approach to recording the classification of liabilities or equity which is focused on distinguishing the interests between the company's creditors and the owners or management of the company (Hill et al., 2021), which is a concept referred to as the entity theory (Jayne Godfrey, 2010). However, this conventional view of the separation of the entity from its owners may not reflect the dynamics of the very fast-paced development of financial and capital markets in the modern era that has given rise to a new category of financial instruments combining the general characteristics of liabilities and equities, known as hybrid instruments, additionally proprietary ownership has multiple dimensions, each of which must be recognized. Furthermore, these dimensions vary depending on the type of organization; this adds complexity and makes distinguishing equity and liabilities based on a single criterion extremely challenging (López-Espinosa et al., 2012).

A study focused on the implementation of IAS 32 in the Netherlands noted that the implementation of IAS 32 caused most preferred shares to lose their classification as equities. Hence, these shares would be classified as liabilities (de Jong et al., 2006). Another recent study in South Korea looked into whether cooperative member shares are more like equity or liabilities in terms of economic substance. Members' shares have both equity and liability characteristics: they give members voting rights (like equity) and are redeemable (liability-like). The existing accounting norms for such classification are determined by the legal form. Redeemable member shares in South Korean consumer cooperatives have the same economic value as equity (Seo & Choi, 2021).

After the release of IAS 32, there was confusion about how to bifurcate convertible bonds into their liability and equity components. IAS 32 also does not specifically regulate how to calculate the liability

and equity components but rather only offers recommendations (Arak & Martin, 2005). To simplify and clarify the classification of liabilities or equities, (Hill et al., 2021) offer an alternative solution, namely the Earned Capital Approach, which is an approach based on the difference between the capital obtained from the issuance of claims (external capital) and capital obtained from the sale of goods and services (earned capital). In another research (Fargher et al., 2019) explained the result of their research that there are four approaches that standard makers can use to address this issue of liability or equity classification, namely: (1) Improve the definition of a liability; (2) Enhance the differentiation of the component approach; (3) Enhancing presentation and disclosure; (4) Using a mezzanine category.

Convertible Bonds

Convertible bond issuance may be the best option for companies that do not have a track record of outstanding historical performance but have a pipeline of good projects with unpredictable timelines (Liu et al., 2013). Convertible bonds give investors the right to convert such bonds into shares. This conversion right is restricted to investors only. The conversion itself is not mandatory and therefore remains at the investor's discretion, so the conversion is optional. The conversion ratio refers to the number of shares received at the moment of conversion, which is normally specified in the prospectus (Spiegeleer et al., 2014). Some convertible bonds may have a mandatory conversion feature whereby the debt obligation is mandatorily convertible to equity in the issuing entity once certain pre-determined criteria are met. Some convertible bonds also have a cash settlement feature that protects investors from losses. In addition, the issuing entity may also add some sweeteners to the conversion feature to attract investors, particularly at the early stage of the start-up business. This additional feature in convertible bonds remains advantageous for the issuing entity, as compared to direct-interest loans, as convertible bonds can result in lower cash outflows. In this case, the lender receives a lower interest rate on the funds upfront because the conversion feature will potentially increase investors' overall return (BDO, 2018).

Equity Instruments and Financial Liabilities

PSAK 50 (2014) (Ikatan Akuntan Indonesia, 2014) defines an equity instrument as any contract evidencing a residual interest in an entity's assets after all of its liabilities. A financial liability, on the other hand, is defined as any liability that is: (a) a contractual obligation: (i) to deliver cash or another financial asset to another entity; or (ii) to exchange financial assets or liabilities with another entity under potentially unfavorable circumstances for the entity; or (b) a contract that will or may be settled in the entity's equity instruments and is either (i) a non-derivative for which the entity is or may be required to deliver a variable number of the entity's equity instruments, or (ii) a derivative will or may be settled through means other than the exchange of a predetermined amount of cash or another financial asset for a predetermined number of the entity's own equity instruments.

