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THE FUTURE OF LEASING ACCOUNTING

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Abstract

The purpose of the paper is to understand what are the consequences of the new standards for financial leasing to the companies that use the IFRS and operating leases, at the purpose to find out if they have done any preparation towards approaching these new standards. This study also aims to shine a light why companies use the rent and if they actively try to secure a healthy lease classification. The standards on leasing have been changing from past to now, at the main purpose to help the companies to release themselves at new standards accountings. However, worldwide as well as in Albania, to follow the pace of development of the leasing industry, will need to develop and improve lease accounting requirements, harmonized and combined with the reality that offers the Albanian market. An important element of the SME financing is not giving it directly through loans from traditional banks, but through lease financing or factoring companies. New standards of accounting this method are very important, because many companies mainly adverse this technique because of the limits that the old standard imposes. In this line, we particularly discuss the new standards on leasing contracts due to its importance to the companies, especially the SMEs.

Keywords

IFRS; IASB; Leasing contract; SME; New standards.

Introduction

Rent, as a contemporary of emerging industries is becoming a very important form of investment and financing in financial sector, as in developed markets, and in developing markets. Compared with the pace of development in these markets, in our country, this industry is still in its infancy. Corresponding to the recording and reporting of financial data to the industry still left to be desired. Having not found a widespread use in the Albanian market, accounting practices Various surveys show that funding for bank loans and overdrafts constitute the most prevalent means of debt financing to SMEs, their addition, alternative sources such as leasing and factoring caught the same weight and importance. In many countries, rent is finding wide use as many form of financing for SMEs in particular, that in countries such as Belgium, Finland, Ireland and Spain. The concept of rent is based on the assumption that the profits generated by the tenant more through the use of assets, rather than having their ownership. Unlike credit, in this case we do not have the cash provided by financial institutions for the client, but the client making available of an asset.

But the dilemma is, operating leases or finance leases? This is a question that often make themselves the company managers, before dealing with a lease agreement. The results of the surveys, as in domestic market but also in foreign markets seem to approach the objectives of company managers, given more priority option accounting treatment of a lease as operating leases.

What are the reasons why companies prefer an operating lease instead of a capital lease? What are the effects on the financial statements by the use of one or another method? Is the company making the right choice, treating as a finance lease off balance, taking into account the fact that the produced information about the financial situation of a company should be fair and understandable by interested parties?

Nowadays rents seem to find a wide use in all global markets. Their application is very common in all natures of business and accounting limits. But while their application is ever expanding, accounting for leases is not so clear cut. Given that there are different ways of accounting for leases, companies often choose the method that they believe that best fits their financial situation. On the other hand financial procedures for handling the forms of rent should bring benefits and limitations and to ensure that every company is fairly reflect all of its financial information.

This study analyses the above points along the proposed changes to lease accounting and explores how managers consider the accounting effects of their decisions. Specific hypothesis is tested through questionnaires with a group of private companies in the role of tenants and landlords to identify variables that will determine the different strategies in response to new accounting guidance lease.

Leases of fixed assets, is a central component in the financing strategy for many companies. Leasing can be used to minimize risk, increase cash flow, reduce costs or improve the financial reports. (DeMarzo Berk, 2010). Therefore, being one of the main tools lease financing is necessary and required to lease accounting standard quality. Currently, all EU listed companies seeking to follow accounting standards issued by the International Accounting Standards (IASB). The IASB is an organization whose main goal is to develop a single set of reporting standards and globally accepted quality called IFRS. When the IASB and the Financial Standards Board (FASB) jointly launched a project in 2002, an important step in the harmonization of international standards was undertaken. The purpose of this project was to improve standards in effect at the time the poor who were in turn different from the IFRS and U.S. GAAP.

Several projects were undertaken for recognition but only one survived project is exactly IAS 17, the current standard of leasing accepted yet by the IASB .In 2010, he introduced a draft lease standards. Since then, several attempts to change and in 2012, a new one was received to re exposed. However, major changes in lease accounting were left hence the classification between operating and financial lease will be deleted.

