THE ANNALS OF "DUNĂREA DE JOS" UNIVERSITY OF GALAŢI
FASCICLE I - 2006, Economics and Applied Informatics, Year XII, ISSN 1584-0409

# PARTICULARS OF LEASING CONTRACTS ENTRIES ACCORDING TO IAS 17

**Violeta ISAI**

*"Dunărea de Jos" University, Galati*

*Leasing operations are today an efficient means for the leasing companies to sell long-term use goods under advantageous conditions of price and delivery terms while third companies become owners without outstanding financial efforts*

***Keywords:*** *Operational leasing, financial leasing, location contract, lessor**,** lessee, rent, rate, interest, residual value*

## Introduction

Leasing operations are contract- based, according to HG 51/1997, IOG 686/1999 and whit IAS 17, between leasing companies and users. The leasing companies – also called "lessors" – commit themselves to, upon users' request –also called "lessee" – to buy from a supplier an asset to be further submitted to the users in leasing in exchange of a royalty (rent).

## 1. Types of leasing

Leasing is, therefore, an agreement where the lessor transmits to the lessee, in exchange of a sequence of payments, the right to use a certain asset for a previously agreed period.

According to IAS 17 leasing can be: ***operational*** and ***financial***. In both cases, the leasing company, Romanian legal person, buys from a supplier an asset which is further registered at its input value (purchasing cost). The supplier can be home or foreign. The leasing company may also be a foreign legal person, having its headquarters abroad, who implies specific accounting entries as regards: customs charges, taxes, royalties interest taxes, VAT etc. The leasing company gives the asset to the user as per a leasing contract making specific provisions on: the value of the asset-object of the contract (equal to the purchase cost); contract duration in years (generally covering the use duration); the rated duration and the mortgage method applied (acc to Law 15/ 94); annual interest rate (the profit margin, as applicable); the residual value as provided in the contract (which is charged to the user upon the leasing contract termination/completion date). During the contract time, operations may differ depending on the type of leasing applied, as follows:

a) In case of the operational leasing, the lessor – owner of the asset, keeps its own accounting record and balance during the entire period of the contract, and enters its mortgage as well. The Lessee registers the asset in prime entry**,** without making any entry in the balance In this case , the lessor produces monthly rate bills to the lessee (royalty) aiming at covering the mortgage expenditures and provided a profit margin;

b) In case of the financial leasing, the location appears as a purchase operation based on a loan, while the lessee behaves as if he were the asset owner, keeping record of its mortgage. In this particular case the value user registers it as a medium and long-term loan, in both cases specifying the corresponding interests. According to IAS 17, both risks and benefits associated with the ownership rights are to a large extent transferred to the user.

In both cases, upon completion of the contract, the user may give up the option of asset ownership transfer right (especially in case of the financial leasing), may ask for the contract extension or may reimburse the asset to the owner (lessor) according to the leasing contract clauses. If the lessee requests to become owner, the asset ownership transfer from lessor to lessee is carried out in terms of residual value as provided in the contract upon mutual consent.

## 2. Methodology of keeping record of the operational leasing

### 2.1. Accounting entries in the *locato's* bookkeeping (leasing company) shall be

**Lessor** (leasing company)

1. Purchase form the supplier as per invoice:

% = 404
2133
4426

This paper was recommended for publication by Prof. Emil HOROMNEA, PhD

2. Payment to the supplier by money order. (money order):

404 = 5121

3. Annually, for 4 years, the following is entered:

a) the mortgage depending on the input value and use time: $\frac{Vi}{D}$

6811 = 2813

b) an invoice is issued for the rent (royalty) which consists of:

- rate equal to the mortgage per expenditure
- profit margin = rate × % according to the leasing contract

411.1 =%
706
4427

Details may be further provided:
706.1 "income from mortgage royalties"
706.2 "income from profit margin royalties"

c) the sum stipulated in the invoice is cashed:

5121 = 411.1

4. a) Upon completion of the leasing contract, a deed of sale is signed and an invoice for the shipping means as per residual value is issued:

461 = %
7583
4427

- the sum stipulated in the invoice is cashed:

