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Lease Finance in Emerging Markets: An Eastern European Study

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1. Introduction

The emergence of lease markets in Eastern Europe provides a new menu of opportunities for inward foreign leasing investment by Western Multinational Enterprises (MNEs). The Eastern European markets, like other emerging markets, exhibit high expected returns as well as high volatility.

Leasing is a form of debt whereby a lessee (or borrower) acquires the use of an asset under an agreement to compensate a lessor who is the owner of the asset (and the lender). In recent times, leasing has been acknowledged as an important form of financing and has expanded considerably in developed and some developing countries. Currently, leasing provides more finance worldwide than Euro-commercial paper, medium-term notes, Euronotes or international equities (World Leasing Yearbook, 1995). In the USA for example, leasing provides more finance than the corporate bond, according to the US Department of Commerce. During the past 25 years leasing has grown at a faster rate than any other form of finance in the Western world. It now provides about one eighth of the world's equipment financing requirements every year. Currently, the world leasing volume stands at US$ 323 billion. In Eastern Europe, the market for leasing has witnessed a steady growth in recent times. However, very little is known about this regional market, except the fact that it is highly volatile with a potential for high returns.

This paper investigates developments in lease finance in the emerging markets of Eastern Europe, using the Czech Republic, Hungary, and Poland (CHP) as country case studies. The paper analyses the market for leasing in the CHP and highlights the major problems dwarfing the development of the industry in the region. The paper also discusses the regulatory environment of, and accounting treatment for, leases in these countries. The selection of these countries is, apart from their geographical importance, informed by a number of factors. First, the CHP have, in many aspects, similar backgrounds, in terms of culture, legal systems, and economic and accounting reforms. Second, the CHP have had a relatively stable political system since the demise of communism. Third, they are the leading countries in Central and Eastern Europe (CEE) in the development of leasing industries. Finally, these countries have adopted more or less a similar approach in developing their accounting standards and reforming their accounting systems. As Berry and Swiderska (1992) observe, these three countries have adopted a similar pattern in their accounting reform programmes with respect to harmonisation of accounting and financial reporting and in developing accounting laws with the European Community (EC) Directives.

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The remainder of the paper is organised into four sections. The relevant trends in the economic progress and investment profile of the three countries are summarised in the first section. The next section reviews the development of leasing markets in the CHP. Major characteristics of leasing in the C.H.P. are also discussed. The third section presents an overview of the countries' legislation related to leasing, accounting treatments of leases with emphasis on new accounting laws, and emerging regulatory changes. The final section contains the main conclusions of the paper.

To strengthen the association to subsequent analyses of leasing markets in these countries, background research to this study includes examination of relevant trends of economic and financial policies and accounting laws pertaining to leasing. Complementary information, corroborating interviews with senior managers in leasing companies in CHP, was obtained from reports by Leaseurope[1], and the Czech, Hungarian and Polish Leasing Associations.

2. Economic Performance and Investment Behaviour

The countries of Central and Eastern Europe (CEE) are presently engaged in the process of radical economic restructuring. The transition from a command (centrally-planned) economy to a market-based system was undertaken against the background of severe economic, social and political turmoil. CEE, like the other emerging markets, is a promising region whose developments have significant economic and political implications for the new world economic and political order.

The CHP are the leading countries of CEE in the process of economic reforms. Since the reform began, these countries have witnessed a gradual improvement in their economic situation, particularly the Czech Republic and Poland. The period since economic transition has seen large shifts in the pattern of economic developments and of competitive advantage. A summary of some of the relevant indicators of economic performance in CHP is provided in Table 1. One clear attribute of the relatively poor economic performance of these countries in the early 1990s and before is their relatively low level of net national investment. These countries had seen their relative national economic positions deteriorate continually. Although improvements have been recorded steadily since 1991, these countries have also realised that to achieve stronger economic growth and to tackle the chronic industrial difficulties, they will require substantial increases in business investment from their present low levels.

Investment behaviour is a complex phenomenon: its level is determined by the business cycle and a network of macroeconomic variables. The level of national investment is closely linked with its savings behaviour. Over the years, there has been a persistently low savings ratio in CEE countries. In order to raise growth and productivity, these countries require higher investment which needs to be funded by higher private and public sector savings. The process of economic reforms and the opportunity to invest will be associated with increased demand patterns and perceived need for finance. Theories of economic development suggest that the services provided by financial intermediaries such as mobilising savings, facilitating transactions, evaluating projects, managing risks or monitoring managers are a sine qua non for economic development (see Schumpeter, 1991; King and Levine, 1993).

