Aoyama Sogo Accounting Firm Innovation Speed Quality

NewsLetter

Aoyama Sogo Accounting Firm

Vol.22 5/31/2023

Chairman's Column

Japan Lease Accounting Standards to change in the future

(Credit: Dentsu)

Hello all. Today, I will talk about the draft accounting standards for Japan related to lease transactions. Lease transactions are transactions whereas the lessee borrows and utilizes stores and facilities. There are basically two types of leases. One is a finance lease which essentially places the burden of all liability on the lessee. All other leases are classified as operating leases.

Until now, the lessee had only recorded finance leases on the balance sheet. However, under this draft, in general principle, the lessee will be required to record all assets and liabilities related to the lease. The intent is to align the Japen accounting standards with IFRS and to more accurately reflect the financial position and performance of companies so that investors can more easily evaluate companies.

The draft is expected to be applicable starting 2026. If the standards take effect, there is a possibility that some industries may see big changes on their balance sheets. For example, assets and liabilities on the balance sheet may increase for companies that lease property and subsequently sub-lease to tenants and likewise for retail companies that rent storefronts. For example, companies like Daito Trust Construction, Daiwa House, and AEON are applicable in this context.

Furthermore, the accounting treatment of sale and leaseback transactions, where real estate like office headquarters and logistics warehouses is sold and subsequently leased back for continued occupancy, will also change. Previously, this type of transaction had the advantage of separating real estate from the balance sheet. However, under the new lease accounting standards, depending on the contractual terms, the shrinking effect on the balance sheet may be diminished.

To provide a clearer picture, you can think of Dentsu Group, Avex, and Recruit Holdings, which have made such transactions in the past.

The new lease accounting standards have the potential to significantly impact corporate finance. Therefore, providing careful explanations to investors and other stakeholders is crucial. While the underlying business remains unchanged, the balance sheet itself will change, which may lead to a decrease in metrics such as return on total assets and equity ratio.

This concludes the overview of the draft for the new lease accounting standards. As professionals in accounting, it may feel unfamiliar since we are accustomed to record just the finance leases on the balance sheet. Moving forward, the draft will be finalized after getting public feedback. Companies and investors are advised to consider their preparations for the new lease accounting standard based on this draft.

by Kazuhiro Matsuzawa, Chairman

Renewable Energy

The Plan for Battery Storage Funds

One of the challenges of renewable energy is balancing supply and demand. Energy storage technologies are crucial in stabilizing the fluctuating supply of renewable energy. We have been receiving more and more inquiries about structures that invest in battery storage.

The battery storage business is the business of utilizing rechargeable batteries to stabilize power supply and demand. Unlike the feed-in tariffs (FIT) for renewable energy, there is no fixed purchase price, so it does not ensure stable income. Instead, revenue depends on the daily movements of various markets, and it becomes a business where you buy electricity for cheap in the market when there is surplus, then store and sell it for a profit when the price rises.

Tokyo is facing both a climate crisis and an energy crisis. To overcome these immediate issues and aim for a systematic transition towards decarbonization and improved energy self-sufficiency, they will implement measures centered around 'reduction (H)', 'creation (T)', and 'storage (T)' energy, referred to as 'HTT'.

From April 28 to May 31, 2023, they are recruiting operators for the renewable energy/battery storage fund. The purpose is to promote a broad-scale implementation of grid-scale batteries that can contribute to the stabilization of power systems. To establish a finance model for grid-scale batteries, a public-private partnership fund will be setup with capital of 2 billion yen. The plan is to establish four new funds in FY2023, with a total investment of 150 billion yen to build out battery storages and charging infrastructure.

