

***Dummy Report for Financial
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A Business Report for FRS102



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This report will discuss an international accounting hotspot issue. On January 13, 2016, the International Accounting Standards Board (IASB) issued IFRS 16 - Leases (IFRS16 Lease), which will be officially launched on January 1, 2019. This new regulation has had a major impact on the lessee's accounting treatment. This report will compare and summarize the new and old criteria to find the difference between those two.

Section 1 Operating Lease & Finance Lease

In order to better understand the specific changes in the impact of IFRS 16 on the lessee, the author first describes the accounting treatment of the lessee in the old criteria.

According to the provisions of FRS 102, the lease is divided into two types: operating lease and finance lease. The definition of the two lease types will not be repeated here.

For the lease of the operating lease, the lessee should use the direct-line theory to ensure the expense into current profit and loss in each period of the whole leasing period. The direct expenses incurred by the lessee in the operating lease shall be included in the current profit and loss (administrative expenses). (Altamuro, J, 2014)

For finance leasing, the lessee should use the lower of the fair value of the leased asset and the present value of the minimum lease payment as the book value of the leased asset, and the minimum lease payment is as the book value of the long-term payable. The difference is treated as unrecognized financing charges. (Teng Biao 2018)

It is not difficult to see that the process of financial leasing is more cumbersome and complicated than operating leases.

In addition, for any accounting behavior, it must abide by the principle of substance over form, and operating leases and financial leases are no exception. It can be seen from the literal meaning that the principle of substance over form means that the enterprise should conduct accounting according to the economic substance of the transaction or event, and should not be used as the basis for accounting according to

their legal form. In actual work, the external form or artificial form of a transaction or matter does not fully reflect its substance. Therefore, the transactions or events to be reflected in the accounting information must be accounted for according to the substance and economic reality of the transaction or matter, rather than according to their legal form.

In the old accounting standards, the principle of substance over form in the following aspects: the introduction of the fair value measurement model, the initial direct cost capitalization, the unconfirmed financing costs and the unrealized financing income, the lessor or the rent It is confirmed at the time, the provision for impairment of unsecured residual value and long-term receivables, the accounting of sale and leaseback transactions, the determination of the value of the lessee's leased assets, and the disclosure of information related to the lease business.(Xu Wei, 2017)

Although the assets leased by the financial leasing method do not have ownership in the legal form, the lease period specified in the lease contract is quite long, which is close to the service life of the asset; at the end of the lease period, the leased enterprise has priority to purchase. The right to choose the asset; the leased enterprise has the right to control the asset and benefit from it during the lease term. Therefore, from the perspective of its economic substance, the future economic benefits created by the enterprise can control the assets of the financial lessor are recognized, measured and reported in the accounting. Assets leased by financial leasing should be regarded as assets of the enterprise. It should be listed in the company's balance sheet.

Section 2 Analysis of the reasons for implementing the new criteria

From the definition of the two types of leases in Section 1, it can be found that the old lease criteria IAS17 has some restrictions on the processing of the lease business. In this section, the author will explain one by one.

There are two major situations in the old criteria (Xu Wei 2017):

- **The old criteria IAS17 can no longer accurately reflect the economic reality:** the transaction in the form of financial leases is disguised as operating leases through operating contract terms, concealing corresponding assets and liabilities, greatly reducing the comparability of financial statements.

➤ **Off-balance sheet assets and liabilities in different regions are undervalued:**

According to the data given by the IASB, 14,000 of the 30,000 listed companies in the statistics disclosed information on off-balance sheet leased assets, including aviation, retail, and tourism. The industry accounts for more than 60%, and these operating leases that generate liabilities will not be recorded on the balance sheet, and external information users such as investors will not be able to know.

From the above two situations, it can be concluded that the old accounting criterias have defects, that is, they are easy to be used for off-balance sheet financing, the financial statements are less comparable, and the financial report has insufficient information on leasing.

The old accounting standards are measured by the financial accounting concept framework. It is contrary to the second level and the third level. It is the identification, measurement, recording and reporting of financial accounting elements and accounting information quality characteristics and accounting elements. The reason is that the assets and liabilities of off-balance sheet leases are not recorded on the balance sheet.

Section 3 Changes and Significance of the New Criteria

Based on the old criteria IAS17, the new criteria IFRS16 adds the following requirements (Zhang Yu, 2016)

- Retain IAS17's definition of leases and introduce the concept of “control” of assets, which specifies whether the customer controls and uses a identified asset as a criterion over a period of time to determine whether a contract includes a lease.
- For the lessee, all lease activities are treated uniformly in accordance with the financial leasing method, which exempts two cases: one is a lease with a term shorter than 12 months; the other is a lease with a relatively small value. And for the lessor, no major changes have been made in operating leases and finance leases.
- Adhere to the overall objectives of full disclosure, disclose relevant information

on leased assets (related expenses during the lease period and cash flow), disclose the analysis of the time limit for the lease, and disclose the information of other favorable overall goals of the enterprise.

It can be seen from these improvements that the new standard IFRS 16 is an extension and supplement to the old standards: It can improve the transparency of the company in terms of leverage and asset base, and reasonably safeguard the interests of information users. It can solve the problem of operators using operating leases to manipulate financial statements. It can improve the symmetry of accounting information, so that external information users can understand the real debt scale of the enterprise. It can improve the comparability and reliability of accounting information of IAS17, and improve the quality of accounting information.

IFRS 16 will help companies pay more attention to the management of contracts: the new standard defines the criteria for the differentiation of leases and services to be judged by contract, and the re-measurement of all leases needs to be judged according to the specific terms of the contract. In addition, the company should also judge the impact of the lease contract on the financial indicators of the company, and negotiate with the other party in accordance with the relevant provisions of the criteria.

IFRS 16 will also help to change the business model or strategy of the business: the new standard will have a major impact on companies with more leasing activities such as aviation and retail. In addition, the new standard brings about systemic impact, and will have a direct impact on the company's budget, performance appraisal, taxation and other aspects.

For the financial statements that accounting is most concerned about, the new guidelines have had a significant impact on them:

The new criteria has a greater impact on the lessee's financial statements: the new criteria greatly increases the company's lease assets and financial liabilities to the lessee, and should recognize assets and liabilities for all leasing activities, while increasing the cash flow of business activities, financing Activity cash flow is reduced.

On the other hand, the new criteria also has some impact on the lessor's financial statements: since the new criteria requires the lessor to write off the underlying assets of

the operating lease at the initial measurement, the lessor's total assets are reduced, the asset-liability ratio and the total return on assets. All indicators will be affected, and the payment of each period will be included in the 'cash flow generated by investment activities'.

In short, compared with the old standard IAS17, the accounting system of the new standard IFRS16 is more perfect and fair to the renter and the lessee, and also regulates the various behaviors of the accounting market.

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