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The natural resources and consumer markets of the CHP offer huge and exciting incentives to foreign investors as well as to the fledgling indigenous entrepreneurs. These locational advantages offer investment opportunities for Western MNEs through leasing, joint ventures and strategic alliances.

Table 1
Selected Measures of Economic Performance since Transformation, 1991-94

	GDP Growth				Inflation			
Country	1991	1992	1993	1994	1991	1992	1993	1994
Czech Republic	-14.2	-7.1	+0.5	+4.0	+52.0	-12.6	+18.2	+9.5
Hungary	-9.3	+4.5	-3.0	+1.0	+32.2	+21.6	+21.1	+19.0
Poland	-7.6	+1.3	+3.5	+4.5	+60.4	-44.3	+37.6	+31.0

However, the flow of foreign investment in these countries is complicated by a plethora of obstacles. Kraljic (1990) has identified ten major gaps in the development of foreign investment in CEE. We reclassify these impediments into three broad categories: Structural barrier, encompassing technology, productivity, marketing, capital, and environment gaps; Governance structure barrier, encompassing legislative and democratic gaps; and Human capital barrier, encompassing motivation and management gaps. These barriers not only impede the flow of foreign investment but also constitute a source of risks, and are, possibly, instrumental to the limited and disappointingly low capital flows into these countries reported by Aghion and Burgess (1993, p.102). Despite the evolving liberal policy[2] being pursued in CHP, the level of foreign investment is thought to be far below that required to modernise economies with obsolete capital and infrastructure. Among the CEE countries, Hungary is the largest recipient of foreign direct investment (FDI), attracting US$130 per capita compared to US$75 in the Czech Republic and US$11 in Poland (The Economist, 3 December 1994).

2.1. Business Profiles of the CHP

Table 2 presents the business profiles of CEE countries. The CHP were rated as investment grade countries in the region across the range of criteria used internationally to assess country investment risks and business opportunities. Of the the countries in the region (and in the survey), the Czech Republic possesses the best profile (as shown in Tables 1 and 2). The Czech Republic's main advantage is its political and economic stability. It is the only CEE country that boasts a trade surplus, a stable currency, comparatively low inflation (at around 10% and declining) and a budget surplus of $400million[3]. Despite these positive developments, many obstacles still exist which forestall the flow of foreign investment. Overall, the general economic and political situation will have considerable influence on corporate inward investment decisions.

Also, the nature and pace of accompanying economic reforms will be associated with investment patterns and perceived comparative advantages of these countries. Apart from cultural distance and poor infrastructure, such related problems as the high level of

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Table 2
Business Profiles of CEE Countries

	Business Opportunity	Political Risk	Credit Rating	Status of Local Economy	Stability	Business Infra-structure	Total
Bulgaria	3	4	4	3	3	3	20
Czech	2	2	2	3	1	2	12
Estonia	4	2	3	3	2	3	17
Hungary	3	2	2	3	2	2	14
Kazakhstan	2	3	4	4	3	4	20
Latvia	4	2	3	3	2	4	18
Poland	1	2	2	3	2	2	12
Slovakia	4	3	3	4	3	3	20
Slovenia	4	2	2	3	2	2	15
All others	≥3	≥3	≥4	≥3	≥3	≥3	≥21

Notes:
i) Rating is based on the inward investors perception of the emerging markets based on the following categories: *Business opportunities* = Size and structure of domestic market and attitudes towards foreign investment; *Political risk* = Stability of government and market oriented policies; *Credit rating* = External debt - attitude of financial markets; *Status of local economy* = Domestic economic performance; *Stability* = Overall political and economic stability; *Business infrastructure* = Legal framework, professional services, telecommunications and distribution.
ii) 1 = Best rating; 5 = Worst rating

Source: Ernst & Young, Emerging Markets Profiles, London

bureaucratic bottlenecks, dearth of management skills in market economy, labour and social unrest, uncertainty about the outcome of reforms, among other factors, all combine to impede the inflow of foreign investment.

