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KONTINENT PLAST, ST. PETERSBURG

Packaging Company Expands Production Using Leasing

As we walk through Kontinent Plast’s polyethylene packaging plant, located on the outskirts of St. Petersburg, Igor Bobylev, Financial Director of Kontinent Plast, explains how his company first began and how it works today.

The Russian packaging industry took off in the mid-1990s as Russian consumers grew more accustomed to seeing a wide selection of goods on store shelves and became more discriminating shoppers. Although the shelves were stocked with both imported and Russian goods, consumers nevertheless preferred imported goods over their Russian counterparts. One of the main reasons for this choice was the attractive packaging of the imported goods.

The present managers of Kontinent Plast were among those who understood that Russian products were no worse than western ones, and that all that was needed was to package them better. At first the entrepreneurs began to import polyethylene packaging from Finland. Then, in 1997 they decided to produce their own packaging. In order to do so, they rented a factory and began to renovate it.

Continued on page 16
HOW LESSEES SHOULD ANALYZE THE FINANCIAL TERMS OF A LEASE AGREEMENT

Veronika Shtelmakh, Economist
IFC Leasing Development Group

The LeasingCourier has already devoted several articles to the subject of lease payments, but until now we have always written from the perspective of the lessor. In this article, we will write about the interests of the lessee. We hope that these materials will enable lessees to make judicious comparisons of the financial terms offered by different leasing companies.

Russian law allows for considerable freedom in determining the size, methods and forms of lease payments. Lessors and lessees are free to negotiate terms that they find mutually agreeable.

In this article, we will discuss some important factors that lessees should consider during the negotiating process.

The leasing company's essential aim, when calculating lease payments, is to cover all of its related expenses and turn a profit. Lease payments usually include compensation for the cost of the leased asset, the leasing company's loan interest, the cost of any additional services that the leasing company has to provide to the lessee either before or during the lease term, and any taxes that the leasing company incurs in connection with the lease.\(^1\) Perhaps the most important question of all is the leasing company's commission, so let's begin our discussion there.

The Leasing Company’s Commission

Inexperienced lessees often make the mistake of asking leasing companies the following question during their preliminary negotiations: «How much is your commission?» One leasing company might say 5%, another 10%, and a third 12%. But a closer look right reveal that all three figures work out to be exactly the same. How can that be?

Not only does the name of this payment vary from one company to the next («margin,» «commission,» etc.), so does its actual composition. Some leasing companies include taxes, insurance payments and other expenses in their stated rate of commission, while others do not. One way or another, every leasing company will require compensation for these expenses; the only question is whether they will be defined as part of the commission or as separate components within the lease payments.

As we mentioned at the beginning of this article, lessors and lessees are free to determine the size and methods of the lease payments as they see fit. Therefore, the sums on which the commission is based can also vary from one company to the next. For example, a 5% commission based on the leased asset’s original book value may be identical to a 10% commission based on its residual value at the beginning of each payment period or a 12% commission based on its residual value at the end of each period. Let’s consider an example:

Example:

Let’s assume that the leased asset’s original book value is $1,000. Lease payments are made quarterly. The asset depreciates at an annual rate of 12%, and the parties have agreed to apply an acceleration factor of 3, so the asset depreciates fully over the term of the lease.

Leasing Company A charges a 5% annual commission on the leased asset’s original book value. Thus, the lessee must pay a commission of $12.50 every quarter. Over a three-year term, this adds up to $150.

Leasing Company B charges a 10% annual commission on the leased asset’s residual value at the beginning of each payment period. The amount of commission therefore decreases over time, and after three years it adds up to the same total: $150.

\(^1\) Potential lessees should not be put off by this long list of expenses. Because leasing enjoys a number of tax benefits and other privileges, it is not as expensive as this list might suggest.
Asking about the lessor’s rate of commission clearly isn’t very helpful. This is the wrong question to ask. Even if the lessor tells you exactly how he calculates his commission, you still need additional information before you can make a wise decision. What do you need to know in order to compare the financial terms offered by different leasing companies?

**Comparing the Financial Terms Offered by Different Leasing Companies**

Imagine a company, Boxes Inc., that specializes in manufacturing cardboard boxes and wishes to expand its production. It decides to lease a new piece of equipment that carries a price tag of $350,000 (10 million rubles at an exchange rate of 28.57 rubles to the dollar). It wants to pay off the lease over a three-year period (12 quarterly payments). It submits applications to three leasing companies. Some time later, it receives the following estimates:

<table>
<thead>
<tr>
<th>Total Lease Payments (in rubles)²</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aurora</td>
</tr>
<tr>
<td>Babochkin &amp; Co.</td>
</tr>
<tr>
<td>Mona Lizing</td>
</tr>
</tbody>
</table>

Does this mean that the estimates are all the same? Not at all. Even if the total sum of the lease payments is the same for all three companies, there are several other factors that will affect the lessee’s cash flow:

1) The distribution of the payments over time  
2) The payment due dates (beginning or end of fiscal period)  
3) The frequency of the payments.

In the next issue of the Leasing Courier, we will take a closer look at how these three factors actually affect the lessee’s expenditures. We will also consider what happens if the leasing company pegs the value of the lease payments to exchange rates.

² Let’s assume that the lessee will have no other expenses in connection with the lease — just the lease payments themselves.
One of the lessee’s main obligations under a lease agreement is to make regular lease payments. In this article we will not consider the financial aspects of lease payments, but instead focus on a single legal aspect: how to restructure the lease payment schedule during the term of the lease.

Since every entrepreneur depends on financial stability in his business and must be able to predict his expenses, lawmakers have established that rent payments (including lease payments) may not be rescheduled except by the mutual consent of all interested parties. Moreover, lease payments may not be rescheduled more than once per year, even by mutual consent, according to Article 614, Clause 3 of the Russian Civil Code.

In order to protect themselves against the instability of the Russian ruble, leasing companies generally quote the value of the lease payments in dollars (or any other freely convertible currency), which is permissible under Russian law. However, this arrangement offers no protection to lessees. This became painfully evident after the financial crisis of August 1998. The arbitration courts did not find the several-fold devaluation of the ruble a sufficient reason for freeing lessees from their financial obligations. The Federal Arbitration Court of the Northwest Region ruled that companies that had entered into agreements prior to the Crisis should have foreseen high levels of inflation. Those that committed themselves to financial obligations in dollar equivalents were subjecting themselves to high currency risks.\footnote{See the Federal Arbitration Court of the Northwest Region’s ruling on case #A56-14871/99 (09/27/99).} Thus, lessees essentially had no legal recourse if lessors refused to reschedule their lease payments. In order to protect themselves against this sort of scenario in the future, lessees should be sure to write provisions into the lease agreement requiring the lessor to reschedule the lease payments under certain circumstances, such as drastic changes in exchange rates.\footnote{The parties should agree beforehand on a formula for restructuring the payments.}

One often sees lease agreements where the value of the lease payments is not expressed as a fixed sum, but rather as a formula. A provision that allows one of the parties to adjust the value of the lease payments under certain circumstances (such as major fluctuations in interest rates or the Central Bank’s refinancing rate) can also be considered a kind of formula. If the leasing company wishes to write such a provision into the lease agreement, the lessee should keep the following points in mind:

- If the lease payments are pegged to interest rates or the Central Bank’s refinancing rate, they will have to be adjusted whether these factors rise or fall. Considering that both have been falling recently, it will be in the lessee’s interest, not the lessor’s, to restructure the lease payments.
- Be sure to write a clear formula for restructuring the payments into the lease agreement. Lease agreements often stipulate that the lease payments will increase in proportion to any increases in the size of their components. However, they sometimes fail to specify whether this proportional increase pertains only to the relevant component (e.g., compensation for the lessor’s loan interest) or to the total value of the lease payment.
- Also be sure to include a precise and unambiguous definition of the possible grounds for rescheduling the lease payments. Such phrases as «significant changes in the Russian economy» are far too vague.
The Lessor’s Control over the Leased Asset and the Lessee’s Actions

As the lessee’s creditor, the leasing company always has a vested interest in the lessee’s solvency. For this reason, the leasing company will always wish to maintain some control over both the leased asset and the lessee’s actions. Most lease agreements contain provisions that authorize the leasing company to exercise this kind of control. However, these provisions often violate corporate law, particularly the Federal Law on Leasing.

The lessor’s right to exercise control over the leased asset is dealt with explicitly under Articles 37 and 38 of the Law on Leasing. These two articles are terribly flawed, especially where they give lessors the right to audit the lessee’s finances and sit in on the lessee’s board meetings (Article 38, Clause 4), both of which are clear violations of Russian corporate law. Every commercial enterprise has its secrets; forcing lessees to divulge every scrap of information about themselves to their lessors could endanger their businesses. That is why corporate law makes very specific provisions regarding corporate governance and the procedures for auditing a company’s finances. The Law on Joint-Stock Companies, for instance, is very specific about who has the right to attend shareholder meetings (Article 51) or initiate a financial audit (Article 86). The Law on Leasing’s generosity towards lessors, in allowing them to attend their lessees’ board meetings and audit their finances, is both legally dubious and ethically unacceptable, as it constitutes a clear infringement of the lessee’s internal affairs.

Therefore, the lessor should be made to understand that he will not be able to exercise his «rights» under Article 38, Clause 4, of the Law on Leasing without the lessee’s consent. We should also note that the Law on Leasing only gives lessors the right to attend the lessee’s board meetings or launch a financial audit if the lessee has defaulted on his lease payments. We should add, however, that it will reflect well on the lessee and serve as proof of his good intentions if he does allow the lessor to exercise these rights.

1 Current legislation also gives the lessor the right to sue for annulment if the lessee misuses or significantly impairs the leased asset, or if he fails to perform required maintenance.

In practical terms, we would like to offer lessees the following recommendations:

- Unless your business works 24 hours a day, be sure to restrict the lessor’s access to the leased asset to working hours only.
- Specify which documents the lessor may requisition and under which circumstances; also stipulate how much time you will have to prepare and submit these documents.
- Limit the lessor’s access to your board meetings (i.e., the topics of discussion that he may hear).

Contract Annulment Due to Non-Compliance or Payment Default by the Lessee

All of the parties to a lease have a vested interest in seeing that the terms of the lease agreement are fully observed. In real life, however, it often becomes necessary to terminate the agreement. For the wronged party, this is usually a last, desperate resort. Since the lessee is the debtor under a lease agreement, it is usually the lessee who precipitates annulment by failing to honor his obligations.

