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UDK: 657.41/.45:339.187.6](497.5)
Review article

Received: November, 26, 2018
Accepted for publishing: March 26, 2019

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IMPLICATIONS OF THE NEW ACCOUNTING MODEL FOR LEASES

ABSTRACT

Leases often appear to be a practical way of securing some property. The advantage of the lease is in easy replacement and minimum engagement of resources for the acquisition of assets. However, sometimes leases, depending on their form, also serve to hide the financing through the so-called “off-balance financing”. With the aim of eliminating these unwanted effects, the IASB has adopted a new standard for leases – the International Financial Reporting Standard 16 Leases. The key change from the previous accounting model for lease recognition is in the financial statements of the lessee. This change results in recognition of lease liabilities for practically all forms of leases. Of course, this also entails recording the appropriate property item of asset in the financial statements. The result of this approach is also significantly different recognition of expenses during rental time, as well as the nature of expense. This applies particularly to operating leases that do not recognize assets and liabilities in the existing model, and the effect on profit and loss is based on a linear model that most often corresponds to the contractual lease payment dynamics. In this paper the authors research the implication of the new accounting model for leases on financial statements.

Keywords: Lease, operating, financial, IFRS 16, present value, discounting

1. Introduction

Leasing is an important source of finance to business and according to PWC (2016: 2) it enables companies to access and use property and equipment without incurring large cash outflows at the start. In January 2016, the IASB adopted the International Financial Reporting Standard 16 Leases (IFRS 16). This is a completely new standard that replaced International Accounting Standard 17 Leases (IAS 17), but also changed a significant number of other standards. The main changes brought by this new lease standard are the accounting for leases by lessees and the accounting treatment of leases in their financial statements.

IFRS 16 should lead to improved quality of financial reporting, which will benefit investors and analysts, as well as companies. Investors who analyse financial information will not have to adjust financial statements for off-balance sheet leases and companies with significant off-balance sheet leases will benefit from managing all leases in the same way for internal and external reporting purposes, which should lead to improved decision-making.

Also, IFRS 16 should lead to improved comparability because companies will recognise assets and liabilities, in essence, for all leases; measure all lease assets and all lease liabilities in the same way; and recognise only the rights that are obtained, and the

liabilities that are incurred, through a lease. As a result, financial statements will reflect the differing operating decisions made by different companies (IASB, 2016a)¹.

The U.S. Securities and Exchange Commission (U.S.SEC) recognized the inadequacies of the existing lease accounting standards and recommended that the FASB undertake a project to reconsider the leasing standards, preferably as a joint project with the IASB (U.S. SEC, 2005)².

In 1996, the G4+1³ published a discussion paper that proposed an approach to lease accounting that would abolish the requirement to classify leases as operating leases or finance leases. Under this approach, a lessee would recognize as assets and liabilities all material rights and obligations arising in a lease contract (McGregor, 1996). Under the G4+1 proposal, lessees recognize the fair value of any assets and liabilities contained in a lease contract. Recognition begins when the lessor makes the property available to the lessee. Thus, lessee balance sheets are expected to reflect additional lease liabilities if this new approach is adopted. The research paper by Imhoff and Thomas (1988) suggests that additional lease liabilities could be substantial. Using the operating lease commitments disclosed under SFAS No. 13, they constructively capitalize operating leases by estimating the present value of operating leases (PVOL) for a sample of 29 airlines and 51 grocery stores. The median PVOL is US\$ 195 million for airlines and US\$ 57 million for grocery stores, and these amounts are 35-40 percent as large as median total on-balance sheet liabilities (Imhoff, Thomas, 1988). The G4+1 published another discussion paper that set out proposals for how the approach described in the 1996 paper might be made to work and included proposals on lessor accounting (Lennard, Nailor, 2000).

The adoption process of IFRS 16 was rather long. The process started in July 2006, when the issue of lease accounting and the development of an appropriate standard were included in the plan of the International Accounting Standards Board (IASB). The discussion paper was published in early 2009, while the standard draft was published in August 2010. However, due to significant updates and reactions, the IASB announced in mid-2011 that it intends to prepare a completely new standard draft. This new draft was published in May 2013, and almost three years later, a new standard – IFRS 16 was finally adopted. The standard was adopted in

November 2017 by the European Union. The start of the application of this standard is foreseen for the beginning of 2019 (European Financial Reporting Advisory Group – EFRAG, 2017)⁴.