The situation in these countries has been exacerbated by the external debt problem which deteriorated rapidly in the late 1980s[4]. To be sure, the large external imbalances represent serious macroeconomic constraints on the process of economic and political transformation. In consequence, available capital resources in the CHP are far less than demands by firms desperate to upgrade production processes through borrowing to purchase new plant and equipment. Broadening the argument about the determinants of investment suggests that the rate of productivity and the success of economic reforms are to a large extent determined by the growth of national capital markets, ownership structure, macroeconomic policies, managerial incentives, sociocultural norms and other influences (some of which are endogenous).

3. Leasing Industry and Market in the CHP

The combination of external debt burden and associated problems of underdevelopment of capital markets makes leasing an attractive and valuable tool in coping with financing and investment problems in the CHP. In the last few years, leasing has grown rapidly in

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Table 3. Volume, Growth and Market Penetration of Leasing in CHP					
Country	**Annual volume in US$ bn (% Growth)**				**% Market Penetration**
	1991	**1992 (%)**	**1993 (%)**	**1994 (%)***	**(1993)**
Czech Republic	0.25	0.60 (140%)	0.65 (8.3%)	0.70 (7.7%)	**16%**
Hungary	0.18	0.67 (272%)	0.73 (9.0%)	0.80 (10.0%)	**15%**
Poland	0.07	0.10 (42.9%)	0.12 (20.0%)	0.15 (25.0%)	**3%**

CHP[5], as shown in Table 3. In particular, the Czech Republic and Hungary witnessed a significant expansion of the markets and industries in 1992. While Poland showed a slightly low percentage, both the Czech Republic and Hungary surpassed the average figure of about 13 percent for the world. An analysis of the type of assets funded by leasing shows interesting differences among the three countries (see Table 4).

Table 4 New Assets Acquired in CHP by Asset Type in 1993 (Ecu million)							
Country	**Machinery & Industrial Equipment (%)**	**Computers & Business Machines (%)**	**Commercial Vehicles (%)**	**Cars (%)**	**Ships Aircraft Railcars (%)**	**Other (%)**	**Total**
Czech	151 (31.33)	51 (10.58)	63 (13.07)	196 (40.66)	7 (1.45)	14 (2.91)	482
Hungary	220 (44.90)	49 (10.00)	49 (10.00)	147 (30.00)	25 (5.10)	0	490
Poland*	22 (26.83)	6 (7.32)	21 (25.61)	33 (40.24)	0	0	82

In Hungary, for example, about 45 percent of the leasing market finances machinery and industrial equipment, whereas in the Czech Republic and Poland commercial vehicles and cars account for 54 percent and 66 percent respectively, of the national markets, much higher than the world average. The early focus on cars and commercial vehicles is typical of young leasing markets because such products are thought to represent good security. Their market value is predictable over the leasing period and because of their strong demand, the primary domestic finance market for these products is predictably attractive.

The development of leasing market in the CHP has been somewhat slow. There are at least three reasons for this slow pace. First, there is an acute shortage of domestic capital to finance lease operations. Second, the inferior development of the banking and financial sector implicates the reluctance of foreign firms to engage in leasing activities in the region. Finally, the difficulty of transacting in an unfamiliar economic and regulatory environment is a daunting prospect for foreign investors, although, in recent years, there has been a steady influx of foreign leasing companies. National developments in these countries reveal important differences.

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3.2. National Market developments in Leasing

The Czech Republic:

In the Czech Republic, there are about 50 member companies of the national leasing association. About 80-90% of the leasing business is devoted to private sector financing. For example, Corfin, one of the largest leasing companies in the Czech Republic, generates 90% of its turnover from financing private sector businesses. The range of products covered includes factory machinery, real estate, medical equipment, cash registers, and cars and trucks. Two major obstacles to the development of leasing in the Republic are the dearth of medium and long-term financing, and the absence of protective legislation.