Article 450 of the Russian Civil Code stipulates several grounds for annulling an agreement. It makes a clear distinction between the right to demand annulment and the right to renege on one’s obligations. Allowing the lessor the right to renege on his obligations makes the lease agreement less stable and therefore less attractive to the lessee. In this section we will focus on one of the most common grounds for annulling a lease agreement: the lessee’s failure to meet his lease payments for three or more consecutive periods.

Russian law is somewhat inconsistent on this question. Article 619 of the Russian Civil Code gives lessors the right to sue for annulment if the lessee fails to make his lease payments for more than two consecutive payment periods. Article 13 of the Law on Leasing, on the other hand, simply gives lessors the right to renege on their own obligations under these circumstances. The Civil Code has precedence and cannot be overridden by either the Law on Leasing or the parties’ mutual consent. Therefore, the lease agreement cannot legally authorize the lessor to unilaterally annul the agreement in the event of payment default.³
Leasing companies often try to get around Article 619 of the Civil Code by stipulating that they have the unilateral right to annul the lease agreement if the lessee fails to make his payments within, say, 30 days of their due date. While such provisions are not in direct violation of Article 619, they can hardly be considered legal. The courts are unlikely to uphold such practices, since it is unfair to institute a simpler procedure for annulling an agreement (unilateral termination, rather than a lawsuit) for a lesser offense (30 days’ lateness, rather than 3 or more consecutive non-payments).

In conclusion, we should add that the parties are free to stipulate provisions for unilateral annulment under any other circumstances that are not covered under the Civil Code or other legislation.

**Provisions for Redeeming the Leased Asset**

Lessees generally opt for leases in the first place because they do not have enough working capital to make an outright purchase of the equipment they need, and most lessees would generally like to assume ownership of the leased asset upon expiration of the lease. If the lessee intends to assume ownership of the leased asset, he should be sure to include provisions for redeeming the asset within the lease agreement itself. Current legislation does allow the parties to conclude this kind of «mixed» agreement, consisting of both a lease agreement and a sales agreement.

Lessees should bear in mind that a lease agreement cannot be considered anything more than a preliminary sales agreement if it fails to specify the exact terms for redeeming the leased asset. These include a time frame for transferring ownership rights and an exact redemption price.

According to Article 429, Clause 4 of the Russian Civil Code, a preliminary agreement should specify the date on which the parties will conclude the primary agreement. Otherwise, the principal agreement must be concluded within one year after the preliminary agreement was signed. Therefore, unless the lease agreement specifies an exact date or other time frame for concluding the redemption agreement, the latter must be signed within one year. Otherwise, the lessee will lose his right to redeem the leased asset (Article 429, Clause 4, of the Russian Civil Code). From the lessee’s perspective, it would be best to stipulate a time frame for concluding redemption of the lease asset, rather than for concluding the primary agreement.

It is extremely important to stipulate the leased asset’s redemption price within the lease agreement. Because prices are not considered an essential condition for a sales agreement, omitting the redemption price from the preliminary agreement (the lease agreement) will not affect that agreement’s validity. However, it will make the redemption price subject to Article 424, Clause 3 of the Russian Civil Code, which defines the redemption price of a leased asset as «the price that is normally charged for similar goods under similar circumstances.» The lessee should make certain that the lease agreement contains specific provisions for calculating the leased asset’s redemption price.

Finally, we should point out that the common practice of simply transferring the leased asset to the lessee without so much as a nominal redemption payment is inappropriate and may invalidate the transfer itself. Russian leasing law does not require the lessor to transfer ownership of the leased asset to the lessee upon expiration of the lease. Therefore, the parties must conclude a legal agreement capable of serving as a legal basis for transferring ownership. Article 218, Clause 2 of the Russian Civil Code lists three kinds of agreements that may serve this purpose: sales agreements, barter agreements and donation agreements. However, Article 575 of the Russian Civil Code prohibits donations between commercial entities. Therefore, the only way for the lessee to assume ownership of the leased asset is by concluding a sales agreement for a specified sum.

This article only begins to address some of the provisions that can affect lessees. We would like to return to this topic in future issues of the Leasing Courier. Therefore, we ask that you, our readers, tell us about your own experiences with lease agreements and the provisions that serve to protect the lessee’s interests. Please join our ongoing discussion!

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4 Upon expiration of the lease agreement, for example.
5 Unless the sales agreement is for a piece of real estate.
6 See Article 454, Clause 1 of the Russian Civil Code
Analyzing the Lessee’s Financial Situation

Sources of Information

The main source of information about a lessee’s current financial situation are the company’s own financial records. As everyone knows, accounting records do not always give an accurate reflection of an enterprise’s real cash flow. Therefore, one must be cautious about drawing any direct conclusions from them. The only way to check the accuracy of a company’s accounts is to conduct an independent audit.

A private enterprise’s accounting records include the following:

- Accounting Balance Sheet (Form #1)
- Report on Profits and Losses (Form #2)

Supplements to the Accounting Balance Sheet and the Report on Profits and Losses, including:
- Report on the Movement of Capital (Form #3),
- Report on the Movement of Monetary Funds (Form #4) and Supplement to the Accounting Balance Sheet (Form #5). Form #5 details an enterprise’s assets and liabilities, including its non-liquid assets, financial investments, outstanding debts and trade liabilities.

In addition to these five documents, the leasing company may also request to see the following:

- An auditor’s report confirming the accuracy of the lessee’s bookkeeping records
- Tax inspection reports
- A list of all debtors and creditors, including sums and due dates
- Bank statements
- A certificate of good standing from the State Tax Inspectorate
- Statements for all guarantee accounts not recorded on the balance sheet

Methods of Analysis

The main goal in analyzing a potential lessee’s financial situation is to determine whether the enterprise will be able to generate sufficient cash to make lease payments and fulfill all obligations under the lease agreement. The leasing company should try to identify some of the financial problems that the lessee may experience over the course of the lease and to determine whether these problems can be averted.

When analyzing the lessee’s financial records, the leasing company should try to see the big picture: the main trends in the lessee’s financial history. The usual practice is to look at data from the last three years.

There are several different methodological approaches to conducting a financial analysis:

- **Horizontal analysis:** comparing the same financial indicators from one period to the next and determining both absolute and relative changes. This method allows one to see trends in the lessee’s financial development and calculate the overall rate of growth. This, in turn, will help you to predict the lessee’s future cash flow.
- **Vertical analysis**: studying the lessee’s financial structure in terms of relative indicators. This method enables you to analyze the lessee in the context of industry conditions and external factors as inflation.
- **Ratio analysis**: calculating the relationship between various financial data.
- **Factor analysis**: ascertaining the causes behind any changes in the lessee’s financial indicators.
- **Comparative analysis**: comparing the lessee’s financial indicators to industry averages or to those of industry leaders and other competitors.

There are several aspects of the potential lessee’s finances that one needs to examine:
- **Balance**: an appraisal of the potential lessee’s total assets
- **Liquidity**: the potential lessee’s ability to meet short-term obligations by converting assets into cash
- **Profitability**: the potential lessee’s ability to generate profit using current assets
- **Return on Investment**: the potential lessee’s ability to provide the lessor with a return on investment
- **Turnover**: how the potential lessee manages working capital

**Analyzing the Lessee’s Balance Sheet**
The lessee’s balance sheet indicates the composition of assets and liabilities. We can use the following diagram to illustrate the structure of a balance sheet:

```
<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fixed Assets</td>
<td>Equity</td>
</tr>
<tr>
<td>Current Assets</td>
<td>Long-term Liabilities</td>
</tr>
<tr>
<td>Short-term (current) Liabilities</td>
<td></td>
</tr>
</tbody>
</table>

Assets = Liabilities
Fixed Assets + Current Assets = Equity + Debt
```

Assets are subdivided according to their period of use into fixed and current assets. Liabilities (sources of finance) are subdivided into equity and debt. Debt is subdivided further into long-term (more than one year) and short-term (current) liabilities.

There are essentially two methods for analyzing the lessee’s balance sheet:
- Analyzing it directly, without altering its composition
- Calculating the aggregate balance and use this as the basis of your analysis

It is often time-consuming and ineffective to analyze the lessee’s balance sheet directly, as the number of indicators makes it difficult to see the main trends in the lessee’s financial development.

Aggregate balance means combining all the similar items on the balance sheet, regrouping assets according to their degrees of liquidity, and listing liabilities in the order of their maturity. This makes it easier to analyze the data and detect important trends. The basic structure of the balance sheet remains the same: assets are subdivided into fixed and current assets, and the same distinction is made between equity and loan capital. However, several changes occur within the subdivisions:
- Transfer any receivables listed under «Current Assets» (accounts receivable) that will not mature within the next twelve months to «Fixed Assets»
- Remove «Receivable Contributions to Charter Capital» from «Receivables» and reduce «Working capital» accordingly
- Regroup «Current Assets» and «Current Liabilities» and isolate any items that characterize the lessee’s management of working capital or that might be altered by changes in the lessee’s relationship with customers and suppliers

We can use the following diagram to illustrate the aggregate balance method:

**ASSETS**
- Fixed assets:
  - Intangibles
  - Capital investment
  - Other non-liquid assets
- Current assets:
  - Unfinished goods and products
  - Advance payments to suppliers
Production stock and objects of little value or short service life
Finished goods and products (Inventory)
Accounts Receivable
Cash and Cash Equivalents
Other current assets

LIABILITIES:
Equity
Debt
  Long-term liabilities
  Short-term liabilities
  Accounts payable
  Advance payments from customers
  Taxes and duties
  Payroll
  Other current liabilities

Analyzing Changes in the Balance Sheet (Horizontal Analysis)
By looking at changes in the balance sheet items over time, you can determine how the lessee has invested or disbursed capital and financed these transactions.

Analyzing the Structure of the Balance Sheet (Vertical Analysis)
Analyzing the structure of the balance sheet means determining each section’s share of the total balance, as well as the share of individual items within each section. This analysis will allow you to see which items are most significant and which have changed the most; this in turn will help you determine which items require further analysis.

What conclusions might you draw from the fact that the lessee’s current assets have been growing? On the one hand, it may mean that the lessee’s asset structure is becoming more flexible. On the other, it might simply mean that the lessee has been managing his working capital irrationally, i.e.:

- Irrational procurement policies have increased the amount of raw materials in storage (this can only be confirmed by analyzing the turnover rate of stored materials, the specific composition of these materials and the timing of their delivery; large surpluses may be explained by the remoteness of suppliers and high transportation costs).

