



Alternative Sources of Credit Under the Scheme Leasing as a Form of Enterprise Investment in An Unstable and Inflationary Economy

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Abstract: The problems of investing in leasing objects are not just relevant today. The future of all initiated reforms depends on how leasing relations develop. At domestic enterprises, for example, the depreciation of fixed assets by the beginning of 2020 reached 29.6%, and the annual coefficient of their renewal is only 16.0% ¹.

INTRODUCTION

The legal basis for financing the innovative activities of enterprises as lessees is the Law of the Republic of Uzbekistan "On Leasing" (with amendments and additions) and the Law of the Republic of Uzbekistan "On Investment Activities". The law on investment activities carried out in the form of capital investments determines the economic essence of the main categories, establishes the obligations and responsibilities of participants in investment relations, forms of investment, etc. In accordance with Art. 3 of this Law, financing is carried out by investors at the expense of their own and borrowed funds, including foreign investors ².

If there are sufficient unused profits from previous years and subject to preferential taxation of profits spent on the acquisition of property, it makes sense to buy equipment for one's own funds. In other cases (and the vast majority of them), property is acquired for funds raised. In this case, the main factor or condition for the acquisition of property should be its impact on the financial performance of the enterprise. In the conditions of dynamic development of the economy, any enterprise should maximize its profit (income) and help minimize the costs of production and sales.

Of the main options for acquiring property (purchase both at the expense of own and borrowed funds, i.e. on a loan), you should choose the one that provides the minimum amount of tax liabilities under equal financial and commercial conditions. From the initial cost of the purchased fixed assets, at which they are registered, the tax on the property of enterprises (with non-moving property) depends. This cost (Article 244 of the Tax Code of the Republic of Uzbekistan) includes both interest on a loan taken for a purchase and leasing payments. But from this it is still impossible to conclude that the smallest amount of property tax will be when buying leasing equipment for the

¹ Calculated according to the State Committee . Republic of Uzbekistan according to statistics for 2019

² Law of the Republic of Uzbekistan " On investments and investment activities " dated December 25, 2019 No. ZRU-598.

company's own funds. A thorough financial analysis of alternatives to acquiring fixed assets is required.

To make an informed decision, they usually compare adequate sources: lending or a leasing scheme (Fig. 1).

