New Trends in Leasing Accounting

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Abstract

The financial leasing market in Romania has a history of about 20 years. During this short relationship, there have been impressive growth rates almost every year until 2009. By the end of 2009, the new volume per year has fallen more than 4 times compared to 2008, reaching EUR 1.3 billion in 2009 compare to EUR 4.8 billion (ALB Romania, 2017).

An entity shall apply IFRS 16 Leasing contracts for annual periods beginning on or after 1 January 2019. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure for accountimg of the leases. The objective is to ensure that leasing companies and locators provide relevant information in a way that accurately represents those transactions. Based on this information, users of financial statements can assess the effect that leases have on an entity's financial position, financial performance and cash flows.

Key words: lease, accounting, fair value.
J.E.L. classification: M41, G32

1. Introduction

The year 2017 was a good year for the financial leasing industry, so in the first nine months of the year, the leasing companies financed the value of Lei 7,627 million (EUR 1,700 million), up 14% over the same period of the previous year (Association of Financial Societies - ALB Romania, 2017). However, growth has been robust in terms of the leasing market, remarkably slowing the growth rate compared with the previous years.

The growth of the industry was mainly due to the increase in motor vehicle financing (24% year / year), with the leasing industry being positively influenced by the increase in demand for new cars that advanced 17% in the first three quarters of the year, but also for second hands that grew by 70%, according to data published (ALB Romania, 2017). Light vehicles registered a substantial increase (27% a year /year), such as farm equipment (48% year / year) and real estate financing (54% year / year), although the latter have a relatively low share of total financing of financial leasing companies. Other categories of equipment recorded declines, mainly medical (ALB Romania, 2017) .

Vehicles have increased their market share in total funding to 38% in the first three quarters of the year, gaining ground over other vehicles (34%), while equipment financing continues to account for a quarter of total new financing (ALB Romania, 2017) .

Although there is a tendency to orient the new financing to the local currency, the financing in the euro remains prevalent, holding a share of 79% of the total financing, but decreasing compared to 2015 when it accounted for 85% (ALB Romania, 2017).

2. Recognition of the lease

Leases are classified as financial leasing or operating leases. The classification of leasing contracts depends on the economic way of executing the transactions and not exclusively on the form of the contract. A lease transaction is financial when all the costs and benefits associated with ownership are transferred to the lessee; all other leasing operations are operational leasing operations (IASB , 2016).

The operating leasing market recorded an increase of 12.3% in the first half of 2014 compared to the same period last year, exceeding the threshold of 45,000 units, according to a press release of the Association of Operating Leasing Companies (ASLO). In the first six months of the year, approximately 5,400 new vehicles were registered by operating leasing companies, more than double the first half of last year, accounting for more than 15% of total new car registrations and light commercial vehicles. The evolution recorded in the first six months of 2014 overlaps over a period of economic growth and the resurgence of car sales, says ASLO (ALB Romania, 2017).

According to data centralized by the Association of Operating Leasing Companies, LeasePlan Romania, ALD Automotive, Porsche Mobility, Arval Service Lease Romania and Fleet Management Services were among the top five companies. ASLO estimates that the total operating lease market could reach 47,000 units at the end of 2014, given the interest in operational leasing and fleet management services, manifested by an increase in the number of requests from car fleet companies (ALB Romania, 2017).

The demand for operational leasing and fleet management has increased significantly in the first half of this year, and the results have not been delayed, with the trend being materialized by the conclusion of a larger number of contracts than in 2013. This has contributed both re-launching investments by increasing the absorption rate of European funds and increasing competitiveness, which has led to a reduction in costs for end-users, according to ASLO President Daniel Ivan (ALB Romania, 2017) .

At the level of the members of the association, which represent 90% of the total market, the full operational leasing (fleet financing and fleet management) dominates with a 69% share, followed by fleet management 23%, the rest representing operational leasing).

According to ASLO, the trend is a migration of preferences to small and compact cars with a 1.6-liter engine and low operating costs.

3. Cost-based model

To apply the cost model, a user must assess the use of the asset at the historical cost less the cumulative depreciation in the account and any additional impairment losses that are adjusted for the lease revaluation resulting from the lease (IASB, 2016) .

The operating leasing market exceeded 62,000 units in management at the end of the first quarter of 2017, up 3% from the end of 2016, according to data announced by the Association of Operating Leasing Companies (ASLO) (ALB Romania, 2017) .

During January-March, nearly 4,300 vehicles were registered by operating leasing companies, accounting for 16% of all new registrations, of about 26,000 cars and light commercial vehicles.

