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On the Financial Impact of the New Leasing Standard on Lingnan Holdings

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Abstract

In 2018, China issued the revised New Accounting Standard No. twenty-first - lease. The new standard has a certain impact on the aviation industry, retail industry, hotel industry and other industries. Therefore, this study takes Lingnan Holdings as an example to analyze and explore the expected impact of the new standard on hotel accounting. The study found that implementation of the new standard increases the financial risk of enterprises and affects the capital structure of enterprises. Finally, according to the actual situation of Lingnan Holdings, this paper puts forward some countermeasures in order to help our hotel enterprises to optimize and adjust the business management mode in time after the implementation of the new standard and reduce the enterprise risk.

Keywords

New Lease Criteria; Hotel Industry; Lingnan Holdings; Financial Impact.

1. Introduction

Under the requirements of the old leasing standard, the leasing business of an enterprise is divided into operating leases and finance leases. The operating leases are regarded as short-term operating leases which only need to be disclosed in the notes and do not affect the balance sheet. This requirement enables enterprises to design some operating lease businesses to hide important financial information of the enterprise, which has a significant impact on the economic decisions of information users. After the international revision of IFRS16, which combines two rents into one, our country has also followed the pace and revised the lease standard. The new standard greatly reduces the maneuverability of statements, which is beneficial to curb off-balance-sheet financing and improve the authenticity of accounting information quality. This paper takes Lingnan Holdings as an example to analyze the financial impact of the adoption of the new lease standard by hotel enterprises.

At the end of 2018, the Ministry of Finance revised and issued the Accounting Standard for Business Enterprises No.21–Leases (the "New Leasing Standard"), which has aroused extensive discussion in academic circles. Lin Jing (2020) and others, taking Jinjiang Shares as an example, specifically analyzed the expected impact of the new lease standard on finance and operation management, and finally put forward corresponding suggestions. Lu Sha (2020) and others conducted a case study of Hongqi Chain, adjusted the financial statements of Hongqi Chain accordingly, compared the presentation of financial statements of Hongqi Chain before and after the change in standards, calculated the major financial indicators and analyzed the differences and the reasons for the changes. Zhang Chi and Liu Fang (2021) took Jiajiayue as an example to analyze the impact of the new lease standard on retail enterprises and financial indicators. At last, the paper puts forward the countermeasures of retail enterprises facing the new lease standard.

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2. Comparison between New and Old Standards

2.1. Differences in Accounting Treatment

The old standard used a two-model approach to account for lease operations. The leasing business is divided into finance leases and operating leases based on whether all the risks and rewards associated with ownership of the lease are transferred. For finance leases, the lessee should include them in the intangible asset and depreciate them in subsequent measurements and recognize finance charges. For operating leases, only rentals are recognized for each period. The new standard uses a single model for accounting, i.e. no distinction is made between finance leases and operating leases and all leases are recognized in full as use assets and lease liabilities. Interest expense is calculated and recognized as finance expense under the effective interest method and depreciated under the straight-line method.

2.2. Presentation Differences

The old standard required lessees to present financial data relating to finance leases in the statements and to disclose information relating to operating leases in the notes. The new standard requires the lessee to list the right-of-use assets and lease liabilities in the balance sheet, and the accrued depreciation and interest expense shall be included in the relevant items in the income statement. In addition, specific information such as the nature of the lease contract and the method for determining the incremental borrowing rate should be disclosed in the notes.

3. Case Study

3.1. Sample Selection and Data Sources

Guangzhou Lingnan Group Holdings Co., Ltd. (hereinafter referred to as Lingnan Holdings) is a leading enterprise of hotel listed companies in South China, with market value ranking among the top ten listed companies in the A-share tourism hotel industry. Lingnan Holdings was mainly engaged in the operation of individual hotels in the early days of its establishment. Since the implementation of a major asset restructuring in 2016, the Company has developed into a comprehensive tourism group integrating business travel, accommodation, exhibition, scenic spots, car services and other businesses.