2. Theoretical ex ante and ex post framework

Eisfeldt and Rampini (2008: 1647-1650) divided the literature into two parts: (1) theories of leasing (Miller, Upton, 1976; Lewellen et al., 1976; Myers et al., 1976; Smith, Wakeman, 1985; Wolfson, 1985; Kim et al., 1978; Coase, 1972; Bulow, 1986 and (2) empirical literature on leasing (Graham et al., 1998; Krishnan, Moyer, 1994; Sharpe, Nguyen, 1995; Ang, Peterson, 1984; Yan, 2006; Lewis, Schallheim, 1992; Slovin et al., 1990; Ezzell, Vora, 2001; Gilligan, 2004). Lipe (2001: 300) highlights how most empirical research on lessee accounting is based on financial statement analysis as the decision context, with particular emphasis on how unrecorded lease commitments might affect assessments of shareholder risk. Possible reasons for this emphasis are: 1. finance theory links debt-like obligations to risk (Modigliani, Miller, 1958; Hamada, 1969; Rubenstein, 1973; Bowman, 1979, and Christie, 1982); 2. unrecorded leases are large for some companies (Ely, 1995); and 3. mandated disclosures facilitate estimation of the unrecorded obligations (Imhoff et al., 1993).

Before, Eisfeldt and Rampini (2008) and Lipe (2001), Lasfer and Levis (1998: 161-162) show the essential division of leasing and identified the following three main reasons for the existence of leasing: (1) tax differential - if the lessee pays little or no corporation tax, he/she will pass on the capital allowances to the lessor. Part of these allowances will be returned to the lessee through lower rental payments; (2) debt substitutability - leasing can be a substitute for debt finance because both of them reduce debt capacity. However, given the fact that lessors have first claim on the asset leased, leasing is likely to be advantageous for financially distressed companies; and (3) agency costs - modern corporations characterized by a divorce between ownership and control are likely to suffer from the free cash flow problem where managers undertake negative NPV projects. Given that leasing is not an investment decision and lessors have first claim over the asset, it can reduce the agency conflict.

Miller and Upton (1976: 761) state how the choice between renting or buying for any firm would depend on which method of acquiring the services of

capital goods had the lower nonfinancial costs in the sense of the costs of acquisition, maintenance and disposal. Lewellen, Long, and McConnell (1976: 797) went a step further than Miller and Upton (1976) and conclude that environmental factors which can bring about significant differences in the costs of asset purchase and asset leasing will seldom prevail, especially since the tax rate effect on the transaction can go either way. Myers, Dill, and Bautista (1976: 799) present a formula for evaluating financial lease contracts and use it to solve the firm's lease vs. borrow problem, and to examine the economic rationale for leasing. Smith and Wakeman (1985: 895) provide a unified analysis of the various incentives affecting the lease-versus-buy decision and employ that analysis to explain observed variation in corporate leasing policy. Wolfson's (1985: 159) study is designed to augment the buy-versus-lease literature by incorporating risk-sharing motives, moral hazard-related incentive problems and their mitigation, and tax considerations in the choice of how to allocate an asset's property rights. Sale-and-leaseback agreements and enterprise valuation showed up in Kim, Lewellen, and McConnell (1978: 871). Yan (2006: 709) presents a model to incorporate different theories on the substitutability and complementarity between leases and debt, and test the model implications empirically in a GMM framework (generalized method of moments) that simultaneously controls for endogeneity problems and firms' fixed effects and, second, finds that in those firms with more growth options or larger marginal tax rates, or in those firms paying no dividends, the substitutability is more pronounced, i.e., the cost of new debt increases to a larger degree with extra leases. Evidence from Slovin, Sushka, and Polonchek (1990: 289) indicates that the announcements are associated with positive abnormal returns to lessees and they conclude that this positive market reaction results from an overall reduction in the present value of expected taxes occasioned by the transactions. Their evidence, also, suggests that the gains from sale-and-leasebacks accrue solely to lessee firms. Ezzell and Vora (2001: 44-45) begin the paper by confirming the Slovin et al. (1990) finding that lessee equity values increase when new sale and leasebacks are announced. Additionally, they show that lessee equity values remain unchanged when new direct leases are announced; second, that the lessee's tax rate is significantly negatively related to lessee return, that is, the lower the lessee's tax rate, the greater the return from the sale and leaseback

and, also, find that equity value increases are greater for nondividend-paying lessees than for dividend-paying lessees. On the other hand, they show that in direct leases the gains from leasing are lower for high information asymmetry firms that lease assets whose values are sensitive to use and maintenance decisions. Gilligan's study (2004: 1179) uncovers a negative and statistically significant relationship between trading volume and depreciation when evaluated for above-average qualitative uncertainty and below-average leasing frequency which is inconsistent with results contained in the paper by Porter and Sattler (1999).

