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ACCOUNTING MEASUREMENT AND DISCLOSURE OF LEASE CONTRACTS AND ITS ROLE IN FINANCING PROJECTS AND RATIONALIZING ADMINISTRATIVE DECISIONS (APPLIED STUDY IN UR ENGINEERING INDUSTRIES)

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Abstract:

The research aims to identify the role of accounting measurement and disclosure of lease contracts in financing projects and rationalizing administrative decisions, in addition to shedding light on the most important accounting standards that dealt with the subject of leasing, including International Accounting Standard No. (17), with an indication of the role of accounting information in supporting lease decisions. The research was applied in Ur Engineering Industries. The research came to the conclusion that the process of financial evaluation of the lease transaction leads to the transfer of ownership to the lessee at the end of the lease term, and it includes the fixed and irrevocable lease contract, and the accounting measurement and disclosure of lease contracts helps in financing projects and rationalizing administrative decisions.

Keywords:

INTRODUCTION:

Leasing activities have a major role in the development of multiple activities in different countries and are the main pillar of their economy and the growth of their national income, as the expansion and growth in the use of lease finance is only a reflection of the efforts made in the field of business financing by finance companies, in order to finance the leasing of assets. As a result of the great development in economic activity, rental contracts have received great attention from the accounting point of view, despite the fact that dealing with them dates back to a long history through standard No. (17) issued by the International Accounting Standards Committee (IASC).

THE FIRST TOPIC: RESEARCH METHODOLOGY

1.1. Research problem:

The problem of the research is the lack of interest of the Iraqi economic units in lease contracts, despite the creation of accounting standards, methods and procedures that ensure the integrity of the application and accounting measurement of these contracts. Can it help in taking appropriate decisions to finance investment projects? .

1.2. Research importance:

The importance of the research comes from the importance of lease contracts and their role in improving and modernizing the means of production in order to keep pace with technological developments. On the other hand, reaching the best accounting practices for rents can help in providing accounting information that enables management to make effective and efficient decisions regarding rents in the way that It is commensurate with the requirements of the competitive environment in which the economic unit operates.

1.3. Research objectives:

The research aims to identify the role played by accounting measurement and disclosure of lease contracts in financing projects and rationalizing administrative decisions, in addition to shedding light on the most important accounting standards that dealt with the subject of leasing, including International Accounting Standard No. (17), with an indication of the role of accounting information in supporting lease decisions. To finance projects and work on rationalizing administrative decisions related to them.

1.4. Research hypothesis:

The research is based on a basic premise that: (The accounting measurement and disclosure of lease contracts in accordance with International Accounting Standard No. 17 can help in making appropriate decisions to finance investment projects).

1.5. Research Sample:

The research sample is represented by Ur Engineering Industries, for equipment rental at the beginning of 2018 and for a period of 5 years.

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THE SECOND TOPIC: THE THEORETICAL SIDE OF THE RESEARCH

2.1. The concept of leases:

The lease contract is seen as a contractual agreement between the lessor, according to which the lessee transfers the right to use certain assets owned by the lessor for a specified period in return for a specific return to be agreed upon (Lawson,2014:34).
This means that leasing is an agreement contract that grants the right to use property, equipment, or equipment (land, depreciable assets, or both) for a specific period of time, noting that agreements for services are not included in the agreements that treat the lease of assets (Al-Hasnawi, 2011: 59).
The Seventeenth International Accounting Standard for the year 1994 defined lease contracts as an arrangement whereby the lessor transfers the right to use an asset in exchange for a lease consideration due to the lessee. (Abdul Aziz, 2000: 183).
The concept of a lease contract is known under the name of financial leasing, as it is considered a modern idea in financing methods, and this method spread rapidly by investors because of the advantages that were available to this contract, as it helps in obtaining fixed and movable assets and real estate by renting to someone who buys them with a residual value usually It is low at the end of the contract term and the payment is made in agreed installments that reflect the rental price (Josette, 2009: 58).
Thus, the lease is a long-term lease contract under which (the lessor) the owner or owner of the assets allows the user to use the property in exchange for organized lease payments. Thus, the lease contract includes two parties, the lessor and the lessee, where the second makes periodic payments to the owner of the assets, which is called the lessor (Al-Amri, 2009 : 665).
There is a set of characteristics of the lease operations that take place between the lessor and the lessee, which can be clarified through the following: (Al-Hasnawi, 2011: 58-59), (Grenadier, 2015: 6).