Hungary:

The majority of Hungary's leasing companies were established under the Corporate Law of 1988. The expansion of domestic leasing in the last few years is the direct result of the expensive nature of domestic bank loans, especially short-term loans (up to 12 months). There are two principal types of leasing in Hungary: domestic and import (cross-border) leasing, each developing with different characteristics. Most leasing agreements involve finance lease transactions, although operating leasing is becoming increasingly popular. Domestic leasing plays a very important role in the Hungarian economy for, according to the Hungarian Leasing Association, domestic lease financing accounted for 15% of the total investment in 1993. Leasing companies normally finance 18% of their transactions from bank loans, 44% from own capital, and the balance from other sources. The typical assets financed include machinery and consumer goods. Available statistics cover medium to large companies, that is, those employing 50 or more people. In all, the shrinking level of investments combines with the dearth of finance to bedevil the Hungarian leasing industry.

Poland:

Leasing activity is small scale business in Poland. In 1993, it represented about 3% of the annual capital expenditure. In contrast to the Hungarian and Czech markets, the Polish leasing market is comparatively small both in terms of volume and market penetration (see Table 3). The main products funded include cars, trucks, computers, industrial/construction equipment and office machines. Depending on the client and type of equipment, the longevity of most leases is restricted to 2-3 years. An industrial analysis of leases shows that the market is dominated by industrial and construction companies (with 41% of assets) and private sector services (with 39%). Surprisingly, only 4% of state services are funded through leasing. Lease transactions are generally finance leases, although they are not comparable with western style leases and are treated as off-balance sheet items on the lessee's books. The absence of competition contributes to the slow development of operating leases.

In general, the leasing industry in the CHP is young and the market is under-developed. However, the industry is plagued by two major problems, capital investment and legislative framework. Estimating the size of leasing market and performance of leasing companies in the CHP is difficult: it is complicated by differences in accounting standards.

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Accounting standards vary both across and within countries. Also, leasing transactions are treated as off-balance sheet items, and available statistics do not cover small companies where most leasing activities are domiciled.

3.2 Lease Legislation in the CHP

The main legislative platform for commercial activities in the CHP comprises the civil code and the commercial code. The civil code is the basic law covering ownership and property rights, contract, and equity actions. However, the civil code contains little provisions on equipment leasing. The commercial code, which is the principal act that governs general business activities and relations, contains very little with regards to equipment leasing. The legislative umbrella for leasing business is the tax law.

Complementary tax reforms are important in transition economies and are generally believed to underpin the success of the economic reform programmes. To this end, the CHP have embarked on fundamental changes to their tax legislation. Initial reforms have introduced tax and legal framework compatible with capital market development. Later changes involve reconciling the tax system with other legal changes necessary for the transformation process. For instance, Hungary had to introduce a new tax legislation at the beginning of 1992 to complement the 1991 accounting legislation which altered the taxable base of corporations. Presently, it would appear that extant tax legislations in the CHP are in a state of flux. Legislations are hastily enacted and are often incomplete, ambiguous and open to manipulation. There are no specific provisions for the taxation of equipment leasing. The taxation of leases tends to be governed by the general provisions covering the taxation of all corporate activities (Gao, 1994, p.127). We now examine the national trends in lease legislation.

The Czech Republic:

Equipment leasing in the Czech Republic is regulated by (1) the Civil Code, which contains the general provision on leasing and special provisions for business purposes, and (2) the Commercial Code, which contains special provisions on transport means and purchase of leased assets. The Commercial Code is the main law governing business activities and relations. A substantial amendment to the Civil Code and a new Commercial Code came into effect in January 1992. As yet, there is very little judicial interpretation or academic commentary on these codes, and it is hard to predict how they will operate in certain areas. In the case of equipment leasing, this uncertainty is compounded by the broad and general nature of many of the provisions. Furthermore, the entire taxation regime in the Czech Republic has been substantially revised with the enactment of a new law in January 1993 which was further amended in July 1993. The impact of tax varies depending on whether or not the lessee will exercise the option to buy the asset at the end of the lease term. If the option is exercised, the lessee has a choice of straight-line or accelerated depreciation under the normal rules. There are special rules which permit the lessor to claim faster tax depreciation. Under these rules, the allowance for the first year is effectively half the normal allowance. A business lessee claims tax reductions for rent in the normal way. There is generally 25% withholding tax on rent payments to a non-Czech resident lessor, subject to relief under double tax treaties.