Therefore, it is important that lease accounting provides users of financial statements with a complete and understandable picture of an entity's leasing activities. The existing accounting model for leases has been criticized for failing to meet the needs of users of financial statements. In particular (IASB, 2009: 14)⁵:

- many users think that operating leases give rise to assets and liabilities that should be recognized in the financial statements of lessees. Consequently, users routinely adjust the recognized amounts in an attempt to recognize those assets and liabilities and reflect the effect of lease contracts in profit or loss. However, the information available to users in the notes to the financial statements is insufficient for them to make reliable adjustments to the recognized amounts.
- the existence of two very different accounting models for leases (the finance lease model and the operating lease model) means that similar transactions can be accounted for very differently. This reduces comparability for users.
- the existing standards provide opportunities to structure transactions so as to achieve a particular lease classification. If the lease is classified as an operating lease, the lessee obtains a source of unrecognized financing that can be difficult for users to understand.

Preparers and auditors, also, have criticized the existing model for its complexity. In particular, it has proved difficult to define the dividing line between finance leases and operating leases in a principled way. Consequently, the standards use a mixture of subjective judgements and 'bright-line' tests that can be difficult to apply. (IASB, 2009: 15)⁵. Changes,

according to PWC (2016)⁶, to the lease accounting standards have a far-reaching impact on lessees' business processes, systems and controls that will require significantly more data around their leases than before given the on balance sheet accounting for almost all leases (i.e. cross-functional approach).

3. Definition of leases

In 2016, the IASB published a report in which they observed that over 14.000 listed companies (of about 30.000 listed companies) disclose information about off balance sheet leases in their latest annual reports. The future payments for off balance sheet leases for those 14.000 listed companies totalled US\$ 2.86 trillion (on an undiscounted basis). The present value of those payments is estimated to be US\$ 2.18 trillion (IASB, 2016)¹⁰. For the purposes of accounting for leases, it is crucial to define, or to recognize, whether the contract is, or contains, a lease. However, the definition of a lease is different from current IFRIC 4 guidance and might result in some contracts being treated differently in the future (PWC, 2016: 3)⁶.

According to Biondi et al. (2011: 3-4), inappropriate distinctions between operating and financing leases are achieved by managers due to the following weaknesses of current lease standards:

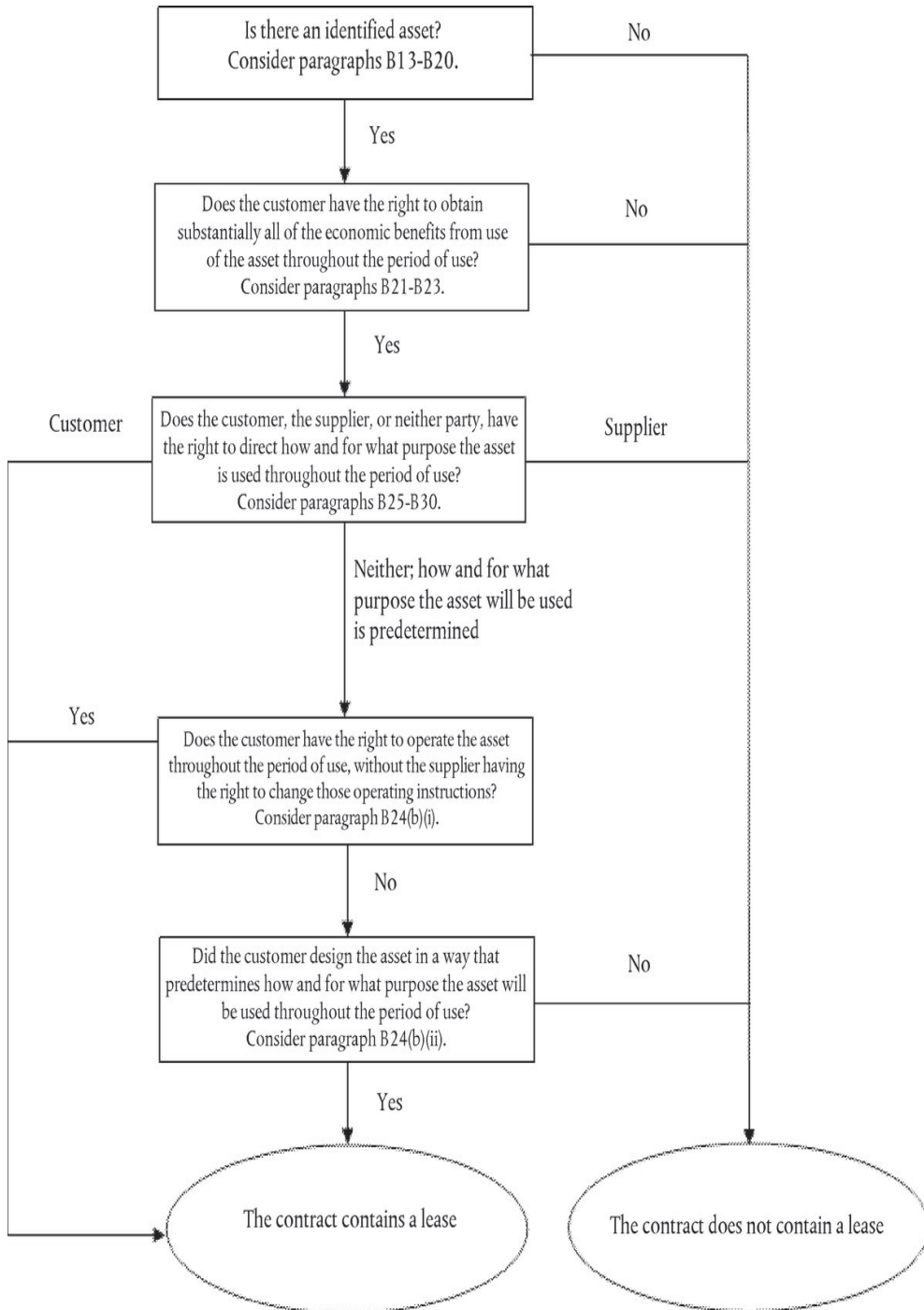
- a) knife-edged accounting, whereby small changes in a transaction lead to large differences in how the transaction is accounted for. Current lease accounting standards create such knife-edged accounting whereby small changes in a transaction can result in either 0% or 100% of the transaction reported on the balance sheet.
- b) bright line tests to determine accounting classifications as described above in point a (e.g., 75% and 90% thresholds in current lease standards) make it easy for managers

to structure transactions to achieve the accounting treatment they desire.

- c) there is lack of symmetry in the way a transaction is accounted for by the lessee and the lessor. Having the same transaction reported differently by the two parties to the same transaction creates lack of comparability and consistency.
- d) scope exceptions create loopholes that can be used by management to defeat the intent of the standard (Jamal, Tan, 2010).
- e) executory service contracts are not considered to be part of the lease standard (and are not reported on the balance sheet), so management can get around the lease standard by structuring a lease transaction as a contract for services and not report any debt (see Ryan et al., 2001).
- f) management can use renewal terms, options and contingent payments to get around the intent of the standard (Jamal, Tan, 2010).
- g) management can use special purpose entities to move leases off balance sheet.

Further, in accordance with paragraph 9 of IFRS 16, this assessment must be carried out at the very beginning of the contract or agreement. It is considered that the agreement is a lease agreement, or it contains lease elements, if it gives the right to control the use of an identified asset over a period of time in exchange for a consideration. It is therefore crucial to determine which asset is the subject of the lease and to determine the existence of control over that asset. Once assessed, the lease contract is not reassessed unless the lease conditions change. In that case, it is necessary to determine again whether the contract is a lease or contains a lease. To determine whether a contract contains a lease, the following decision tree can be used (Figure 1).