- Disruptions in production may have increased the volume of unfinished goods (one should compare the growth rates for production and unfinished products on the balance sheet; one should also consider the turnover rate for unfinished products, analyze any changes in this rate and compare it to the lessee’s normal production cycle).

- Sales problems have increased the volume of finished goods in storage (one must compare storage volumes to the sum of advance payments received from buyers and analyze the lessee’s normal turnover rate for finished products).

- A decrease in consumer purchasing power has increased the lessee’s accounts receivable (one should analyze the lessee’s turnover and compare it to the sum of advance payments received and the volume of finished products).

Several factors can change the value of the lessee’s permanent assets:
- The sale or purchase of new fixed assets
- Depreciation of fixed assets
- Revaluation of fixed assets (this can be seen in the value of «Additional capital» under liabilities)

The lessor should also pay attention to changes in «Unfinished construction.» This item does not play any role in the lessee’s production process, and its growth can have a negative effect on the lessee’s financial results. On the other hand, a stable value under «Unfinished construction» may indicate that the lessee has frozen his building projects. A decreasing value usually indicates that the building projects are nearing completion (which should be accompanied by an increase in «Fixed assets»).

The lessor should analyze not only the changes in the lessee’s assets, but also liabilities. Capital investments should be drawn from long-term sources of finance, not from short-term liabilities. We will deal with this question in more detail when we examine the lessee’s financial stability.

In the next issue of the Leasing Courier, we will look more closely at methods of analyzing the lessee’s liquidity and financial stability.

This article incorporates materials from «How to Analyze an Enterprise’s Financial Situation: Essential Methods,» ALT Investment Company, St. Petersburg, 1999
Marina Valyerevna, please tell us about the history of your company. Who founded it and when?

Our leasing company, Lizing-Biznes Tyumen, was founded in May 1997 by Zapsibkom Bank and the Tyumen Shipbuilding Plant. One of the main reasons for forming the leasing company initially was to help the founders themselves acquire new equipment. Thus, our first deal was to supply twenty-five of Zapsibkom’s branches and subsidiaries with new computer equipment. Then came leases for automatic teller machines, money-sorting machines and vehicles. At the same time, the company was working on a plan to modernize the Tyumen Shipbuilding Plant. Of course we didn’t limit ourselves to these few contracts. We launched an aggressive advertising campaign and managed to expand our portfolio by attracting new companies.

One thing that made it easy for us to expand was the relative weakness of our competitors. In 1997 there were only four leasing companies in the region, two of which specialized in agricultural leases and had financial support from the regional government. A third focused exclusively on leasing its own products (air conditioners).

What sort of equipment is most in demand in Tyumen, and does Lizing-Biznes Tyumen do any business outside of the region?

Almost all of our lessees are located in Tyumen. The farthest we have ventured from home so far is to the neighboring districts of Khanty-Mansiysk and Yamalo-Nenetsk. The reason we limit our geographical range is to keep our overhead expenses down. Expenses really start to add up when you have to monitor assets in other regions.

As for the types of businesses that operate in Tyumen, most of them are in the oil and gas industries. Tyumen is also beginning to develop new industries, particularly timber, printing and communications, where it previously relied on other regions, like Sverdlovsk, Omsk and Novosibirsk, for these services. We have been getting more and more applications from companies in these industries.

At the moment, our lease portfolio includes a wide variety of equipment: bank equipment, office equipment, cars, trucks, road-building equipment, dental equipment, specialized equipment for television studios, pharmacy equipment, etc. But the two things that we lease most frequently are automobiles and computers.

Who finances your company’s lease agreements?

We have two main sources of finance: first of all our own working capital, which we have managed to accumulate over the years, and then commercial bank loans.

How many leases have you signed so far? What is the average size of your contracts and the average duration of your leases?

Lizing-Biznes Tyumen has signed 64 leases to date. We do not restrict the size of our contracts in any way, so their value tends to vary quite a bit - from $1,000 to 8 million rubles. The leases vary in length from one to seven years. So far this year we have signed nine new leases. Most of these were for automobiles (VAZes and UAZes). We also signed a lease for some wood-processing equipment and two leases for office equipment.

Obviously some of your equipment suppliers are not local.

That’s right. Our suppliers come from all over Russia: Novosibirsk, Yekaterinburg, Moscow, St. Petersburg and so on. We have even worked with suppliers from as far away as Belarus and Germany.

Does Lizing-Biznes Tyumen ever work with lessees that are just starting up their businesses?

Yes, we do sometimes work with lessees that are starting from scratch. We have signed four leases with private entrepreneurs, and we helped one small business get off the ground with a series of four equipment leases.
When working with small businesses, we have generally tried to make it easier for them by lowering our requirements as far as guarantees and collateral are concerned. We have found that even in the face of real adversity, these lessees tend to be iron-willed and usually generate enough revenue to cover their own expenses and meet all of their financial obligations.

Apart from leasing equipment, we have also granted some short-term loans to small businesses in order to give them an extra boost. This has generally yielded good results. With only one exception, all of these businesses have thrived. Unfortunately, we did have to terminate one of our agreements. That particular project had the misfortune to begin on the eve of the August Crisis, which none of us foresaw, and to this day that is the only project we ever had to cancel. Fortunately, we were able to sell the equipment at a considerable profit.

What are some of the major risks that your company faces, and how have you managed to avoid them?

The biggest problem is that some of our lessees have, at times, become temporarily insolvent for as long as a month or two. In order to avoid that kind of risk, we try to obtain as much information as possible about our potential lessees and their projects beforehand and to analyze that data thoroughly. Both our lawyers and our financial experts analyze the client’s documents, and we always send our experts out to the potential site to get a better feel for the people who will be running the project.

Another important way that we protect ourselves is by requiring guarantees from our lessees. Every one of our lessees has to provide us with a letter authorizing us to deduct funds from his account in the event that he defaults on his lease payments or incurs penalties for violating the terms of the lease agreement. We also require the lessee, or a third party, to offer some highly liquid form of collateral. Finally, the director of the enterprise himself must sign a guarantee agreement. All of these measures help discipline our clients and give them a greater personal interest in the outcome of their projects.

Of course any lending institution takes similar measures to protect itself against the risk of default. However, there are certain subtleties in the relationship between a leasing company and its clients. We go to great lengths to make sure that the lease payment schedule is really feasible for the lessee and that he still has enough cash left over after each payment period to cover his own expenses. If his business hits a snag, we do everything we can to help. We might, for example, grant him a payment deferral. We also try to use all of our connections (other clients, partners, etc.) to help our lessees. For example, we might persuade one of our other clients to supply a lessee with raw materials or components at discounted prices, or to distribute his products through his own retail network.

Do you face any other obstacles? If so, how do you overcome them?

I would say that we have three main problems. The first is the lack of affordable, long-term capital. The banks that we work with are doing quite well with short-term loans and do not see any particular need to invest in long-term projects.

The second problem is one that every leasing company in Russia has to deal with: the instability of Russian tax laws and leasing regulations. Unfortunately, the tax police and other inspection agencies often fail to keep up with changes in government policy, which prevents us from finding reasonable, workable solutions.
whenever the law changes in the middle of a deal. The same applies to the highway police, where automobile leases are concerned, as well as the State Registration Chamber.

The third problem is the fact that many lessees fail to understand how leases are supposed to work. Potential lessees often fail to recognize the advantages of leasing over other means of acquiring new equipment. In the hope of educating them, we have published several articles on leasing in the local press. Our experts have also come up with some educational materials that highlight the advantages of leasing over bank loans. Last year, the Tyumen Regional Committee for Industry and Entrepreneurship helped us organize two conferences: «The Principles of Leasing» and «The Legal, Economic and Tax Aspects of Leasing.» We invited company directors, financial managers and accountants from throughout the region. That is how we have tried to raise people’s awareness about the benefits of leasing.

Does the regional government do anything to support the local leasing industry? Has it passed any regulations to encourage leasing?

In February 2000, the regional government of Tyumen passed Law #158 on the Creation of a Leasing Fund for Regional Agriculture. This fund has been used to help Tyumen farmers lease equipment, property and livestock. It was created not only to support local farmers, but also the Tyumen leasing companies that specialize in agricultural leases (Tyumen Agricultural Leasing Company and Tyumen Agropromsnab [Agricultural Suppliers]). The regional government also drafted a Law on Investment in the Tyumen Region, which was aimed at improving the local investment climate (for leasing companies as well), but this law has not gone into effect.

So this is what we have to work with. There is some hope that the new regional government will learn from its neighbor, the government of Khanty-Mansiysk, which exempted leasing companies from local profit and property taxes as early as 1998. We hope that the new government will understand that the region’s leasing industry (and hence its overall investment climate) depends on well-functioning regulations and government support.

Finally, please tell us a little bit about Lizing-Biznes Tyumen’s plans for the future.

I think the chances are quite good that our company will continue to grow. Our latest advertising campaign has brought in a lot of new potential clients.

We are currently working on 11 new lease agreements with local small businesses. The municipal government of Tyumen has shown an interest in these projects, and we are hoping that the Federal Fund for Small Business Development will also give us some financial support.

We also hope that business will boom when our lending bank starts expanding its investment activities. Certain industries in Tyumen, such as the timber, construction and food-processing industries, are going to take off in the near future, and all of those companies will be looking to lease new equipment.

Thank you very much for speaking with us today. The Leasing Courier would like to wish Lizing-Biznes Tyumen success in its leasing projects!
The Petersburg Leasing Association was founded in 1999 by a consortium of six major leasing companies: Baltic Leasing, Baltinvest, Rust, The Petersburg Leasing Company, Anker Industrial Leasing Company and RT-Lizing, with additional support from the Russian Association of Leasing Companies. The consortium actually dates back to 1998, when the St. Petersburg Council for Foreign Investment invited these six companies to join its special committee for the improvement of local leasing laws. By 1999, we had all begun to realize that reforming St. Petersburg’s leasing laws was going to be a very long and difficult process. Our small committee was not really up to the task, so we decided to form a permanent body that would be capable of representing the interests of the entire leasing industry — not only leasing companies, but also lessees and equipment suppliers. We called our nonprofit organization the Petersburg Leasing Association. Despite the name, the organization is also open to banks, insurance companies, equipment suppliers and other interested parties.

The Association has set itself a wide variety of goals. First, it seeks to improve leasing laws at the federal level. Several members of the Association were invited to join the State Duma’s Working Group on Leasing Legislation under the Committee for Economic Policy and Entrepreneurship. The Association contributed a number of important suggestions for improving the Federal Law on Leasing and the new Chapter on Profit Tax. The Association pushed for consistent and stable regulations and government support for the leasing industry (in the form of tax incentives and other initiatives). These conditions would enable the Russian leasing industry to fuel the growth of Russian manufacturing.