The results of the first quarter of 2017 confirm the positive evolution of the operational leasing and fleet management market, in line with the expectations for the end of the year. Increase of the full service leasing share by over 8% over the similar period of the year the past is proof of increasing market maturity and adoption of the benefits of our core product, according to Dan Boiangiu, ASLO President (ALB Romania, 2017). Another indicator that marks a significant increase is the share of operating lease registrations in total new vehicle registrations, which reached 16% compared to 13.3% as it was at the level of the whole year 2016. This share by 20% large, reconfirms both the growing popularity of our product among local companies, including SMEs, as well as the significant contribution of our industry to increasing the pace of company renewal. This is all the more important as the removal of stamps has significantly reduced the share of new vehicles in total new registrations in Romania, he added (ALB Romania, 2017).

According to data centralized by the Association of Operational Leasing Companies, LeasePlan Romania, ARVAL Service Lease Romania, ALD Automotive, Porsche Mobility and BCR Fleet Management are among the top 5 companies (ALB Romania, 2017).

The members of the association account for over 97% of the total market. The portfolio structure (at the association level) consists of full operational leasing services (fleet financing and management) with a 76% share, followed by fleet management 16%, the rest representing operating leasing without administration services (ALB Romania, 2017).

Starting with 2019, for companies reporting IFRS financial statements, a new standard - IFRS 16 *Leases* - will enter into force with 2018 training (IASB , 2016) . According to expert estimates, these changes will not diminish the benefits offered by the operational leasing product.

4. Classification of leasing contracts

A lessor must classify each of its lease contracts either as an operating lease or as a finance lease. A lease is classified as a finance lease if it transfers substantially all the risks and rewards of ownership over a underlying asset. All other leasing contracts that are not financial leases will be classified as operating leases (Nicolae, 2010).

The problems raised by the sale and leaseback contracts sometimes make the leasing companies difficult, according to an analysis of ALB Romania (ALB Romania, 2017). The criteria for qualifying a leasing contract as financial or operational differ from the accounting perspective to the fiscal one. Although the two sets of criteria provided by the Order of the Minister of Finance number 1804 from 2014 and according to the Fiscal Code, respectively, seem to be very similar, there are some differences of nuance that can lead to the different classification of the same leasing contract from the accounting and tax point of view respectively.

A lease may be recognized as an operating lease if it does not meet any of the conditions listed above. For example, if, under a sale and leaseback operation, the lease is financially accounted for as a financial asset, the transaction would be treated as a simple financing operation - generating only interest and commission charges paid in the leasing contract.

On the other hand, if the same leasing contract concluded in a sale and leaseback operation were classified as operational from a tax point of view, the sale and leaseback operation could be treated, at least in terms of tax, as a sale followed by a lease of the same asset, generating both incomes and expenses different from those recorded in the accounting. Under these circumstances, the question arises as to whether the differences in tax treatment from the accounting one would, in the calculation of corporation tax, generate similar items of income and expense. On an affirmative answer, there is a need for a double register of youngsters - for accounting and tax reporting, which would further aggravate the administrative obligations of Romanian companies.

5. Initial assessment of lease payments included in the net lease in lease

At the date of commencement of the lease, the lease payments included in the net lease valuation include the following payments related to the right to use the underlying asset during the lease term and which are not paid when the leasing contract commences (Nicolae, 2010) fixed payments (including fixed payments to the fund), minus any debt arising from leasing contracts.

If the lessee has calculated the present value of the minimum lease rates using the interest rate specified in the lease, such a present value will normally be less than the fair value of the leased property (net grant and tax credits) at the beginning of the transaction of leasing (Nicolae, 2010). During the leasing operation, each lease rate will be allocated between a debt reduction and the financial expense so as to produce a constant periodic rate of residual debt throughout the amortization period. The asset initially recorded is depreciated in a manner consistent with that used by the lessee for the assets it holds (Nicolae, 2010).

Depreciation is usually based on the useful life of the leased asset; or, for the shortest duration between the duration of use and the duration of the leasing contract. Conditional rentals are generally not included in the minimum lease rates and therefore are not accounted for as part of the capitalized leased asset (Nicolae, 2010). They should be credited over the periods they are related to. Minimum lease payments exclude contingent rentals (part of the lease payment whose settlement depends on an event, other than the passing of time), but includes any payment due by the lessee.

It is important to note that from the point of view of the quality of the national portfolio, according to the National Bank of Romania, a decrease in the share of overdue and doubtful debts in the total net asset value by 14.5% is recorded in the NBR registered in the Special Register (ALB Romania, 2017).

