NORMALIZING LEASING OPERATIONS. NATIONAL ISSUES

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Abstract:

The current economic context requires companies to have the capacity for innovation, dynamism and flexible approach of the techniques to finance business, meaning choosing the best solutions both in terms of costs and in terms of the accounting impact.

A financing decision must be the result of management involvement and company accountancy involvement. Changing the economic environment where companies act requires the reconsideration of financing sources and the use of all solutions, including leasing.

The dynamics of the leasing sector, the increase in the level of using this technique as a financing source, both due to the lending restrictions caused by the eligibility conditions imposed by the banking sector and as a consequence of increasing the degree of economic culture, make it necessary to know how the normalization of leasing operations works.

Based on such considerations, the present paper aims at highlighting the main issues of leasing operations, both as a trade and financing variant, and their accounting treatment.

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1. Conceptual Approaches

Leasing is a technique of economic affairs, namely of trade and finance with tangible and intangible assets, which is based on a tenancy agreement granted by financial companies specializing in these operations, by financial institutions or directly by producers, to enterprises or individuals, and on the expiry of the tenancy agreement, the user is entitled to a threefold option: to buy the asset at its residual value, to extend the lease agreement, or to cease the operation (Puiu Al., 2008).

Typically, performing a lease transaction requires the existence of three people: the supplier - asset manufacturer, the financing company - leasing company, and the user. The mechanism of initiation and development of leasing involves the following direction, namely: the leasing company, following an inquiry received from the user, acquires an asset from the manufacturer and gives it to the user for a definite period of time in return for fixed monthly royalties. The mechanism generates the existence of two agreements: a sales and purchase one concluded between the leasing company and the manufacturer, and a tenancy agreement concluded between the leasing company (the lessor) and the user (lessee).

Leasing is treated both as a trade variant - as it allows the manufacturer to identify new ways of meeting customers' needs to access products and services to meet the most diverse needs, as well as a form of financing, because the user within a leasing operation uses the business technique when he/she does not have enough resources for financing an activity, or wishes to allocate the resources to other more profitable areas.

Using leasing as a business financing technique can be the result of less favourable circumstances in obtaining bank loans, efficiency in obtaining a certain asset and some simplicity induced by the process of obtaining the asset via leasing.

The main advantages of using this financing technique for the user aim at (Ciochină I., 2009):

- performing investment without having the necessary funds;
- using available funds to increase working capital;
- accessing the latest technology;
- having the opportunity to benefit from a series of tax incentives offered by the state, namely the deduction of expenses via leasing installments;

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- having the threefold option, that is the opportunity for the user to decide whether or not to return the asset upon agreement completion, whether or not to extend the agreement or whether or not to purchase the asset at its residual value. This allows the user to have access to necessary assets even if the work they perform is conjectural.

2. Leasing Market

The world leasing market indicates a total value of 884 billion Dollars for the year 2013. While evolving, the leasing market has three points (Table no. 1):

- period **1994 – 2007** – a period of growth from 356.4 to 732.8 billion Dollars, i.e. an increase of 118.97 times. During this period, the highest growth was reported by Europe, from 87.5 to 401.2, i.e. an increase of 4.59 times
- period **2007 - 2009** - a period when the economic-financial crisis which began in the US affected the leasing market which decreased from 780.4 to 557.5 billion Dollars
- period **2010 – 2013 -** a period of economic recovery, of improving businesses including leasing businesses which managed to reach 884 billion Dollars (globally).