The Association also tries to improve leasing laws at the regional level. The investment laws of St. Petersburg allow the city to offer certain tax benefits. With this in mind, we drafted a series of bills aimed at exempting lessees from local property, profit and highway taxes (on the condition that they reinvest the money they save into production). The Association’s other initiatives have included a drive to create the official title of «Authorized leasing company of St. Petersburg» and an ongoing attempt to obtain government guarantees for leasing projects. All of our bills have been approved by local government committees, and we hope they will soon be submitted to a vote by the Legislative Assembly.

The Association also provides consulting and training programs for all participants in the local leasing industry. Leasing is a complicated and fairly novel concept in Russia. One of the reasons that it has developed so slowly in this country is the fact that people are generally unaware of its benefits. We therefore have to enlighten the very parties that stand to benefit from leasing. With this purpose in mind, the Association holds regular conferences and seminars about leasing as a form of investment. Last year we held two leasing seminars in St. Petersburg, one of which was organized by the IFC Leasing Development Group.

Earlier this year, the Association organized a roundtable discussion on leasing at the international conference «Investment 2001: New Realities and New Possibilities for Russia’s Northwest Region.» One of the Association’s strategic aims was to help local leasing companies prepare to do business with foreign investors. Of course, foreign investors are unlikely to invest very heavily in the Russian leasing industry until the country itself earns a reputation as a reliable borrower. In the meantime, the Association’s authority will continue to grow as financial institutions — both foreign and domestic — turn to it for information about reliable partners. In the future, the Association also plans to help local leasing companies resolve disputes with the tax authorities.

One of our most important aims is to recruit new members. The Northwest region is currently home to around 60 registered leasing companies. We would be
The Northwest region of Russia contains eleven distinct political entities, each with its own investment climate. Unfortunately, there are no general data about investment in the Northwest. Each of the eleven regions, districts and cities keeps its own statistics, and no one has yet undertaken to synthesize the data into a unified whole.

Nevertheless, by comparing the data that is currently available, one can draw a number of interesting conclusions:

• In virtually every region, the total residual value of all fixed assets is currently falling at a rate of about 5-10% per year. This means that depreciation is outpacing the renewal of fixed assets.

• Throughout the Northwest, the level of investment in fixed assets declined steadily from 1991 until late 1998, when it finally began to rebound. In 1999, it grew by 1.8 times in Murmansk and 1.5 times in Karelia. As one might have expected, the trend continued in the year 2000.

As for the actual sources of investment, let’s consider some data from St. Petersburg as an example.

**LEASING AS A FORM OF INVESTMENT IN THE NORTHWEST REGION OF RUSSIA**

On a related topic, we present a survey of leasing in the Northwest region of Russia. The following article is based on a speech delivered by D.V. Korchagov, general director of Baltisky Leasing, at a conference in St. Petersburg (Investment 2001: New Realities and New Possibilities for the Northwestern Region of Russia) in March 2001.

Petersburg Leasing has clearly demonstrated that the development of leasing in Russia largely depends on regional initiatives. We therefore strongly encourage everyone to concentrate their efforts locally in order to be heard in Moscow.

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**Investment in Fixed Assets: Financial Sources**

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*Note: "-" indicates data not available. Figures in %

As you can see, the main source of funding for investment in fixed assets has always been, and continues to be, Russian companies’ own working capital, which accounts for some 46-53% of total investment in Russian industry. You can also see a clear decline in government funding. At the same time, external sources of capital have increased rapidly. One of these sources is leasing.

**Leasing has constituted a significant share of the region’s total investment:**

• Russia as a whole invested around $23 billion (659.3 billion rubles) into fixed assets in 1999.

• According to V. Cherkesov, President Putin’s representative in the Northwest region, the Northwest attracts around 16% of total investment in Russia. That means that in 1999, some $3.5 billion (100 billion rubles) was invested in the region.

• Throughout Russia, leasing accounts for some 4.8% of total investment in fixed assets. That means that the Northwest region poured around
4.8 billion rubles ($1.6 billion) into investment using leases in 1999.

- The city of St. Petersburg received 29.7 billion rubles’ worth of investment in fixed assets in 1999, including approximately 1.5 billion rubles in leases (one third of the Northwest region’s total). These are obviously very rough estimates, but they give us some idea of leasing’s role in the local economy.

Over the last few years, leasing has become more and more popular as a form of investment throughout Russia. Last December, the number of registered leasing companies in Russia reached 1,162. Most of these (75%) were concentrated west of the Urals, including some 40% in the cities of Moscow and St. Petersburg. However, according to the State Registration Chamber, only 25% of all registered leasing companies are currently active. This means that there are no more than 350 active leasing companies in Russia today.

What are the general prospects for leasing in the Northwest region?
Leasing is most common among industries that constantly require new equipment:

- Computers
- Telecommunications
- Automobiles
- Highway construction
- Machine building

There are several factors that could spur the growth of leasing in the Northwest region:

1. The strong demand for new equipment.
Around 60-70% of the region’s equipment is obsolete and will have to be replaced if we are to avert an industrial crisis. The need for new equipment is particularly acute in the following industries:

- Mining
- Metals
- Electric power
- Telecommunications
- Pulp and paper
- Logging and timber
- Transportation
- Shipbuilding
- Fishing
- Light manufacturing
- Food processing

2. The availability and affordability of investment capital. Let’s consider some of the main sources of finance and their current drawbacks.

- **Russian banks.** It is no secret that the level of capitalization among Russian banks is rather low. There is not enough long-term capital to finance large-scale leases, and interest rates are high.

  - The main players in the Northwest region are the Northwestern branch of Sberbank, the St. Petersburg Industrial and Construction Bank, and a handful of Moscow banks (Alfa Bank, Nikoil Financial Group, etc.). Regional banks are still too weak to invest in large-scale leases.

- **The regional government.** This has never been a significant source of funding, and these days it is actually shrinking as Moscow continues to centralize state spending.

- **Foreign investment.** This largely depends on government policy. The region will have to improve its credit rating if it hopes to be taken seriously by foreign investors. However, the region cannot realistically succeed at this task until such time as the federal government begins to improve Russia’s credit rating as a whole.

- **Russian companies’ own working capital.** This can be an ineffective source of funding, since it drains companies’ resources.

3. Developing the leasing industry itself. The number of professional leasing companies in the Northwest region currently includes:

- Alfa Leasing
- Baltic Leasing
- Baltinvest
- Delta Leasing and the RKM Leasing Center
- Dorleasing
- Leasing Ugol
- The Novgorod Leasing Company
- Promleasing (Cherepovets Metals)
- Rosagrosnab [Russian Agricultural Suppliers]
- RUST

  Improving the region’s leasing laws would also help stimulate the local leasing industry. The government must take measures to support leasing in the Northwest region. Such measures could include:

- Tax incentives for investing in leases
- State funds to finance leasing, especially for small businesses
- State guarantees and collateral funds
- Tenders for state leasing contracts.
KONTINENT PLAST, ST. PETERSBURG
How Packaging Company Expands Production Using Leasing

Eleonora Veitsman,
Public Relations Specialist
IFC Leasing Development Group

Continued from pg. 1

By 1998, Kontinent Plast had completed the renovations, installed all of the necessary electrical wiring and communication cables, built a new warehouse and purchased a foreign-made production line. The factory was up and running.

Almost immediately, Kontinent Plast’s new packaging products were in great demand. Not only were they of the highest quality, but also they were less expensive than their foreign-made equivalents. Orders started coming in from firms not only in Northwest Russia but also from firms in Moscow, the Moscow region, and other regions throughout Russia. The company soon realized that they would have to expand to keep up with demand. Though Kontinent Plast had enough funds at its disposable to purchase new equipment, they could not really afford to deprive themselves of so much working capital in the long run. Financing the purchase with a bank loan was problematic.

In February 2000, Kontinent Plast turned to the Baltic Leasing Company with a request for three new Kosmos injection molding packaging machines (for making buckets, containers, glasses and the like) and a Battenfeld extrusion machine for making bottles and canisters. The work involved in drafting the leasing contract was completed by the staff of Baltic Leasing very efficiently; all the formalities were taken care of in less than one month. The companies signed two separate lease agreements, each for terms of three years. The value of both deals was over $500,000.

The new equipment enabled Kontinent Plast to significantly diversify its production. Nine new types of packaging were added to its product line, and as a result the company’s turnover increased by 20%. It hired 32 new workers to operate and maintain the new machines.

Having experienced the benefits of leasing first-hand, Kontinent Plast is now convinced of the effectiveness of leasing as a financing instrument and plans to continue to use leasing in the future. The firm plans next to lease another Kosmos packaging machine. After using Kosmos equipment in its production and being pleased with the results, Kontinent Plast became the company’s official dealer and distributor in the CIS and the Baltics. Currently the firm is pursuing its new role as dealer and distributor with the help of leasing and is negotiating an agreement with Baltic Leasing. If the negotiations are successful, Kontinent Plast will enter into its next leasing agreement in a new role - as an equipment supplier.
In our last issue, we noted that ChuvashKreditprom Bank had agreed to finance leases through the Chuvashia Small Business Leasing Company. The first lessee to benefit from this partnership was Telefonstroy.

TELEFONSTROY, NOVOCHEBOKSARSK, REPUBLIC OF CHUVASHIA

Telefonstroy Manufacturing and Construction Company, the first and only cable television operator in the city of Novocheboksarsk (Chuvashia), specializes in building infrastructure for the telecommunications and electricity industries. To put it more simply, Telefonstroy lays cables.

The company currently brings nine cable channels to some 12,500 subscribers around the city. It has already invested more than 2 million rubles in its cable network. By the year 2005, Telefonstroy plans to bring cable to every street in Novocheboksarsk (42,000 apartments). The local landscape makes cable television virtually essential: Novocheboksarsk is situated in a basin where television reception is very poor. Soviet urban planning hasn’t helped: a typical neighborhood in Novocheboksarsk consists of a «core» of five-story apartment blocks completely encircled by nine-story buildings; those who live in the smaller buildings have virtually no hope of getting decent reception. Until 1999, when Telefonstroy started building its cable network, local residents had to content themselves with two or three channels broadcast from the nearby city of Cheboksary. In 1998, the municipal government finally authorized Telefonstroy to lay cables.