Figure 1 Decision tree

Source: IASB, 2017⁷

A certain asset is subject to rent if it is explicitly or implicitly stipulated by the contract and if the lessor cannot and does not have the right to substitute that asset with another. It is considered that by lease agreement the lessor transfers the right of use of a particular asset to a lessee if economic benefits of using the asset during the lease period will flow to the lessee, and the lessee decides on the use of the asset during the lease period.

In the end, leases are different from services because, at the start of a lease, the customer obtains control of a resource (the right to use an item). So the definition and accompanying guidance focus on whether a customer controls the use of an item when the customer has exclusive use of the item for a period of time and can decide how to use it (IFRS, 2015: 3)⁹. In contrast, in a service contract, the supplier retains control of the use of any items needed to deliver the service, even if those items are located at the customer's premises. In such contracts, the customer does not obtain control of a resource at the start of the contract but, instead, commits to purchasing a particular service that it will receive in the future (IFRS, 2015: 3)⁹.

4. Recognition and measurement in the financial statements of the lessee

The most significant changes in the accounting model for the recognition and measurement of leases are related to their accounting treatment in the financial statements of the lessee. The new standard provides only one unique model for the recognition and measurement of all leases instead of the two-model approach used so far (one model for on-balance sheet leases and another model for off-balance sheet leases). With the application of the new lease standard, it will become irrelevant to determine whether it is an operating or finance lease. Furthermore, the lessee will, in both cases, recognize the asset and the lease liability in their financial statements. In other words, there will be a uniform approach to the lessor lease accounting. In doing so, the model to be applied by the lessee is comparable to the current model applicable to finance leases.

4.1 Recognition and measurement

With the adoption of the new standard, the lessee will, in accordance with paragraph 23 of IFRS 16, at initial recognition of the lease, measure the right to use assets at cost. The cost of this asset includes (IFRS 16, paragraph 24):

- a) the amount of the initial measurement of the lease liability;
- b) any lease payments made at or before the commencement date, less any *lease incentives* received;
- c) any *initial direct costs* incurred by the lessee; and
- d) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.

As apparent from the aforementioned, the amount recognized as an asset under the lease contract is based primarily on the present value of the liability and not on the value of the asset as such. However, the cost includes all the related costs normally associated with the acquisition of long-term intangible and tangible assets.

At the commencement date, the lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate (IFRS 16, paragraph 26).

The interest rate included in the lease can be relatively easily determined for lease agreements that involve the transfer of ownership of the asset, which is the subject of the lease contract, at the end of the lease period. Furthermore, determining the interest rate that will equalize the contractual cash flows with the fair value of the leased asset in the aforementioned case will result with the interest rate implicit in the lease. However, if asset ownership is not transferred nor will be transferred, the determination of interest rate to be applied in measurement of lease asset and liabilities is usually not possible. In that case, it is much more practical and in accordance with the standard to apply the interest rate at which the lessee would be able to get financing at that time and for a similar financing period.

This means that the lessee will have to calculate the present value of the liability upon initial recognition

of the assets and liabilities so that the contractual amount of the lease is discounted to the present value using the interest rate to be determined on the level of the interest rates that company is currently paying, or would be paying, to creditors (source of financing). Then, the present value would be determined as follows:

$$Present\ value = \sum_{i=1}^n \frac{N_i}{r^i}$$

$$r = 1 + \frac{p}{100}$$

Where:

n ... total number of rent payments (compounding periods)

N_i ... rent amount (payment) in the period i

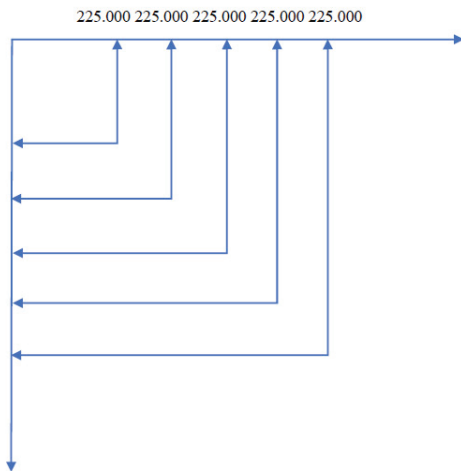
p ... discount rate for one compounding period (in the case of monthly payments that would be a monthly discount rate).