Instead, all lease transactions will appear on the balance sheet. The so-called short-term lease, the lease for a year, will be assessed again as operating leases (kpmg.com – independent company In for auditing in Albania). With changes in lease accounting, the IASB believes that the biggest user of them, investors will provide more reliable information about transactions and lease agreements. Moreover, comparability will be expanded. It is important for investors, as it will help them make decisions.

When taken into consideration the decision "to take rent" or "buy" decision makers should evaluate unquestionably the advantages and disadvantages of each alternative, to assess the real situation and needs, to conduct an analysis of cost - benefit both alternatives, the carefully study and evaluate the results to alternative Individual costs. If all this is done in the correct way and the right to assess all the factors influencing the decision making would then lead to a result of either cost-effective alternative to other alternatives.

Methodology

Search results are based on primary and secondary data. In the secondary data may include journals, books and literature containing studies on similar topics. These data help with the problem, as well as all the theoretical part of this thesis. For the benefit of those data can be main support resources such as the Internet, literature, documents and books. By the inadequacy of these secondary data to answer every element of this study, we believe it is necessary to rely on the data obtained from questionnaires. In accordance with the purpose of the study, we believe that a qualitative study would be more appropriate. Moreover, it will be used a small sample, which is also consistent with qualitative research. In this line, it is important to know that a qualitative study is subjective and dependent on context.

Sample

Selection of companies

Selection of companies and respondents was conducted with deliberate sampling method. Thus, it conducted a strategic choice about certain conditions and key features. In this line, the prerequisites include implementation of the IFRS, as companies applying for IFRS are requite red to follow standards and use the rental lease.

A key feature in the selection of companies will be using operating leases. However, the idea is to achieve a differentiated view of the expected consequences and thus, were interesting selection of companies with varying degrees of operating lease. Moreover, it is expected that more companies lease agreements are less affected than companies lease agreement (O'Donovan, 2011). Large companies are expected to have a number of lease agreements compared to small companies, and therefore, in order to obtain a variety of data, both companies are involved, large and small, giving more emphasis on large companies. So is compiled a list of 26 companies but only 16 of them responded.

Discussion

In this section we discuss the impact that the new lease standard may have for companies if apply the IFRS. In this line, one may note that the purpose of this study is to understand the consequences of the new standard lease and companies using the IFRS operating leases, and to find out if the companies have done some preparation. Furthermore, the research also aims to illuminate why companies use leasing and if they actively try to secure a lease classification. Finally, the paper points out that the financial procedures for the treatment of forms of rent should bring benefits and limitations, as well as to ensure that every company is fairly reflect all of its financial information.

Research question

The paper attempts to clarify and answer the question how the new standards will affect firms if they apply the IFRS. This theme will present a background in lease accounting and the planned changes in accounting standards. Furthermore, we will also present a discussion on the subject, resulting in the scope of the study.

According to the IASB, financial reports will be useful, as the comparability between companies will grow with new standards of rent. However, the increase affects the comparability of the fact that all rental costs are recognized in the balance sheet. This will have consequences for the company. Thus, further studies of these effects are beneficial.

Comparison of National Accounting Standard 7 to Draft Proposal

Definition of rent

Current draft- The rent is an agreement whereby the lessor passes tenants in exchange for a payment or series of payments the right to use the asset for a set time period between the two parties.

The draft proposal defines a lease agreement where the right to use a specific asset is conveyed in return for a consideration. A contract is or contains a lease agreement if the following conditions are met. This contract conveys the right to use a specified asset. This contract conveys the right to control the use of the asset.

Operating lease versus operating

Current draft - A lease is classified as a finance lease if it transfers so considerably all the risks and benefits in an actual ownership over the asset or meets one of four conditions specified in the standard. A lease is classified as an operating lease if it does not transfer substantially the risks and rewards incidental to ownership.

The draft proposal has specified all leases greater than 12 months should be capitalized and recorded in a manner similar to how capital lease is currently registered.

Short-term rent

Current draft - It appears like long-term operating lease.