The evolution of the Romanian leasing market follows the same upward trajectory of the entire balance of commitments granted by the IFNs, a balance that registered an annual growth of 14.2% according to the NBR statistics (ALB Romania, 2017).

Recovery of the leasing business is a feature at European level, particularly evident in the car leasing segment, with most of the national markets registering double digits, while leasing equipment financing indicates growth discrepancies between countries. The volume of new leasing finance for cars increased by 15.9% in 2015 compared to 2014 (ALB Romania, 2017).

A slower but still vigorous overall growth of 11.3% was for commercial vehicles. The IT & Office equipment segment improved well on average, increasing by 10.9%, largely due to significant increases in only a few countries(ALB Romania, 2017).

6. Accounting for a financial lease in the user's account

At the commencement of the term of the lease, lessees shall recognize the finance lease in their balance sheet as assets and liabilities at an amount equal to the fair value of the leased asset or the present value of the minimum lease payments if the latter is smaller. For calculating the present value of the minimum lease payments, the implicit interest rate in the lease is considered as an update if it can be determined. Otherwise, the marginal interest rate of the lessee should be used. Any direct lessee's direct initial costs are recognized as assets (Nicolae, 2010).

Lease payments have to be divided into leasing financing costs and reduction of unpaid debt. Funding costs should be allocated over periods over the lease term so as to obtain a constant periodic rate of interest on the outstanding balance of each period (Nicolae, 2010).

A finance lease gives rise to amortization expense and financial expense in each accounting period. The depreciation policy for leased assets should be consistent with that applied to depreciable depreciable assets, and depreciation recorded should be calculated based on the provisions of IAS 16 Tangible assets. If there is no reasonable assurance that the lessee will acquire the right of ownership until the end of the lease term, the asset must be fully depreciated for the shortest duration of the lease term and the useful life of the lease (Nicolae, 2010).

<u>Example</u>

The entity Subalroxl purchases a car under a finance lease in 2016 under the following conditions: CIP value (excluding taxes) = 34,000 Euro; DDP (with taxes included) = 40,800 Euro; Advance (CIP) = 10,000 Euro; Contract duration = 5 years; Annual interest rate = 6.5%; Annual CASCO insurance rate = 6%; Exchange rate: 4.5 lei / Euro.

CIP value (excluding taxes) = 34,000 Euro x 4,5 lei = 153,000 lei

Advance (from CIP) = 10,000 Euro x 4,5 lei = 45,000 lei

Funded volume (Capital) = € 34,000 - € 10,000 = € 24,000

Monthly capital / debt ratio = 24000 euro / 60 months = 400 Euro x 4.5 lei = 1800 lei;

Interest rate = 24.000 Euro x 6.5% = 1560 euro / 12 months = 130 Euro x 4.5 lei = 585 lei

Monthly CASCO insurance rate paid = 40,800 euro x 6% = 2448 euro / 12 months = 204 Euro x 4,5 lei = 918 lei

Accounting records:

1.Advance payment receipt:

Table no. 1 Sales on credit vendor

Debit	Credit	Amount
%	Providers of tangible assets	<u>54,000</u>
Suppliers borrowers		45,000
VAT deductible		9,000

Source : Author processing

2. Advance payment:

Debit	Credit	Amount
Providers of tangible assets	Balances with banks	54,000

Source : Author processing

3. Car registration:

Debit	Credit	Amount
Means of transport	Other borrowings and assimilated debts	153,000

Source : Author processing

4. Invoice for the monthly installment - capital + interest:

Debit	Credit	Amount
%	Providers of tangible assets	2,862
Other borrowings and assimilated debts		1,800
Interest charges		585
VAT deductible		477

Source : Author processing

5. Rate invoice payment:

Debit	Credit	Amount
Providers of tangible assets	Balances with banks	2,862

Source : Author processing

6. Invoice Insurance CASCO:

Debit	Credit	Amount
Expenditure on insurance premiums	Providers	918

Source : Author processing

7. Payment of Invoice CASCO insurance:

Debit	Credit	Amount
Providers	Balances with banks	918

Source : Author processing

8. Calculate and record depreciation:

Annual amortization = 153,000 / 5 years = 30,600 lei / 12 months = 2,550 lei

Debit	Credit	Amount
Operating Expenses on Depreciation of Fixed Assets	Depreciation of machinery and equipment	2,550

Source : Author processing

7. Conclusions

Financing and operational leasing is an interesting alternative for all categories of entities in the Romanian economy. In the current period, the chances of a sustained increase in the volume of leasing transactions are seen.

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