Classification of Liabilities and Equity

PSAK 50 (2014) (Ikatan Akuntan Indonesia, 2014) in paragraph 16 states that the firm should consider the following factors when determining the categorization of liabilities and equity: When the firm uses the definition in paragraph 11 to decide whether a financial instrument is an equity instrument or not; If and only if both of the following conditions (a) and (b) are met, the instrument is an equity instrument: (a) the instrument has no contractual obligations: (i) to deliver cash or another financial asset to another entity; or (ii) to exchange financial assets or liabilities with another entity under potentially unfavorable conditions for the entity; or (b) (i) a non-derivative for which the entity has no contractual obligation to deliver a variable number of equity instruments of the entity; or (ii) a derivative that will or will not be resolved by exchanging a predetermined amount of cash or another financial asset for a predetermined number of the entity's own equity instruments.

PSAK 50 (2014) paragraph 18 (Ikatan Akuntan Indonesia, 2014); requires that the substance of a financial instrument determines its classification in the entity's statement of financial status, not simply its legal structure.

III. Research Method

This research uses a qualitative method with a case study approach, with the purpose of research to be able in-depth, comprehensive, holistic, thorough, and humanistic understanding of the background of a problem or the interaction of persons within a social unit or about a group of individuals (Yusuf, 2014).

This research uses a document review data collection method, consisting of data collected from various literature from previous research. The research approach used in this article is a case study method, using secondary data obtained directly from official sources to ascertain its credibility. These data are in

the form of data obtained directly from the company that is the object of research which is then reprocessed, plus relevant official data collected from the official websites of official professional bodies or organizations (i.e., IASB, FASB, IAI) as well as from the official websites of regulators in Indonesia (i.e., OJK, IDX).

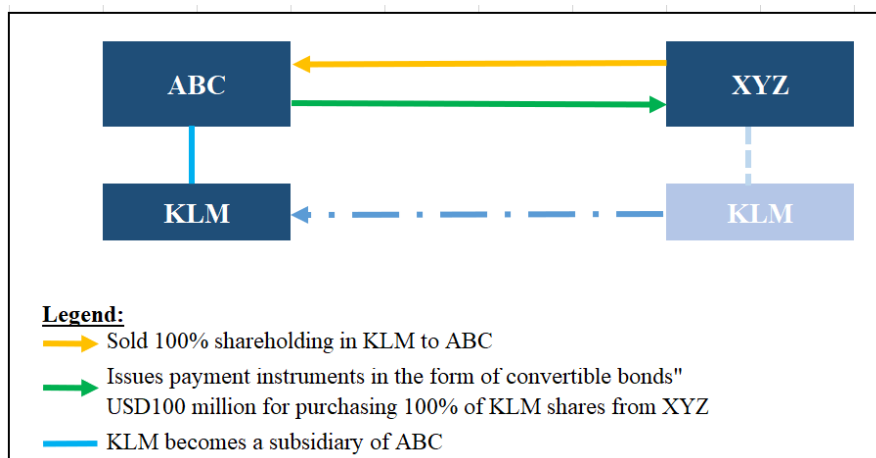
The data analysis technique in this study is the technical analysis of interactive data models in qualitative research by Miles and Huberman (Yusuf, 2014). First, the data reduction will start from ABC's 2020 – (unaudited) financial statements, where the analysis will focus on one transaction that is most material in the financial statements and in accordance with the subject matter in this case study, namely the convertible bond issuance transaction.

The convertible bond issuance transaction analysis will refer to the accounting standards directly related to the transaction, PSAK 50 (2014). In order to understand the substance of the transaction comprehensively, the analysis will also refer to the accounting standards that still intersected with this convertible bond issuance transaction, namely PSAK 7 (2015) and regulations from related regulators.

This study will use the content analysis approach to come to a conclusion on the subject matter of the study. Content analysis is a research method for drawing repeatable and reliable conclusions from a text (or other significant material) in relation to the context it was used (Krippendorff, 2004). Drawing conclusions in this study will use a text-based content analysis method, where temporary conclusions obtained during the data reduction process, presentation, and data analysis as mentioned above will validate along with new data and understanding throughout the analysis process in this case study.

IV. Results and Discussion

The transaction between ABC and XYZ began with the signing of a convertible bond agreement between ABC and XYZ, in which the agreement stated that the convertible bonds were issued by ABC to be used as a payment instrument for the purchase of KLM shares by ABC from XYZ for USD100,000,000, below is the flow of the transaction process:



Source: Data processing (2022)

Figure 1.1 Illustration of convertible bond issuance transaction and share acquisition by ABC

In the transaction process above, there are two interrelated transactions, namely:

1. XYZ transferred KLM's shareholding to ABC; and
2. Issuance of USD100.000.000 convertible bonds as a payment instrument for KLM's share acquisition transaction.

