ACCOUNTING TREATMENT AND LEGISLATION OF LEASING ARRANGEMENTS

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ABSTRACT

Companies are not always able to purchase fixed assets required to start, expand or modernize their own operations, and also do not have adequate resources that could offer as security for bank loans. Leasing is the answer to such problems, as it provides the possibility of leasing recipient to obtain the necessary equipment. Company pays lease fees from the profits generated from leasing subject use. Leasing, as a contemporary form of funding from year to year, plays a more prominent place in the international business world, making it necessary to devote special attention to the legislation and accounting coverage of business changes, which occur while taking and giving funds to leasing. The importance of these issues in accounting, or financial reporting is confirmed by the fact that International Accounting Standard (IAS) 17 Leases is dedicated to this aspect.

Keywords: *accounting for leases with the lessor and lessee, financial and operating leasing, IAS 17-Leases*

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1. INTRODUCTION

Leasing, as a contemporary form of financing, is characterized by a specific accounting coverage. Leasing arrangements are an effective and flexible solution for getting the property for use, in many cases without shouldering the risk of property. Lease accounting scope is facilitated by the publication of IAS (International Accounting Standards) 17 Leases. This standard prescribes appropriate accounting policies and disclosures, for the lessee and the lessor, to be applied for lease.

Graham and Dodd, back in 1934, discussed the importance of the investment decision-making and offered a relatively simple procedure addressed to the implications of off-balance sheet lease obligations (Graham & Dodd, 1934). Similar discussions occurred with Cottle in 1988 and Copeland in 1990 (Cottle et al. 1988; Copeland et al. 1990; Boatsman and Dong, 2011). However, there are some disadvantages noticed lately and a new accounting solution needs to be discovered. FASB and IASB's joint efforts are focused on the changes that are based on the review of lease accounting. Recently, both boards have issued a "preliminary view" debate on the issue (FASB, 2010). Hospitals and health systems are the subject of great consideration, because most of medical equipment is obtained through the leasing, which suggests that the leasing arrangements are a significant part of their infrastructure. Structuring the transaction in the form of operating leases allows hospitals to be presented with debt lower than it really is. The accounting model proposed by the FASB and IASB, that is Draft, replaces the current model with the "right of use" model, which would be applied to all leases, including lease in effect at the time of adoption. Under the proposed approach, the

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basic accounting model for all leases will be similar to the model currently used for capital leases (Valletta & Huggins 2010).

The main goal of this work is to present leasing as a way of obtaining long-term assets and investigate the validity of dealing with them in the accounting, legal and tax terms, in order to obtain a realistic view of its importance. Hypothesis is that the accounting procedures, policies and disclosure in accordance with IAS 17 Leases, are adequate instruments and that they meet the needs of accounting and financial reporting, tax and legal regulations regarding leasing arrangements implemented in Bosnia and Herzegovina. Based on the research questionnaire, considerable information regarding the specifics of the accounting coverage of leasing arrangements will be collected, which will be processed and collectively shown in the tables.

This paper consists of six parts. The first part deals with the origin and historical development of leasing in general. The following section contains a summary of legal regulations of leasing arrangements. The third part deals with leasing arrangements in terms of the ISA 17. Accordingly, the fourth section discusses accounting scope of leasing arrangement, whereby it examines the coverage of financial accounting and operational leasing arrangements with the lessee and the lessor and proposals for changes in lease accounting. The fifth chapter presents a discussion on implementation of leasing arrangements in Bosnia and Herzegovina as well as exploration of the accounting treatment of leasing arrangements. The last part presents conclusion.

2. DEFINITION OF THE TERM AND HISTORICAL DEVELOPMENT OF LEASING

In today's era, company's business includes the use of modern technological equipment which is very expensive and many companies are forced to purchase it, using some form of financing, among which an important position takes acquisition of equipment through a lease arrangement - rental or leasing. The term *leasing* comes from the English verb "to lease", which means that something is to be leased or rented, or the English noun "lease" which means a lease or rental. The popularity of risk is understandable, since it provides great flexibility and economic benefits, compared to the very owning of assets (Epstein & Abbas 2006).

Although leasing is considered one of modern methods of financing, the first cases of practical applications appeared in ancient history when the Babylonians in 2000 BC applied a type of lease for boats and livestock, while the first theoretical description of the lease is found in the Roman legal documents. Financial leasing as a modern form of funding came from the United States of America. Leasing appears in the U.S.A. in the 1930s when the phone company The Bell Telephone System began to lease, at that time very expensive telephone and teletype machines to their subscribers.

