Volume **IX**/2019 ISSN 2344-102X
Issue (XIX) / **February** 2019 ISSN-L 2344-102X

ACCOUNTING AND RECOGNIZING LEASING CONTRACTS IN FINANCIAL REPORTS

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Abstract
Significant changes to the International Financial Reporting Standard IFRS 16 Leases have led to the introduction of some provisions in national accounting regulations regarding the accounting registration method for the assets consisting of the rights to use the support assets covered by the leasing contracts and also the support assets leased. These major changes brought by IFRS 16 refer to a new approach in defining the lease and also to the recognition and measurement of assets and liabilities generated by lease agreements to the lessee, all of which are presented and substantiated in the present work.

Key words: *financial reports; lease agreement; IFRS 16; right to use the underlying assets.*

JEL Classification: *M41.*

I. INTRODUCTION

As a result of the new major changes produced by the application starting with 01.01.2019 of the financial reporting standard IFRS 16 Leases, which establishes new rules for the recognition and evaluation of leasing contracts, which will generate changes in the values of the elements recognized and presented in the financial reports, National Accounting Regulations conforming to the International Financial Reporting Standards, approved by the Order of the Minister of Public Finance no. 2.844 / 2016, bring substantial changes to Section 9.1. called "Fixed assets and leases". Thus, these provisions present the main aspects related to the accounting record of the assets representing the rights of use of the underlying assets that are the subject of the leasing contracts, as well as the underlying assets taken over in the lease, the specific accounts of the leasing contracts and their accounting function. Compared to the old provisions, new accounts appear regarding the assets taken in the lease, changes regarding the reflection in accounting and the transitional measures at the end of the financial year. All these new measures apply only to entities that fall within the scope of the Accounting Regulations in accordance with International Financial Reporting Standards, approved by the Order of the Minister of Public Finance no. 2.844 / 2016, as subsequently amended and supplemented.

The International Accounting Standards Board (IASB) issued the International Financial Reporting Standard IFRS 16 "Leasing Contracts", in January 2016, a standard that entered into force from 1.01.2019, replacing both the international accounting standard *IAS 17 " Leasing contracts ", as well as the interpretations issued in the previous period by the international body in support and clarification of the former IAS 17, respectively SIC-15" Operational leasing-Stimulants ", SIC-27" Evaluation of the economic fund of transactions involving the legal form of a contract of leasing "and IFRIC 4" Determining the extent to which a commitment contains a leasing contract "*. Significant changes brought about by the new standard are presented especially for the tenants, who will be based on a unique model of accounting reflection of leasing contracts, without distinction being made to the tenant between financial leasing and operational leasing, all leasing contracts being thus recognized in the statement of financial position (in the balance sheet), this treatment thus generating changes in the information presented in the financial statements of the lessee, where there will be an increase in the value of assets and liabilities. Regarding the requirements contained in IFRS 16, from the perspective of the lessors, they do not support modifications, being similar to those of the IAS 17 standard (Tudor, 2018).

Major changes thus occur, both in the new definition of leasing, with an impact on the accounting and reporting by the lessee, which focuses more on who controls the asset and can change the classification of contracts as leasing, as it is possible that some leasing contracts may no longer be corresponds to the definition of leasing and vice versa, as well as to the new way of accounting for leasing operations and the impact on financial reporting. IFRS 16 also introduces a number of additional requirements regarding the information to be presented in connection with the lease agreements. There are many sectors of activity such as: Retail Sales (property leasing), Airlines (aircraft leasing), Hotels (hotel rentals), Telecommunications (networks and other goods) which have a large volume of operational leasing contracts that aren`t recognized in the balance sheet (Morales-Diaz & Zamora-Ramirez, 2018).

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Based on the principle of IFRS 16, an important concept is the so-called right of use, and also the fact that an important focus is on the prevalence of the economic background of transactions and events over the legal one. The provisions of IFRS 16 apply to all companies that report financially in accordance with IFRS - International Financial Reporting Standards (listed or unlisted companies that have chosen IFRS for consolidated accounting, including their subsidiaries) and also approximately all leases, including leasing contracts for assets related to the right of use within a subcontract of leasing, with certain exceptions provided for by the standard (leasing for mineral exploration or biological assets; service concession commitments; intellectual property rights; licensing rights).

In Romania, the entities that are obliged to report locally under IFRS are the credit institutions, the non-banking financial institutions, the insurance and reinsurance companies, the brokerage companies, as well as the companies listed on the Bucharest Stock Exchange.