The draft proposal - For leases with maturities less than 12 months: The tenant should be allowed initially to measure the amount of undiscounted obligation to lease and right-of-use asset value of lease obligations plus initial direct costs; A lessor would recognize not allowed additional assets and liabilities arising from lease contracts and to recognize the leased assets.

Conditions for renewal of lease

Current draft - If at a later time the lessee and the lessor agree to change the terms of the rental agreement, without the update, in a way that would result in a different classification of the lease under the criteria of paragraphs 7-12, the terms of the amended agreement have been part of the beginning of the lease, the revised agreement will then be considered as a new agreement during the term of the lease.

The draft proposal - Defines the term under the terms of the lease as a longer term lease. If no extension of the lease term, should be anticipated that early in the lease agreement

Variable lease payments

Current draft - Variable lease payments are recognized as expenses when incurred.

Draft proposal - The draft proposal should determine the present value of payments based on expected revenues. Revenues are expected present value of future cash flow for a no reasonable income.

The discount rate

Current draft - For the property owner is for the interest rate implicit in the lease. For tenants, increase borrowing rate.

Draft proposal - ED stated: tenant lease obligation measures of its lease payments discounted at the incremental borrowing rate or, if it can be easily determined, the rate the lessor charges the lessee.

Rent / No rental

Current draft - Service costs or maintenance are considered indistinguishable part of the rental agreement.

Draft proposal - Capitalization draft proposal and recognizes rent expense divided by service components when they occur.

Sale

Current draft - A transaction of sale and leaseback means that asset sale and rent recovery of the same asset and it serves as a way of financing. Sales transactions and leaseback not classified as a sale to be classified as financing.

Draft proposal - Sales transactions and lease classified as a sale would result in the seller multipurpose tenant asset and the recognition of a gain or loss for the difference between the carrying amount of the lessor and buyer value delivered by the seller tenant.

Sublease

Current draft - The net present value of all costs including rent and depreciation deductions, offset by sublease income.

Proposal draft - Intermediate lessor shall present lease obligation separately for the payments from other assets and liabilities arising from sub lease and submit data in balance sheet referring the right to use assets; and the right to receive lease payments under sublease obligations.

The above mentioned points are some comparisons between the current national accounting standard number 7 and the draft proposal.

Analysis

One of the basic tests that are based on the received information and important conclusions about the spread of knowledge and lease financing as a means of questionnaire analysis is as one of the main primary sources. The sample on which we rely mainly consists of large firms. The sample size is 16 entities, chosen by random. Most of the units are part of the trade and service industry, and just few are in the production. The discussion upon the findings is noted below.

As to whether companies use the lease as financing, insurance funds, asset use or other elements, the interviewed firms came to the fact that the lease agreement is used in businesses in Albania at a level of 75% serving as a business or as tenants of rental property.

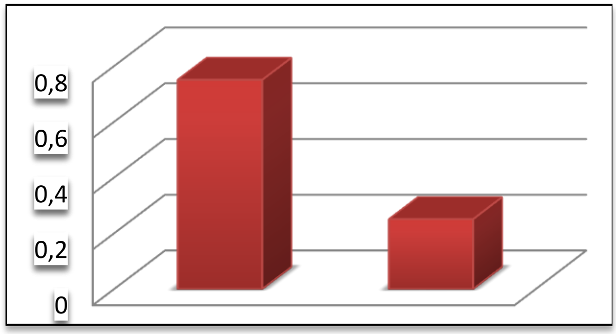

FIG. 1 LEASING CONTRACTS

Figure 1 shows the spread of leasing financing of Albanian companies. 75% answered yes and 25% answered no to the financing with this contract.