The first financial leasing company was found by Henry Shofeld back in year of 1952 in the USA. The company was founded with the aim to realize a particular transaction in the field of railway transport. After implementation of the transaction, Shofeld recognized economic efficiency of financial leasing and decided to establish the U.S. leasing company, "United States Leasing Corp." (today known as the "United States Leasing International, Inc."). Development of leasing in Europe started in late 50-ies and early 60-ies (ALC BiH 2010). First leasing companies were founded in 1961 in Britain, then France, Germany, Italy, Belgium, etc. We find various subjects of lease such as: capital equipment, machinery, computer and communications equipment that quickly obsolete, means of transport from passenger cars to trucks, ships, aircraft, and fixed assets, and other durable products for personal consumption.

3. LEGAL REGULATION OF LEASING ARRANGEMENTS

Legal regulation of leasing arrangements includes all types of these contracts, but it usually consists of a detailed elaboration of two basic forms, operational and financial leasing. Operational leasing is also called the extrinsic leasing, in which there are two parties, i.e. provider and user of leasing, where the provider is also the owner of the lease. In financial leasing, there is a third contractor, i.e. the seller or supplier of leasing subject. "Financial leasing is a legal transaction in which the lessee, during the period of possession and use of the leased asset, pays the agreed lease fee with the option of purchasing and acquiring the ownership of the leased asset and bears the costs of depreciation of the leased asset." (F BiH Legislation of leasing. Article 5., paragraph 2.)

For both types of contract it is common that the user of the item or the object of leasing, is not its owner as well. Since the financial lease requires the conclusion of two different contracts, sales contract on lease subject and contracts on financial leasing, financial leasing is to be determined as the associated legal work. The user pays a fee for the transferred right to use. In doing so, leasing provider reserves the right to own the subject of lease until the end of the contract. After the deadline determined by the contract, the user can become a legal owner of leasing property, only under the condition that financial leasing is concluded with an option to purchase. Thus, transfer of ownership does not come by default. The contract on financial leasing must include a clause with an option to purchase which may or may not be realized.

The subject of financial leasing in the local legal regulations may be movable unconsumable goods (eg., various equipment, motor vehicles, etc.) and immovable assets. The same solution in terms of the leasing subject is located in the Croatian Law on Leasing (Official Gazette, 135/06). Quite a different solution was adopted in the Serbian Law on Financial Leasing (Official Gazette of the Republic of Serbia, 55/03; 61/05). According to this Law, the subject of leasing may be only movable unconsumable tems.

Leasing transactions are found in full implementation of local business practices. For example, when it comes to buying vehicles, customers most often choose to purchase through leasing arrangements. In the role of leasing provider, there are leasing companies, as financial institutions specialized for this type of activity, whose founders are banks, under which company leasing houses do business. Due to the increasing presence of the leasing arrangement, implied by advantages and benefits offered by this institute, in terms of purchasing durable goods intended for personal use, leasing is becoming a serious alternative to bank loans intended to citizens.

4. LEASING ARRANGEMENTS IN THE CONTEXT OF THE INTERNATIONAL ACCOUNTING STANDARD (IAS) 17

According to IAS 17, lease is defined as a contract under which a provider of lease (the lessor), transfers to recipient of leasing (the lessee), in return for payment or series of payments, the right to use certain means for the agreed period (FAAFW BiH 2006, p. 376). In purpose of correct accounting and tax treatment it is necessary to distinguish between:

- Operating and
- Financial leasing.

Basic characteristics of the operating and financial leases are presented and compared in Table 4.1.

Table 4.1. Characteristics of the operational and financial leasing

No.	Characteristic	Financial leasing	Operating leasing
1.	Transfer of ownership - legal	Yes	No
2.	Transfer of economic ownership	Yes	Yes
3.	Depreciation	User	Provider
4.	Credit risk	Yes	Yes
5.	Costs of exploitation	User	User
6.	Additional services	No	Possible
7.	The risk in the leasing	No	Yes

Source: Vujić et al. 2010, p. 23

In addition to these two types of leasing arrangements, there are also (Andrijanić, 2001):

a) according to the method of funding and relationships that arise during the course of leasing transactions: indirect and direct leasing;
b) by duration of lease: short term and long term lease;
c) by maintenance of subjects: net and gross leases;
d) by case of leasing: leasing of investment equipment, leasing of complete plants and leasing of consumer goods;
e) by usage of leased items: leasing of unusable goods, leasing of usable goods;
f) by determination of leased items: individual and blanket leasing;
g) by the type of leasing contract: normal (standard) lease agreement, agreement with the right options and contract with a clause on the right of purchase;
h) other types of leasing: time leasing ("run-off-leasing"), rotating leasing, return leasing and lease with a decision on purchase.

Financial leasing is the leasing that substantially transfers all the risks and benefits related to the subject lease to recipient, even though, during the entire period of the lease arrangement the subject is the property of the lessor. Risks include the possibility of loss of unused capacity or technical obsolescence and fluctuations in revenue due to changes in economic conditions, while benefits may represent the expectations of lucrative jobs in the economic life of assets and gains from the increased value or realization of residual value. Ownership of the subject lease is transferred to the recipient of lease, after repayment of the last installment to the lessor. Unlike financial leasing, operational leasing has the characteristics of classic rental. The lessor remains the owner of the entire lease after the expiry of the lease.