The important features of the convertible bond instrument agreed by ABC and XYZ are as follows:

- i. The total bond value of USD100,000,000 for the acquisition of 100% ownership of KLM shares the total value of the bond is equal to KLM's book value on the transaction date.
- ii. No interest is charged on these convertible bonds.
- iii. The maturity date is not specifically stated, but it depends on an event in the future, namely when ABC, as the issuer, has listed its shares on the IDX.
- iv. Full conversion and payment cannot be made before the due date.

- v. Full conversion is mandatory upon the pre-determined event (i.e., listing on the IDX) occurring. There is no other option for redemption or repayment of the bonds other than via the mandatory conversion.
- vi. Full conversion on the maturity date is carried out using an agreed conversion price rather than the stock market price on the maturity date.
- vii. The number of convertible shares to be issued to the convertible bondholders after full conversion is calculated according to the formula: Number of convertible shares = X/Y ; where X = Purchase Price to be converted and Y = Value per issued share as determined by the independent appraiser.

Background on the issuance of the convertible bonds and the relationship between the parties

As noted above, PSAK 50 (2014) paragraph 18 emphasizes the importance of understanding the substance of a financial instrument, rather than solely the legal form. One of the areas important to understanding the substance of the convertible bond issued by ABC to XYZ is the relationship between the parties and the motivation for the issuance of the convertible bond, which on conversion is likely to result in XYZ becoming the majority shareholder of ABC. While the relationship between the parties is not determinative in the classification of the instrument as a liability or equity, it is an important factor that goes to the substance of the transaction, which will be further discussed later in this paper. For the purposes of the discussion on the relationship between the parties this paper uses the definitions and concepts within PSAK 7 (2015) “Related Party Disclosures” as a reference for the analysis.

The 2020 Financial Statements of ABC do not disclose whether the issuance of the convertible bonds by ABC and the 100% absorption of such convertible bonds by XYZ were transactions between related parties as stipulated in PSAK 7 (2015).

However, considering the nature of the transaction, and the day-to-day operating practices of ABC, there are indications that ABC and XYZ may be related parties.

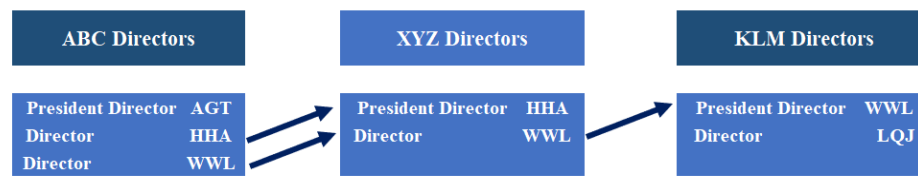
One of the key reasons behind the acquisition of XYZ and the issuance of the convertible bond is the need for ABC to strengthen its balance sheet and show an operating track record, both to meet the requirements for the planned listing on the IDX, and to give substance to the claim that it is a company that has the financial capability to make further acquisitions. Prior to the acquisition of XYZ and the issuance of the convertible bond the net asset value of ABC was only IDR695,000,000 and IDR191,000,000 as at 31 December 2019 and 2020, respectively, mainly representing the initial capital injection of the shareholders.

Based on the direction from the controlling shareholder of XYZ (“the controller”), the method that was taken to improve the value of ABC's financial position was to transfer ownership of one of the assets controlled by the controller through XYZ, namely KLM, to ABC. In return for the transfer of KLM, ABC then issued a convertible bond worth USD100,000,000 (equal to the net asset value of KLM at the time) to XYZ as the 100% shareholder of KLM.

It is clear that ABC did not have the financial resources to acquire KLM without XYZ (the 100% owner of KLM) accepting the convertible bond issued by ABC in full settlement for the transfer of ownership of KLM from XYZ to ABC. It is also unlikely that ABC would have been able to borrow from financial institutions or other investors on arm's length terms to fund the acquisition of KLM, given it did not have an operating business to cover interest payments or loan installments, or assets to provide as collateral.