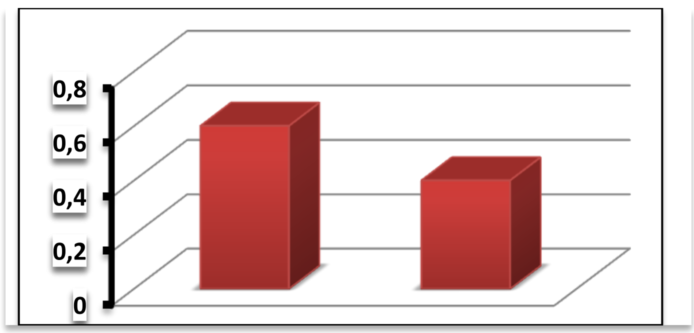

FIG. 2 LEASING MATERIALITY

Figure 2 poses answers about the materiality. 60% of the companies answered yes and 40% answered no. The payments of common contract leasing are registered as expenses at the time of payment. If these payments are made in cash, explanation should be given at the illustrations of financial sheets. The financial sheets are prepared at basis of materiality, that means to give the right importance to the financial records that are specific important for the users of balance sheet and financial result sheet. The worsening financial statements with excessive detail and information immaterial damages their clarity and understanding. Financial statements based on assumptions built-basic principles and characteristics of accounting information. Based on survey data, we conclude that rental costs are material to 60% since the firms use leasing as a financing or fundraising, so that the main items listed in their financial statements and notes, which appear in.

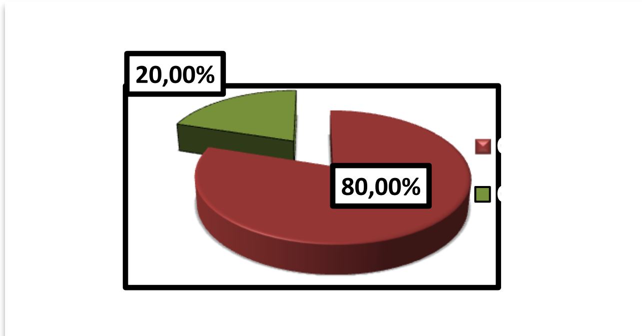

FIG. 3 REPORT LESSOR / TENANTS

Furthermore, one of the main questions was whether the company serves as lessor or lessee. From the questionnaires is evident that tenants are highly increased compared to lessors. Namely, from Figure 3 one may notice that most of the companies serves as the lessor in 80% of cases. Here we must distinguish if given the size and nature of business. Other information would take the small businesses where most of them serve as tenants: 11% - to land, 89% - to buildings, 80% - machineries, 40 % - equipment, 22 % - software, 20 % different equipment (Figure 4).

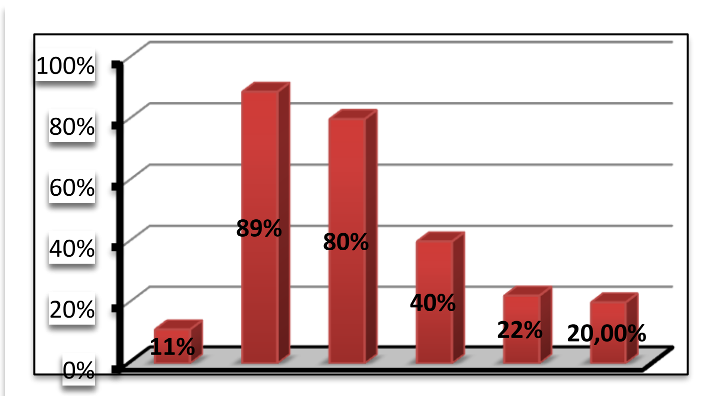

FIG. 4 DATA ASSETS MOSTLY RENTED

Assets are mainly land lease object, building, machinery, equipment, Software released, means of transport. But making reports or lease business change. In some businesses mainly engaged in building, has other entities that acquire or lease the building and land together, or several simultaneously active.

Focusing now on lease terms that constitute the basis of the study Officers to reach the information if we in Albania mostly used operating lease or financial lease. So in terms of the lease term, the question of what are the key terms of the rents that firms use their entities have responded as follows: 66.7% last 1-5 years, 22.2% last 5-10 years, 11.1% last 10-15 years, 0% pertain more (Figure 5).