5. ACCOUNTING SCOPE OF LEASING ARRANGEMENTS

5.1. Accounting coverage of financial leasing arrangements with the lessee and lessor

Under the provisions of IAS 17 "tenants should recognize financial leasing as assets and liabilities in its balance sheet in amounts that are at the beginning of the leasing period equal to the fair value of leased assets or the present value of minimum lease payments for the lease, if lower. All initial direct costs of the lessee are added to the amount, which is recognized as an asset" (FAAFW BiH 2006, p. 381).

Amount of initial direct costs incurred in connection with a leasing contract or putting funds from the leasing in function may be included in the value of the leased asset. The tenant should separate minimum payments based on financial lease into a part that is considered as a financial expense (interest expense - not included in the cost of acquiring the funds based on financial leasing) and the part that reduces the balance paid by the financial leasing liabilities. Potential rent should be treated as an expense for the period in which it was made.

The tenant of financial leasing performs the calculation of depreciation of assets supplied through leasing and includes it in its income statement. Depreciation is calculated on estimated useful lives of leased assets and not for the period in which the financial leasing lasts.

Specific release should be made for property, plant and equipment, which the company purchased on the basis of financial leasing, regardless of the fact that they are recorded along with the property owned by the company to perform core business activities. It is useful to record that property in analytical or sub-analytical accounts.

Posting of purchasing and repayment of long-term assets on the basis of financial lease, when an asset becomes the property of the tenant at the expiry of rent is shown in the Scheme 5.1.

Explanation of posting:

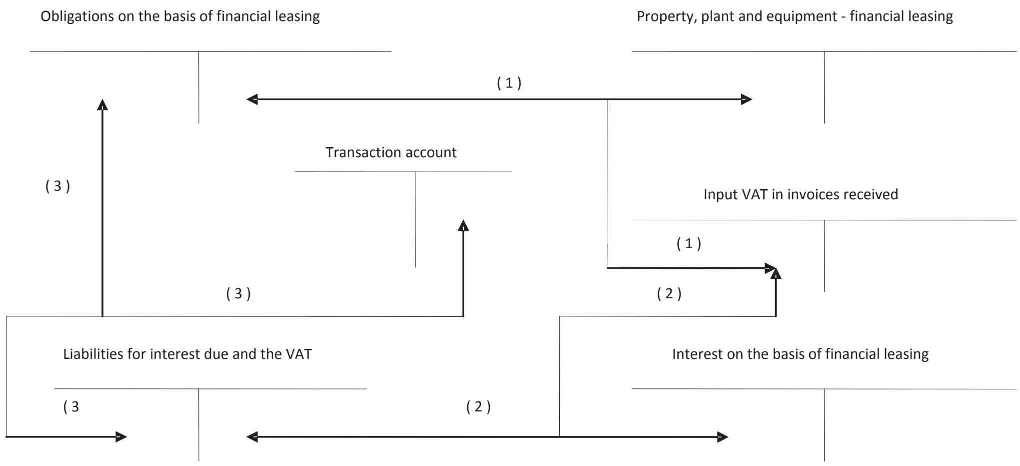
(1) posting when a firm acquires a fixed asset through financial leasing arrangements;
(2) represents posting when the provider of financial leasing issues an invoice for interest and VAT to interest before maturity of repayment;
(3) represents posting when the first installment of payment is due for the financial leasing.

In accordance with the standard "the means that landlords have given on the basis of financial leasing, should be recognized in their balance sheets and presented as a receivable at an amount equal to the net investment in leases"(FAAFW BiH 2006, p. 384). In the accounting of leasing provider, the act of giving means to lease shall be recorded as if such means has been sold on credit. At the beginning, the lessor usually experiences direct costs such as commissions, attorneys' fees and internal costs, which in fact are incremental costs that can be attributed to the signing of a leasing contract.

With financial leasing, the lessor transfers almost all the risks and benefits inherent in ownership to the lessee, and therefore received rent is considered return of capital and financial income, which is charged as a reward for their investments and services. Recognition of financial revenue should be based on the model which reflects a constant periodic rate of return on the lessor's net investment in financial leasing.

"The manufacturer or lessor mediator should recognize a gain or loss on sale, in accordance with the policies adopted by the legal entity applying in direct selling. Costs incurred by the manufacturer or lessor mediator in connection with the negotiation and conclusion of a leasing contract, should be recognized as an expense in the period when it recognizes income from the sale" (FAAFW BiH 2006, p. 385).