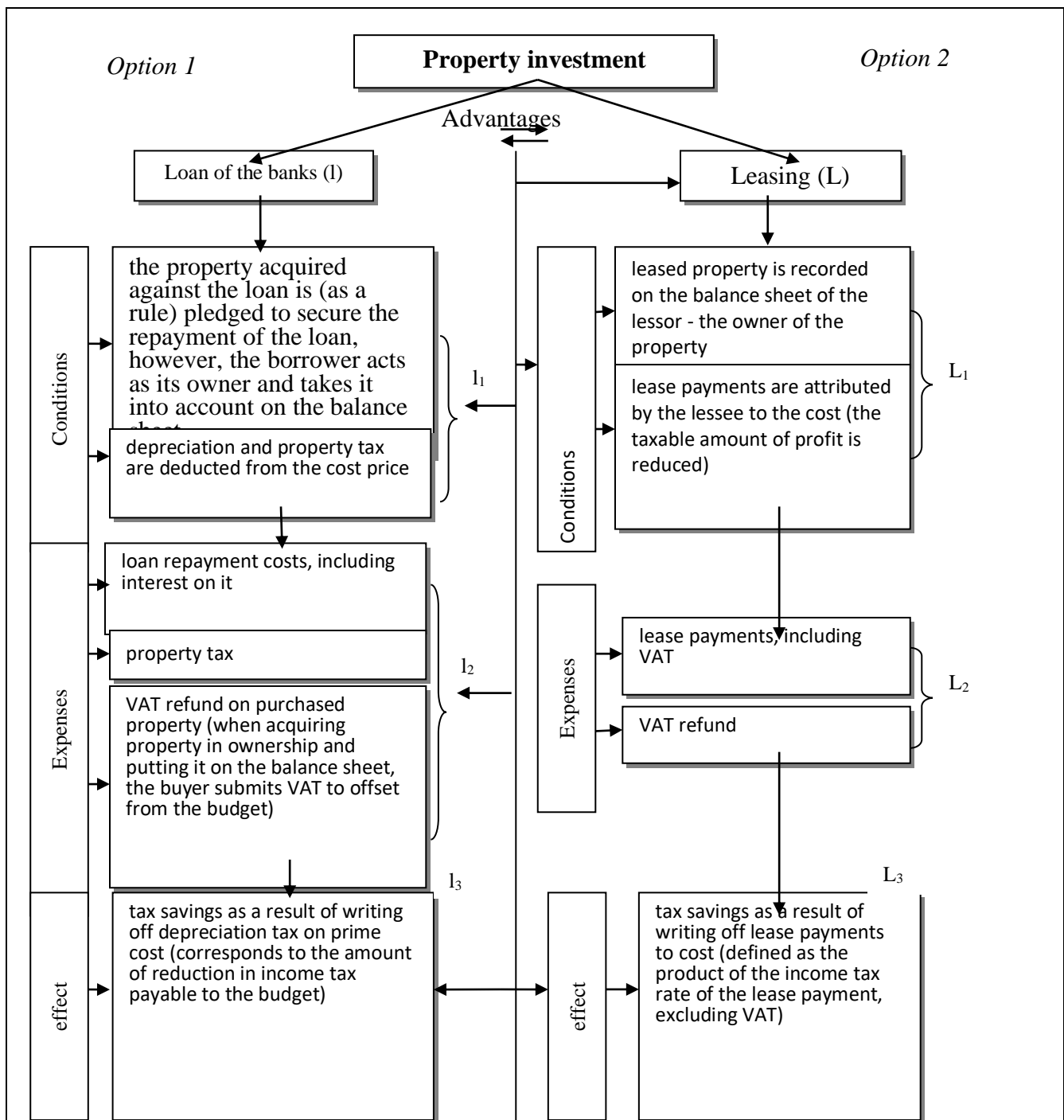


Figure 1. Comparison of investment options when buying a leased property

Here $l_1 < L_1(1)$;

$l_2 > L_2(2)$;

$l_4 \leq L_3(3)$.

So, investing in the purchase of leasing property under the leasing option has a significant advantage (see formula 4):

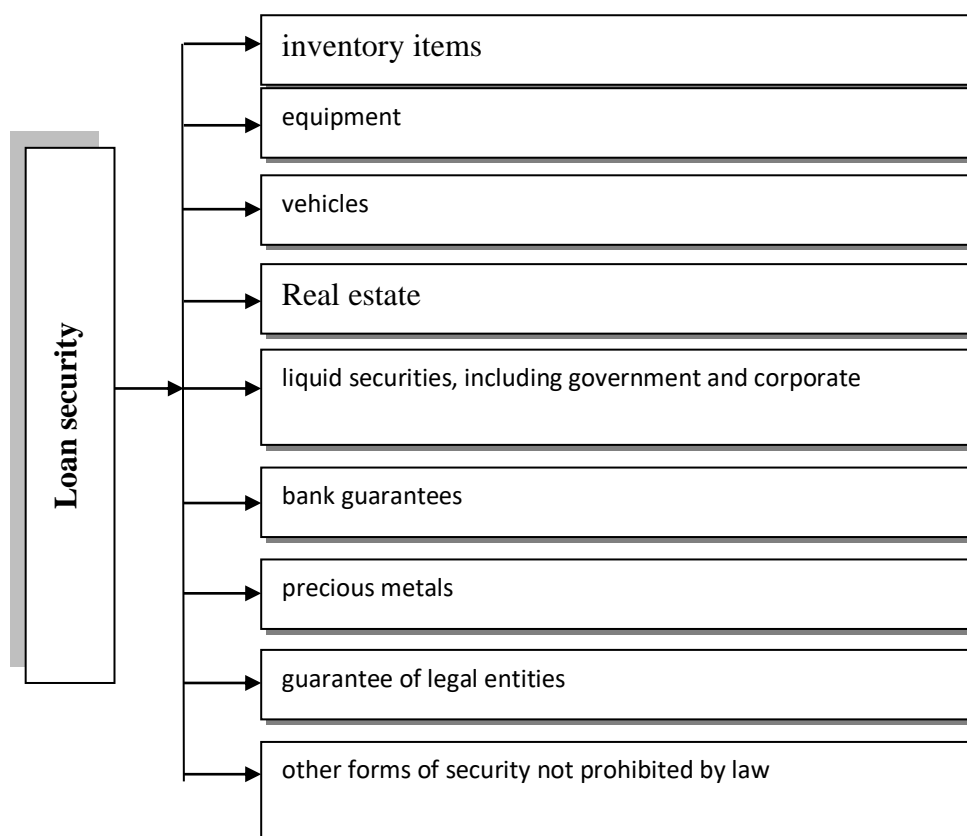
$$l_1 + l_2 + l_3 < L_1 + L_2 + L_3(4).$$