Building a cable network obviously requires some highly specialized and costly equipment. In December 1998, Telefonstroy took out a lease on a hydraulic hammer, which allowed the company to dig ditches for cables even during the long winter. This equipment was provided by the Chuvashia Small Business Leasing Company. Telefonstroy shared the costs of this project with Chester Construction, one of the region’s largest contractors. The hammer paid for itself within twelve months and is still seeing intensive use.

Last year, Telefonstroy took out a lease on a whole set of transmitting and receiving equipment: a base station, including broadcast and satellite modules for a headend, a satellite antenna (manufactured in Kazan) and German-made amplifiers and switches. The lease, which expires in 2005, was valued at a total of 180,000 rubles. Telefonstroy hired eleven new employees to operate and maintain the equipment, raising its total payroll to 70 people.

Telefonstroy has tried other means of obtaining new equipment besides leasing. «Last year we got
a loan for 300,000 rubles from the Small Business Development Fund,» explains Nikolai Lisin, Telefonstroy’s general director. «But we had to pay 80,000 rubles in interest out of our revenue, which was only 110,000, so the end gain was pretty small. Apart from the interest payments, we also needed money to develop our business, to cover our operating costs, to pay people’s salaries, and so on. We decided to stick with leasing. Leasing makes more sense to begin with in a business like ours, since most of our projects are fairly long-term. Banks rarely give loans for more than one year, while leases usually last for three. And with leasing we can actually get our hands on the equipment we need within a few days after signing the contract.»

The digging machine that Telefonstroy intends to lease is manufactured at the MTZ 82 Plant in Minkhevo (Moscow region). Telefonstroy is currently negotiating the terms of the lease with the Chuvashia Small Business Leasing Company. The two companies are expected to sign a three-year lease valued at 509,000 rubles.

In the future, Telefonstroy also plans to lease a new compressor to replace the one it has been using since 1996, as well as some specialized laboratory equipment for measuring cables.

By the end of this year, Telefonstroy will extend its cable network to two more neighborhoods, raising its total number of subscribers to 18,492. Its ultimate goal is to reach every home in Novocheboksarsk by the year 2004. The municipal government has also approved a plan to create the first local television station, to be operated by none other than Telefonstroy.

PS. As we were writing this article, we were informed that Telefonstroy and the Chuvashia Small Business Leasing Company have already signed a new lease agreement.

By Viktoria Struts
We are pleased to introduce a new staff member:

This May the IFC Leasing Development Group welcomed a new Deputy Project Manager, Greg Alton. Before joining the Group, Greg worked for several years as Second Secretary and Vice-Consul at the Canadian Embassy in Moscow. He also worked as an analyst at Troika Dialog Investment Bank. Greg holds a Master’s degree in public policy and economics from Princeton University and a Bachelor’s from McGill University in Montreal.

RUSSIA’S GOLD MINERS TAKE AN INTEREST IN LEASING

Aleksei Tropykhalin, Training Manager
IFC Leasing Development Group

On April 23-24, the city of Irkutsk hosted an international seminar on «Integrated Approaches to Financing Gold Mining Companies and the Advantages of Financial Leasing: Irkutsk 2001», organized by Western Pinnacle Mining of Canada and the IFC Leasing Development Group.

The Leasing Development Group’s interest in the subject is not by chance. The Group is financed by the Canadian International Development Agency (CIDA), and Canada occupies a leading position in mining projects throughout the world. While Latin America draws some 27% of Canada’s total foreign investments, Russia attracts only 6%. The Russian Ministry of Natural Resources and its Canadian counterpart have been working together to increase Canadian investment in the Russian mining industry since 1997, when the two countries formed a special Working Group on the Mining Industry within the Canada-Russia Intergovernmental Economic Commission. Last year, Russia and Canada signed a memorandum on the investment climate in the Russian mining industry, which identified the steps that must be taken if Russia is to attract more investment.

For many years, Russia obtained all of its gold from placer deposits, since this was by far the most inexpensive method of extracting the precious metal. Other countries, meanwhile, were developing effective methods of extracting gold from large ore deposits that contained relatively small amounts of gold. Russia is now moving towards this approach, and if the Russian government succeeds in improving the investment climate, Russia’s output of gold should increase severalfold.

This means that Russia’s eastern regions will gain in significance as a source of natural resources. Russia’s railroad infrastructure will make it possible to develop these new regions actively, to attract both foreign and domestic investors to existing projects and to use modern forms of finance in the gold-mining industry.

The Irkutsk region is a perfect example of a region with a highly developed infrastructure. In the 1990s, Irkutsk solidified its gold-mining industry, becoming the fourth largest producer in Russia. The region’s mines are currently at different stages of development. Gold placers are being mined fairly intensively, but ore deposits have hardly been touched. For example, 80% of placer deposits have been licensed and are either being developed or can be developed, while only 10% of ore deposits have been licensed for development.

Last year, Irkutsk produced 16 tons of gold - more than its previous record of 15,758 kg set in 1915, and 42% more than it produced in 1999. The local mining industry employed more than 10,000 people.
Nevertheless, there are some serious obstacles to the industry’s growth. The biggest problem for most local enterprises is the shortage of investment capital. Financial leasing could help them overcome this difficulty. During the «Irkutsk 2001» seminar, the IFC Leasing Development Group gave a presentation about the advantages of leasing as a form of investment.

The presentation was structured like all of the IFC’s seminars on «Leasing as a Means of Acquiring Fixed Assets,» but tailored to address the specific needs of the mining industry. Topics included a variety of legal, economic and financial issues related to leasing, as well as tax policies and accounting procedures for leasing transactions. The participants also learned about strategies for building effective partnerships with their leasing companies. The miners listened to these discussions with particular attention, since very few of them had had practical experience with leasing before.

The audience included representatives from the governments of Irkutsk, Buryatiya and Krasnoyarsk; Russian and foreign investors; representatives from the gold miners’ associations and processors; domestic and foreign equipment vendors and Russian financial institutions. Participants were invited to ask questions and take an active part in the seminar. Both local and national media were on hand to cover the event, and a separate press conference was held after the seminar.

The seminar clearly demonstrated that Russian and Canadian businesses are interested in working together to attract more forms of investment, including leases, to the Russian natural resources industry. It also proved that Russia and Canada can cooperate by exchanging technical know-how in the field of geological prospecting and by sharing information about possible joint activity in the raw materials market.

KRASNODAR HOSTS SEMINAR FOR LESSEES

On May 24, «Leasing as a Means of Acquiring Fixed Assets,» a seminar targeted especially for leasing recipients, was conducted in Krasnodar with support from Kubaninvest, a state-owned leasing company, and the Krasnodar regional government. This was not the first IFC event in the region. In 1999 the Leasing Development Group held a seminar on «The Principles of Leasing» in Krasnodar, which played an important role in stimulating activity in the local leasing sector.

The Deputy Head of the Regional Administration for Finance, Budgeting, Economics and Strategic Planning of the Krasnodar Regional Administration, A.A. Remezkov, opened the seminar by emphasizing the importance of developing new financial services — particularly leasing — in the Krasnodar region. He also announced that the regional government has allocated 100 million rubles this year from its budget for the development of leasing.

«Leasing as a Means of Acquiring Fixed Assets,» a seminar designed for both potential lessees and firms that already have experience with leasing, drew representatives from 170 local firms, including small- and medium-sized businesses, insurance companies and financial institutions. It is no surprise that local firms showed such a strong interest in leasing. Most of producers in Krasnodar is in urgent need of new equipment but many are unable to invest large sums of working capital or to commit themselves to expensive bank loans. The development of leasing in the region will make it possible for these companies to obtain new equipment, which in turn will raise productivity and create new jobs. As a result, the regional government will also receive more tax revenue.

Small- and medium-sized businesses play a crucial role in the region’s economic development. According to the Krasnodar city government, during the first quarter of 2001 there were 27 individual entrepreneurs per 1000 residents (a total of 20,600 people). Small-scale producers still account for approximately 10% of the region’s manufacturing sector. This figure reflects a great potential for growth in small-scale production.

There are currently nine licensed leasing companies in the Krasnodar region, but only six of these are active on the market: Inko-
AND, Kubaninvest, The Municipal Investment Company, Delta-Leasing, Krasnodaragropromnab (Krasnodar Agricultural Suppliers) and Yug Bank. During his presentation in the seminar, M.V. Kaklyugin, Deputy Director of The Municipal Investment Company, emphasized that there is strong demand for leasing services in the region. Nevertheless, local leasing companies face some formidable obstacles, such as an inadequate legislative and regulatory framework, limited access to financing, and a lack of understanding on the part of local entrepreneurs of the advantages of leasing. Despite these obstacles, The Municipal Investment Company continues to expand its leasing services on the local market. Its current portfolio includes food-processing, manufacturing and dry-cleaning equipment, as well as motor vehicles.

The seminar began with a speech by KADR’s director, Olga Andreyeva. Ms. Andreyeva noted that approximately half of Krasnodar’s 10,000 small businesses are run by women. «When we started sending out the invitations for today’s seminar, some people asked why we were discriminating against men. This is what I told them - women entrepreneurs distinguish themselves by their extraordinary dynamism. They also have a better grasp of management techniques and are much better at networking. Nevertheless, they rarely have the opportunity to gather as we have gathered here today. It is meetings like today’s that can help businesswomen expand their knowledge and improve their self-confidence.»

Seminar participants included directors of small- and medium-sized businesses, including a bakery, a furniture manufacturer, a fur factory, a fashion design company, a crafts distributor, and several auditing and consulting firms.

The seminar drew the attention of the city’s women entrepreneurs to leasing - an important source of financing that has yet to be widely understood and taken advantage of by the local business community. Leasing Development Group specialists provided comprehensive answers to a large number of questions from the audience. Two local leasing companies, Kubaninvest and Delta-Leasing, were also present and gave individual consultations to seminar participants.
CUSTOMS REGULATIONS

The State Customs Committee has suspended (until further notice) all interest charges on deferred customs duties for goods subject to the temporary import regime (Telegram #TF-9644 of April 23, 2001). Considering that the time limit for temporary imports is two years (after which the imported goods must either be transported out of Russia or reclassified as regular imports), this is certainly a positive development for the Russian leasing industry, as it effectively lowers import costs for leased assets.

Furthermore, enterprises will now be able to change the import status of their goods by submitting an application to the State Customs Committee, provided that they do not have any outstanding debts on customs duties.