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Hungary:

The legal framework for leasing is located in the Ministry of Finance Decrees. The Association Law, which came into force in January 1989, modernised Hungary's old business law by replacing the Corporate Law chapters of the 1875 Merchant Code as well as the 1930 Act on limited liability companies. The Association Law is, to a large extent, modelled on German corporate law. The law covers the basic forms of business formation such as general and limited partnership, joint venture, limited liability, and share holding status. The limited liability form is the predominant organisational mode of leasing companies in Hungary. This form requires the minimum capital of *Forints* 1 million. Prior to the Corporate law, prompt leasing was popular because it offered full tax deduction to the lessee in which leasing charges are expensed. This was changed under the Corporate Tax Law and the Accounting Law of 1992 which defines leasing as: "transfer of products under a lease contract for a determined, minimum period of 365 days". The accounting law stipulates that "should the lessee charge more than 36% (13% for real estate leasing) of the total net leasing fee to expenses in one calendar year, he is obliged to increase his pre-tax profit with the surplus". The Accounting Law prescribes further that limited liability companies, may charge the net leasing fee to expenses only in proportion to the time elapsed from the leasing term (i.e. 3% in a month) without increasing their pre-tax profit. These regulatory changes have increased the range of lease finance and risk assessment.

Poland:

Poland's Civil Code covers most commercial transactions, with leasing a notable exception. However, the framework of general legal and regulatory principles incorporates all associated transactions but leasing by name. Usually, there is a distinction between leasing and sale on instalment. With the latter, title passes automatically with the final payment, whereas with the former, the lessee is granted the first right to buy the asset at the end of the lease term. Until 1993 only the legal owner of an asset capitalised and depreciated leased assets. Lessees did not capitalise assets except in certain privatisation cases. For taxation purposes, the lessor was allowed to deduct an amount equal to the depreciation charge. Rentals were taxed as lessor's income at 40 per cent, while the lessee was allowed to deduct the full lease payment for taxation purposes. There is a dichotomous development of lease finance under the new regulations issued by the Ministry of Finance in 1993. These affect the conceptual operations of operating and finance leases, including their accounting and tax treatments, and special restrictions on the depreciation and tax-deductibility of lease rentals of passenger cars. The new regulations define operating lease as any rental, hire or similar agreement meeting specified criteria such as lease term to depreciation periods, but most importantly giving only the option to buy[6]. Operating lease rentals are taxable income for the lessor and a tax deductible expense for the lessee[7]. The lessor is the owner of the asset and is allowed to depreciate it for tax purposes as well as deduct interest costs from tax. VAT is chargeable on the whole of the lease rental but may be reclaimed, except in the case of passenger cars.

Finance lease, on the other hand, is defined as transactions not meeting the operating lease criteria. Because a finance lease offers the lessee the option to buy, it is treated as

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an asset of the lessee and is tax-depreciated by the lessee. The lessee may also expense the interest element of the rental. The lessor records only the interest portion of the lease rental as taxable income against which interest expense can be offset. Lease agreements are also subject to a five per cent turnover tax. Leased equipment remains the property of the lessor until the expiration of the lease, and is subject to customs duties unless it is intended for export at some future date. Leasing companies and other companies with foreign capital established under the old foreign investment law are allowed a three-year corporate income tax holiday. The new foreign investment law has removed the general relief and in its place is a more selective system which grants tax exemption for major investments in priority sectors of the economy is granted.

3.3. The Accounting Treatment of Leases in the CHP

Since the release of the "Discussion Memorandum on Accounting for Lease" by the US Financial Accounting Standards Board in December 1974, lease accounting issue has attracted a considerable amount of attention and debate (see, for example, Martin et al., 1979; Bowman, 1980; Fox, 1983; Imhoff and Thomas, 1988; Gao, 1991; and Vergoossen, 1992). However, these studies were concerned with lease accounting in USA, UK, Netherlands, and Australia. Very little is known about lease accounting in CEE, ostensibly because leasing is a new type of financing instrument in emerging markets. The leasing market is a recent phenomenon in CEE as prior to 1989 they were practically nonexistent in the region.

Accounting systems in centrally planned economies are different from those of Western market-oriented countries. First, accounting in a centrally planned context is perceived as having primarily a record-keeping function and is not decision-oriented or concerned with efficiency at the enterprise level (Gray and Roberts 1991, p.46). Secondly, accounting in centrally-planned economies was treated as an administrative instrument employed for monitoring the implementation of plans by state enterprises and for compensating for normal profitability with the state budget (Jaruga 1988). Moreover, accounting was not treated as a separate discipline in its own right. The political principles of the socialist economy influenced the financial system and accounting regulation (Jaruga 1993).