If the amount of each payment is equal (annuity payments), then this calculation can be simplified by using the following annuity formula:

$$Present\ value = N \times \frac{r^n - 1}{r^n \times (r - 1)}$$

This can be shown on a graph, as follows:

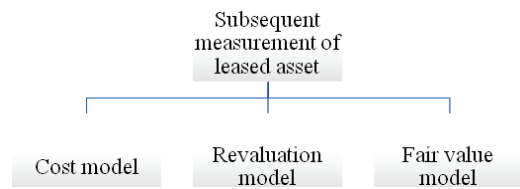
Figure 2 Present value determination



Source: Authors' work

Based on this initially recognized amount, subsequent measurement of recognized asset and liability will be carried out according to the applicable standard in a particular situation. This means that the assets recognized under the lease will be subsequently measured at cost and depreciated over the useful life of the lease period according to IAS 16 – Property, Plant and Equipment. However, it is also permitted to subsequently measure the leased asset at revalued amounts if the lessee's accounting policy for that type of asset is the revaluation model for subsequent measurement (IAS 16). However, if the leased asset is subleased or, in other words, released by the lessee and the asset satisfies the definition of investment property measured at fair value, this asset must be measured at fair value according to IAS 40 – Investment Property.

Figure 3 Alternative subsequent measurement models for the leased asset



Source: Authors' work

Subsequent measurement of lease liability is based on the initially recognized amount by (IFRS 16, paragraph 36):

- a) increasing the carrying amount to reflect interest on the lease liability;
- b) reducing the carrying amount to reflect the lease payments made; and
- c) re-measuring the carrying amount to reflect any reassessment or lease modifications, or to reflect revised in-substance fixed lease payments.

Therefore, it follows that the subsequent measurement of liabilities is in fact equal to the regular measurement of liabilities, for example, loans set in the International Financial Reporting Standard 9 – Financial Instruments. In other words, the initial amount recognized is increased by interest accrued by applying the interest rate determined at the beginning of the lease term on the outstanding principal. This will also require an allocation of total amount of payment to principal repayment and payment of interest accrued.

4.2 Exemptions

This complex approach to recognition and measurement of leases has to be applied to all lease agreements, but two. A company can choose not to apply the regular approach to recognition and measurement of the lease to either short-term leases or leases for which the underlying asset is of low value. Paragraph 6 of IFRS 16 prescribes that the lessee in that case may choose to recognize all payments associated with such leases as an expense either on a straight-line basis during the lease period or on some other systematic basis. The lessee shall apply another systematic basis if that basis is more representative of the pattern of the lessee's benefit.

A short-term lease is a lease that, at the commencement date, has a lease term of 12 months or less. The same exemption applies to a lease where the underlying asset is of low value. In this case, the lease term is not important because the exemption is based on the low value of the asset. However, unlike for short-term leases, "low value" is not defined by an absolute number, nor can it be related to the size of the company. Examples of such assets can be computers, printers, etc. Although the standard does not specify the top limit for the "low value" asset, at the time the standard was drafted, the amount of US\$ 5,000 was considered, which could serve as a guideline for determining the significance of the leased asset.

4.3 Implications of changes in the accounting model for leases

In addition to the additional recognition and measurement requirements for assets and liabilities, the application of a new lease model will result in an increase in leverage (gearing) of the lessee, as existing liabilities will be increased for those relating to operating leases that were off-balance sheet according to the current lease standard.

Figure 4 Implications of the new lease model on the lessee's statement of financial position

Statement of financial position	
Right-to-use asset	Non-current lease liability
	Current lease liability

Source: Authors' work

For companies that have material off-balance sheet leases (operating leases), application of the new lease model will result in an increase in lease assets and financial liabilities. As a result of an increase in non-current assets, the asset turnover ratio will decrease, implicating the lower efficiency of the asset. Recognition of lease liabilities will also increase current liabilities (for the part due within 12 months), which will decrease the liquidity of a company, since current assets are not affected by new lease accounting.