Scheme 5.1. Posting of purchasing and repayment of property on the basis of financial leasing for the lessee to the requirements of IAS 17 and other accounting regulations in BiH



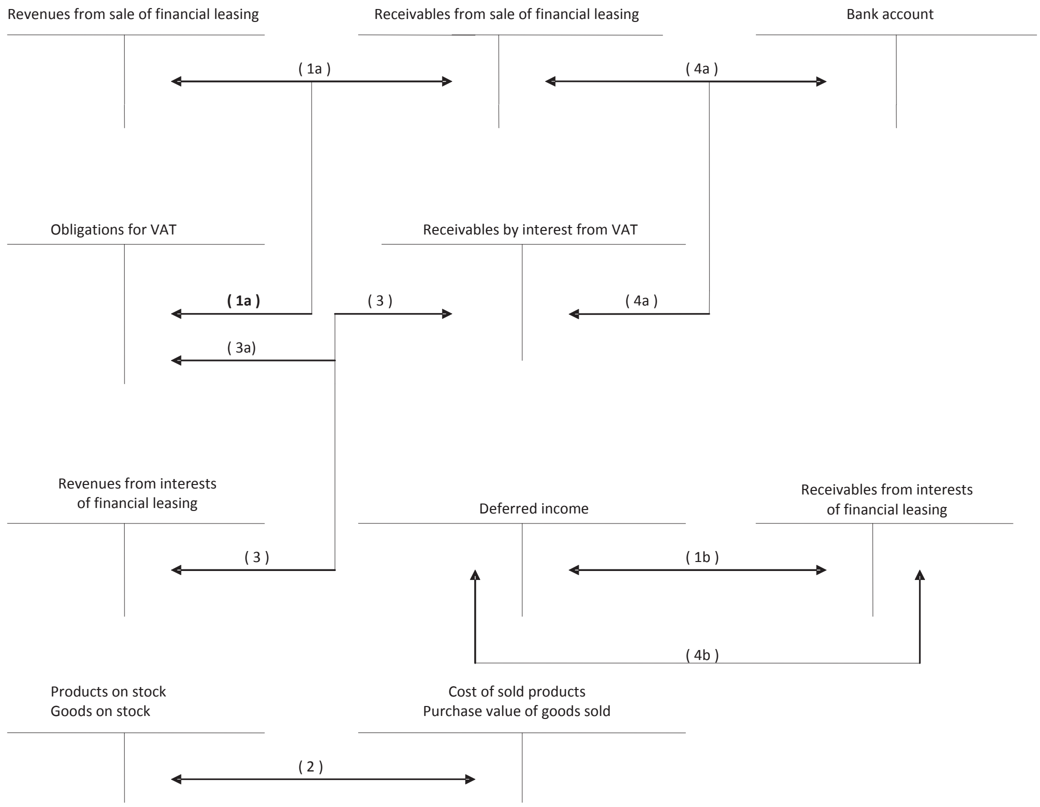
Source: *Author's scheme*

If, in financial leasing, ownership is not transferred to the lessee at the end of lease, then the VAT is not included in net investment and is not posted to the long-term receivables, because the lessor's tax liability arises only for the portion of rent which refers to the accounting period. In case of retail leasing or leasing under which in addition to interest income the lessor realizes revenue from the sale of assets, such leasing arrangement involves two types of income:

- gain or loss arising from the direct sale of means under leasing;
- interest income, which is realized in the period of lease.

Retail value of the asset, which is given in the leasing by the manufacturer or dealer, represents revenue of producer or merchant, except when the present value of minimum lease payments, which are calculated at a market interest rate, is lower than the selling price. In this case, income by the means given to financial leases are recognized at a lower value, since the fair value of means is lower than the usual selling price at the time of execution of lease arrangements. A sale posting of fixed assets through leasing arrangement is explained in the Sheme 5.2.

Scheme 5.2. Posting a leasing arrangement for leasing provider according to the requirements of IAS 17 and other accounting regulations in BiH



Source: *Author's scheme*

Explanation:

(1a) represents posting sales of fixed assets in financial leasing;
(1b) at the same time receivable for interest from financial leasing (excluding VAT) is posted;
(2) represents posting of permanent assets discharge sold through financial leasing arrangements;
(3) represents posting when leasing provider issues an invoice for interest and VAT on interest payments for the repayment installment;
(4a) represents posting of the first installment payment consisting of equity, interest and VAT on the interest for this installment;
(4b) at the same time recognition of outstanding deferred revenue are posted.