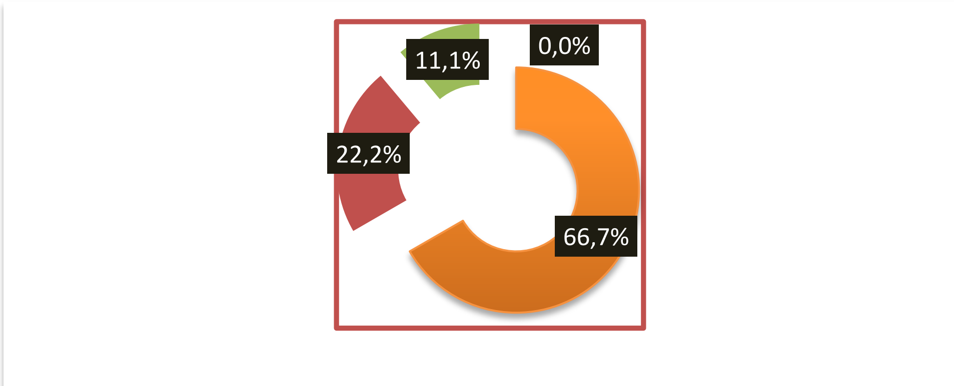

FIG. 5 SPREAD OF LEASING CONTRACT

As we may see from Figure 5, the majority of time is 1-5 years in 67.7% of the rents studied, 22.2% of cases constitutes the lease term 5-10 years, 11.1% of leases are within 10-15 years and almost 0% to more than 15 years. We see that with increasing time there is a decrease in the number of leases. This is an indication that the majority of operating lease rental was occupied.

Figure 6 presents that time greater than 75% of the economic life of the lease of the encounter only 16.67% of the cases studied in entities in Albania. 83.33% of the cases studied companies with lease terms that are lower, than 75% of the asset's economic life, by not fulfilling one of the conditions of leasing. Such a conclusion may be derived from the Figure 5 as well. So, both data leads us to the same conclusion.

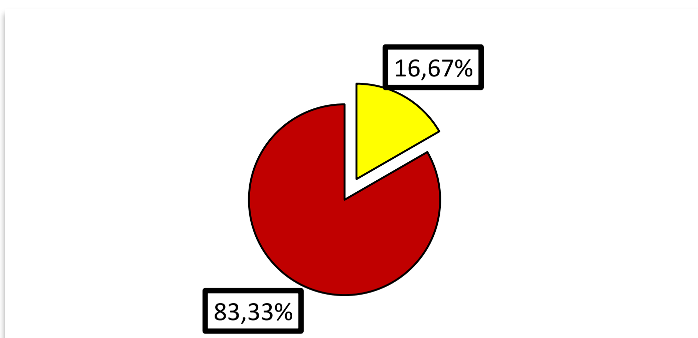

FIG. 6 LEASING TERMS

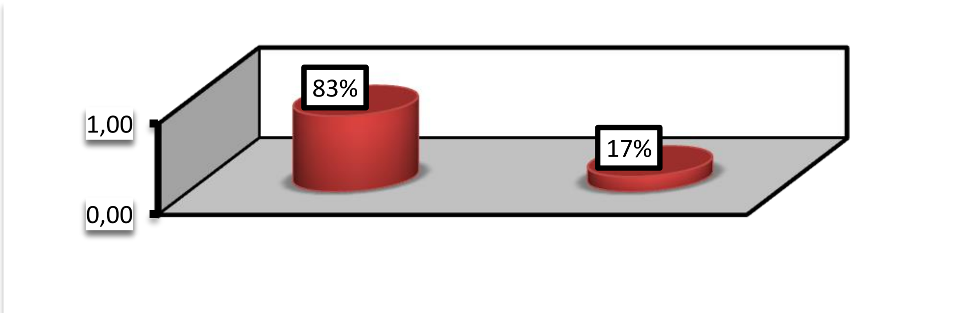

FIG. 7 RENEWING RIGHT AS A LEASING CONTRACT CONDITION

The right of renewal is a suitable criterion for leasing as well as operating leases. Figure 7 shows that 83% of leases have renewal lease condition, which means that expiry, if decided by the two parties to the contract, lease can continue in a second term conditions similar to the initial contract or taking other lease form, as set out above is the rent for each of the types of lease classification.