At the time of issuance of the convertible bond, ABC was a shell company with no active operations. Therefore, upon issuance of the convertible bond and acquisition of KLM, the ownership of KLM effectively represented the entire operations and financial position of ABC. As the owner of the convertible bond, XYZ would therefore ultimately become the majority shareholder of ABC at the time of listing on the IDX.

In relation to the above, it can be noted that the triggering event of the issuance of convertible bonds is not to obtain cheap funding as is customary, but in substance, the transaction of issuance of such convertible bonds is an instrument of payment for the transfer between assets owned and controlled by the controller. The controller's ability to control the financial and operating decisions of ABC can be seen in the structure of the board of directors directly appointed by the controller at each of ABC, XYZ, and KLM as follows:



Source: Data processing (2022)

Figure 1. 2 Illustration of Board of Directors

In the composition of the board of directors, it can be seen that there are two individuals who sit on the board of directors of both XYZ and ABC, namely HHA and WWL. By looking at this organizational structure, it can be understood that the process of issuance and acceptance of 100% of the convertible bonds by ABC and XYZ, was controlled by the same controlling party, namely the controller, through the officers of the companies, namely the directors of the entities.

This situation can be seen to be consistent with that contemplated in PSAK 7 (2015), Paragraph 10 (Ikatan Akuntan Indonesia, 2015), which is explained as follows: "In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely the legal form."

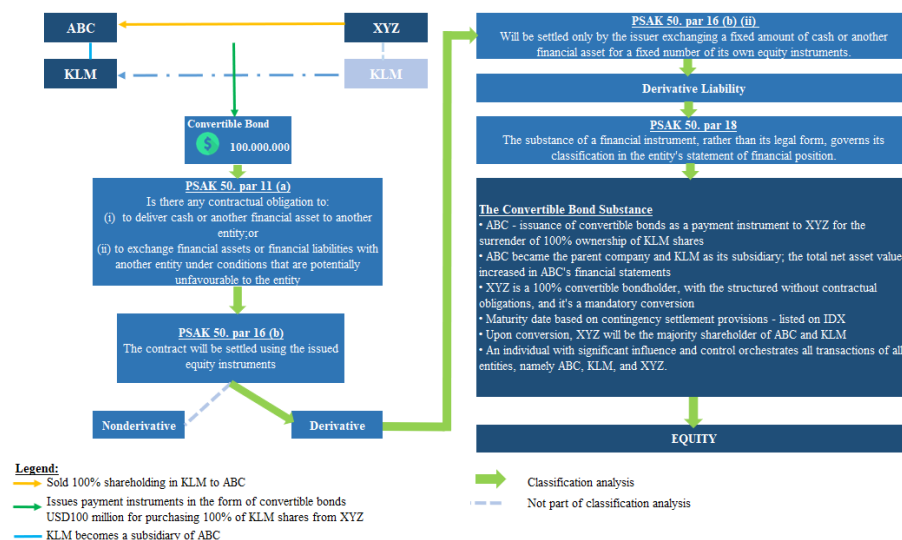
Based on the aforementioned presentation, it can be understood that the background to the issuance of convertible bonds by ABC which were fully absorbed by XYZ is a transaction to transfer the ownership in KLM, which is a subsidiary of XYZ, to become a subsidiary of ABC. The value of the convertible bonds used as a payment instrument for this transaction is equal to the net asset value of KLM, which is USD100,000,000.

Furthermore, ABC recorded the transaction in the financial statements for the year ended 31 December 2020, resulting in KLM becoming a consolidated subsidiary of ABC. In the consolidated financial statements for 2020 (unaudited), the net asset value of ABC has increased sharply in just four months since its acquisition was acquired in August 2020. This scheme is in line with the research findings that firms-issuers with poor financial performance will likely use convertibles in their investment strategy to boost their financial performance (Karpenko, 2019).

The facts and circumstances, therefore, indicate that the transaction was orchestrated by the controller, who, although not listed in the company structure, acts as ABC's operational funder, as well as has the ability to control the operating and financial decisions of ABC, XYZ, and KLM.