5121 = 461

- the shipping means at the input value is erased from the records taking into account the mortgage value and the remaining value:

% = 2133
2813
6583

b) Upon completion of the contract the shipping means is received again without any specific entry as this is already registered. For the forthcoming years the associated mortgage is registered:

6811 = 2813
121 = 6811

Erasure from the record at the input value is carried out upon expiry of the use time:
2813 = 2133

**2.2. The user's accounting entries** shall be:
User
1. –
2. –
3. Annually the following are to be entered:

a) the prime entry of the shipping mean (in addition to the balance) – as per account 8036 "Royalties, accounting locations and rents", where the value of the sum to be paid is registered (rate + user margin):

8036 (D) = value to be paid

b) the rent invoice is received (rate + profit margin) according to the leasing contract:

%= 401
612
4426

Details may be further provided:
612.1 "royalties expenditures associated with the mortgage"
612.2 " royalties expenditures associated with the profit margin "

c) the invoice is cashed:

401 = 5121

at the same time the account 8036 is credited

8036 (C) = rent

In this moment, after the last invoice has been cashed the account 8036 is paid off.

4. a) Upon completion of the leasing contract, based on the deed of sales, the invoice is received at the residual value of the fixed means:

% = 404
2133
4426

- the invoice is cashed:

404 = 5121

- the mortgage registered by the user during the contract duration is taken over

2133 = 2814

- when the user becomes the owner of the shipping means, he keeps record of the residual value during the remaining use years:

6811 = 2813

And erase from the record the shipping means at the input value when the use contract date expires:

2813 = 2133

b) Returns the shipping means to the user without making any entry

**2.3. If the company remains in leasing, the shipping means shall be imported** and record of the following differences shall be kept:

Lessor

1. Imported asset

2133 = 404 the external value

2. Payment depending on the currency

% = 5124 or 404 = %
404 5124
665 765

Remaining entries are identical

Lessee

1. Annual entries are identical
2. Upon completion of the contract, the asset is registered at its residual value

% = 404
2133
4426

and at the same time, the customs taxes are registered and paid according to the legislation in force, which increases the value of the shipping means:

2133 = 446

with the custom taxes associated with the residual value and

446 = 5121

(upon receipt of the invoice).

If the leasing contract is a foreign legal person having its address abroad, the following modifications shall be performed in the user's accounting:

1) Annually, the external rent invoice shall be received:

612 = 401

at the external value depending on the daily exchange rate.

At the same time, the associated deductible VAT is paid:

4426 = 5121

19% from the external value of the rent invoice and also the royalty tax is registered and plaid to the external leasing company, but paid off by the user reducing the external debt according to the convention for avoiding double taxation.

(to which our country has subscribed along with other countries ):

401 = 446
the associated tax
and
446 = 5121

at the daily exchange rate.

2) Upon completion of the contract, if the lessee gives away to the ownership right transfer option, he will register the asset at its residual value based on an external invoice as received from the lessor:

2133 = 404

at the residual value (external).

At the same time, he will pay the associated deductible VAT at the customs office:

4426 = 5121

19% at the residual value, registers and pays the customs taxes related to the residual values, possible the excises – associated with the residual values, which increases the value of the shipping means:

2133 = 446
and
446 = 5121

(at the custom office) as per daily exchange rate.

## 3. Methodology of recording the financial leasing

### 3.1. The entries in the lessor's accounting documents are:

Lessor

1. The asset purchased and the related invoice from the supplier:

% = 404
2131
4426

Invoice payment:

404 = 5121

2. Submittance of the asset at its contract value and recording the debt (medium and long -term loan) along with the total interest to be cashed (in advance in the account 472 – passive):

2673 = 2131
and
2674 = 472

- prime entry in the account 8038 " Other values in addition to the balance" – analytical – "Assets submitted in financial leasing ":

8038 (D) = the total amount to be cashed

3. Annual recordings:

Year 1:

- issuing the rate and interest invoices to the lessee, according to the leasing contract:

411.1 = %
706
2674
4427

- register the interest quota

472 = 706
706 = 121

- decrease the debt with the rate:

658.8 = 2673
$\longrightarrow$ other overheads

- cash the amount stipulated in the invoice:

5121 = 411.1

- crediting the account 8038:

8038 (C) = with the sum cashed

For the next years the formulas from Year I remain valid.

b) Receives again the asset at the contract value:

2131 = 2813

(with the value of the mortgage as registered by the lessee)

### 3.2. The lessee's accounting balance entries shall be:

Lessee

1. -

2. Entry of the asset at its contract value and register of the medium and long -term loan (received) along with the total interest (as an advanced expense in account 471 – active):

2131 = 167
and
471 = 1687

- prime entry in account 8036 "Royalties, locations and rents":

8036 (D) = total sum to pay

3. Annually the asset mortgage and the lessor's invoice:

Year 1:

$$6811 = 2813 \ \frac{Vi}{D}$$

| | | |
|---|---|---|
| % | = 404 | |
| 167 | | Rate 1 |
| 1687 | | Interest 1 |
| 4426 | | |

- register the expense quota associated with the interest:

666 = 471

- invoice payment:

404 = 5121

- crediting the account 8036:

8036 (C) = with the amount paid

b) Reimburse the asset at its contract value:

2813 = 2131

(with the mortgage value during the entire period of the leasing contract)

**3.3. If the Romanian leasing company imports the asset,** the differences recorded shall be:

Lessor

1. Asset imported against external invoice:
2131 = 404 at the external value
2. Payment to the supplier depending on the currency exchange rate

| | | | |
|---|---|---|---|
| % | = 5124 | or 404 = | % |
| 404 | | | 5124 |
| 665 | | | 765 |

- Remaining entries are identical

Lessee

1. Annual entries are identical
2. Upon completion of the contract, a deed of sales is signed and the customs taxes are recorded according to the legislation, thus further increasing the asset value:

2131 = 446

with the customs tax and subsequent payment:

446 = 5121

If the leasing company is **foreign legal person having its headquarters abroad**, the following modifications shall be made in the lessor's (user) accounting book:

1) Annually, the lessor's external invoice including the rate and the interest is registered:

% = 404 at the external value
167
1687
666 = 471 with the associated interest

The interest tax is registered by the foreign leasing company and paid by the user, decreasing the external debt, according to the conventions to avoid double taxation:

404 = 446

with the associated taxes and:

446 = 5121

paid at the daily exchange rate.

At the same time, the VAT to the external invoice is paid:

4426 = 5121

19% of the external value of the invoice (standing for both rate and interest).

2) Upon completion of the contract, if the lessee gives up the ownership transfer option, the deed of sales is received from the lessor.

Now the customs taxes are registered and paid thus increasing the value of the asset:

2131 = 446

with the associated customs taxes (possibly excises) and:

446 = 5121

The VAT of 19% is also paid:

4426 = 5121

As a conclusion, with the operational leasing, in the user's annual balance the value to be reimbursed and registered as prime entry in the account 8036 shall be registered under "*Informative data*" (account of class 8 which has no box in the balance sheet). With the financial leasing, in the lessor's balance, the value to be cashed is registered in the accounts 2673 and 2674, under "*Situations of debts and claims*", while in the lessee's balance , the value to be reimbursed is registered in the accounts 167 and 1687, under "*Situation of debts and claims*". Duration of the leasing contract may coincide with the rated duration of utilization. The residual values are recorded only if this value is specified in the leasing contract upon mutual agreement.

**Conclusions**

The leasing operations have lately become a means of credit- based purchase of fixed assets, quite often resorted to.

Both lessor and lessee have clear advantages:

- the former sells large amounts of fixed assets against rents or interests, as applicable;
- the latter purchases fixed assets in installments , behaving more often than not as an owner.

**Bibliography**

- *Violeta Isai – Financial accounting, Editura Didactică şi Pedagogică, Bucureşti, 2003*
- *IAS 17 - Guide of implementing the International Standards of Accounting, Editura*

This paper was recommended for publication by Prof. Emil HOROMNEA, PhD