3.2. Impact of the New Leasing Standards on the Three Major Accounting Statements

3.2.1. Impact on Balance Sheet

Table 1. Minimum operating lease payments for Lingnan Holdings in 2020(unit: RMB10,000)

Remaining lease term	Operating lease payments
First year after balance sheet date	1745.02
Second year after balance sheet date	1766.76
Third year after balance sheet date	1776.39
Fourth year after balance sheet date	1678.62
Fifth year after balance sheet date	1678.62
Total	8645.41

In accordance with Lingnan Holdings' financial report for the year 2021, for operating leases that existed before the date of initial execution, in the measurement of lease liabilities, Lingnan Holdings measures lease liabilities based on the remaining lease payments discounted at the date of initial execution using the Company's incremental borrowing rate as the discount rate; In the measurement of right-of-use assets, the Company selects one of the following two

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methods to measure: ①Assuming that the book value of the new leasing standard is adopted from the commencement date of the lease term, using the Company's incremental borrowing rate at the date of initial execution as the discount rate; ②an amount equal to the lease liability, adjusted as necessary based on prepaid rent.

The minimum lease payments disclosed in Lingnan Holdings' 2020 financial report are as in Table 1.

As Lingnan Shares did not disclose the specific lease term of its lease contract and the contract rent, therefore we choose the average lease term of the industry in the same industry was selected as the lease term of Lingnan Shares, the minimum operating lease payments as at 31 December 2020 was used as the future discount basis, and the lease payments were discounted using the lessee's incremental borrowing rate as at 1 January 2021 (weighted average: 3.85%). From this, it can be calculated that Lingnan Holdings discounted the minimum lease payments at the date of initial execution of the new CAS21 as shown in Table 2.

Table 2. Discount table of minimum lease payments of Lingnan Holdings in 2020 (unit: RMB10,000)

number of years	Operating lease payments	discount rate	current value
First year	1745.02	3.85%	1680.33
Second year	1766.76	3.85%	1638.19
Third year	1776.39	3.85%	1586.06
Fourth year	1678.62	3.85%	1443.20
Fifth year	1678.62	3.85%	1389.70
total	8645.41		7737.47

As can be seen from the above table, the amount capitalized under the operating lease of Lingnan Holdings was RMB77,3747 million, and the right-of-use assets and right-of-use liabilities of RMB77,3747 million should be recognized simultaneously in accordance with the new lease criteria. The specific entry is as follows (unit: ten thousand yuan):

Dr: Right-of-use assets 7737.47

Cr: Lease liability 7737.47

Table 3. Balance sheet differences of Lingnan Holdings at the beginning of 2020 under the new and old standards

Report item	Before adjustment	Adjustments	After adjustment	Amplitude of fluctuation
Current assets	191,472.87		191,472.87	
Non-current assets	160,395.08	7,737.47	168,132.55	4.82%
Total assets	351,867.95	7,737.47	359,605.42	2.20%
Current liabilities	102,273.97	1,680.33	103,954.30	1.64%
Of which: lease liabilities due within one year		1,680.33	1,680.33	
Non-current liabilities	10,797.46	6,057.14	16,854.60	56.10%
Of which: lease liabilities		6,057.14	6,057.14	
Total liabilities	113,071.43	7,737.47	120,808.90	6.84%
Owner's equity	238,796.52		238,796.52	
Total liabilities and owners' equity	351,867.95	7,737.47	359,605.42	2.20%

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Under the new lease criteria, right-of-use assets are classified as non-current assets, and lease liabilities are classified as lease liabilities due within one year and lease liabilities due for more than one year based on the length of the lease term, which are reflected under current liabilities and non-current liabilities respectively. Differences in the balance sheet of Lingnan Shares at the beginning of 2020 under the new and old standards are shown in the table 3.

From the comparative analysis in Table 3, it can be seen that the change in lease criteria has a significant impact on the balance sheet items of Lingnan Holdings. After adjustment in accordance with the new standard, total non-current assets of Lingnan Holdings increased by 4.82% and total liabilities increased by 6.84%, among which, non-current liabilities increased by 56.10%

The new leasing standard stipulates that for right-of-use assets, the lessee should use the cost model for subsequent measurement, i.e. the book value of the right-of-use assets = cost-accumulated depreciation-accumulated impairment losses; For the book value of the lease liability = original value + interest incurred on the lease liability-amount of lease payments paid + revaluation adjustment on the lease liability. For example, in 2021, right-of-use assets and lease liabilities are accounted for as follows (unit: ten thousand yuan):