Analysis of convertible bond structure with reference to PSAK 50 (2014)

The chart below illustrates the assessment of the terms of the convertible bond issued by ABC to XYZ as described in the aforementioned analysis, against the criteria for the classification of a financial instrument as a liability or equity set out in PSAK 50 (2014):



Source: Data processing (2022)

Figure 1. 3 Decision tree summarizing analysis of the classification of the convertible bond of PT ABC as a liability or equity based on PSAK 50 (2014)

PSAK 50 (2014) paragraph 11 (a) – Financial liabilities – contractual obligation

In the convertible bond agreement, there is no contractual obligation as intended in PSAK 50 (2014) paragraph 11 (a) mentioned above, namely that the issuing party has no contractual obligation to pay off the convertible bonds by surrendering or exchanging cash or other financial assets to the convertible bondholders. The only option for settlement of the convertible bond is conversion to shares in ABC upon the occurrence of the predetermined event, being the listing of ABC on the IDX.

Under normal circumstances, it would be expected that the convertible bond would be subject to interest, a specified maturity date, and a clear acknowledgment of a contractual obligation that needs to be settled either by conversion to shares or repayment under certain circumstances.

However, as discussed earlier, since the motivation for issuance of the convertible bond was effectively to transfer ownership of KLM to ABC, under the control of the controller, the controlling shareholder of XYZ, it is understandable that the only form of settlement of the convertible bond is conversion to shares in ABC, which would effectively result in XYZ becoming the majority shareholder of ABC, and the controller, therefore, maintaining control of both ABC and KLM.

Further, the legal terms of the signed convertible bond agreement also do not specify any contractual liability as intended in PSAK 50 (2014) paragraph 11 (a) in respect to the definition of a liability. So, in this case, the convertible bond agreement does not meet the definition to be classified as a liability.

PSAK 50 (2014) paragraph 16 (b) Settlement using equity instruments

PSAK 50 (2014) paragraph 16 (b) states that a financial instrument is an equity instrument if there is no contractual obligation to conclude the contract by delivering or exchanging cash or other financial assets, and the settlement of such contract will also or may be settled using equity instruments issued by the entity and is: (i) a non-derivative for which the entity has no contractual obligation to deliver a variable number of equity instruments of the entity; or (ii) a derivative that will or will not be resolved by exchanging a predetermined amount of cash or another financial asset for a predetermined number of the entity's own equity instruments.

As analyzed previously, the convertible bond agreement does not meet the definition of a liability because it does not have a contractual obligation in its structure, but rather the convertible bond agreement requires that the bond will be settled using an equity instrument, namely by conversion into ABC's own shares at the maturity date, which is the date when ABC is first listed on the IDX.

The conversion of ABC's own shares will be carried out with a predetermined conversion value, namely:

1. 10% discount from the price of the weighted average volume of ABC's shares within the specified seven business days immediately prior to the notification of the conversion.
2. A cash premium of US\$5 (in the form of equivalent Rupiah) per share, paid in cash to the Issuer.

Based on the predetermined conversion above, then this option to convert shares can be categorized as a derivative liability because:

- i. The value of the shares that are later converted will change in response to price changes based on the weighted average volume of shares within seven working days prior to the conversion date.
- ii. The net initial investment of a smaller amount compared to the required amount on other types of contracts is expected to produce a similar impact on changes in market factors.
- iii. It will be settled in the future, in this case, when it matures, that is, when ABC is listed on the IDX.

The characteristics of the derivative above are in accordance with the definition of derivatives in PSAK 71 (2020), namely: A financial instrument or another contract that contains all three of the following features: (a) Its value changes in response to changes in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or another variable, provided that the parameter is not specific to a contracting party (occasionally referred to as the 'underlying'); (b) It requires no initial net investment or a lower initial net investment than would be required for other types of contracts that are expected to respond similarly to changes in market factors; (c) it will be resolved at a future date.

Under the convertible bond agreement, the aforementioned derivative liabilities will not be settled by exchanging a certain amount of cash or other financial assets for a certain amount of equity instruments issued by the entity; in other words, the fixed for fixed criteria do not apply, but rather the settlement will use the following formula: Number of convertible shares = X/Y ; where X = Purchase Price to be converted and Y = Value per issued share as determined by the independent appraiser.

Derivative liabilities will be settled by converting X , which is the value of a fixed convertible bond totaling USD100,000,000, divided by Y , i.e., the value per share determined by an independent appraiser based on market conditions and ABC's own conditions in the future. Such value will then be discounted again by 10% of the price of ABC's weighted average volume of shares within the specified seven business days immediately prior to the notification of conversion.