ANTITRUST LEGISLATION

On February 28, 2001, the Antitrust Ministry issued Order #210 ratifying the Statute on Approval for Transactions Involving the Acquisition of Shares in, or Managerial Control over, Financial Institutions. This statute, which is based on the Law on Fair Competition in the Financial Services Industry, defines the procedures for:

1. Obtaining prior approval from the antitrust authorities for any transaction involving the transfer of more than 10% of a financial institution’s total assets, if its charter capital exceeds 5 million rubles

2. Informing the antitrust authorities of any transaction involving the transfer of more than 10% of a financial institution’s total assets, if its charter capital exceeds 5 million rubles

Since leasing companies are considered financial institutions, they must comply in full with these requirements.

CURRENCY REGULATION

On July 6, 2001, Federal Law #72-FZ (05/31/2001) on Amendments and Additions to the Federal Law on Currency Regulation will go into effect. Several of the law’s provisions will have a positive effect on both foreign trade as a whole and cross-border leases in particular:

1. Payment for the following export products will no longer require the approval of the Russian Central Bank: machinery, equipment, electronics (section XVI of the Foreign Trade Inventory of Goods (TNVED)), ground vehicles, flying vehicles and waterborne vehicles (section XVII of the TNVED), provided that hard-currency revenue is received within three years of the export date.

2. The list of noncommercial agreements exempted from control by the Central Bank has been expanded to include the following:

   • Payments for notary and legal services, as well as court, arbitration or administrative fees.

   • Monetary payments, such as fines, imposed by the courts or other law-enforcement agencies

3. Currency regulators must decide within two months whether or not to authorize a given transaction. They must also present valid reasons for all refusals.

4. The Law’s summary procedures for imposing fines and other sanctions have been replaced by Section 4 of the Code on Administrative Violations.

AGRICULTURE

On May 22, 2001, the federal government passed Resolution #404 on Measures to Support Agricultural Leasing, which authorizes the transfer of federal funds (in accordance with the Federal Law on the Russian State Budget for the Year 2001) to finance leases for agricultural machinery and pedigree livestock. Some federal funds will also be used to increase the charter capital of Rosagro Leasing Company.
ACCOUNTING

«Accounting for Fixed Assets», Accounting Regulation 6/01, has been confirmed by the Ministry of Finance (Decree 26N of March 30, 2001). The regulation establishes the basic accounting rules governing fixed assets for most organizations (save for financial organizations and state-funded institutions). The decree enters into force for the 2001 fiscal year and replaces the previous Regulation of 6/97.

The main differences in the new regulations over the previous are:
- The introduction of regulation two, which establishes the application of the regulation with respect to the investment of revenues in tangible assets.
- The change from a value-based criteria when transferring property to fixed assets; the applicable criteria will now be the expected usable life. Future sale of the asset is not to be considered, as assets should be capable of generating additional revenues in the future.
- The removal of the section regulating accounting for rental of fixed assets.2

Ministry of Finance decree No. 27N of March 30, 2001 introduces changes and additions to the normative acts governing accounting. The changes affect Accounting Regulation 9/99, «Revenues», Accounting Regulation 10/99, «Expenses», and regulation 11/2000 «Information on related organisations.» The changes explain in more detail the conditions under which operating revenues and expenses are accounted for and widen the list of ‘non-sales revenues and expenses’ (such as including the results of revaluing non-operational assets).

Regulation 11/2000 defines additional requirements for disclosing information about related companies and organizations in accounting reports. The changes take effect for the 2001 fiscal year.

NEW BILL OF AMENDMENTS TO THE FEDERAL LAW ON LEASING

On April 11, 2001, the State Duma’s Committee for Economic Policy and Entrepreneurship approved a bill of amendments to the Federal Law on Leasing and formally submitted it to the State Duma. The bill attempts to achieve the following:
- To bring the statutes of the Law on Leasing into agreement with the Russian Civil Code
- To remove most tax-related statutes from the Law on Leasing, since taxation is the prerogative of tax laws. The only tax-related provisions that were not expunged were those of a temporary nature; these will remain in effect until the new chapter on profit tax is added to the Russian Tax Code.
- To bring the Law on Leasing into partial agreement with current customs regulations for cross-border leases. It is hoped that the remaining contradictions (regarding customs waivers) will be resolved by means of amendments to the Russian Customs Code.
- To resolve inconsistencies within the Law on Leasing itself.

• To add new civil regulations that would facilitate the growth of leasing. Specifically:
• New general procedures for assigning legal responsibility for maintaining and repairing leased assets. The new procedures place full responsibility on the lessee, unless otherwise stipulated under the lease agreement;
• Provisions for rescheduling lease payments once per fiscal quarter, rather than the current limit of once per year;
• Provisions for insuring the lessor against the risk of default or other contract violations on the part of the lessee;
• Provisions for extending the legal requirements applying to certain types of property owners to either the lessor or the lessee, as agreed by the parties.

This bill of amendments is expected to pass its second hearing in the State Duma before the end of the Spring session (July 14).

2 In our opinion, the withdrawal of this section should not affect the basic accounting procedures for financial leasing. Since accounting for operations under a lease agreement are governed by Ministry of Finance Decree No. 15 «Accounting for operations under a lease agreement» of February 17, 1998, which repeated the relevant aspects included in Accounting Regulation 6/97 until the entry into force of Decree No. 15.
THE TAX CODE’S CHAPTER ON PROFIT TAX

In April 2001, the State Duma began consideration of a proposed Bill of Amendments and Additions to Part Two of the Tax Code and Other Tax Laws of the Russian Federation. The bill adds a chapter on profit tax to Part Two of the Tax Code.

The bill was drafted by a joint working group of the Ministry of Finance and the State Duma’s Budget Committee. It represents a compromise between the two reform bills that were submitted to the Duma in October 2000.

The new bill passed its first hearing in the State Duma on May 4, 2001, and is currently being reviewed by the Duma’s Budget Committee. The bill offers a more attractive tax regime for leasing transactions than either of its predecessors. Its main features include the following:

- Accelerated depreciation using a factor of up to 2 for declining balance depreciation - that is, double declining balance.
- The leased asset may be recorded on either the lessor’s balance sheet or the lessee’s.
- A grandfather clause: Enterprises may depreciate assets according to the methods, rates and acceleration factors that were in effect when the assets were transferred (i.e., the new tax regulations will not be applied retroactively unless the enterprise so chooses).
- Loan interest deduction for leasing companies: Companies will be prohibited from writing off loan interest if (1) the loan was granted by one of its founders (previous bills used the term «interdependent entities») or (2) if the sum of the loan exceeds the leasing company’s own working capital by more than 10 times (for other taxpayers, the limit is 3 times the sum of working capital).

Let’s take a closer look at the bill’s depreciation policies. The bill classifies assets into twelve depreciation groups according to their useful service life and defines two depreciation methods: straight-line and declining balance. Taxpayers will not be allowed to choose between these methods. Assets in depreciation groups 1-7 (useful service life of 1-18 years) must use the declining balance method, while assets in groups 8-12 (useful service life of more than 18 years) must use the straight-line method. Since most leased assets fall into groups 1-7, they will normally use the declining balance depreciation method. In other words, the depreciation rate, which is calculated on the basis of the asset’s useful service life, will be applied to the asset’s book value at the end of the previous year.

We should note that the new bill’s acceleration factor of 2 for leased assets represents a significant improvement over the last two bills. However, it is still less attractive than the current norm of straight-line depreciation and an acceleration factor of 3. Consider, for example, a piece of equipment with a useful service life of 10 years. Under current norms (acceleration factor of 3), it depreciates within 3.3 years, but under the new bill (factor of 2) the depreciation period increases to 4.9 years (note that depreciation for tax purposes in Russia is calculated on a monthly basis, which gives quite different depreciation charges than the equivalent yearly declining balance calculation). The distribution of depreciation charges looks like this:

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 4.9</th>
</tr>
</thead>
<tbody>
<tr>
<td>37.8%</td>
<td>61.3%</td>
<td>75.9%</td>
<td>85%</td>
<td>100%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 4.9</th>
</tr>
</thead>
<tbody>
<tr>
<td>30%</td>
<td>60%</td>
<td>90%</td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

In our opinion, the new bill is more progressive than its predecessors. However, some of its provisions remain unclear and require further refinement.

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1 We published a comparative analysis of these two bills, including their possible effects on the Russian leasing industry, in the November–December 2000 issue of the Leasing Courier (#6/12)
RUSSIAN LEASING NEWS

The Altay regional government has earmarked 150 million rubles to finance equipment leases this year. Altayagrosnab (Altay Agricultural Suppliers) received 40 million rubles, which it has already used to purchase 18 Don-1500 combines and 23 Nivas. All of the harvesters are fitted with motors from the Altay Diesel Plant. Throughout the Altay region last year, Altay Diesel Plant motors outperformed their competitors from Kharkov and Yaroslavl in terms of reliability, cost-effectiveness, durability and ease of maintenance. The new combines will soon be delivered to local farmers.

Altayskaya Pravda (Barnaul) April 3, 2001

RTK Leasing Company, a member of the Rostelecom Group specializing in financial leasing in the telecommunications industry, has floated its first bond issue for 500 million rubles. By striking out on its own (without any backing from Rostelecom), the company hopes to build its own credit history and gain access to foreign capital. The semiannual bonds were issued on April 4 via open subscription on the Moscow International Currency Exchange (MMVB) and have a yield of about 21%. Principal and Investment Bank oversaw the floatation. RTK Leasing will use the new funds to develop Internet and inter-city telecommunications by linking the Moscow Municipal Telephone Network (MGTS) to Rostelecom’s national network. Rostelecom will also contribute to the project. RTK Leasing’s bond offerings this year are expected to bring in up to $50 million. The company’s revenue from spare parts enabled it to invest 10 million rubles in leasing in 2000. The Samara region’s leasing program will provide local farmers with 200 combines (including 50 fodder harvesters) and 100 tractors (including 40 Russian-German Kirovetses) this year. The leasing program will also provide for the creation of eight maintenance stations throughout the region.

Kommersant (St. Petersburg) April 3, 2001

Inkasbank has lent 20 million rubles to the Russian Collection Association for armored vehicle leases. According to Inkasbank, the 85 new Praktik and Konalyu armored cars will enable the association’s 30 regional branches, which provide cash delivery services, to transport money more securely. Inkasbank’s subsidiary, Inkas Service, will also take part in the deal. The leases have been signed for a three-year period.