Table no. 1. Leasing Market Development

US($bn)	1994	2007	2008	2009	2010	2011	2012	2013
Europe	87.5	401.2	336.7	220.4	233.0	302.7	314.0	333.6
N. America	108.0	237.9	226.1	190.8	213.3	292.5	336.4	335.1
Asia	99.2	84.6	99.2	103.8	105.6	153.4	180.2	177.3
S. America	11.1	41.4	54.2	30.2	25.4	27.5	13.2	18.0
Australia/NZ	5.9	8.6 4	1 6.9	5.7	10.8	12.0	16.1	12.5
Africa	4.7	11.2	9.6	6.5	6.4	8.6	8.2	7.5
Total	356.4	780.4	732.8	557.3	594.5	796.7	868.0	883.96

Source: World Leasing Yearbook, White Clarke Global Leasing Report, 2015

Trying to make a ranking of the most developed regions in terms of leasing business (Table no.2) provides important data, namely: North America region which includes the US, Canada and Mexico is the largest region in terms of the leasing business, with a level of 335.1 billion Dollars, i.e. 37.9% of the market (Table no.2). Europe ranks second with a share relatively close to the North American market, while Asia ranks third with a share of the total business market amount of 20%.

Table no. 2. Structure of World Leasing Market (2013)

Ranking per amount	*Region*	Amount	% of world market amount
1	America de Nord	335,1	37,9
2	Europa	333,6	37,7
3	Asia	177,3	20,1
4	America de Sud	18,0	2,0
5	Australia	12,5	1,4
6	Africa	7,5	0,8
	Total	**883,96**	**100**

Source: World Leasing Yearbook, 2015, p.5

Analyzing the leasing market in terms of its share of the GDP, one can see that the most developed market across Europe is Estonia which keeps its ranking first during the analyzed period (2011-2013, Table no. 3), whereas the leasing market in Romania reported a decrease from ranking 27th in 2011 with a transaction amount of 1.37 of the GDP, to ranking 35th in 2013 with a transaction amount of 0.78 of the GDP.

Table no. 3. Amount of Leasing Transactions in Some EU Countries

2013			*2012*			*2011*		
Rank-ing	**Country**	**Share**	**Rank-ing**	**Country**	**Share**	**Rank-ing**	**Country**	**Share**
1	Estonia	5,91	1	Estonia	6,32	1	Estonia	5,13
19	Bulgaria	1,51	20	Bulgaria	1,42	4	Bulgaria	2,48
28	Hungary	1,09	33	Hungary	0,87	6	Hungary	2,45
35	**Romania**	**0,78**	**34**	**Romania**	**0,86**	24	Serbia - Montenegro	1,55
37	Serbia - Montenegro	0,72	40	Serbia - Montenegro	0,63	**27**	**Romania**	**1,37**
43	Ukraine	0,50	42	Ukraine	0,46	49	Ukraine	0,29

Source: World Leasing Yearbook, Global Leasing Report 2015, p.14

In Romania, the information on the leasing market is provided by the Association of Financial Companies - ALB Romania and the Association of Operational Leasing Companies.

Table no. 4. Structure of Financial Leasing Market

Ranking	Structure	Amount (thousand euro)	Share
1	vehicles	596,093	77.53%
2	equipment	153,861	20.01%
3	Real-estate sector	18,888	2.26%
	Total	**768,842**	**100**

Source: Financial Leasing Market in Romania, ALB, 2015

The data emphasize the very high share of vehicles in financial leasing business, namely 77.53%.

Financial leasing market users on 30 June 2015 indicate the following structure:

- 99% corporate,
- 1% retail.

Agreements concluded in a financial leasing system by type of purchase, are divided into: 82% new and 18% used.

Leasing operations prove profitable if the contracting period is average. Moreover, in terms of agreement duration, the ALB report shows that 86% of finance leasing agreements are concluded for a period exceeding 2 years, whereas long-term agreements over seven years hold a 2% share, and short-term agreements account for only 4%.

Globally, the operational leasing market in Romania shows an increase of 16% in 2015 compared to 2014, that is 52,000 units administered at the end of the first half of 2015 (http://www.aslor.ro/news/comunicat-de-presa-aslo-30-07-2015).

3. Issues Regarding Leasing Operations' Accounting

It is specified that leasing operations are dealt with in this article both according to the rules of national law (GEO 51/1997 of the Tax Code) and according to international accounting standards, IAS 17 Leasing.

Developing leasing business has also generated the development of forms in which they are done. Specialized literature classifies leases by several criteria: a) position of the supplier in the leasing agreement: direct leasing and indirect leasing; b) conditions to perform leases: net leasing and gross leasing; c) conditions to perform lease: financial leasing and operational leasing, d) features of doing leasing business: lease back, shareholder leasing, time sharing, experimental leasing, hire and renting operations.