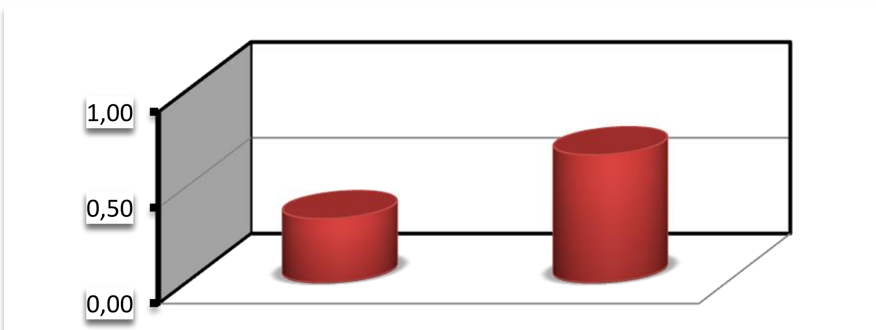

FIG.8 PURCHASING OPTION AT THE END OF LEASING CONTRACT

One of the conditions listed in IAS 17 is the criterion of the call option at the end of the lease. From Figure 8 we may conclude that 33% of leases contain purchase option, while 67% of the contracts do not contain purchase option at the end the lease term. Since the call option is one of the conditions of capital lease classification, we may note that the majority of operating lease rental is occupied.

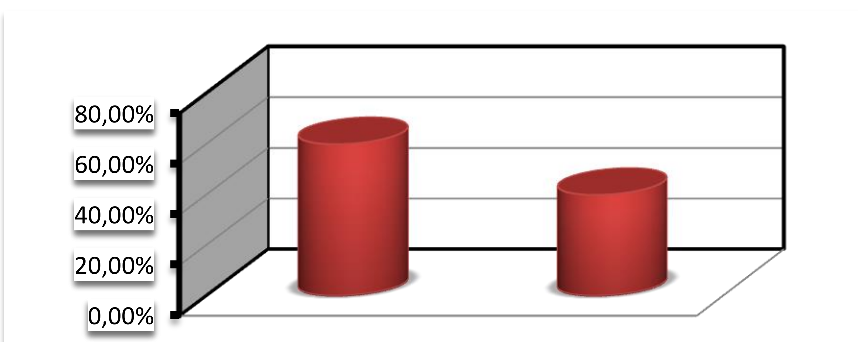

FIG. 9 EARLY TERMINATION CLAUSE OF THE LEASING CONTRACT

Additionally, the leases have early termination clause being implemented in 60% of cases leases entities. Yet, despite the fact that this is not always related to lack of funds, one thing is related only to 20% of cases or leases. In this line, Figure 10 shows that 20% of the tenants close the contract because of the lack of funds, which is a premature closure of easing contract.

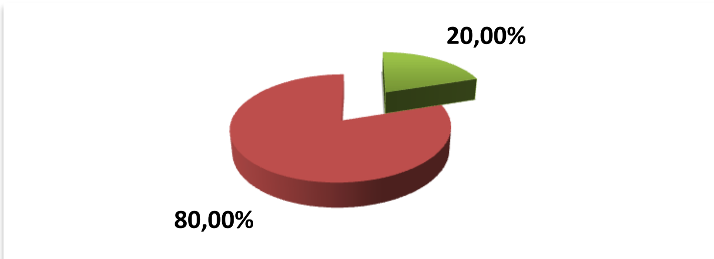

FIG.10 LACK OF FUNDS

Conclusions

In fact leasing financing approaches many advantages:

• Leasing contract is profitable to all the parts included;

• To the furnishers, leasing wides their market basis;

• Differing with the simple loan, leasing financing does not need a guarantee;

• Any expenses like: loan payments, insurances and administrating expenses can be registered as expenses at your bookkeeping.