II. Summary Regarding The Objective Of Ifrs 16 Leasing Contracts

The principles for recognizing, evaluating, presenting and describing leases are covered by IFRS 16, and the objective of the standard is to ensure that tenants and lessors provide relevant information, in a way that exactly represents transactions within leases, and based on this information, the users of the financial statements being able to evaluate the effect that the leasing contracts have on the financial position, financial performance and cash flows of an entity.

The main objective of this standard is to specify the principles for the recognition, measurement, presentation and disclosure of leases.

Leasing is a contract or part of it that gives the right to use an asset for a period of time in exchange for a fee (Grosu & Hlaciuc, 2018).

III. Concepts Established On The Basis Of The Lease

Lessing is a contract (or part of a contract) whereby an owner (lessor) of a particular asset grants a third party (tenant) the right to use only for a certain period of time, in exchange for a lease payment. By acquiring the right to control the use of the identified asset, the lessee obtains the resulting economic benefits.

Operational leasing operations, similar to leasing contracts, consist of a manufacturer offering the right to use the direct asset to the user, while financial leasing contracts consist of a financial holding company that buys an asset on behalf of a third company and confers the right to use the asset under restrictive conditions. This type of contract establishes a three-way relationship (lessor, lender and end user) and the presence of a financial intermediary. The Leasing is the largest foreign source of financing in America, higher than bank loans or commercial mortgages (Taylor, 2011).

According to IFRS 16, the leasing contract is a contract, or part of a contract, which grants the right to use an asset (the underlying asset) for a certain period of time in exchange for a consideration, and the classification of leases into financial leasing and operational leasing only to the lessor, who will continue to account for the different types of leasing contracts differently. Regarding the effective definition of the concepts and terms, IFRS 16 introduces in the definition of the two types of contracts, the term "asset-support", the asset that is the basis of the lease being thus defined, in relation to the right of use, as an asset for which a lessor has granted the right to use that asset to a lessee. Thus, financial leasing is a leasing that transfers most of the risks and rewards related to the ownership right on a support asset, and the operational leasing is a lease that does not transfer most of the respective risks and rewards.

Schematically, the definition of leasing is shown in Figure 1.

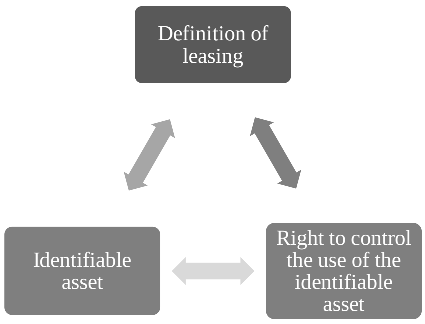

Figure 1 - Terms in defining the lease
Source: Own elaboration

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In order to be qualified as a right of use, the contract must meet 3 criteria, presented in Figure 2:

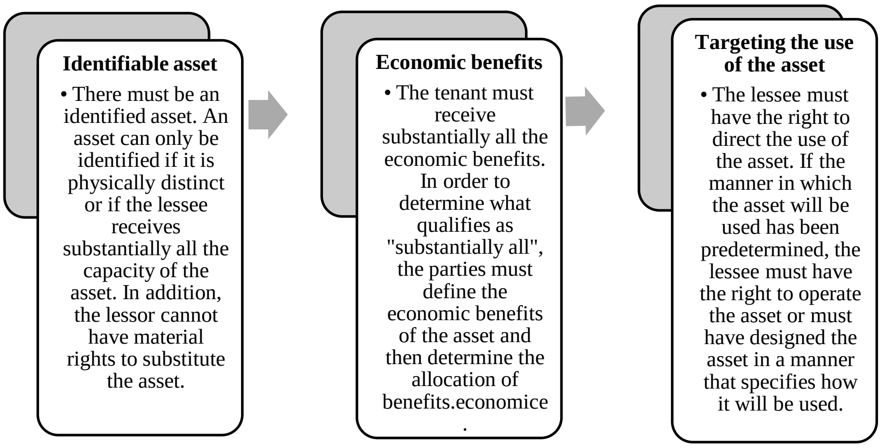

Figure 2 - The criteria considered when qualifying a contract as a right of use
Source: Processing after: https://leaseaccounting.com/what-is-ifrs-16/

IV. IDENTIFICATION OF A LEASE

Under IFRS 16, an important aspect is the identification of a lease, this assuming that at the beginning of each contract, an entity must assess whether that contract is, or contains, a lease. Thus, as can be seen from the definition of the lease, a contract is or contains a lease if that contract grants the right to control the use of an asset (asset-support) identified for a certain period of time in exchange for a consideration. It is noted that the existence of a supporting asset, will provide indications regarding the existence of a leasing contract according to the provisions of IFRS 16 or if the problem of a service contract is raised and falls under another accounting standard.