1. The parties to the lease are three: the lessor who purchases and leases the assets, the lessee (the beneficiary project) who selects and rents the assets, and the supplier who sells the equipment chosen by the lessee to the lessor.
2. The lease contract is based on the lessor's purchase and ownership of the assets and leasing them to the lessee.
3. Confirmation of the tenant's commitment to pay the rental fee in return for his use of the assets.

The researcher believes that the lease is nothing but an agreement whereby the lessor transfers the right to use an asset for an agreed period of time in return for collecting payment or payments from the lessee. The lease is classified as either an operating lease or a financing lease.

2.2. The importance of leases:

The importance of leasing lies as a suitable financing alternative for the lessee and an investment for the lessor, as the lessee benefits from the low requirements related to guarantees and credit history and financing a greater percentage of the value of the asset than that offered by bank loans in proportion to the needs of the lessee. There are several reasons for resorting to leasing as a financing alternative, the most important of which are the following: (Abdul Aziz, 2000: 114), (Abdullah, 2002: 96), (Lips, 2011:302)

1. Meeting temporary needs: Sometimes projects need certain equipment and assets for an occasional activity (such as a digging machine, a car...etc), so instead of buying, these projects rent them because they will not need them again.
2. Possibility to terminate the lease: This condition becomes more important in the case of equipment that is characterized by rapid development, such as computers, for example, as the risk of obsolescence is transferred from the lessee to the lessor.
3. Tax benefits: Both the lessee and the lessor achieve tax benefits as a result of the leasing process, as the lease installments are considered similar to the interest on loans from the costs that are deducted from the revenue before paying the tax.
4. Capital Retention: Leasing enables the project to keep its money and use it in alternative investments as long as it obtains the services of the asset it needs without having to purchase it.

Leasing has become an important and growing method of financing, as enterprises can obtain their needs of fixed assets either by purchasing them or by leasing them, as the enterprises, in the usual cases, own the fixed assets that appear in the balance sheet (Maxted, 2016:18), not What is important is the use of these assets in operational operations and not merely their possession, and one of the possible ways to obtain these assets is purchase, and there is an alternative method, which is leasing (Al-Amri, 2009: 665).
The researcher believes that the importance of leasing lies in enabling enterprises, especially small and

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ISSN: 2749-3628,

medium ones, to obtain fixed assets such as equipment and devices despite their limited financial capabilities and the inability to borrow from banks, in addition to expanding and opening new units or production lines for these facilities and increasing the volume of their activities, including employment increase in economic units.

2.3. Types of leases:

There are two main types of leasing, namely the financial (capital) lease and the operating lease, and these two types can be explained as follows: (IAS-17,2005:5)

1. Financial (capital) lease: A financial lease is a lease that does not include maintenance services and cannot be canceled by the lessee, who fully consumes the value of the leased equipment, i.e. the value of the installments paid by the lessee is equal to the total value of the leased equipment (Al-Amri, 2009: 680), Thus, it is the lease in which the entire cost of the asset is covered during the lease term, and it is called the capital lease or the full payment lease as well. This type of lease represents a source of financing for the leased project as it gives the lessee the possibility to purchase machinery at the end of the contract term, and it cannot be canceled or terminated. Except with the consent of both parties to the contract (Abdul Aziz, 2000: 80).
2. Operational lease: The operating lease is defined as a commercial system that achieves a possible benefit for the capital asset, and then the asset is leased for a somewhat specific period of time and to a number of lessees, which allows the lessor to recover the asset for the purpose of leasing it again to another lessee. The lease value differs from the previous value according to the demand and according to the value of the asset (Abdul Aziz, 2000: 83), and the operational lease is sometimes called the lease of services, that is, the contract includes the lease of the service (or operation) in general, in which the lessor covers two aspects together, namely financing and maintenance. These two aspects are taken into account when determining the rental value. Or in other words, it is the contract in which the assets are leased to do a specific job and then the lessor retrieves the assets to lease to another tenant and so on. The operating lease is a short-term contract, as it covers a period much less than the expected useful life (Al-Hasnawi, 2011: 63).