Depreciation of right-of-use assets:

Dr: Costs 1547.49

Cr: Accumulated depreciation 1547.49

Accrued interest expense on lease liabilities:

Dr: Finance costs 297.89

Cr: Lease liabilities 297.89

Payment of rent:

Dr: Lease liabilities 1745.02

Cr: Bank 1745.02

The specific calculation process is shown in the following table:

Table 4. Results of subsequent measurement of the right-of-use assets of Lingnan Holdings (Unit: RMB10,000)

Year	Rental①	Opening balance of lease liabilities ②	Interest expenses ③=②×3.85%	Closing balance of lease liabilities ④=②-①+③	Opening balance of right-of-use assets ⑤	Depreciation expense of right-of-use assets ⑥	Closing balance of right-of-use assets ⑦=⑤-⑥	Total expenses ⑧=③+⑥
2020				7737.47			7737.47	
2021	1745.02	7737.47	297.89	6290.34	7737.47	1547.49	6189.98	1845.39
2022	1766.76	6290.34	242.18	4765.76	6189.98	1547.49	4642.48	1789.67
2023	1776.39	4765.76	183.48	3172.85	4642.48	1547.49	3094.99	1730.98
2024	1678.62	3172.85	122.15	1616.39	3094.99	1547.49	1547.49	1669.65
2025	1678.62	1616.39	62.23	0.00	1547.49	1547.49	0.00	1609.73
total	8645.41		907.94			7737.47		8645.41

3.2.2. Impact on the Income Statement

From the above analysis, it can be seen that Lingnan Holdings should have recognized right-of-use assets of RMB77,374,700 at the beginning of 2021, and financial expenses of RMB2,978,900, accrued depreciation of RMB154,749,900 and paid rental of RMB1,745,02 in 2021. Adjustments to the income statement based on this information are shown in Table 5:

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Table 5. Differences in the 2020 profit statement of Lingnan Holdings under the new and old standards

Report item	Report data	Adjustments	Adjusted amount	Amplitude of fluctuation
I. operating income	187756.35		187756.35	
Less: operating costs	159159.56	-1547.49	157612.06	-0.97%
Financial expenses	-3179.52	297.89	-2881.62	9.37%
Other related taxes and fees	60445.72		60445.72	
Add: Relevant adjustment items	-2672.65		-2672.65	
II. operating profit	-31342.06	-1249.60	-32591.67	-3.99%
Plus: non-operating income	71.92		71.92	
Less: non-operating expenses	332.99		332.99	
III. Total Profit	-31603.13	-1249.60	-32852.73	-3.95%
Less: income tax	-5431.25	-312.40	-5743.65	-5.75%
Iv. net profit	-26171.88	-937.20	-27109.08	-3.58%

As can be seen from Table 5, in 2021, the operating profit and net profit of Lingnan Holdings both decreased to a certain extent, while the amount of financial expenses increased by 9.37%. Judging from the absolute value of the change range of reporting items, the new leasing standard has a significant impact on the financial expense items in the profit statement.

Table 6. Comparison of the impact on the profit statement of Lingnan Holdings under the new and old standards

Age	Lease expenses under the old leasingstandard	Depreciation expense under new leasing standard	Interest expense under new leasing standard	The amount that affects profit under the new leasing standard	Margin
2021	1745.02	1547.49	297.89	1845.39	100.37
2022	1766.76	1547.49	242.18	1789.67	22.91
2023	1776.39	1547.49	183.48	1730.98	-45.41
2024	1678.62	1547.49	122.15	1669.65	-8.97
2025	1678.62	1547.49	62.23	1609.73	-68.89
total	8645.41	7737.47	907.94	8645.41	0.00

As can be seen from Table 6, because the operating leases are included in the table in the new lease criteria, the operating lease expenses are advanced, so that the total expenses are distributed "first high and then low" throughout the lease term, and the total profit is "first low and then high" throughout the lease term.

3.2.3. Impact on Cash Flow Statement

Under the old lease criteria, rentals paid by an enterprise for operating leases were classified as cash outflows from operating activities, while under the new criteria, the original operating leases and finance leases were treated as activities of a financing nature for the enterprise. Expenses on lease expenses were shown in the cash flows from financing activities.