Based on the above formula, it can be seen that XYZ as the convertible bondholder, will receive a number of shares (percentage of ownership of ABC) that varies with a fixed total value of USD100,000,000 convertible bonds.

Based on the analysis above, the convertible bond will be settled using an equity instrument, namely by conversion into ABC's own shares at the maturity date, so that the convertible bond is a derivative liability as intended in PSAK 50 (2014) paragraph 16 (b) (ii).

PSAK 50 (2014) Paragraph 18 – Substance of the Transaction

PSAK 50 (2014) paragraph 18 emphasizes that in determining the classification of a financial instrument as a liability or equity, the substance of the financial instrument and not only its legal form should be considered. In addition, PSAK 50 (2014) paragraph 11 (a) states that the basic criterion for classifying a financial instrument as a liability is when there is a contractual obligation for the party issuing the financial instrument to settle the instrument by handing over cash or other financial assets or exchanging financial assets or financial liabilities under unfavorable conditions.

Meanwhile, the structure of the convertible bond issued by ABC does not contain a contractual obligation as contemplated by PSAK 50 (2014) Par 11 (a).

On the contrary, the substance of the convertible bond terms clearly requires settlement of the bond only through conversion into shares of ABC once it has been listed on the IDX. This may even be interpreted to require mandatory conversion of the bond into shares of ABC upon the occurrence of the predetermined event, being listing of ABC on the IDX, as set out in the convertible bond agreement:

“The Maturity Date with respect to this Convertible Bond is defined as seven days after the date on which the Holder requests the Issuer to convert the Convertible Bond into shares in the Issuer; therefore, the Convertible Bond may be considered perpetual ON THE CONDITION THAT the Issuer must first be recorded on the IDX prior to such request”.

There is no other clause in the convertible bond agreement that provides a maturity date or deadline for when ABC should be listed on the IDX. Meanwhile, there is no cash transfer either in the form of interest payments and installments for repayment of the principal of the loan or other financial assets within the time frame until the fulfillment of the aforementioned conditions and also no obligation to repurchase or repay the convertible bonds in the event that ABC is determined to have failed in its efforts to be listed on the IDX.

Further, prior to this maturity date (i.e., listing of ABC on the IDX), there is no avenue for the bond to be converted either at the option of the issuer or the holder, as stated in the terms of the convertible bond agreement:

“Issuer hereby waives and denies any right to, and shall not be entitled to, pay the Purchase Price prior to the Maturity Date for any reason and the Holder hereby acknowledges that it is not entitled to request the conversion of the Convertible Bonds prior to the Maturity Date for any reason”.

Further, settlement of the convertible bond is designed to be carried out only by way of conversion, as stated in the convertible bond agreement as follows:

“(a) On the Maturity Date, the Bondholder exercises his or her right or option to convert this Convertible Bond into Shares; (b) In the event of a Full Conversion, immediately upon receipt of an issued and signed share certificate proving the Convertible Shares, a photocopy of the Share Register showing the Holder as the owner of the Convertible Shares, and all payments, if any, under this Convertible Bond, the Holder shall return these Convertible Bonds to the Company, and this Convertible Bond Certificate shall be deemed to have been paid off.”

As explained in the clauses in the convertible bond agreement presented above, it can be seen that indirectly the convertible bond agreement is designed with an unusual power relationship, where the issuer of the convertible bond has no contractual obligations and has the power to be able to regulate and determine when the maturity date can occur unilaterally, while the convertible bondholder does not receive any economic benefits in the form of cash given the absence of interest and repayment of the principal of the loan. There is also no certainty of the timing of settlement given the contingent elements, namely the listing of the bond issuer on the IDX without any specified deadline and the absence of certainty of control over the occurrence of the event in the future.

Furthermore, in the convertible bond agreement, it is stated that the convertible bond is issued as a payment instrument for the purchase of KLM shares, as follows:

“The parties have entered into the Share Sale and Purchase Agreement on the same date as the convertible bond agreement, in which the Parties agree that the purchase price of KLM Shares is USD100,000,000. - to be paid to the seller by issuing convertible bonds to the Seller.”