These are the reasons that the usage of these contracts has increased from year to year. Basing on survey data, we conclude that rental costs are material to 60% of firms use leasing as a financing or fundraising, so that the main items listed in their financial statements and notes, which appears in. The fact is that we have a higher level of rental lease that derives from the aforementioned advantages of leasing. But no entity to serve as the property owner as a tenant. In fact, the answers have been more different from, for example Classic firm has a landlord-tenant ratio 60% to 40%, Copier Computer System has a 2 to 1 ratio, etc. (source: the questionaries). The value of the total rent is different assets. The information collected will see that the major share of business units in buildings occupied Albania with 89% of cases being rented, than the machines are in 80% of the units that this asset is subject to a lease. Many are less equipment in 40% of businesses and even fewer vehicles in 20% of cases the rent. Others listed as the graph above.

We have listed above some of the key terms of the lease that are examples of situations that individually or in combination would lead to the classification of the lease as a finance lease. In this line, we refer to:

- The lease transfers ownership of the asset to the lessee at the end of the lease term;

- The lessee has the option to purchase the asset at a price that is expected to be significantly lower than the true value of the asset at the time when this option becomes possible and it is clear that at the beginning of this option agreement will be used;

- The lease term is most economic life of the asset even if title is not transferred yet;

- At the beginning of the lease the present value of total minimum lease payments is significant in all manner of fair value of the leased asset; and

- The leased assets are of a special nature in such a way that only the lessee cannot use them without major modifications carried out.

According to the questionary it indicates, that the majority of operating lease rental occupied from Albanian Companies.

From all forth noted, we may conclude that in Albania is used mainly operating lease and rent less capital. This only confirmed the features and conditions of the lease, the time, the call option at the end of the lease term relationship with the economic life of the asset. The firms that consisted the sample, especially in those where the rent was an item in the financial statements, 88.89% are operating leases and occupies only 11.11% capital lease. This is actually an indication of a new market rent in Albania. Hence, we find indications primarily in economies in transition, but despite the fact of a low level, we see an increase in this market which may be followed by new standards. However, in conditions, which have a spread primarily operating leases, as would be expected that the new standard is an element that will continue to be developed in the future. In fact, the sample consisted mainly from a small accounting firms, responded positively to our research question. In addition, that leaves us to understand that lack of information is a reason not to take any action for the future to adapt to new accounting standards.

Upon the research findings, we may draw the following general conclusions:

• Replacing the current lease standard, IAS 17, removes the possibility for companies to choose between operating leases and finance leases. In the next moment, all leases are classified as financial, which means that the tenant will have to recognize an asset and a liability on its balance sheet.

• Changing the standard rent is considered necessary to achieve an increase comparability between companies and reduce the abuse of accounting rules. However, the process of setting new standards characterized by criticism, controversy and delay, which makes it clear that the replacement of IAS 17 is a controversial topic.

• The findings of the present study indicate that the new lease standard would have consequences on companies that use IFRS operating leases and from which we can conclude that a bigimpact will be from vocational companies as resulted from our study. The data make note that from 88.89% of companies use primarily operating leases.

The forth mentioned conclusions, imply potential consequences which may include:

- Increased balance;

- Debt structure changed;

- Increased administrative burden;

- Need to buy new IT systems; and

- Educational efforts and changes in the behaviour of companies that are included in rent.

In response to increasing balance, key financial ratios will deteriorate. However, the basic effects of key financial ratios are very individual and will be affected by the types of deals that companies are required to meet currently. The results also show that companies lease not due to concealment of assets from the balance sheet, but mainly leasing as a financing source. Furthermore, we noticed a lack of information about these companies possess new lease standard. Regardless, efforts to change the standard plan, we expect companies to be a little more informed and prepared for change. However, this study shows that most companies have not examined any preparation about changing the standards.

Recommendations

A new IT-system will be necessary in all companies. Moreover, it will be necessary educational efforts in all companies. However, to what extent remains unclear. In general, it seems that most of the costs and administrative burdens associated with IT systems are transition costs. Furthermore, we recommend the following:

- To carry out a preliminary assessment on the impact of the Draft Proposal of the new standard on the financial statements of the company;
- To assess processes for data collection, internal control and IT systems;
- To pay attention to the estimated tax positions related to the proposed lease; and
- To communicate effect adjustment to interest groups, analysts, regulators and shareholders.

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