3.3. Impact of the New Leasing Standard on Financial Indicators

From the perspective of solvency, after the implementation of the new lease standard, the short-term solvency of the enterprise will decrease and the long-term solvency will increase. From the above analysis, it can be seen that under the condition that other conditions remain unchanged, the new leasing standard recognizes all operating leases of an enterprise as right-of-use assets and lease liabilities at the same time, in which the right-of-use assets are non-current assets, lease liabilities due within one year are classified as current liabilities, and lease liabilities repaid within more than one year are classified as long-term liabilities. The current

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liabilities of the enterprise increased while the current assets remained unchanged, so the current ratio and quick ratio of Lingnan Holdings decreased, which means that the short-term solvency of the enterprise decreased. An increase in the long-term liabilities of an enterprise with the owner's equity remains constant, therefore, an increase in the equity ratio means an increase in the long-term solvency of the enterprise.

From the perspective of operating capacity, after the implementation of the new lease criteria, the operating capacity of the enterprise decreased. The main reason is that the enterprise has confirmed the right to use its assets without increasing its operating income. The decrease in the asset turnover rate reflects the decrease in the utilization rate of the enterprise's assets and the poor investment efficiency of the assets.

From the perspective of profitability, after the implementation of the new leasing standard, the profitability of the company decreases. From the above analysis, it can be seen that, under the condition that other conditions remain unchanged, the right-of-use assets are amortised on a straight-line basis to increase operating costs, and the provision of interest charges on lease liabilities results in an increase in financial expenses, while operating income does not increase, resulting in a decrease in gross profit margin and net interest rate, indicating that the enterprise's ability to obtain profits through sales has weakened.

4. Conclusion and Suggestions

4.1. Conclusion

For lessees, the most significant change in the adoption of the new leasing standard is the inclusion of off-balance-sheet short-term leases in the balance sheet and their recognition as right-of-use assets. Such a change has a significant impact on a large number of enterprises to which leases are applicable, such as those in the aviation and hotel industries. This paper took Lingnan Holdings, a leading hotel company, as an example to analyze the financial impact of adopting the new standard. The research finds that the new lease standard improves the quality of accounting information. For a long time, one of the major advantages of the operating leasing business is "off-balance-sheet financing and report optimization". However, after the adoption of the new standard, the operating lease of an enterprise enters into the balance sheet, so that the financial statements can more truly reflect the operation and management of the enterprise, and more in line with the characteristics of objectivity in the quality of accounting information. In addition, the new leasing standard can affect the capital structure of an enterprise. Capitalization of operating leases resulted in an increase in assets and liabilities, mainly represented by a significant increase in non-current liabilities and an increase in long-term debt ratio.

4.2. Suggestions

First, the leasing method of business premises should be adjusted reasonably. The new leasing standard requires that low-value leases and leases within one year be not disclosed in the table. Considering the high value of the assets leased by the hotel enterprise, it is impossible that the enterprise will enter into low-value leases to avoid the right-of-use assets and lease liabilities. Therefore, Lingnan Holdings should try its best to enter into short-term contracts with the lessor for not more than one year to meet the exemption conditions stipulated in the new standard.

Second, the enterprise should explain the differences in financial indicators caused by the differences in accounting treatment before and after. Many report users may not be familiar with the changes in accounting policies for leased assets. When they see significant changes in related items in the financial statements, they may mistakenly believe that the business operation and management are not sound. Therefore, the enterprise should inform the report

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users of this accounting treatment and the changes in its impact in the financial statements or other announcements, so as to enhance the confidence of the report users and maintain the corporate image.

Third, reasonably develop other business of the Company. Taking Lingnan Holdings as an example, apart from hotel operation, the Company has implemented a major asset restructuring since 2016. Besides hotel operation, the Company's main business has also expanded into business travel, accommodation, exhibition, scenic spots and car services. Therefore, other hotel enterprises can reasonably develop other related businesses according to their own operating characteristics, reduce the proportion of hotel operations in the company's main business, and broaden the sources of corporate income, to reduce a series of risks brought about by the implementation of the new standard.

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