It should be noted that if the lessee sells products or services subject to VAT, then VAT is not considered in the lease payment when calculating income tax savings. If the sale is not subject to VAT, then the income tax savings will also be determined on the basis of the lease payment, including tax.³

Despite significant differences in the formation of cash flows when using these alternatives, there are common problems, in particular for banks that assess the financial position of borrowers and provide credit resources. The priority ones are how to get a loan, in what amount and at what interest rate of the bank.

To obtain a loan from a bank, you must provide a correctly completed loan application and attachments to it. Evaluation of loan applications is based on three main factors: collateral, the performance of the borrower and its bank account servicing teams, and the financial position and credit history of the borrower and its guarantors.

One of the main conditions (the first factor) for granting a loan to a borrower is the availability of collateral. On fig. 3 shows forms of collateral for a loan.



The second significant factor influencing the conditions of lending is the work of the borrower on bank accounts. Subject to significant turnover, the borrower can count on lower interest rates and less stringent security. In case of successful cooperation, credit limits can be increased by switching to factoring operations (purchase of receivables by the bank).

The third factor is the financial position and credit history of the borrower and its guarantors. An enterprise that has a profitable business, a good financial position and a credit history, has an advantage in considering loan applications.

The interest rate on foreign currency and national - soum loans is oriented to the market level. The bank is ready to reduce interest rates to customers who provide reliable collateral or who have

³ Tax Code of the Republic Uzbekistan. - T.: State Tax Committee of the Republic of Uzbekistan, 2019. <https://lex.uz/ru/docs/4674893>

large turnovers on bank accounts. As a rule, reliability is more important for a bank than profitability.

Loan interest rates depend on the amount received, term and other factors, such as credit history.

The legal relations of the parties under the loan agreement are regulated by the Civil Code of the Republic of Uzbekistan. The loan agreement is considered concluded from the moment of transfer of money or other things (Chapter 41, Clause 1, Article 742 of the Civil Code of the Republic of Uzbekistan). Loan interest is included in non-operating expenses .

Figure 4 shows the collateral scheme for obtaining a loan, taking into account insurance.