In accordance with the new IFRS 16, the lessee is not obliged to classify leases into operational leases, or as financial leases, they must take into account all leases in the same way, except for exemptions (lease term less than twelve months and a reduced value asset). The classification in the two categories rests with the lessor, the nature of the classification of the leasing contracts also depends on the substance of the transaction rather than the form of the contract. Thus, a leasing contract will be classified as financial leasing, if it essentially transfers all the risks and rewards related to the ownership right on a support asset, and a leasing contract will be classified as operational leasing, if it does not transfer all the risks in essence and the rewards of ownership over a supporting asset.

The lessee evaluates all leasing commitments (financial or operational) as a conferment of the right of use on all the leased goods (except those which are of small value or which are rented for an equal period or more than 12 months) in exchange for subsequent payments (so-called Leasing Debt). The usage rights and the Leasing Debt will be recorded in the balance sheet of the tenants applying the International Financial Reporting Standards, regardless of the type of the lease, financial or operational.

IFRS 16 eliminates this difference and requires the inclusion of liabilities in operating leases in the financial statements. This change will not bring about a substantial change for the lessor, but will produce obvious accounting effects on the tenant's financial statements.

The application of IFRS 16 is always a necessity, except for the following two cases, in which the lessor has the right to choose to apply it or not:

- if the lease lasts less than 12 months;
- if the value of the contract is not significant, which means it does not exceed the material threshold of $ 5,000.

IFRS 16 standard will lead to a substantial alignment of the financial and operational leasing contracts and will affect the way the leases are reported in the balance sheet, with a strong impact especially on the companies that have numerous leasing contracts in their portfolio.

V. ACCOUNTING TREATMENT FOR THE TENANT

IFRS 16 standard does not bring changes or changes in the accounting for the lessor, instead it is observed substantially, the unique accounting treatment for the lessee, which aims at the recognition in the balance sheet of the assets and liabilities related to the rights and obligations arising from the lease agreements. Thus, the provisions of IFRS 16 regarding the accounting treatment of the lessee reflect the economic background of the lease agreement by the fact that, at the time of initiation, the lessee obtains the right to use the underlying asset for a

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period of time, while the lessor has provided this right by making available the asset for the purpose of being used by the tenant. The right to use the asset is recognized as a distinct asset in the tenant's accounting and is depreciated accordingly, while the property right remains in the background and has no influence on the way of accounting. Thus, IFRS 16, provides that a lessee may obtain the title of property for a supporting asset before the ownership title is transferred to the lessor and the asset is leased to the lessee.

Obtaining the title does not in itself determine how the transaction is accounted for. The main elements that fall within the scope of the accounting treatment of the tenant are presented in Table 1.