Based on the explanation in the convertible bond agreement mentioned above, it can be concluded that the trigger event for the issuance of the convertible bond itself was when XYZ handed over 100% of its ownership of KLM to ABC. The convertible bonds represent the full and final payment instrument for the acquisition of the shares in KLM. The issuance of the convertible bond by ABC was therefore not triggered by the internal plan of ABC management in order to develop its business by obtaining cheap funds in the investment market, taking into account the financial condition of ABC itself which was not yet bankable to obtain loans directly from financial institutions.

In addition, when taken from the point of view of XYZ as a convertible bond holder, the underlying economic motive is very unusual, where XYZ gives up 100% ownership of its assets, namely KLM, which has a book value of USD100,000,000 and receives payment in the form of financial instruments which are interest-free conversion bonds with an unclear maturity date.

This is certainly very contrary to the motives of convertible bondholders in general who seek economic benefits by obtaining a fixed interest rate and repayment of the principal of the loan in full on the maturity date and or can exercise their rights, namely converting into ownership shares. In terms of risk, investors will be better protected because even if the share price of the convertible bond issuer is declining, investors will still receive interest payments and repayment of the loan principal in full on the maturity date (Brigham & Ehrhardt, 2017).

From these conditions, it can be concluded that XYZ as a convertible bond holder has no intention to obtain economic benefits in the form of cash since the beginning of the convertible bond agreement was signed, nor does it "require" ABC to be listed on the IDX.

With reference to PSAK 50 (2014) paragraph 18 (Ikatan Akuntan Indonesia, 2014), considering the substance over the form of the transaction and based on the analysis of the motives for the issuance of the above convertible bonds by ABC, it can be concluded that:

- Prior to the issuance of the convertible bond, ABC only had a net asset value of IDR191,000,000 and did not have an income stream from its own business operations.
- ABC issued a convertible bond as a payment instrument to XYZ for the handover of 100% of KLM's share ownership
- There are no contractual obligations, and repayment can only be made by way of conversion.
- XYZ is the only holder of such convertible bonds, with a convertible bond structure designed not to provide any economic benefits to XYZ other than ultimate conversion into shares of ABC.
- The convertible bond is designed as an instrument to unite two assets owned by XYZ, namely ABC and KLM, in which case ABC is chosen to be the parent company and KLM as its subsidiary.
- XYZ will remain in full control and will legally become the majority shareholder of ABC and KLM if, upon the maturity date, XYZ will exercise its rights by converting the bonds into shares in ABC once listed on the IDX.

Based on the above conclusions, it can be understood that the substance of the transaction of issuance of convertible bonds by ABC is not a transaction of financial instruments that can be classified as a liability in the financial statements of ABC, but rather it is in the nature of an equity transaction.

V. Conclusion

The analysis provided above in this case study of the issuance of convertible bonds by ABC clearly demonstrates the importance of considering the substance of a financial transaction rather than only the legal form. The comprehensive application of accounting principles, in this case, the provisions of PSAK 50 (2014), assists the practitioner in coming to the right conclusion in the classification of a financial instrument as either a liability or equity based on the substance of the transaction.

Based on the results of the analysis of the application of the substance over the form of the transaction, and applying a comprehensive understanding of the relevant accounting principles in relation to the issuance of convertible bonds by ABC, the following conclusions can be drawn: (1) The transaction is a transaction between related parties; (2) The substance of the convertible bonds supports its classification as an equity instrument rather than a liability; (3) The impact of classification as equity will reduce ABC's debt-equity ratio, and reflect the true substance of the transaction which is likely to result in XYZ becoming the majority shareholder once the bonds are converted, and ultimately dilute the existing shareholders.

Apart from the above, there are still limitations in this research in terms of the following: (1) Limitations of the case study by taking the ABC convertible bond transaction as the object of the case study, which does not include hybrid financial elements in the transaction; (2) Limitations in the discussion of XYZ as the principal in this transaction due to the limited information available.

Based on the case study and data analysis, conclusions, and limitations of the study, suggestions for further research are as follows: (1) Using the example of financial instrument transactions – convertible bonds, which are more complex, so as to require an assessment and understanding of accounting principles from a broader perspective; (2) Using benchmarks of similar transactions that occurred in developed countries to provide a different point of view; (3) Using the example of financial instrument transactions in public companies in Indonesia.

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