The specific legislation of leasing operations in Romania: **Government Ordinance no. 51/1997 of 28 August 1997 regarding leasing operations and leasing companies with**

subsequent amendments and additions, and the **Tax Code** use as a differentiation criterion the conditions to perform the operations: **financial leasing and operational leasing**.

As compared to everything shown in specialized literature, the Romanian Fiscal Code (Article 7, Paragraph 7) defines a **financial leasing agreement** as any lease that meets one of the following conditions:

a) the risks and benefits of asset ownership being subject to the lease are transferred to the user at the time the leasing agreement takes effect;

b) the leasing agreement expressly provides for the transfer of ownership of the asset that is leased to the user at the end of the agreement;

c) the user has the option to purchase the asset at the end of the agreement, and the residual value shown in percentage is less than or equal to the difference between the normal duration of maximum functioning and the duration of the leasing agreement, relative to the normal maximum functioning duration, expressed as a percentage ;

d) the leasing period exceeds 80% of the normal maximum functioning duration of the asset that is subject to the lease; for the purposes of this definition, a leasing period includes any period for which the leasing agreement can be extended;

e) the total amount of leasing installments, not including accessory expenses, is higher than or equal to the value of the asset;

Additionally, an operational leasing agreement is defined in the Tax Code Article 7 Paragraph 8 as any leasing agreement between the lessor and the lessee, transferring to the lessee the risks and benefits of ownership, less the risk of asset recovery at the residual value, and which does not meet any of the conditions stated in point 7 letter b)-e); the risk of asset recovery at the residual value exists when the purchase option is not exercised in the beginning of the leasing agreement or when the leasing agreement expressly provides for the return of the property upon agreement completion;

- International Standard (**IAS 17 Leasing**) describes the appropriate accounting policies and information to be supplied regarding leasing agreements. Essentially, the Standard applies to those lease agreements where the lessor gives the lessee the right to use an asset for an agreed period of time in return for a payment or series of payments.

The Standard is not used as an evaluation basis for:

- properties owned by lessees, accounted for as real-estate investment and investment property leased by lessors under operational leasing agreements (subject to IAS 40)

- or for the biological assets owned by lessees under financial leasing agreements, or the biological assets leased by lessors under operational leasing agreements (IAS 41).

European directives, as well as international rules, have generated a change in the accounting of assets acquired via leasing.

Although in legal terms, the assets produced by leasing are not the property of the lessee, European directives and international standards require accounting entering of leasing operations in view of the **Substance over Form Principle**. The Principle requires that stating the amounts in the balance sheet and profit and loss account should be done taking into account the economic substance of reported transactions or operations, and not only their legal form.

As shown in IAS 17 “Leases”, in the event of **finance leases,** the lessee enjoys the economic benefits arising from use of the asset, during most of its life duration as if he/she were the owner. As a result, the leased asset should be included in the lessee’s balance sheet. Simultaneously, he/she must report a medium or long-term debt to the lessor to make future payments on behalf of the lease. So, the substance of the transaction prevails in this situation to the legal form.

Since the user in a financial leasing agreement is treated from a tax perspective as an owner, entering the assets covered by lease agreements in financial statements generates the calculation and entry of related depreciation.

It should be noted that the transfer of ownership in a financial leasing agreement, if such an issue has been expressly provided in the agreement, shall be made at the residual value determined by the parties, and the total value of a financial leasing operation is the sum of lease installments plus residual value. If in an agreement the transfer of ownership is not expressly specified, the total agreement value is defined by the amount of the leasing installments.

A financial leasing installment is the result of two elements: the share of the entry value and leasing interest. The interest generated by the lease agreement is deductible, according to current regulations.

Payments related to an operational leasing agreement (excluding the cost of services such as insurance) are recognized as an expense in the linear profit and loss account, or on a systematic basis representative of the pace of user's benefits, even if the payments are not made on the same basis.

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