Table 1. Accounting treatment applicable to leasing operations

The tenant's right to use the underlying asset meets the definition of an asset for the following reasons:	The lessee's obligation to make leasing payments meets the definition of a debt due to the following considerations:	**Initial evaluation**	**Further evaluation**
		The right of use is initially assessed at cost, given by the following elements:	This is done according to the cost model: the tenant will evaluate the right to use at cost from which the accumulated depreciation and depreciation is deducted and will be adjusted at each revaluation of the debt.
1. the tenant has the control of the right to use the underlying asset during the leasing contract; 2. the lessor cannot take back the asset, using it for his own purposes during the lease, once it has been made available to the lessee. 3. the lessee has the ability to decide how to use the underlying asset and, therefore, to decide how to generate future economic benefits from this right of use; 4. from this capacity the tenant's control over the right of use is justified. 5. the right to control and use the asset exists even when some usage restrictions are imposed. 6. the tenant's control over the right of use arises from past events - not only from the contractual commitment but also from the fact that the underlying asset was made available to the tenant for use during the lease period.	1. the lessee has a current obligation to make lease payments once the underlying asset has been made available to him; 2. this obligation arises from past events - both from the contractual commitment and from the fact that the underlying asset was made available to the tenant; 3. the lessee has no right to cancel or avoid contractual payments (or termination of the contract) before the end of the lease term, without a renegotiation of the lease. 4. the obligation results in future outflows of economic benefits - these are given by the contractual cash payments in accordance with the terms and conditions of the lease.	1. the amount of debt initially assessed; 2. any lease payment made on or before the start date, less any incentive received related to the lease; 3. any initial direct costs incurred by the tenant; 4. the initial debt is evaluated at the present value of the lease payments that have not been made up to that date. These lease payments will be updated using the default rate in the contract if it can be determined, otherwise the marginal rate will be used. 5. The lease payments included in the assessment of the lease debt include amounts related to the right of use of the underlying asset that are not paid until that date during the contract period consisting of: a) fixed payments; b) variable leasing payments that depend on a rate initially evaluated using the rate from the moment of the contract start; c) the amounts that are expected to be paid by the tenant related to the residual value; d) the price of the purchase option if its exercise at the end is safe; e) payments and penalties for the termination of the lease	1. The depreciation is made in accordance with IAS 16. If the transfer of the property right at the end of the contract period is foreseen, or if the tenant will exercise the purchase option with certainty, it will depreciate the right of use from the date of the beginning of the contract until the smallest date between the end of useful life of the underlying asset and the date of completion of the contract. 2. The lessee shall apply IAS 36 to determine if the right of use has been impaired. 3. Upon further evaluation, debt increases to reflect interest and decreases to reflect leasing payments made. 4. If the lessee applies the fair value model of IAS 40 for his real estate investments, he will apply the same model and the right of use that corresponds to the definition of real estate investments in IAS 40. 5. If the right of use belongs to a class of buildings, land or equipment on which the tenant applies the revaluation model of IAS 16, then he may decide to apply this model to all the rights of use related to that class.

Source: Processing after Bizon , 2018; Effects Analysis, IFRS 16 Leases, available at: http://www.ifrs.org/Current-Projects/IASB-Projects/Leases/Documents/IFRS_16_effects_analysis.pdf

It is thus observed, as a relevant accounting treatment, in that the tenants must recognize both an asset ("Right of Use - Right - of - Use Assets - RoU", equal to the net present value of future minimum payments) and the corresponding liability. In the balance sheet, more precisely for any lease, the user will record financial assets and obligations to make future payments for the lease.

Leases are "capitalized" by recognizing the present value of the lease payments and indicating them either as leasing assets (the right to use assets) or together with the tangible assets. Thus, rights and obligations will not be recognized outside the balance sheet.

If leasing payments are made over time, a company also recognizes a financial debt that is its obligation to make future leasing payments.

For the reporting period, a tenant must present certain values, presented in Figure 3.

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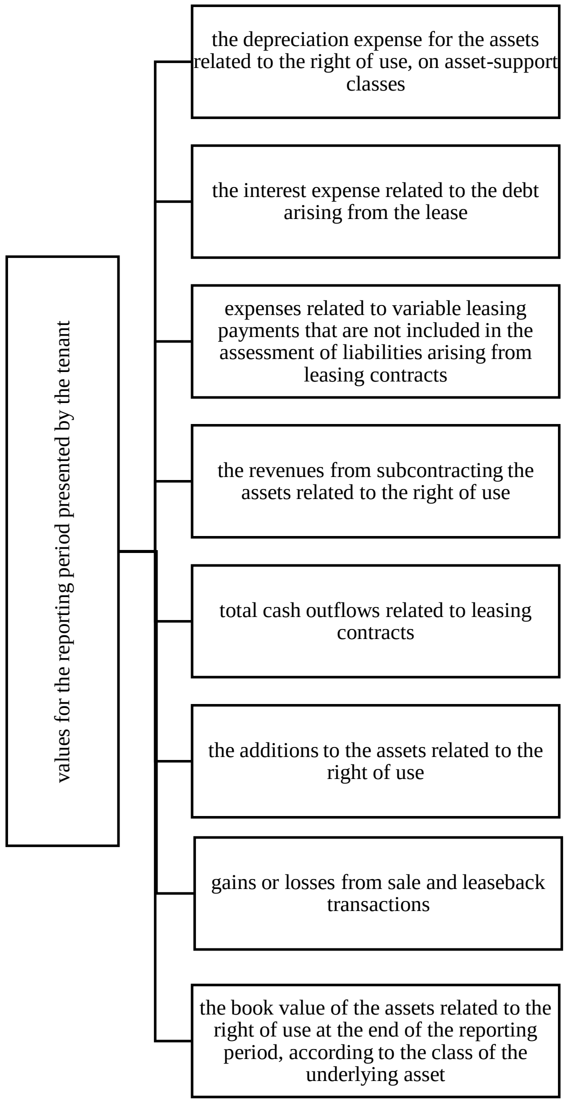

Figure 3 - The values presented by the tenant during the reporting period

Source: Processing after **www.ifrs.org;** Effects Analysis, IFRS 16 Leases, publish by IASB available at: http://www.ifrs.org/Current-Projects/IASB-Projects/Leases/Documents/IFRS_16_effects_analysis.pdf

VI. Analysis Of The Impact Of IFRS 16 On Financial Reporting

If leasing payments are made over time, a company also recognizes a financial debt that is its obligation to make future leasing payments.