The carrying amount of lease assets will normally decrease more quickly than the carrying amount of lease liabilities. This will result in a reduction in reported equity compared to IAS 17 for companies with material off-balance sheet leases. This is similar to the effect on reported equity that arises from financing the purchase of an asset, either through a former on balance sheet lease or a loan (IASB, 2016a). Accrued interest expenses will be recognized under financial expenses in the income statement. Furthermore, there will be a change in operating expenses as well. According to the current lease model, the lessee recognizes accrued rent expense on a straight-line basis as part of operating expense in the total amount of payment made. The new model allocates the total amount of payment on interest expense and depreciation expense, hence decreasing the amount of operating expenses. Consequently, the EBITDA will increase, as it excludes interest and depreciation, which are now fully included as rent expense and are not excluded from calculation of this indicator. EBIT, or operating profit, will also be higher, but only for the amount of interest expenses included in financial expenses.

Figure 5 Implications of the new lease model on lessee's income statement

Income statement	
Depreciation expenses	Operating expenses
Interest expense	Financial expenses

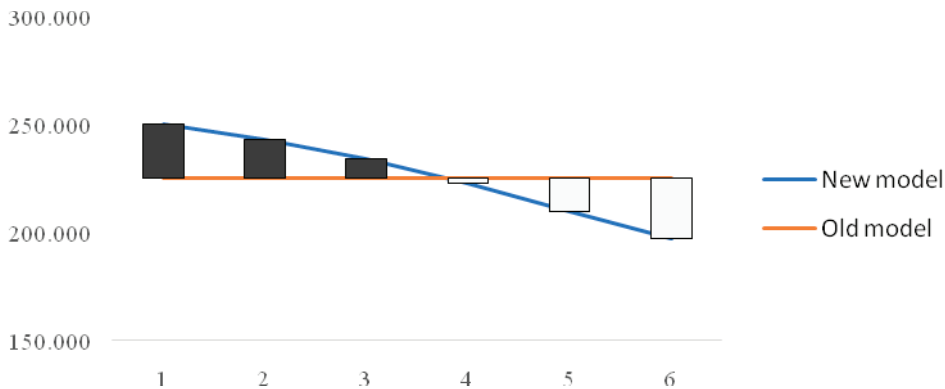
Source: Authors' work

Due to the fact that rent expense, which is mainly recognized on a straight-line basis, is substituted by depreciation expense (which will mainly be recognized on a straight-line basis also), and

the interest expense accrued on the outstanding lease liability, and thus does not have a linear effect over the lease period, there will be *ceteris paribus*, a decrease in income in the initial years of the lease agreement compared to the existing

model. However, in the later years of the lease agreement, this relation will be reversed. The following figure shows the impact of the current and new lease model on total costs in the income statement.

Figure 6 Comparison of total costs in the income statement according to the “new model” and the “old model”



Source: Authors' work

Finally, application of the new model will also have implications on reporting cash flows. Payments made under the current lease model are included in cash flows from operating activities as rent payment. Since payment is comprised of interest payment and principle repayment under the new lease model, this means that it will also be presented differently in the statement of cash flows. Repayment of principal will be presented in financing activities, and interest payment will be presented, depending on the chosen accounting policy, in operating or financing activities. There will be no change to the total net cash flow, but, the operating cash flow will increase.

Figure 7 Implications of the new lease model on lessee's statement of cash flows

Statement of cash flows	
Principle repayment	Financing activity
Interest payment	Financing / Operating activity

Source: Authors' work

Since operating income will increase by the amount of interest expense in the lease payment that is ex-

cluded from operating expenses, and net operating cash flow will increase by the amount of lease principal in the lease payment that is excluded from operating activity, this will impact the quality of earnings ratio. The impact will depend on the length of the lease period, interest rate and the amount of principal outstanding. Different than for other financial statements, impact on the cash flow statement would be only structural. The same amount of cash would be used by an entity for lease payments and, consequently, total net cash flow will be the same. Instead, cash flow from operating activities will increase and cash flow from financial activities will be decreased by the principal payment. There will be no impact on investment activities, or it will be limited to prepayments. This is because only cash or cash equivalent, which will be used for asset acquisition, is limited to advance payment at the beginning of the lease.

The impact of adopting the new standard on statement of changes inequity will be reflected only in the fact that profit or loss for the year is going to be different. The direct impact of applying IFRS 16 will be limited only to the first year and the transition effect. However, due to a different transition model adopted by the standard, even this impact could be eliminated.

