

A PREVALENCE OF THE ECONOMICS IN FRONT OF THE LEGAL. CASE STUDY: FINANCIAL LEASING

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Abstract

For the last years, the financing of the activities of economic entities has been greater and by now one cannot exclude it. In this scientific approach I have tried to illustrate, from the legal and economic standpoint, the terms of a financial leasing agreement as well as comparisons of such agreement with the sales by installments agreement and the lease ones in order to highlight the advantages of the financing by financial leasing.

To choose this object of study I used my professional experience especially as the prevalence of the economics in front of the legal is also a basic principle of the accounting activity.

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1. Introduction

This concept has Anglo-Saxon origins but in Romania it was first introduced in 1999, by the Order of the Ministry of Public Finance no. 403, which stipulated the fact that the information shown by the financial statements must reflect the economic reality of the events and transactions and not just the legal form.

At the moment, Order of the Ministry of Public Finance (OMPF no. 1802/2014), the concept of the prevalence of the economics in front of the legal is found under the form of a principle (Roş, 2018) which, has as its purpose the entry in the accountancy books and the true presentation of economic-financial operations, in accordance with the economic reality, highlighting the rights and obligations, as well as the risks associated to such operations.”

The economic-financial events and operations must be entered in the accounting books as they occur, on the basis of justifying documents. The justifying documents which are the basis of the registration in accountancy of

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economic-financial operations must reflect exactly the way in which such operations occur, i.e. they have to be in accordance with reality.

Also, the contracts signed by the parties must stipulate the way of the operations development and must observe the existing legal framework. (OMPF 1802/2014)

The legal form of a document must be in accordance with the economic reality. When there are differences between the matter or the economic nature of an operation or transaction and its legal form, the entity will enter in accountancy those operations with the observance of their economic matter.

An example of the application of this principle is the users' enclosure of leasing agreements in operational or financial leasing.

At the same time, when drawing up the justifying documents and booking the economic-financial operations, the entities have the obligation to take into consideration all the available information so that situations in which the economic nature of the operation is different from the legal form of the documents which stand at its basis be extremely rare. (OMPF 1802/2014)

1. Financial leasing

The International Accounting Standard (IAS 17): *Leasing Agreements* applies to agreements which transfer the right to use the assets even if it might be necessary the lessor's supply of substantial services related to the use and maintenance of the respective assets.

A leasing agreement is an agreement by which the lessor transfers to the lessee for a consideration or series of considerations, the right to use an asset for an agreed period of time.

A financial leasing is the leasing operation which transfers to a great extent all the risks and compensations afferent to the title of property on an asset. The title of property may be eventually transferred.

The characteristics of a financial leasing agreement are the following:

a) the leasing agreement transfers the title of property on the asset to the lessee until the end of the leasing agreement duration;

b) the lessee has the option of buying the asset for a price estimated to be sufficiently low as compared to the reasonable value on the date when the option becomes exercisable that, upon the start of the leasing agreement, there is the reasonable certainty that the option will be exercised;

c) the duration of the leasing agreement covers, to the greatest extent, the asset economic life, even if the title of property is not transferred;

d) upon the start of the leasing agreement, the updated value of the minimal leasing payments is at least equal to almost the entire reasonable value of the asset in leasing system;

e) the assets in a leasing system have a character so special that only the lessee may use them without major modifications.

At the beginning of the leasing period, the lessees must acknowledge the financial leasing operations in the statements of the financial positions as assets and debts at a value equal to the reasonable value of the asset in leasing or to the updated value of the minimal leasing payments if this value is lower, each being determined at the beginning of the leasing agreement.

The updating ratio which has to be used for the calculation of the updated value of the minimal leasing payments is the implicit ratio of the leasing interest if that can be determined; otherwise, it is the lessee's marginal interest ratio that has to be used. Any initial direct costs of the lessee must be added to the value acknowledged as asset.

The minimal leasing payments must be divided into the leasing financing expenses and the decrease of the existing debt.

The financing expenses must be allocated on each period along the leasing agreement duration in order to obtain a constant periodical ratio of the interest to the balance of the debt remaining in each period.

The contingent rents must be entered as expenses during the periods in which they are paid. (IAS 17, p. A573)

A financial leasing incurs certain depreciation expenses afferent to depreciable assets, as well as financial expenses during each accounting period.

The depreciation policy for depreciable assets in leasing must be consistent with that applied to depreciable assets owned as property and the acknowledged depreciation must be calculated in accordance with the provisions of IAS 16 *Tangible assets* and IAS 38 *Intangible assets*.

If there is no reasonable certainty that the lessee will obtain the title of property until the end of the leasing agreement duration, the asset must be depreciated in full during the shortest period between the duration of the leasing agreement and the useful life expectancy of the asset. (IAS 17, p. A573)

The lessors must acknowledge the assets owned in financial leasing as debts on the position of the financial statement, at a value which comes equal to the net investment in leasing.