As can be seen from the accounting treatment presented above, an impact on the financial reporting is first of all the recognition of the rights of use, as well as of a lease debt in the user's (tenant's) balance sheet, and secondly the recognition in the profit and loss account of the amortization of the rights of use and of the interest that is applied to the lease debt, the cost of the leasing contracts being recognized, both by a linear amortization and a digressive interest over time. Of course, the net result is influenced by the duration of the contract, the payment terms, and the effective interest rate of the contract or the marginal rate of debt, the portfolio of leasing contracts, the way of amortizing the right to use the asset. Regarding the assessment of the right to use the asset and the debt, they are evaluated at the present value (VA) of the payments generated by the lease contract, taking into account an appropriate discount rate (www.arval.ro).

Respecting the objective of IFRS 16, by guaranteeing tenants and lessors the provision of relevant information, any user of financial accounting information will be able to analyze the effect of a lease on financial reporting (financial position, financial performance and financial performance, the cash flows of a company). In the case of cash flows, the lessee divides the total amount paid in cash mainly (presented in the financing activities) and the interest (presented in each operating or financing activity) in accordance with IAS 7. Thus, the value corresponding to the net cash flow cash from the operating activity will increase, and the value of the net cash flow related to the financing activity will decrease by the same amount, the interest paid representing a financing flow.

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Summarizing the effects on financial reporting, we note that at the start date of the lease, the right to use the asset (RoU) is recorded in the active part of the balance sheet, while the debt related to the use of the asset is recorded in the liabilities. Rou corresponds to the present value of future payments due over the entire duration of the lease, plus any potential direct costs paid to the lessee. The rate applied for determining the present value corresponds to the default interest rate of the lease, if it is directly or otherwise determinable to the renter's incremental loan rate. Based on the visible effects of the financial statements provided by IFRS 16, it is also possible to see changes and improvements that may also occur on the financial indicators, such as the positive effect on the Earnings Before Interest, Taxes, Depreciation and Amortizations (Profit Before Interest, Taxes, Depreciation and Amortization), which represents a measure of the overall performance of a company.

VII. Analysis Of The New Accounting Regulations Resulting From The Application Of IFRS 16

At the national level, the order of the O.M.F.P. no. 3456/2018 published in M.Of. no. 942 of 07/11/2018 brings changes and additions to a set of accounting regulations namely: The accounting regulations regarding the individual annual financial statements and the consolidated annual financial statements approved by O.M.F.P. no. 1802/2014; Accounting regulations in line with International Financial Reporting Standards, approved by O.M.F.P. no. 2844/2016 and the Accounting Regulations for legal entities without patrimonial purpose, approved by O.M.F.P. no. 3103/2017. Thus, the accounting regulations approved by O.M.F.P. no. 2844/2016 introduced the new provisions resulting from the application of IFRS 16 standard "Leasing contracts". These provisions concern the specific accounts with their accounting function in the reflection of the operations, of accounting recording of the assets representing the rights to use the support assets that are the subject of the leasing contracts, as well as the support assets taken over in the lease. The new accounts that appear are presented in Table 2.

Table 2. The new accounts are included in the national regulations regarding leasing agreements according to IFRS 16