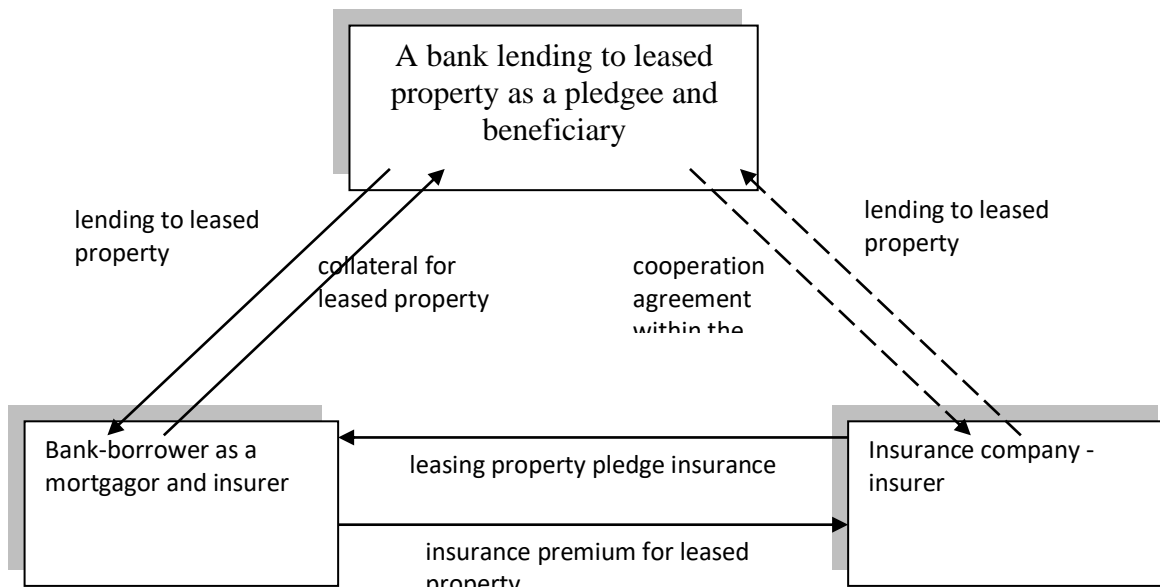


Figure 4. Pledge for leasing property with the participation of the insurer

The most acceptable scheme for the bank would be collateral insurance in a company authorized by the bank. The choice of the insurer by the lender is fully justified, as it reduces its risk. The bank must be confident in the financial stability of the insurer, moreover, it becomes possible to agree in advance on conditions of collateral insurance that are beneficial to all parties.

Estimating the value of collateral depends on the nature of the enterprise, its financial position and asset structure. For short-term loans, it is most profitable to provide goods in circulation as collateral. However, not all banks take such collateral. The easiest way to get a short-term loan secured by machinery and equipment. If a loan for replenishment of working capital is taken for a period of up to 1 year, then a real estate pledge can be offered as security.

Now banks can work with four types of collateral, that is:

- securities having a stock quote;
- production equipment, machinery, vehicles, trade inventory, etc.;
- real estate;
- guarantees of third parties.

The market value of the first type of collateral is usually determined by current exchange quotations in the organized circulation of securities, and the latter, taking into account the situation for a particular issuer, is predicted by price changes for the duration of the security being pledged.

In the second type of pledge, the cost of equipment is determined by studying the prices on the market for similar equipment. Based on this, a conclusion is made about the salvage value of the equipment, i.e. about the price at which it can be sold in a short time. The liquidation value of the

property is usually lower than its market value by 20-30%. Then the calculation of the costs that the bank will incur when selling the property is made. This is how the collateral value of the property is determined, which, as a rule, is 50-60% of the current cost of the equipment.

When choosing the third type of collateral in connection with open information on sales prices and offers in the relevant markets, determining the market value of real estate does not cause difficulties. It should be emphasized that real estate objects can be pledged only if they are separated from all the assets of the enterprise into an independent object of the pledge agreement (office, retail, warehouse, etc.). Objects recognized as emergency, which have not passed a technical inventory, cannot be pledged.

When choosing the fourth type of collateral, the most common guarantee scheme for an enterprise, that is, having a stable financial position in the product sales markets, is taken as the basis. Guarantees of enterprises involved in the borrower's business are also widely used. When securing a loan for a leasing object, the guarantor must submit to the bank legal and financial documents similar to the borrower's package. Acceptance of the guarantee of individuals for the borrowing company in most cases has the function of additional security, since the income of the person on the basis of which the guarantee limit is calculated is usually significantly less than the amount of the requested loan.

Recently, there have been problems in lending to legal entities on the object of leasing due to the transition of banks to IFRS, which is associated with an increase in the quality, awareness and comparability of financial indicators. Today, significant steps have been taken to bring the international and domestic accounting and reporting systems closer together. Some accounting provisions (ARP) related to the accounting of certain transactions and disclosure of information in financial statements are close to IFRS. For example, requirements have been introduced to recognize income and expenses in the reporting period to which they actually relate; some concepts were introduced that are fundamentally new for the domestic practice of accounting and reporting (goodwill, contingent facts of economic activity, events after the reporting date). Accounting rules for individual transactions have been aligned (in many cases incompletely) with IFRS. Reporting forms are declared advisory, not mandatory, and enterprises have the right to choose an accounting policy for certain positions (determining the useful life of fixed assets, methods for valuation and disposal of inventories, etc.).