5.2. Accounting coverage of operating leasing arrangements with the lessee and lessor

Operating leasing, as well as financial, is based on the rental agreement, in which both Contracting Parties, in keeping with the relatively short cancellation notice, have the right to cancel the lease. The entire investtment risk of this business is borne by the lessor, which includes depreciation costs, insurance and maintenance of a fixed asset provided in the leasing. "The subject of operating leases, because of high risk of the lessor, mostly refers to assets which are demanded by a large number of lessees, or assets which can easily be re-provided in the lease. The rent that is paid under operating lease is the lessor's income and expense for the lessee." (Belak et al. 2006, p. 179)

"Receiver of operating lease should equally recognize payments for rent in the income statement as an expense" (FAAFW BiH 2006, p. 384). Thus, user of operating lease posts debit to the appropriate service charges account and account of input VAT, with the credit of vendor's account. If the lease is contracted and paid in advance, then it can be treated as an advance payment of rent. Prepaid lease contains a section that refers to the VAT (if the payer of rent has the right to use it in advance), so this amount must be separated for posting the part that refers to the invoice value of the rent and part related to the input VAT. Part that relates to the input VAT shall be calculated by multiplying the pre-paid rent with recalculated rate, 14.5299%. This input tax cannot be posted to the account of input tax in invoices received, since the right to refund the input tax is not gained until an invoice is received from the supplier, and it is posted to the account receivable input tax in the lease paid in advance. Upon maturity of rent, provider of operating lease issues the recipient an invoice including VAT,, in which deferred costs of rent paid in advance are transformed into rental costs thereby reducing the state to account of deferred costs.

For the lessor, the rent represents income from rent, which covers the costs of depreciation, insurance, training of persons that will work on an item which is subject to leasing, etc. Accordingly, the operating leasing is a classic lease because operating leasing contracts do not transfer risks or benefits arising from ownership to the lessee, the lessor retains them. The lessor calculates depreciation on these assets as well as to other assets, which are used for performing their business activities in accordance with defined accounting policy.

"The manufacturer or the lessor mediator, in accordance with IAS 17, does not recognize any gain from the sale when entering into operating leasing, as it is not equivalent to a sale" (FAAFW BiH 2006, p. 387). IAS 17 allows property that is leased under operating lease, to be recognized as property investment of the lessee and that property can be included in the balance sheet as assets from financial leasing. The necessary condition is that duration of operating lease is covering the entire economic life of the asset.

5.3. Proposals for changes in lease accounting by IASB and the FASB

The International Accounting Standards Board (IASB) and the U.S. Financial Accounting Standards Board (FASB) are currently considering a common proposal which will fundamentally change the way of business concerning leasing and renting of property and equipment. One part of IASB and FASB project is Memorandum of Understanding. The final standard is expected to be completed in December of 2011.

Under the proposed model for lease accounting exposed in the negotiation documents, published by the IASB and FASB in March of 2009, different types of leasing would no longer exist. "Lessee should always have the right to recognize the property, the right to use leased item with a corresponding obligation in its balance sheet. As a suggestion for a future standard, except for the recognition of lease payments made in all leasing and rental agreements, tenants would have to include payment in accordance with the optional periods and potential rents in their balance sheets." (IASB 2010, p. 1). To meet these requirements, tenants should perform assess of the value and revise them at each reporting date.

The negotiating document issued in March of 2009, does not represent any preliminary views on accounting for the lessor as in the original framework for leasing in 2008 it was decided to postpone the consideration of improvements in terms of accounting requirements for the lessor. However, in November of 2009, it was announced that both aspects of lessee and lessor aspects were considered.

The existing accounting model for leasing was criticized because it does not recognize the obligations of lessees under operating lease. This leads to users of the accounts, in some cases, make adjustments in the financial statements.

If proposals for the lessor accounting has the effect of restricting the availability of leasing, as *Leaseurope* expects, these proposals could lead to smaller companies in particular have a much harder way to finance their investments. These are companies with limited sources of external financing at the beginning of businesses and their borrowing could become more expensive and/or less available.

On the tenant side, the most significant reason for concern about these proposals is the level of complexity which will be imposed. Although companies with high participation of leases would also experience adverse effects, paradoxically, the hardest hit would influence those companies which have a big number of smaller leasing inputs, opposed to structured and high value transactions, which are in the center of focus of lease discussion. Examples of these types of contracts include a contract for car leasing, office space, information technology, telecommunications equipment, etc.

"Key elements of the proposed leasing accounting models and their potential impacts on the financial statements are as follows:

- The concept of "tenure" would replace the current risks and benefits principle. This could result in recognition of all rights and obligations arising under any contract of lease, as well as assets and liabilities on the balance sheet.
- Difference between the operating and financial leasing would be eliminated.
- All leasing obligations should be measured by reference to the relevant leasing terms, such as contingent rents and guaranteed residual value at each reporting date, based on current facts and circumstances.
- The carrying value of existing financial leasing should also be changed.
- Existing arrangements would probably be reclassified" (Pricewatererhouse Coopers 2009, p. 1).

This proposal should have an impact on all companies that currently have significant leasing arrangements (regardless of whether they are classified as operating or financial lease at the time of execution). This would result in an increase in debt, total assets and changes in EBIT, interest coverage, etc. Currently, there is no proposal for a solution to financial reporting of existing leasing contracts. It is likely that this would cause problems in financial reporting and operational difficulties for the existing long-term leasing contracts.