Often there is confusion between financial leasing and operating leasing as a means of financing capital assets. When comparing financial leasing and operating leasing, they are often confused due to their convergence in many matters (Al-Hamzawi, 2000: 428).

According to the International Accounting Standard (17), a distinction has been made between the financial and operating lease contract, based on the transfer of the benefits and risks of ownership to the lessee. (IAS-17,2005:5)

1. Transfer of ownership to the lessee at the end of the contract period.
2. The contract included a negotiated purchase option in which the purchase value of the leased asset is less than the fair value.
3. The lease period covers the entire economic life of the leased asset, with the possibility of transferring ownership to the lessee.
4. The present value at the beginning of the lease is greater than or equal to the fair value of the leased asset after deduction of grants and taxes, and the ownership may be transferred to the lessee.

2.4. Accounting treatment of leases and their importance in financing projects:

The accounting treatment of leases can be clarified in accordance with International Standard (17) for the lessee and the lessor, as shown in the following: (Agendum & Mea, 2015:4)

1. For the lessee: For the finance lease, the lessees must show these contracts, assets and liabilities in the financial position, at the value of the contracts at the start of the lease at the fair value of the leased assets, and if it is less, it must be shown in the amount of the fair value of the minimum lease payments and when calculating the present value of the minimum From the lease payments the discount factor is the interest rate implicit in the lease if identifiable and if not the differential borrowing rate should be used, As well as the recognition of the finance lease in the balance sheet of the lessee as an asset and a liability to pay future lease payments and at the beginning of the lease the asset and liability related to future lease payments are recognized (Matawan, 2017:9).As for the operating lease contract for the lessee, the recognition of lease payments under the

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Available Online at: https://www.scholarexpress.net
Vol. 13, August 2022
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operating lease contract must be taken into account as an expense in the income statement on a straight-line basis over the lease period. Lease payments are also recognized, deducting the costs of various services (Robinson, 2019:178).

2. For the lessor: for the finance lease contract, the assets owned by the lessor under the finance lease contract must be recognized in the statement of financial position and displayed as receivables in an amount equal to the net investments in the lease contract, and the lease payment receivable by the lessor is treated as a payment of the original amount for Its investment and services, and the financing income must be recognized based on a pattern that reflects a fixed periodic rate of return on the net investment of the lessor (Agendum & Mea, 2015:4).As for the operating lease contract in the books of the lessors, the assets subject to the operating lease contracts must be presented in the statement of financial position according to the nature of the leased asset. The rental income must be recognized in the income statement on a straight line basis over the lease term stipulated in the operating lease contract. Depreciation is an expense and rental income is recognized, excluding receipts for services (Lawson, 2014:34).