The disclosure requirements in the notes to the financial statements are supplemented by some provisions consistent with IFRS (see Figure 5). Such requirements, in particular, include: disclosure of the main directions of the accounting policy and assessment of the impact of changes made to it in the data of previous reporting periods, provision of information on transactions with affiliates, on the geographical and industrial structure of the enterprise, on the discontinued activities of the enterprise. But the listed requirements are rarely applied in practice, since the financial statements of most enterprises are focused not on the owner, potential investor (creditor), but on tax and other regulatory authorities, for which the specified information is of no value.

It should be noted that the processes of reforming the accounting system in the banking sector and in other sectors of the economy proceed independently of each other. Thus, the effect of RAS, which contain requirements close to IFRS, does not apply to banks. At the same time, the requirements for the consolidation of financial statements introduced for banks in terms of their proximity to IFRS are ahead of similar requirements for enterprises.

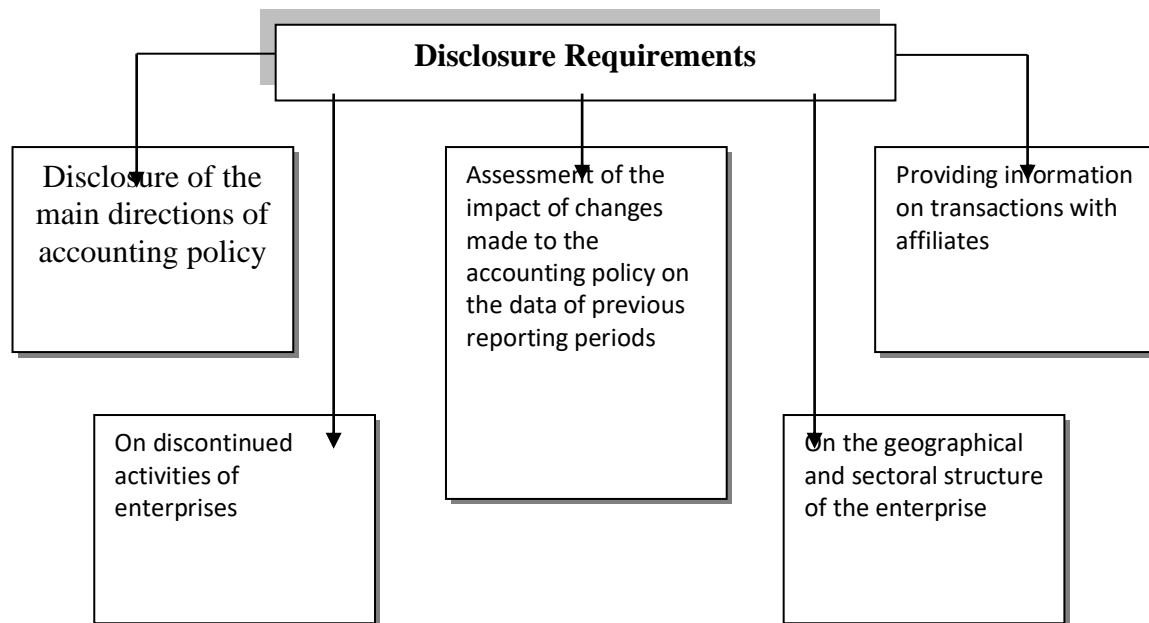


Figure 5. Disclosure requirements

It should be emphasized that one of the main principles of IFRS is the full application of all the rules and requirements included in these standards. If the financial statements are prepared with any deviations, then they cannot be recognized as conforming to IFRS. It is obvious that the current accounting and reporting standards do not fully meet modern requirements for the quality of information required by users of financial statements, which are banks that supply the economy with credit resources. As a result, the use of reports prepared in accordance with the current standards leads to a number of problems for banks when considering applications from enterprises for loans, which, ultimately, negatively affects borrowers. An assessment of the financial condition of a potential borrower or guarantor, based on financial statements prepared in accordance with domestic standards, is not sufficiently informative, which may lead to an underestimation by the bank of the degree of credit risk. In addition, such an assessment is usually more optimistic than that which is carried out in accordance with IFRS. This is confirmed by the experience of many enterprises converting their financial statements to IFRS: the adjustments necessary for this often result in the recognition of previously unaccounted for losses and liabilities.