However, in August of 2010, the IASB and FASB have given new impetus to the preparation of EDs (draft proposals) for leasing. "The key provisions of the new EDs include re-adoption of the concept of tenure, which should be applied by lessor and lessee for all leases (including those who sublet), except for the rental of biological and intangible assets, leases for use and exploration of natural resources and leases of certain investment properties. According to this model, the lessee should recognize:

a) property which represents its right to use during the entire lease period (initially recognized at the present value of the rent plus all initial direct costs);
b) obligation of paying the rent (initially recognized at the present value of rents).

The lessor should recognize the value that is its right to collect rents and depending on its exposure to the risks and benefits associated with this property, he should:

a) recognize leasing obligations while continuing to recognize the underlying assets (access to liability arises), or
b) not recognize the right to property that was given to the lessee in the lease, but still recognize the rest of the property which represents his right to the end of the lease (derecognition approach)." (AICPA 2011, p. 1).

Board (of IASB) conditionally decided that they should be two types of leasing for the lessor and lessee:

- Financial leases and
- Other leases.

Each type would express its own profit or loss. Finance leases should follow the format of profit or loss as proposed in EDs and other leases would follow the design of the profit or loss in accordance with operating leases under existing U.S. GAAP or IFRS. The Board has not yet adopted criteria for discrimination of financial lease of other leases.

The implication is that the accounting of leasing is a turbulent area for IASB and FASB. We see that there are constant fluctuations in terms of the manner of recognition of assets, which are leased and the obligation to pay the rent, as well as recognizing the right to charge them. The Board represents the views which are presented in IAS 17, while the FASB seeks to impose benchmarks that are expressed in U.S. GAAP. Recent efforts presented in the proposed draft adopted the approach for financial leasing, which is identical to that of the standard 17, while for operational leasing the option is proposed of calling either to standard or U.S. GAAP. The paradox is that criteria for distinguishing between financial and other types of leases have not been adopted yet, as it was proposed in the draft.

We can certainly say that this is not the last project of IASB and FASB when it comes to accounting leasing. With numerous guidelines and exposure of drafts for future standards given and published so far, we believe that a new standard for leases will not have been issued by the end of 2011.

6. DISCUSSION

6.1. Realization of leasing arrangements in Bosnia and Herzegovina

The first leasing company in Bosnia and Herzegovina market is Volksbank Leasing, which was founded in April 2001. On the European leasing market Bosnia and Herzegovina belongs to the *CESEE countries* (Central Eastern and South Eastern Europe), where, according to the statistics, the highest growth of leasing business is currently recorded.

"Association of leasing companies in Bosnia and Herzegovina, was founded in February of 2005. In this period, three of the leading leasing companies in Bosnia and Herzegovina, *Hypo-Alpe-Adria Leasing, Raiffeisen Leasing and VB Leasing*, due to the lack of legislation and common problems, founded the *Association*, which formally started in April of 2005. Currently in Bosnia and Herzegovina eight leasing companies are registered, which are the members of the *Association of Leasing Bosnia and Herzegovina*: *Hypo-Alpe-Adria Leasing, Raiffeisen Leasing, VB Leasing, NLB Leasing, UniCredit Leasing, Euroleasing, S-Leasing and Asa Abanka Leasing*." (ALC BiH 2010, p. 6) In accordance with its objectives, the *Association of Leasing companies in Bosnia and Herzegovina* also operates internationally. In June of 2005 it became an associate member of *Leaseurope. Leaseurope* (Federation of European leasing associations from 30 countries), was founded in 1972, with headquarters in Brussels. Today, *Leaseurope* represents 92% of the leasing industry throughout Europe and, as the biggest institution of the European leasing market, it brings together around 1,200 leasing companies.

Although leasing arrangements are quite present in the world, in Bosnia and Herzegovina they appeared in the last decade. It is interesting to consider, to what extent leasing arrangements are represented in Bosnia and Herzegovina, compared to countries in the region, i.e, Serbia, Montenegro, Slovenia and Croatia, as shown in Table 6.1. In this table we can see the value of signed leasing arrangements in 2009, in Bosnia and Herzegovina, Serbia, Montenegro, Croatia and Slovenia.

Table 6.1. Value of signed leasing arrangements in Bosnia and Herzegovina and the region

Country	Bosnia and Herzegovina	Serbia	Montenegro	Croatia	Slovenia
Year	2009	2009	2009	2009	2009
Leasing Contracts value	110.7	337	138.5	216	371

Source: *Author's Table* according to *Report* by the Association of Leasing Companies in Bosnia and Herzegovina and *www.novosti.rs/vesti/naslovna/aktuelno.69.html:308064-I-lizing-u-krizi*, [accessed in June of 2011]

The data in Table 6.1 show that the value of signed leasing arrangements in 2009 in Bosnia and Herzegovina was two times lower than those concluded in Croatia, while the value of signed leasing arrangements in 2009 in Bosnia and Herzegovina was more than three times lower than in Serbia and Slovenia. In this period one must not overlook the impact of the current recession on the leasing companies, which in this period recorded a decline in registered contracts, particularly relating to Croatia and Serbia (in 2008 the value of contracts awarded in Serbia amounted to € 812 million, while in 2009, this value decreased to only € 337 million).