In the case of a financial leasing, the lessor transfers to the lessee, to a great extent, all the risks and compensations afferent to the title of property and, subsequently, the leasing payments to cash are treated by the lessor as reimbursement of the principal and as afferent financial income, the latter representing the lessor's benefit for his investment and services. (IAS 17, p. A575)

An important aspect which has to be taken into consideration by the lessors who are producers or distributors is the sales profit or loss.

Thus, this has to be acknowledged during the period of the leasing agreement and, if interest rates are used which are artificially lowered, then the

sales profit should be limited to the value of the profit which could be obtained should a market interest rate be used.

Otherwise, the result achieved by the respective entity would be distorted especially as there is the possibility that also certain expenses generated during that period be greater or lower and with bad effect on the financial results. (IAS 17, p. A577)

2. Financial leasing agreement vs. installment sale

As it may be seen, the financial leasing is similar to a sales-purchase agreement with payment by installments because, most of the times, by the end of the leasing agreement the assets pass to the property of the lessor (beneficiary).

There is a similarity between the two and here I refer to the final result of the two types of agreement, i.e. at the end of them the asset changes the proprietor.

The difference between the two types of agreement consists in the financing manner: thus, if in the case of the installment sale the asset making the object of the agreement is changes as merchandise and a money equivalent of it is obtained, in the case of the leasing, the right of its use is transferred until the end of the agreement.

This means that, in fact, the leasing is a credit operation in which the amounts necessary to the purchase of the asset are obtained from its exploitation and its reimbursement is done by the payment of the leasing installment and, in the end, this asset is purchased at a residual value.

Hence, it may be said that in a leasing agreement the crediting is under the form of the leasing equipment and not under a money form.

If, in the case of the installment sale agreement the financing is provided by the buying economic entity through the engaged credit, which leads to the title transfer at the moment of the asset payment, in the case of the financial leasing the financing is provided by the leasing entity and, accordingly, the leasing activity is an installment sale in which the title is transferred at the moment of the payment of the last leasing installment.

From the point of view of the installments payment there is another difference between the two types of sales, i.e. the number of installments which have to be paid may be different in the case of the leasing sales as compared to the installment sales.

Thus, if in the case of the leasing agreement, usually, the installments duration may extend not more than a period which is equal to the asset economic lifespan, in the case of the installment sale agreement the installments payment duration may be longer or shorter than the asset economic lifespan.

3. Financial leasing agreement vs. lease agreement

Even if about the financial leasing agreement it can be said that it is similar to a lease agreement, this agreement is different from a traditional lease agreement.

The main differences between the two types of agreements are shown in the table below:

Table 1

Criteria	Leasing Agreement	Lease agreement
Assets wear	Make the object of these agreements assets which, even when not in use, undergo a moral wear and their use value decreases	The assets making the object of these agreements keep their functioning characteristics for the full duration of the agreement operation and the wear is not taken into account
Calculation of the payment installments	The leasing installments are established in accordance with the asset acquisition price and with certain predefined elements (interest, profit etc.)	The lease is set up according to the market conditions and represents the value of the easement
Title of property	Upon the end of the leasing agreement the asset may pass to the property of the lessees on the basis of the installments paid and the payment of a residual value	The leased asset may not pass to the property of the lessee at the end of the lease period

Differences between the leasing agreement and the lease agreement (Author's processing)

As it may be noticed, in the leasing agreement there is a dissociation between the property right and that of possession, the risk of this type of agreement is not a production risk but one of property over the asset because, by this agreement, the leasing company seeks to cover the expenses and make a profit, just as the beneficiary of the leasing agreement and, last but not least, the leasing company is not disinterested by the activity of the asset user and, when there is the case, grants logistic support for the good running of its activity (maintenance, repair etc.).

Conclusions

In Romania, the leasing market gains more and more ground as shown by the document introduced by the Association of Financial Companies – ALB Romania: at the end of the first 9 months of 2017, leasing companies financed goods valued at 7.627 million lei, the equivalent of 1.700 million EUR, and increase of 14% as compared to the same period of 2016 ((Asociația Societăților Financiare - ALB Romania, n.d.).

Are these great or small values?

Opinions differ but there are a few things which cannot be omitted and on which this market depends.

First, the financial leasing activity is a financing activity from external sources for many economic entities present in the Romanian economy. Their financial potential is limited and as they cannot purchase the assets, they need from their own sources they call on this type of financing.

Secondly, we have to consider the fact that certain specific fields of activity use assets which cannot be found on the Romanian market and then, in order to develop their activity, economic entities go to leasing companies to reach such assets.

And they do this because, mainly, the leasing companies are “cubs” of financial-banking institutions which have other arguments in the negotiations related to the acquisition of assets used in specific activities.

Thirdly, if, initially, the financial leasing market was formed mainly of agreements for vehicles, recently, we may notice a diversification of the assets making the object of financial leasing agreements, in such category being included buildings or even land.

Obviously, many other things may be said about the financial leasing, especially as sales and leaseback agreements gain grounds recently. But, about all these, in a future survey.

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