THE THIRD TOPIC: THE PRACTICAL ASPECT OF THE RESEARCH

3.1. An introduction to Orr Engineering Industries:

Ur General Company is an Iraqi governmental company established in 1988, as a result of the merger of the General Establishment for Electrical Cables and Wires and the General Establishment for the Aluminum Industry in Iraq, and it is one of the companies of the Ministry of Industry and Minerals. And the production and plumbing of aluminum of all kinds of sheets, sections, tubes, wires and in its various forms. Ur State Company for Engineering Industries is located on Nasiriyah Road, Al-Shuyoukh Market. It is about 1 km away from the governorate center. The company contains about (581) specialized German and French-made machines distributed over the production company's departments, which includes about (8) laboratories: the midwives and electrical wires lab, the telephone cables and winding wires lab, and the home wires lab. The wood reel factory. The aluminum industry factories are: the plumbing factory, the extrusion factory, the rolling mill, the foil factory and the medicine stoppers. The design capacity of the Ur State Company is 56,642 thousand tons, while the available capacity is 19,900 tons in 2003 and constitutes (35.3%)) of the design capacity, while the actual production capacity actually achieved reached (2187) tons, i.e. an utilization rate of (10.9%) of the available energy.

3.2. Accounting measurement of lease contracts in Ur Engineering Industries and their importance in financing projects:

At the beginning of 2018, Ur Engineering Company leased equipment from the Heavy Equipment Company, and the lease contract was for 5 years and in equal payments to be paid at the beginning of the financial period in the amount of (2598162) dinars, and on this date the fair value of these equipment was (10,000,000) dinars, and it was The economic life of the equipment is (5) years, and the contract stipulates that the lessor pays all operational costs except for property taxes of (200,000) dinars, which the lessee pays, The contract also does not include any option to renew, as the equipment returns to the leasing company upon the expiration of the lease period. The differential borrowing rate of the lessor was 11% annually and the rate of return for the lessee 10% annually. The straight-line method is used in calculating the depreciation. The data on equipment leasing can be clarified through The following table:

Table (1): Equipment rental information

Details	Amount / Number of Years / Percentage
rental period	5 years
rent payments	2598162 dinars to be paid at the beginning of the period
Fair value of the equipment at the beginning of the lease	10000000 dinars
Economic life of equipment	5 years
The residual value of the equipment after the expiry of the term	zero
Tenant's rate of return	10% annually

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Source: prepared by the researcher.

After obtaining the data in the above table, the amount to be capitalized must be determined, which is calculated by subtracting property taxes from the amount of rent payments after multiplying them by the appropriate discount rate, as shown in the following table:

Table (2): Calculation of the cost of leased equipment (the amount to be capitalized)

Details	Amount
rent payments	2598162
- property taxes	(200000)
= net	2398162
x discount rate (n=5, i=10%)	4.16986
Cost of leased equipment (amount to be capitalized)	10000000

Source: prepared by the researcher

It is clear from the above table that the cost of the leased equipment (the amount to be capitalized) was 10,000,000 dinars, which represents the cost of the equipment that a company or engineering industries leased at the beginning of 2018, and the rental payments and the interest rate for leased equipment for the period (2018-2022) can be clarified considering that Payment of the rent amounts has been agreed upon at the beginning of the year, as shown in the following table:

Table (3): Calculation of rent payments and interest rate for the period (2018-2020)

Date	Annual rental payments	operational costs	interest rate (10%)	Reduce the amount of rent	The value of the leased assets
-	-	-	-	-	10000000
1/1/2018	2598162	200,000	-	2398162	7601838
1/1/2019	2598162	200,000	760183	1637978	5963859
1/1/2020	2598162	200,000	596385	1801776	4162083
1/1/2021	2598162	200,000	416208	1981953	2180130
1/1/2022	2598162	200,000	218014	2180131	0
total	12990810	1000000	1990810	10000000	-

Source: prepared by the researcher.

The finance lease contract is recorded as an asset with a liability, and the leased assets are evaluated on the basis of the fair value or the present value of the minimum lease payments, whichever is lower. The minimum lease payments are calculated, and thus a set of accounting entries are recorded as following:

1. Recording origin and commitment on 1/1/2018 with the following entry:

financially leased assets	100,000,000	
obligations of leased assets		100,000,000

2. Recording the rental premium on 1/1/2018 according to the following entry:

property tax expense	200,000	
obligations of leased assets	23498162	
Cash		2598162