For a smooth transition from planned to market economies, accounting is seen as a potentially active instrument of performance measurement, an internationally understood business language as well as a decision-making tool. Accounting reform is a prerequisite for the introduction of capital markets, the promotion of investment and the efficient functioning of the corporate sector in the former centrally planned economics (OECD 1991, Borda 1993). Accounting systems and regulations in CHP are currently in a state of transition. It is interesting to observe that the previous statistical reporting system has not been completely replaced by the new legislation, rather the additional accounting regulations are superimposed upon the old system because they are deemed to be more appropriate to an emerging market economy (Krzywda et al. 1994, p.312). It is equally interesting that these countries have modelled their new accounting regulations on the European Union 4th, 7th and 8th Directives.

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In the case of accounting for leases, the International Accounting Standard (IAS) No.17 "Accounting for leases" was largely used to amend the accounting regulations in Poland (Jaruga 1993, p.90). IAS No.17 is structured according to the concept of "economic ownership" which emphasizes the capitalisation of the leased asset in the accounts of the economic owner rather than the legal owner. The economic owner is the person who assumes the "risks and rewards" attached to the asset. In order to assess risks and rewards, the terms of the contract must be interpreted as a whole. IAS No. 17 calls for the capitalisation of financial/capital leases by the lessee and full disclosure of lease information. IAS No. 17 requires that finance leases should be reflected in the balance sheet of a lessee as an asset and a liability. Lease rentals should be apportioned between the finance charge and the reduction of the outstanding liability. The depreciation policy for leased assets should be consistent with that for similar depreciable assets owned by the lessee. IAS No. 17 also requires that the lessor should record an asset held under a finance lease as a receivable at an amount equal to the net investment in the lease. Finance income should be recognised on a pattern reflecting a constant period rate of return on either the lessor's net investment outstanding or the net cash investment outstanding in respect of the lease. The 1993 regulations by the Polish Ministry of Finance adopted to some extent the accounting treatments of IAS No.17, but it may be problematic to effectively implement. This is because the concept of economic ownership does not exist in the Polish accounting system. Further, there is currently a diversity of opinion in Poland on the information of leasing to be contained in the annual report. Moreover, the scope, form and content of the annual report in Poland are not regulated in detail either by the Government or the Securities Commission. For example, depreciation methods and rates are not standardised across Polish industry (Krzywda et al., 1994). The impact of this regulatory loophole is that it permits both lessees and lessors to choose any accounting methods in relation to leasing transactions in accordance with their commercial interests.

In both the Czech Republic and Hungary, lease accounting requirements and practice do not confirm with IAS No. 17. In the Czech Republic, assets acquired by means of leases are not included as assets on the lessee's balance sheet. They are registered separately and treated as off-balance-sheet items (Dolezal, 1992, p.937). In Hungary, leased assets are valued at historical cost by lessors. Although the straight-line depreciation method is adopted, there is no difference between the depreciation requirements for financial reporting and tax reporting. The capital lease accounting method is not used in Hungary, instead, all leases are considered as operating leases and off-balance sheet items with no requirement for disclosure in financial statements. However, the new accounting law requires that off-balance sheet financing be disclosed as a footnote to the accounts. While the new law encompasses the basic tenet of the 4th, 7th and 8th Directives of the EC (Borda, 1992, p.962), many parts of it fall short of the requirement of the IAS.

Despite the apparent similarities in the development of lease accounting regimes in the CHP, national differences still exist. The differential treatments of lease accounting disclosure requirements in three countries are summarised in Figure 1. The two dominant methods of accounting for leases are the operating lease method and the capital lease method. In both the Czech Republic and Hungary there are no requirements to distinguish between finance/capital leases and operating leases. all leases are treated as operating leases for accounting purposes.