Kommersant (St. Petersburg) April 3, 2001

Samaraoblagpromsnab (Samara Regional Agricultural Suppliers) has won a tender for agricultural equipment leases backed by guarantees from the Samara regional government. The number of contenders for the government contract doubled this year, but Samaraoblagpromsnab was able to offer the most competitive terms. Leasing constituted 18% of the company’s business last year, while retail sales of machinery and spare parts accounted for the remaining 82%. The company’s revenue from spare parts enabled it to invest 10 million rubles in leasing in 2000. The Samara region’s leasing program will provide local farmers with 200 combines (including 50 fodder harvesters) and 100 tractors (including 40 Russian-German Kirovetses) this year. The leasing program will also provide for the creation of eight maintenance stations throughout the region.

Volzhskaya Kommuna (Samara) April 3, 2001

On the sixth anniversary of its incorporation, Yarmarochny Bank officially opened its third branch in the Priok district of Nizhny Novgorod. The new branch will serve as a universal bank, offering a full range of services to both private and corporate clients. The Priok branch will also administer the bank’s new leasing program, offered in association with Delta Leasing, part of the TUS-RIF group. The leasing program will make more funding available to the local leasing industry.

Monitor (Nizhny Novgorod) April 16, 2001
Leasing comprises 30-35% of agricultural equipment sales in developed countries, but only 2-3% in Russia, according to Avtoselkhozmash Holding Company. Even though Russian harvesters cost only one-third the price of imports, they are still too expensive for most Russian farmers. Given the reluctance of Russian banks to issue long-term loans, leasing is just the sort of tool that might save Russian farmers, experts believe. At the same time, the Russian Leasing Fund, which was created in 1994 and remains to this day the only real form of state support for Russian farmers, has been growing at an agonizingly slow pace. The Fund received only 7 billion rubles in the year 2000, while demand easily exceeded 30 billion last year. During the first quarter of 2001, the Fund will invest 1 billion rubles in agricultural leases. The federal government will invest a total of 3 billion rubles in leases by the end of the year.

Novosti Russian Information Agency
April 23, 2001

The Northwestern Logging Company (SELK) has signed a deal with Sberbank’s leasing subsidiary, Globus Leasing, to lease new equipment for its offset paper factory in Kamennogorsk. The agreement is valued at over $3 million. Under the terms of the agreement, Globus Lizing has taken out a loan from another subsidiary of Sberbank, Northwestern Bank, to purchase two new paper production lines from Germany’s E.S.N. Will GmbH, which it will lease to SELK for a period of five years. The production lines will be installed at the Kamennogorsk Offset Paper Plant, a member of the SELK Group. The first line will be launched in June of this year, and the second in September. SELK also plans to lease other types of equipment from Globus Leasing for its Kammenogorsk factory this year, including stacking-machines, compressors and electric carts. The Northwestern Logging Company plans to focus its investments not on expanding production volumes, although production is at full capacity, but rather on improving quality and selection, lowering production costs and renovating its aging facilities.

Delovoy Peterburg (St. Petersburg)
April 24, 2001

Farmers in Tatarstan have leased more than 700 tractors and combines. The first batch of 110 Don grain-harvesters was shipped to Tatarstan on April 24, according Nail Suleymanov, department chief for the Tatagropromkomplekt Leasing Compa-

ny. Since the beginning of the year, Tatagropromkomplekt has supplied local farmers with 200 Don combines, 54 Yenisey combines, and 475 DT-75 caterpillar tractors worth a total of more than 470 million rubles. All of these machines have either been leased or sold on deferred payment (hire-purchase) plans. The leasing company has cut its margin to a mere 1.5%. Over the last decade, the region’s farmers have not been able to afford straight purchases of new equipment, so leasing has become the preferred means for renovating and modernizing local farms.

ITAR-TASS
April 24, 2001

The Almaz Maritime Plant in St. Petersburg has started manufacturing a unique passenger ferryboat that makes use of an underwater propulsion system. Hansa Leasing Eesti of Estonia placed the order for the vessel, which will be operated by Linda Line Express. The vessel, known as the Superfoil, was developed jointly by M.T.D. of St. Petersburg and L.D.G. of Sweden. The ferry will be able to attain the unprecedented speed of 55 knots (107 km/h) while maintaining a high level of passenger comfort. The 40-meter passenger catamaran will be made of Russian aluminum alloy. The main deck will contain high-comfort economy and business-class salons with a seating capacity of 300. Most of the technical components will be foreign-made. The deal with Hansa Leasing Eesti represents the first foreign order for a Russian passenger vessel in the last ten years. The ferry will be tested in April 2002 and, if all goes well, it will be delivered in May.

Novosti Russian Information Agency
April 25, 2001

The Southern Urals Chamber of Commerce and Industry plans to create a regional fund for leasing guarantees. According to the Chamber’s president, Fyodor Degtyaryov, lessees in the Chelyabinsk region must be able to offer guarantees to commercial banks in order to obtain long-term loans and equipment leases. Most local firms do not have enough assets to offer as collateral. By pooling their assets in the Chamber’s guarantee fund, they will be able to obtain more long-term funds to renovate and modernize their facilities. The Chelyabinsk Regional Property Fund has already signed a partnership agreement with the Chamber to lease new equipment to regional enterprises.

Ural Press Inform (Chelyabinsk)
April 26, 2001
The Bank of Moscow (Bank Moskvy) has begun to take an active interest in the Urals region. The bank’s main shareholders include the Moscow City government (62.7%), Lukoil, Surgutneft, Mosenergo and Sheremetevo Airport. The Bank of Moscow is the authorized bank of the Sverdlovsk regional government and belongs to the Regional Union of Defense Enterprises. The bank’s Ekaterinburg branch offers a full range of banking services, including corporate accounts, many types of loans, guarantees and leasing plans.

Urals Business News Information Agency
April 30, 2001

The Pskov Regional Fund for the Support of Small Business has won a nationwide competition to participate in the Federal Program for Small-Business Development. The program is awarding valuable contracts for its ongoing small-business development project for the years 2000-2001. Contenders for the prize included banks, leasing companies and small-business development programs from 38 Russian regions. The federal government has announced eleven winners. The Pskov Regional Fund will receive 3.5 million rubles in funding, part of which will be used to finance leases.

Nota Bene Information Agency,
May 4, 2001

St. Petersburg Bank and Petroconsult Leasing Company have agreed to cooperate on leasing projects. In order to expand its range of services, St. Petersburg Bank had already signed similar agreements with several prominent local leasing companies, including Baltic Leasing, PL Leasing, Russky Mir and Rosstro Leasing. The bank and its new partner, Petroconsult, have already worked out a set of procedures for their joint projects. They have taken into account the great flexibility that leasing plans allow, particularly in regard to payment schedules, which helps ensure that lessees remain solvent. One of the principal advantages of leasing, from the lessee’s point of view, is that it does not require a large investment of working capital. It also offers a financial alternative to companies that do not have access to affordable bank loans. Petroconsult and St. Petersburg Bank have already signed three lease agreements valued at a total of 3 million rubles. The lessee under these agreements is St. Petersburg Bank itself, which will lease banking equipment directly from the leasing company.

Nevskoe Vremya (St. Petersburg)
May 4, 2001

Farmers in the Kirov region will now be able to lease new equipment. Governor V.N. Sergeyenkov has authorized Vyatkaagrosnab (Vyatka Agricultural Suppliers) to use 50 million rubles in federal funds to supply regional farmers with new machinery. The Kirov Regional Department of Finance will guarantee repayment of the funds.

Vyatsky Kray (Kirov)
May 9, 2001

Farmers in Krasnoyarsk have already begun to receive new machinery through the federal leasing program. The first shipment included 12 tractors, 6 feed-harvesters and 6 grain-harvesters, worth a total of 37 million rubles. Some of the machines will be given to private farmers, while others will be distributed among the larger agricultural producers. The leases will be paid off gradually over the next 5-7 years. The region expects to receive 90 million rubles worth of farming equipment through the federal leasing program this year.

Gorodskiy Novosti (Krasnoyarsk)
May 15, 2001

The Russian government plans to create a state-owned leasing company to provide new equipment and pedigree livestock to Russian farmers. According to Vice Premier Aleksei Gordeyev, the federal government has invested around 11 billion rubles in leases over the last few years. However, new budget regulations will classify all funds earmarked for leasing programs as federal loans, which means that these funds will have to be guaranteed by established banks. Russian banks are not yet ready to guarantee such large sums. One possible solution would be to create a state-owned leasing company capable of financing leases out of its own working capital.

Ekho Moskvy Radio Station
May 15, 2001

On May 16, the Russian Agricultural Bank (Rosselkhozbank) and the Belarussian Agro-Industrial Bank (Belagroprombank) signed a general partnership agreement, which stipulates, among other things, the creation of a joint leasing company, RB Leasing. The two banks will cooperate on developing agricultural finance in both countries, as well as on financing the production, processing, storage and distribution of agricultural produce. They will also participate in joint investment projects, including agricultural
equipment leases. Rosselkhozbank and Belagroprombank will make equal contributions to RB Leasing’s charter capital. The company will lease Belarussian tractors to Russian farmers. Belarus currently supplies its tractors to Russian farmers as a form of payment for Russia’s natural gas exports. By enabling payments through a unified structure, RB Leasing will be able to lower the cost of new tractors to Russian farmers by almost 40%.

Novosti Russian Information Agency
May 16, 2001

The Russian government plans to open bidding for state contracts under a new leasing program for Russian aviation technology. Vice Premier Ilya Klebanov made this announcement during a session of the State Duma. The vice-premier explained that several leasing projects are already underway to supply Russian airlines with 21-25 modern Russian aircraft. The federal government has decided to underwrite risk insurance for 85% of the total value of these contracts. The aircraft will be leased for periods of 8-10 years. The federal government will also subsidize bank loans used for these projects, lowering interest rates to 11-12%. The government does not intend to limit its support to these projects, and plans to continue financing aviation leases over the next 6-7 years. The vice-premier believes this will allow sufficient time for Russia’s commercial banks to be convinced of the creditworthiness of leasing deals. Investors had been rather skeptical of the government’s previous assurances that it had already created all of the necessary preconditions for Russian aviation leasing. But last Tuesday’s historic delivery of a Tu-214 to Dalavia Airlines under lease from the Gorbunov Aviation Plant has rekindled hope for the resurrection of Russia’s aviation industry. Ilya Klebanov predicts that the federal leasing program will help the industry get back on its feet. By the year 2015, he says, more than 1000 Russian aircraft will already be in service.