The market share of leasing companies in 2008, taking into consideration the total financial volume in Bosnia and Herzegovina, did not show a significant dominance of any of the leasing companies, which is evident from the data obtained from the *Association of Leasing Companies in Bosnia and Herzegovina* for 2005: *Hypo-Alpe-Adria Leasing* 32%, *Raiffeisen Leasing* 22%, *VB Leasing* 11%, *NLB Leasing* 7%, *UniCredit Leasing* 23%, *Euroleasing* 1%, *S-Leasing* 4%.

"In 2008, the European leasing companies represented by a member of association *Leaseurope*, approved new leasing transactions valued at more than €330 billion. These leasing arrangements were used to finance equipment, vehicles and real estate across Europe. *Leaseurope* estimates that in 2008, European leasing industry funded around 24% of all new European investment (excluding real estate). Out of all new leasing operations approved in 2008, almost 90% were approved for funding of different type of equipment and vehicles, and with leasing of cars, and in total they make up more than 50% of all new jobs." (Leaseurope 2010, p. 1).

The average size of leasing contracts in Europe, with all assets categories together, is approximately €42,500. *Leaseurope* estimated that with exclusion of leased property from all leased items, the average size would be €25,000. A significant number of leasing activities in Europe belongs to financial leasing operations. Below are the details on the implementation of the leasing arrangements for subjects in Bosnia and Herzegovina in 2010.

From Table 6.2 we can see that in Bosnia and Herzegovina in 2010 leasing arrangements were mostly used for purchase of vehicles (passenger cars, vans, trucks, trailers, etc.) in amount of € 74 million, or 59.11%.

Table 6.2. Realization of leasing arrangements per subjects in 2010

Subject of leasing	million €	%
Vehicles	74.0	59.11
Equipment	23.4	18.69
Real Estate	27.8	22.20
Other	0.0	0.0
Total	125.2	100.00

Source: *Author*'s table according to *Report* by the Association of Leasing Companies in Bosnia and Herzegovina

6.2. The study of accounting treatment of leasing arrangement

Based on research conducted on the basis of a questionnaire distributed to branch offices of leasing companies operating in the area of the Tuzla Canton (out of eight leasing companies registered in Bosnia and Herzegovina which are members of the Bosnia and Herzegovina *Leasing Association,* five of them have offices in the area of the Tuzla Canton), we collected information regarding the specifics that occur during accounting covers of leasing arrangements. The obtained data is systematized in Table 6.3. and Table 6.4.

According to the current *International Financial Reporting Standards* (IFRS), company, considers leasing or renting as financial lease or operating lease. In financial leasing, the lessor is considered to have the right to transfer most of the risks and benefits related to the ownership of the leased property from the lease. Therefore, leased assets are shown in the balance sheet of the lessee in a similar way as its own property. The results of the research concerning financial leasing shown in Table 6.3 indicate that:

- the majority of respondents, 49.90% consider as important that all risks and rewards associated with ownership are transferred to the lessee;
- 45.6% of respondents consider as important the transfer of ownership to the lessee at the end of the lease;

Table 6.3. Specific characteristics data for accounting coverage of financial leasing

Financial leasing	in %				
Characteristic	Irrelevant	Somewhat important	Important	Very important	Extremely important
Transmit all the risks and benefits associated with ownership	0.2	3.4	49.90	31.30	15.20
Ownership is transferred to the lessees at the end of the lease	8.8	33.70	45.6	3.7	8.2
Recognized as an asset in balance sheet of the lessee	1.0	2.2	51.1	42.2	3.5
Asset is recognized depending on which is lower: at fair value (practically at original cost with no interest increased by initial costs) or the present value of minimum lease payments	1.4	2.5	3.9	25.3	66.90
Depreciation of asset is calculated by lessee under IAS 16 and IAS 38	1.7	3.3	62.1	30.8	2.1

Source: *Author's research*

- 51.10% of respondents consider as important that the subject of leasing is recognized as an asset in the balance sheet of lessee;
- 66.9% consider as very important that the asset is recognized depending on which is lower, fair value of leased assets or present value of minimum lease payments for the lease;
- 62.1% of respondents consider as important that lessee calculates depre-

ciation of asset under IAS 16 and IAS 38.