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Until 1993, there was no distinction between finance leases and operating leases in Poland. The 1993 law changed accounting treatments of leases in a number of ways. First, it recognized the differences between finance leases and operating leases and defines two separate treatments: capital lease method and operating lease method. Under the former method, the lessee is assumed to have acquired an asset by borrowing an amount equal to the cost of the leased assets. The leased asset is recorded at cost and the lease payments are shown as a liability on the balance sheet. Under the operating lease method, neither the leased asset nor the lease liability is reported on the balance sheet of the lessee. The lease rental is fully deductible as an expense against income each year and the lease contract may be mentioned as a footnote on the balance sheet.

Conclusion

Leasing is increasingly developing both as a financial instrument and a growing industry in the CHP following their transition to a capital market economy. The 1990s have witnessed the establishment of leasing associations, the growth of cross-border and domestic leasing, and the evolution of new accounting regulations in the region. However, apart from the range of systematic market imperfections, other common problems slackening the pace of the lease industry include the dearth of finance and capital investments, especially the shortage of credible banking and financial institutions to facilitate secondary equipment market, and the absence of appropriate protective legislation. Inaccess to international leasing markets and the cautious approach of foreign investors are a corollary effect of the absence of a legal system for corporate control and ownership protection. The region also suffers from high risks of long-term investments and unpredictably changing tax laws. Although there is as yet no single European leasing market (Matthews and Mayes, 1994), however, the desire to attract foreign lease investors should provide the emerging markets of Eastern Europe the necessary incentive and impulse to develop towards a harmonisation of the region's leasing industries.

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Figure 1.
Accounting Treatments of Leases in the CHP

	Accounting Treatment		Disclosure Requirements	
Country	*Lessor*	*Lessee*	*Lessor*	*Lessee*
Czech	Rents treated as income; depreciation expense charge to income; Initial direct costs amortised over the lease term.	The lease rental is fully deductible as an expense against income.	The costs of leased assets and the amount of depreciation are disclosed; Rental income is also disclosed.	Leases treated as an off-balance sheet item. Neither the leased asset nor the lease liability is required to disclose.
Hungary	Rents treated as income; depreciation expense charged to income; Initial direct costs amortised over the lease term.	The lease rental is fully deductible as an expense against income. Prior to 1992 the lease rental in one lump sum could be written off in one lump sum as expense. Since 1992, lessee could only charge less than 36% (in a real estate lease less that 13%) of the total lease rentals in one calendar year as an expense against income.	The costs of leased assets and the amount of depreciation are disclosed; Rental income is also disclosed.	Leases treated as an off-balance sheet item. Neither the leased asset nor the lease liability is required to disclose. 1992 law requires footnote disclosure of the lease assets and the liability.
Poland	Operating leases: Rents treated as taxable income; depreciation expense charged to income; interest costs deducted for tax; Finance lease: The interest portion of the lease rentals treated as taxable income; investment in lease shown as a receivable.	Operating leases: Rents is fully deductible as an expense against income (except for the case of passenger cars which the lessees only deduct the running costs). Finance leases: Depreciation expense charged to income; interest costs deduct for tax.	Operating leases: The costs of assets held for leasing and the amount of depreciation are disclosed; Rental income is also disclosed. Finance leases: Investment in leases and finance income from leases are disclosed.	Operating leases: Leases treated as an off-balance sheet item. However, it requires footnote disclosure of the leased assets and the liability. Finance leases: The cost of leased assets and the amount of depreciation are disclosed; the lease obligations are also disclosed.

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Footnotes

1. The Leaseurope - European Federation of Equipment Leasing Company Associations, established in 1972, currently has over 1050 members from 23 national associations including the Czech, Hungarian and Polish Leasing Associations.

2. This includes the possibility of full repatriation of profits and 100 percent foreign ownership. Except in the banking sector where governmental permission for foreign participation is required.

3. In fact, economists are already claiming that the Czech Republic fulfils more of the criteria for European Monetary Union membership than some of the EU's present members.

4. Except the Czech republic whose foreign debt (IMF loan) was repaid two years early. However, the Czechs have maintained a dignified calm about foreign investment.

5. Leasing in these countries is not treated just as a method of financing, but also as an important mechanism of economic reforms (Gao, 1994: 2-3). In this paper, leasing only refers to lease financing.

6. This is different from the operating leases as conceptualised in the USA, UK, and other Western countries where an operating lease does not confer a buy option.

7. Except for passenger cars. In the case of passenger cars the lessee may only deduct the running costs of the vehicle relative to the actual mileage, and not the whole of the lease rental.

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