The lack of consolidated reporting for most enterprises complicates the analysis of credit risks. Consolidation of financial statements of enterprises, although required in accordance with mandatory accounting standards, is far from always carried out in practice, since regulatory authorities do not require its submission to any authority, and the document of the Ministry of Finance of the Republic of Uzbekistan regulating the issue of consolidation of financial statements is advisory. However, according to IFRS, the consolidation of financial statements is mandatory.

There are difficulties in assessing collateral. If, in accordance with IFRS, almost all the assets of an enterprise are valued at their real ("fair") value, then in the reporting of domestic enterprises, in some cases, revaluation of assets is a right, not an obligation of an enterprise, and sometimes it is not provided for at all. In addition, many small businesses continue to use the outdated Uniform Depreciation Rates, and do not determine the useful life of fixed assets, as provided for by PBU. As a result, the book value of property, plant and equipment and other assets is often inflated and may not be indicative of the true value of collateral.

The use of IFRS as the main and only standard in the preparation of financial statements would solve the problem of information quality. It should be noted that IFRS contain universal rules for accounting and disclosure in the financial statements of most transactions that are mandatory for any type of enterprise. This not only facilitates the understanding of financial statements by all market participants, but makes it possible to prepare informative consolidated financial statements, which is especially important for banks. Obviously, the creditor bank needs to have an adequate idea of the financial situation of borrowers, even if they are separate branches of enterprises.

The use of IFRS would also allow banks to obtain objective information about the value of borrowers' assets directly from the content of their statements, without resorting to additional asset valuation procedures, which would be the responsibility of the enterprise itself. Thus, the assessment of both the value of individual assets pledged as collateral and the financial position of the borrower as a whole would be facilitated.

Let's consider how individual IFRS solve the problem of adequate asset valuation in the borrower's statements ⁴.

IFRS 16 Property, Plant and Equipment establishes a requirement for mandatory revaluation of property, plant and equipment at market value. Revaluation of fixed assets should be carried out on a regular basis (usually annually), while IFRS does not prohibit it from being carried out more often if the market value of fixed assets changes significantly.

IFRS 36 "Collateral of Assets", the equivalent of which is not available in domestic standards accounting, requires enterprises to regularly analyze the state of assets for their possible impairment, which may be indicated by certain signs.

For the necessary adjustment of the value of an asset due to impairment, it is necessary to compare its carrying amount, firstly, with the market value (less costs of its sale) and, secondly, with the "value in use". The latter is determined by discounting the cash flows associated with the object, which may include, on the one hand, income from its use and possible sale in the future, and, on the other hand, the costs of its repair, maintenance, etc. If both of these values are lower than the book value of the asset, it is necessary to adjust its value in the statements by the amount of the difference between the book value of the asset and the larger of the two named values.

IFRS 39 "Financial Instruments: Accounting and Measurement", which regulates, in particular, the accounting for securities, establishes the requirement to record most of them at "fair" value. At the same time, the revaluation of almost all securities is an obligation, not a right, of their holders. The ability to avoid this procedure is limited, which is a significant difference between IFRS and domestic standards.

The concept of "fair" value has no analogue in domestic regulatory documents. "Fair" value is determined either as the market value of securities when quoted, or, if they are not available, is calculated using valuation models. The concept of market value in IAS 39 is formulated quite broadly and is not limited to formalized criteria (eg, such as trading volumes). Valuation models should be based on principles such as discounting future cash flows and comparison with similar securities that have a quoted market price.

IAS 29 Financial Reporting in a Hyperinflationary Economy requires all income statement items and certain balance sheet items, as well as related prior period comparatives, to be adjusted to fair value by applying inflation indices. This approach is absent in domestic accounting standards, however, its application would make it possible to make more informative the trend analysis of the enterprise, which is the most important element in the analysis of the financial position of the borrower when issuing a loan.

⁴ International Financial Reporting Standards. - M.: Askeri, 1999.

Consequently, the application of IFRS significantly improves the quality of information used by banks in credit relations with enterprises. This is in the interests of not only creditor banks, but also the borrowing enterprises themselves. The presence of reporting and the objectivity of its preparation allows the enterprise to more effectively assess its needs for borrowed funds attracted for leasing, determine an acceptable level of costs for attracting leasing, as well as real opportunities for securing and timely repayment of a loan, in particular, for a leasing object.

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