Since the results of the study of financial leasing showed that respondents considered recognition of assets, depending on which is lower, fair value of the leased asset or present value of minimum payments for lease and recognition of an asset in the balance sheet and amortization as important or extremely important issues, it confirmed the justification of the use of standard. It is also considered that in this way potential corrections of financial statements are minimized.

Table 6.4. Specific characteristics data for accounting coverage of operational leasing

Operational leasing	in %				
Characteristic	Irrelevant	Somewhat important	Important	Very important	Extremely important
All the risks and benefits associated with ownership not transferring	29.6	14.3	50.8	3.5	1.8
Ownership is not transferred to the lessees	1.6	2.2	15.9	30.9	49.4
It is not recognized as an asset in balance sheet of the lessee	4.8	3.3	7.1	31.1	53.7
Lease payments are recognized as an expense	1.2	2.9	18.6	31.7	45.6
Lessee does not calculate depreciation of assets, but the lessor	2.5	1.4	21.2	27.7	47.2

Source: *Author's resarch*

Based on information we received during the research regarding operating leases, we can see that:

- 50.8% of them consider as important that all the risks and benefits associated with ownership are not transferred to the lessee;
- 49.4% think that it is extremely important that ownership is not transferred to the lessee;
- 53.7% of respondents said it is extremely important that the asset taken to operating lease is not recognized as an asset in the balance sheet of lessee;
- 45.6% consider it essential that the lease payments are recognized as an expense;
- 47.2% are of the opinion that it is extremely important that the lessee does not calculate depreciation of asset, but the lessor.

Within operating leases, lessor considers that risks and benefits are retained, and therefore the property given on lease needs to be located in its balance sheet. Lessee records payments of expenses and provides details of payments made for leasing arrangements in the notes with their accounts. Under IFRS, since the approach "substance over form" is required, it cannot justify keeping leasing out of balance, if the risks and benefits are borne associated with the leased assets.

7. CONCLUSION

Leasing arrangement is an economically efficient solution to purchase assets necessary for operation of firm in conditions of lack of capital. Users of leasing subject pay lease rate out of revenue generated from use of leasing subject and thus realize certain tax benefits. IAS 17 elaborated in detail the procedure for posting in various forms and contributed to more objective preparing of financial statements. What remained partially unclear is the area of termination of the lease and its proper recording in financial statements. The main disadvantage of leasing is that it is more expensive than any other method of funding. Fee paid by user of leasing contains the price of leasing subject, profit of leasing company, interest on capital involved and overall costs of lease that leasing company has in connection with the contract. This deficiency must be compensated by a number of advantages that lease bears as a form of financing.

Leases, whether financial or operating, are differently recognized by lessor and lessee in the statements. Thus, lessee recognizes financial lease as assets and liabilities in its balance sheet, while it proportionately recognizes operating lease as an expense during the period of leasing. For lessor the situation is quite different. Lessor recognizes financial lease in its balance sheet as receivable, and operating lease is treated as income from operating leases.

Regarding the tax treatment, in operating leasing the monthly rent expense is entered into business cost of leasing user and VAT is recorded as an input tax with the right of deduction. In financial leasing, lessee pays installment for financial leasing from earned income using the subject of leasing, and is entitled to refund VAT on the interest from financial leasing.

The research results of financial leasing proved that respondents consider recognition of assets, depending on which is lower, fair value of the leased asset or present value of minimum lease payments for leases and recognition of an asset in the balance and depreciation as important or extremely important issues, which justifies the application of the existing standards. At the same time, it minimizes potential correction of financial statements. In an operating lease lessor considers that risks and benefits are retained, and therefore the property given on leasing will be recorded in its balance sheet. Lessee records payment of costs and provides details of payments made for leasing arrangements in the notes to their accounts. Under IFRS, since it requires the approach "substance over form", it cannot justify keeping the leasing out of balance if they bear risks and benefits associated with the leased assets.

In recent times, numerous legislation changes in accounting and auditing are made in order to prevent fraud in accounting. This is achieved, among other things, with proper recording of assets and liabilities, on the basis of leasing, as well as on other types of assets and liabilities, which provides high-quality information base for management.

Based on the above presented, we can conclude that accounting procedures, policies and disclosure in accordance with IAS 17 Leases, are adequate instruments and that they meet the needs of accounting and financial reporting, tax and legal regulations regarding implemented leasing arrangements in Bosnia and Herzegovina. Leasing is present in Bosnia and Herzegovina, but on a small scale, with the tendency of growth in recent years. The situation is slightly better in the region. It is interesting that in the world, there are proposals for adoption of new accounting standards for leases, which would significantly change current position of providers and users of leasing.

Future research could demonstrate to what extent harmonization of regulations between the FASB and IASB contributed to real harmonization of accounting regulations in leasing practice and make recommendations, which would not be only declarative through announcements, but rather real solutions that will be incorporated through legislation and mandatory for use in companies. It could also show how such arrangements may affect the accounting regulations in Bosnia and Herzegovina.

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