3. Recording interest expense on 31/12/2018 according to the following entry:

interest expense	760183	
accrued interest expense		760183

4. Calculating the depreciation of the financially leased asset on 31/12/2018 according to the following entry:

equipment depreciation	2,000,000	
accumulated depreciation of equipment		2,000,000

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In the event that the lease contract drawn up between the lessor and the lessee guarantees the residual value of the asset, so that the lessee shall compensate the lessor for any financial differences in the event of a decrease in the value of the asset. Liabilities of leased assets (the lessee) during the accounting period. measurement and disclosure of leases can help in providing appropriate information through which rational decisions can be taken regarding the financing of investment projects and thus improve the performance of the company in general.

The partial budget of Ur Engineering Industries Company on 31/12/2108 can be clarified, as shown in the following table:

Table (4): Partial balance sheet of Ur Engineering Industries on 12/31/21108

Assets		Liabilities	
Current assets		Current Liabilities	
-	-	accrued interest expense	760183
Non-current assets		Non-current liabilities	
-	-	Leased assets obligations	5963859

Source: Prepared by the researcher.

Thus, the financial lease contracts are disclosed as follows, with the net book value of each asset class at the balance sheet date, as a settlement was made between the total minimum lease payments on the budget date and its current value divided for a period of one year, between one and five years and more than five years, whereby conditional rents are recognized. in the income statement for the period and a general description of the general lease agreements of the lessee including, for example, the basis for determining the potential positive value, the existence and duration of renewal or purchase options, provisions for increases and restrictions imposed under lease arrangements such as those for distributions, Thus, it can be said that the Or Engineering Industries Company follows the International Accounting Standard No. (17) for rent measurement and disclosure can help in providing appropriate information through which rational decisions can be taken regarding the financing of investment projects and thus improve the performance of the company in general.

FOURTH TOPIC: CONCLUSIONS AND RECOMMENDATIONS

4.1. CONCLUSIONS:

The research reached the following conclusions:

1. A lease contract is a contractual agreement between the lessor whereby the right to use certain assets owned by the lessor is transferred to the lessee for a specified period in return for a certain agreed upon return.
2. The importance of leasing lies as a suitable financing alternative for the lessee and an investment for the lessor, where the lessee benefits from the low requirements related to guarantees and credit history and financing a greater percentage of the value of the asset than that provided by bank loans and provides.
3. There are two main types of leasing, namely the financial (capital) lease and the operational lease. The financial lease cannot be canceled by the lessee. Either the operating lease covers a period much less than the expected useful life of the leased equipment.
4. When analyzing the rental opportunity, the minimum total cost of ownership of the asset and the restrictions on the use of the asset must be noted, as well as the requirements of the rental management in terms of timely preventive maintenance and balanced use of the asset.
5. The process of financial evaluation of the lease transaction includes a set of steps, namely that the lease leads to the transfer of ownership to the lessee at the end of the contract term, then evaluate the customer in terms of eligibility and financial strength, and finally evaluate the guarantee provided with the contract.

4.2. RECOMMENDATIONS:

In light of the conclusions reached, the researcher recommends the following:

1. The necessity for the relevant authorities to encourage investment by allowing banks to establish financial leasing companies through the investment law.
2. The necessity of direct and indirect government support, whether it is related to the financial or moral aspect of this formula, and the follow-up of its application to ensure a permanent and continuous adaptation of this funding formula with all that is emerging and to ensure its success.

World Economics & Finance Bulletin (WEFB)
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Vol. 13, August 2022
ISSN: 2749-3628,

3. Forming a joint scientific committee of qualified and experienced people in finance, accounting, law and university professors to determine the financial and accounting principles and rules that must be taken in the leasing activity based on international financial accounting standards.
4. The necessity of adhering to International Accounting Standard No. (17) when measuring and accounting disclosure of lease contracts in order to benefit from the information effectively.
5. The necessity of making efficient investment decisions that are commensurate with the capabilities and resources of the economic unit, and that they be supported by rational administrative decisions.

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