5. Recognition and measurement in the financial statements of the lessor

Accounting for leases in the financial statement of the lessor did not experience such significant changes. The lessor will continue to classify the lease as operating or finance lease. According to paragraph 63 of IFRS 16, a lease is classified as a finance lease if:

- a) the lease transfers ownership of the underlying asset to the lessee by the end of the lease term;
- b) the lessee has the option to purchase the underlying asset at a price that is expected

to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised;

- c) the lease term is for the major part of the economic life of the underlying asset even if title is not transferred;
- d) at the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset; and
- e) the underlying asset is of such a specialized nature that only the lessee can use it without major modifications.

Figure 8 Expected impact on lessees with significant operating leases

Metric	What it Measures Calculation	Calculation	FRS 116 effect *	Explanation
Leverage (gearing)	Long term solvency	Liability/ Equity	Increase	Increase because financial liabilities increase (and equity is expected to decrease).
Current Ratio	Liquidity	Current Asset/ Current Liability	Decrease	Decrease because current lease liabilities increase while current assets do not.
Asset turnover	Profitability	Sales/Total Asset	Decrease	Decrease because lease assets will be recognised as part of total asset
EBIT (Earnings before interest and tax)	Profitability	Various	Increase	Increase because the depreciation charge added is lower than the expense for off balance sheet leases excluded.
EBITDA (Earnings before interest, tax and depreciation)	Profitability	Various	Increase	Increase because expenses for off balance sheet leases are excluded.
Operating cash flow	Profitability	Various Methods	Increase	Increase because at least part of the lease payments (those payments relating to the principal) will be moved to the financing section of the cash flow statement.
Net cash flow	Profitability and liquidity	Difference between cash inflows and cash outflows	No change	No change because cash will not be affected.

* FRS 116 Leases as the Singapore equivalent of IFRS 16 according to ISCA (2016: 1)

Source: Extracted from IASB's IFRS 16 - Effect Analysis according to ISCA (2016: 4)⁸

If the lease is a finance lease, the leased asset will be derecognized, and the receivable will be recognized, while lease payments will be allocated to the interest income and the initially recognized lease receivables. If the lease is an operating lease, the lessor will continue to recognize the asset that is the subject of the lease contract and will continue to depreciate leased asset in its business books as well as recognize rent income in the agreed amount shown in Figure 8.

6. Conclusion

Like any other change in standards, this change in accounting for leases carries new demands that need to be taken into account when preparing financial statements. Recognition of leases under the new model will significantly change the financial statements of the lessees. Operating leases will not

have accounting benefits for the lessee, anymore. Operating leases will be accounted for in the same way as finance leases. Therefore, companies that have significant assets leased under operating lease will show a great increase in leverage (gearing). The positive effect is reflected in the increase of commonly used profitability measures used in various analyses, as well as for estimating the value of the company itself. Other than financial ratios, the new standard might also have a negative influence on the borrowing costs and debt covenants for the lessee. Future research in this field could be focused on the investigation of total cost that occurred in the implementation of a new accounting model. Also, it would be important to investigate whether the expectations of financial statement users are achieved. Finally, it would be interesting to investigate the relation of those two aspects and make some cost-benefit analysis.

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UČINCI NOVOG RAČUNOVODSTVENOG MODELA ZA NAJMOVE

SAŽETAK

Najmovi se često pojavljuju kao praktičan način osiguranja neke imovine. Prednost najmova je u lakoj zamjeni i manjem angažiranju resursa za nabavu imovine. Međutim, ponekad najmovi, ovisno o njihovom obliku, služe i za prikrivanje financiranja kroz tzv. izvanbilančno financiranje. S ciljem eliminacije ovih nepoželjnih učinaka, IASB je usvojio novi standard za najmove – MSFI 16. Ključna promjena u odnosu na prethodni računovodstveni model priznavanja najmova je upravo na strani najmoprimca. Ova promjena rezultira priznavanjem obveza praktično u svim oblicima najmova. Dakako, ovo sa sobom povlači i priznavanje odgovarajuće imovinske stavke. Rezultat ovog pristupa je i značajno drugačije priznavanje naknade tijekom vremena korištenja najma. Ovo se posebno odnosi na operativne najmove kod kojih se prema postojećem modelu ne priznaju imovina i obveze, a učinak na dobit i gubitak je temeljen na linearnom modelu koji najčešće odgovara ugovorenoj dinamici plaćanja najamnina.

Ključne riječi: najam, operativni, financijski, MSFI 16, sadašnja vrijednost, diskontiranje