Izvestiya Moskva (Moscow)
May 24, 2001

FOREIGN LEASING NEWS

The government of Belarus has begun to consider ways of helping its farmers through this year’s harvest. It is already working on several major lease agreements for new grain harvesters. In particular, Belagrosnab is hashing out the details of an agreement with Rostselmash, the foremost supplier of grain-harvesting combines on the Belarussian market. The agreement would bring 370 new Don combines to the Belarussian countryside by the end of June 2001.

Belorusskaya Delovaya Gazeta (Minsk)
April 5, 2001

A new bill of amendments to Ukraine’s Law on Leasing, which draws a legal distinction between the concepts of «leasing» and «rent,» has passed its second hearing in the Supreme

Novosti Russian Information Agency
May 22, 2001
The bill would redefine leasing as a kind of commercial transaction, rather than a specific type of business activity, as it is defined under current law. The bill defines leasing as the temporary, paid use of an asset for a specific purpose, including assets specifically acquired on the lessee’s request in accordance with the terms of a lease agreement concluded with the lessor. The bill also imposes far fewer restrictions on the specific terms of a lease agreement. For example, it abrogates the current requirement that the lease period exceed 60% of the leased asset’s depreciation period, as defined on the day when the agreement was signed, and that at least 60% of the leased asset’s original book value should be compensated through regular lease payments over the duration of the lease.

**UNIAN (Kiev)**
*April 5, 2001*

**Latvia has a new Internet site, www.krediti.lv, which may serve as a useful aid to local residents planning to take out leases or commercial bank loans.** The site will contain information about virtually every existing type of credit. Visitors will be able to «try out» various kinds of loans by filling out an on-line questionnaire. Several of Latvia’s most prominent leasing companies are participating in the site, including Hanza l-zings, Unil-zings, Vereinsleasing, R-gas l-zings and Optiva l-zings, as well as Maras banka, Aizkraukles banka and the Baltic-American Business Fund.

**Chas (Latvia)**
*April 17, 2001*

**Kazakhstan will begin to produce tofu with specialized machinery leased from America.** The country’s new production line will be launched this August. According to Pyotr Potapov, general director of Vita Foods, America’s Intaprom is the only company that sells the right kind of technology for producing tofu. The tofu production line will cost Kazakhstan $600,000. Mr. Potapov believes that Kazakhstan’s soya beans surpass America’s in terms of both oil and protein content. Nevertheless, the United States produces 160 million tons of soya annually, while Russia produces only 1 million tons and Kazakhstan a mere 3,000 tons. Kazakhstan plans to sow an additional 7,000 hectares of its high-yield soya beans in the Almaty region this year.

**KazAG Information Agency (Almaty)**
*April 23, 2001*

**Ukraine and Kazakhstan have signed two agreements for a joint venture to produce agricultural machinery in Kazakhstan using Ukrainian components.** The machinery will subsequently be leased to Kazakhstani farmers. Ukragromashinvest Leasing Company represented Ukraine, while KazAgroFinans signed for Kazakhstan. The contracts are part of an intergovernmental agreement between Ukraine and Kazakhstan for the joint production of agricultural machinery. According to the contracts, 10 new Nan harvesters, fitted with components from the Lan Harvester Company in Aleksandria, Ukraine, and adapted to Kazakhstan’s local conditions, will be manufactured in Kazakhstan in time for this year’s harvest. The joint venture will also produce 300 Lan binders. All told, Ukraine will supply Kazakhstan with $3.37 million worth of components, which will constitute 60% of the machines’ value.

**UNIAN (Kiev)**
*April 23, 2001*

**Azerilizing continues to seek an investor to buy out one of its founders, Garanti Leasing of Turkey, after the latter decided to pull out of the company in order to focus on its own domestic market.** Azerilizing was founded in 1999 by a consortium of the International Bank of Azerbaijan (40%), Garanti Leasing (50%) and the International Finance Corporation (10%). Garanti Leasing has authorized its partners to sell its shares to a third party. The partners had expected to find a new co-founder by the end of 2000, but the search continues to drag on with no end in sight. The European Bank for Reconstruction and Development has promised to help search for potential partners.

**Trend Information Agency (Baku)**
*April 24, 2001*

**In March 2001, the Latvian Leasing Association’s total leasing portfolio reached almost 60.2 million lats.** The association includes the commercial banks Baltijas Tranzitu banka, Latvijas Krajbanka and Pirma Latvijas komersbanka, as well as the leasing company Parekss lizings. Parkess had by far the largest leasing portfolio within the group: 48.9 million lats, or 81.2% of the group total.

**Baltic News Service (Riga)**
*May 21, 2001*
QUESTIONS & ANSWERS

During a recent audit, the local tax authorities, referring to their own internal documents, told us that we cannot use accelerated depreciation for tax purposes. They insisted that the legal acceleration factor of 3 could only be used for bookkeeping purposes. Is this true?

No. An acceleration factor of 3 may be used for tax purposes. The law that currently regulates the composition of a company’s deductible expenses is the Statute on the Composition of Expenses that May Be Included in Production Costs and on Procedures for Calculating Financial Results for Tax Purposes, confirmed by Government Order #552. According to Clause 9 of this statute, “Depreciation of Fixed Assets” may include all depreciation charges on production facilities, calculated on the basis of their residual value in accordance with legal procedure, including the legal rate of accelerated depreciation.

Article 31 of the Federal Law on Leasing (10/29/98) gives the parties to a lease the right to apply accelerated depreciation to leased assets using a factor of 3. At the same time, Clause 9 of the Statute on the Composition of Expenses clearly states that accelerated depreciation may be used to lower a company’s taxable base.

No. An acceleration factor of 3 may be used for tax purposes. The law that currently regulates the legal acceleration factor of 3 could only be used for bookkeeping purposes. Is this true?

Russian law does not place any restrictions on leasing used assets. Leasing companies may therefore lease assets that have already reached their full term of useful service life.

The leasing company should record used assets in their books at their acquisition price, as specified under the sales agreement, including any additional expenses arising directly from the purchase.

As for depreciating the used assets, these procedures are set out in the Tax Ministry’s Letter N VG-6-02/731 of Sep. 11, 2000. According to this letter, if a used asset has already reached its full service life, the buyer is free to establish a new service life. Depreciation charges are then calculated accordingly. For example, if the service life is fixed at 4 years, the annual depreciation charges would be 25% over a four-year period.

When a used asset is leased, the service life may be pegged to the duration of the lease itself. According to Letter N VG-6-02/731, these depreciation policies only apply to fixed assets that were purchased after January 1, 2000, and only if their original book value was calculated in accordance with the Statute on Recording Fixed Assets and the Methodological Instructions on Bookkeeping for Fixed Assets.

For bookkeeping purposes, depreciation should be charged in accordance with the Accounting Standards, which allow for four possible depreciation methods: straight-line depreciation, the declining balance method, the sum-of-years digits method, or the units of production method.

1 However, leasing companies cannot lease assets unless they were purchased for a particular lessee. In other words, they cannot lease any assets that were already in their possession. Such assets can only be rented under ordinary rental agreements and do not qualify for any tax benefits.

2 Clauses 7-8 of Ministry of Finance Order 26n on Confirmation of Accounting Standards for Recording Fixed Assets (03/30/2001).
Can spare parts or components, such as a carburetor or an engine, be leased under a lease agreement?

Spare parts and components can be leased, but one should be aware of the following technicalities.

According to Article 666 of the Russian Civil Code, any «non-consumable thing» may be leased. Thus, spare parts and components may be leased as long as they are not consumed or fundamentally altered during use (Article 607 of the Russian Civil Code).

Furthermore, the parts or components must be separable from the lessee’s main piece of equipment. The lessee must be able to return the leased parts without causing damage to his own equipment.

Does a leasing company need to have a license to sell motor vehicles if it wishes to transfer ownership of an automobile to a lessee upon expiration of a lease?

The Statute on Licensing for Trade in Motor Vehicles (confirmed by Government Order 1227 of November 5, 1999) defines «trade» in motor vehicles as wholesale supply, retail sale and commission trade. A literal interpretation of this statute implies the following:

- Transferring ownership of a motor vehicle to a lessee upon expiration of a lease cannot be considered retail¹ or commission trade.

- For licensing purposes, only wholesale supply is defined as «trade.» Therefore, the lessor does not need a license in order to transfer the ownership rights to a single automobile upon expiration of a lease.

If the lease involves more than one automobile, the situation becomes somewhat more complicated. Government Standard R51303-99 defines wholesale trade as trade in goods for subsequent resale or commercial use. The term «commercial use» could certainly be applied to most leases; it might therefore serve as grounds for requiring a leasing company to obtain a license to sell motor vehicles. Accordingly, it might also serve as grounds for imposing penalties on leasing companies that fail to obtain this license. One way to avoid this problem would be to sign a separate lease agreement for each automobile.

Do corporate procedures outlined in federal legislation for concluding large-scale transactions apply to leases?

Leasing companies do not have to fulfill any additional requirements to enter into either a lease agreement or a loan agreement, no matter how valuable the leased property. According to Article 78 of the Federal Law on Joint-Stock Companies, any transactions concluded as part of an enterprise’s routine business activities are not considered large-scale and therefore do not require special approval by the board of directors.² Since lease agreements are part of a leasing company’s «routine business activities,» they

¹ Article 492 of the Russian Civil Code defines retail trade as a public agreement whereby a good is transferred to a new owner for personal, family, home or any other non-commercial use.
should not be subject to corporate regulations for large-scale transactions. The same can be said of loan agreements: as long as they are part of a company’s routine business activities, they should not be subject to these regulations, no matter how large the sum of the loan. Of course, the company charter of a leasing company may outline specific internal requirements for large transactions which would need to be respected.

The lessee, on the other hand, may be subject to both Article 78 of the Law on Joint-Stock Companies and Article 46 of the Law on Limited Liability Companies, since acquiring costly assets is not part of the lessee’s routine business activities.

According to these two laws, a company’s board of directors must unanimously approve any transaction valued at 25-50% of the company’s total assets. If the directors cannot agree, the shareholders must vote on whether to conclude the transaction. Any transaction valued at more than 50% of a company’s total assets must be approved by a 75% majority of the shareholders present at the shareholders’ meeting. If a limited liability company has formed a board of directors, it must follow the same procedures; otherwise, any transaction valued at more than 25% of the LLC’s total assets must be approved at a general officers’ meeting.

3 See Letter #62 of the Presidium of the Supreme Arbitration Court (March 13, 2001), Clause 5, on Conflict Resolution for Large-scale Transactions.