Assets accounts		**Liabilities accounts**	
Account symbol	Characteristics	Account symbol	Characteristics
251 "Assets related to the rights to use the assets leased" from group 25 "Rights to use the assets leased"	keeps track of assets representing the rights to use the assets related to the leasing contracts accounted for according to IFRS 16	1055 *"Reserves from the reassessment of the assets related to the rights to use the leased assets"*	keeps track of the reserves resulting from the reassessment of the assets related to the rights to use the leased assets
4642 " Claims related to leasing contracts "of group 464" Settlements related to leasing contracts "	keeps track of the receivables related to the leasing contracts accounted for according to IIFRS 16	*285 "Depreciation of assets related to the rights to use leased assets"*	keeps track of the depreciation of assets related to the rights to use the leased assets
6555 "Expenses from the reassessment of the assets related to the rights to use the assets leased"	keeps track of the expenses resulting from the reassessment of the assets related to the rights to use the leased assets	*295 "Adjustments for the impairment of assets related to the rights to use the leased assets"*	keeps track of adjustments for the impairment of assets related to the rights to use the leased assets
6682 "Expenditure on interest on prepayments" 6685 "Interest expenses related to leasing contracts"	keeps track of expenses related to interest on prepayments keeps track of expenses related to interest on leasing contracts	*4641 "Debts related to leasing contracts" of group 464 "Settlements related to leasing contracts"*	keeps track of the debts related to the leasing contracts accounted according to IIFRS 16 (On January 1, 2019 in account *4641* "*The debts related to the leasing contracts" the balance of the account 406 "Debts from financial leasing operations*" is transferred. The entities that have chosen a different financial year from the year calendar applies the provisions of the order from the beginning of the first financial year so chosen, which begins after January 1, 2019.)
685 "Expenses with depreciation of assets related to the rights of use of assets taken on leasing"	keeps track of expenses related to the depreciation of assets related to the rights of use of the assets leased	*7555 "Revenues from the revaluation of assets related to the rights of use of assets taken on leasing".*	keeps track of the revenues resulting from the reassessment of the assets related to the rights to use the leased assets

Source: Processing from O.M.F.P. nr. 3456/2018 published in M.Of. no. 942 from 07/11/2018

Reflection in the tenant's accounting of the lease in the context of IFRS 16 and of the provisions of O.M.F.P. no. 3456/2018 can be presented in this way, through the following operations:

- The recognition in accounting of the lease right (This right is recognized as assets representing the rights of use of the assets related to the lease agreements, in correspondence with the lease debt, at the remaining value of the payments, updated according to the interest rate used:

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	x	
251 *„Assets related to the rights to use the assets leased"*	=	**4641** *„Debts related to leasing contracts"*
	x	

- Interest reflection in accounting - financial expenses:

	x	
6685 *„Interest expenses related to leasing contracts"*	=	**4641** *„ Debts related to leasing contracts"*
	x	

- Reflection in accounting of receiving the debt reduction invoice:

	x	
4641 *„ Debts related to leasing contracts"*	=	**404** *„Supplies of fixed assets"*
	x	

- Reflection in accounting of the depreciation of the right of use:

	x	
685 *„Expenses with depreciation of assets related to the rights of use of assets taken on leasing "*	=	**285** *„Depreciation of assets related to the rights to use leased assets"*
	x	

VIII. Conclusions

Based on the assumption that most entities lease assets, in accordance with IFRS 16, users will thus recognize the assets leased on the balance sheet, and the new definition of leasing will be the new test in the balance sheet / off balance sheet for tenants, based on reasoning and judgment professional. By applying IFRS 16, the implementation effort will be a considerable one, which will lead to the change and calculation of financial indicators (performance and indebtedness), these indicators also affecting the clauses in the loan and management contracts, as well as the benchmark of analysts and investors, users of financial information wanting to understand the impact on their business. The accounting effects of the application of IFRS 16 on the entities that have assets taken over or held under a leasing contract, in relation to IAS 17 are given by the following situations: increase of the tenant's assets and liabilities, recognized in the balance sheet; generally diminishing the result in the first years of the lease, the result being identical to that obtained by applying IAS 17; a decrease of the equity in the first years of the lease; a change in the structure of net cash flows, without changing the value of the total net cash flow.

The incidence of the application of IFRS 16 will be different from one sector of activity to another, but nevertheless significant for entities with activities in commerce, air transport and shipping, which currently use high value assets acquired in operational leasing. As IFRS 16 requires that all lease agreements of the lessee be presented in the balance sheet, the distinction between financial and operational leases is no longer necessary. Tenants are initially required to recognize a rental debt for the obligation to make leasing payments and a right to use the right of use for the right to use the underlying asset for the lease period, the leasing commitment being valued at the present value of the payments. leasing to be made during the lease agreement.

For each operating lease, the assets regarding the right of use and the lease obligations will be capitalized in the statement of financial position. This will affect the financial indicators, such as the current ratio, the leverage ratio and the return on assets. Therefore, it is logical to redefine the disclosure requirements to provide more information about the leasing activity in order to achieve the objective of reporting the tenants under fair competition conditions.

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