In addition, the amendment of the Electricity Business Act in May 2022 has gradually expanded the battery storage market as a component of the power generation industry. We look forward to future opportunities in serving SPC structures for battery storage.

by Kenichi Shimizu, Corporate Officer

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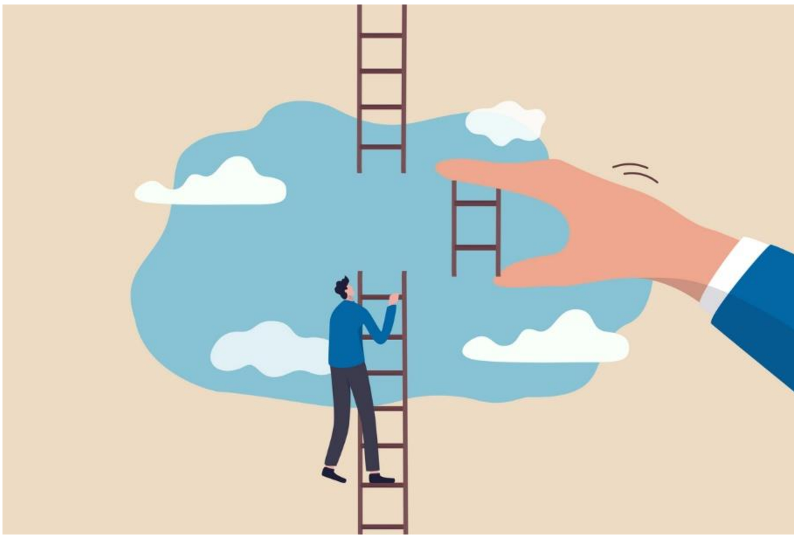
Venture Debt

Fund-raising through Venture Debt



For startups, one method of fund-raising is the use of venture debt. Considered the startup capital of the world, the U.S. has been widely using it for a while now, and it's slowly spreading in Japan as well.

Among those using venture debt are subsidiaries of financial institutions, independent firms, and venture debt funds. Among the types of securities, there are loans and convertible bonds. Most loans seems to have short-term financing periods of 6 to 18 months and annual interest of 5 to 10%.

In general, startups need sufficient time after establishment to become profitable, and in seed and early-stage funding, equity is issued to angel investors and venture capital. In the mid stage to pre-IPO late stages, companies often borrow from multiple financial institutions in addition to venture equity funding.

So, what are potential uses of venture debt which typically has short financing periods and high interest rates relative to typical borrowings from financial institutions? One use may be to bridge financing between investment rounds. Typically, as startups grow, they go through series A to series B to series C equity investment rounds.

However, not all startups succeed in securing sufficient capital. For example, if the next investment round is in one year and the company does not expect financing from a financial institution because of their continued operating losses, their working capital may run short. In this case, venture debt is a viable funding option to keep the company afloat.

Another case where venture debt becomes useful is to prevent dilution of the founder's shares. There's often news of startup founders who make a fortune through the sale of their shares through an IPO or M&A deal. The greatest reason is that these founders held a good portion of their startup's stock. If on the other hand, funds were largely raised through equity from outside investors, the ownership shares of the founder would gradually be diluted. For the founder who poured his life into the startup, his ownership shares in the company would decrease. In such a case, the combination of equity and venture debt prevents dilution of the founder's shares while securing necessary funds.

Since around last year, due to the turmoil in the capital markets, I hear that venture capitalists are becoming more cautious with startup investments. Tough conditions will likely continue for startups as some are facing lower equity prices in a down round from the previous investment round.

As one form of capital in supporting the Japanese startup ecosystem, I certainly hope more opportunities arise in the future for utilizing venture debt.

by Jun Yoshioka, ASA Advisory

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Japan Real Estate

Unizo Holdings files for Civil Rehabilitation (Bankruptcy)

It was reported that Unizo Holdings filed for civil rehabilitation on April 26th, marking the largest bankruptcy of the year with reported debt of 126.2 billion yen. Coincidentally, our company newsletter started internally two years ago (2021), and the first article was about Unizo Holdings. That article is reposted below to provide a better understanding of the past that led to the current situation (The title of the article was named “The Spring Storm” to describe the unseasonal severe storm that swept through much of the Kanto region).

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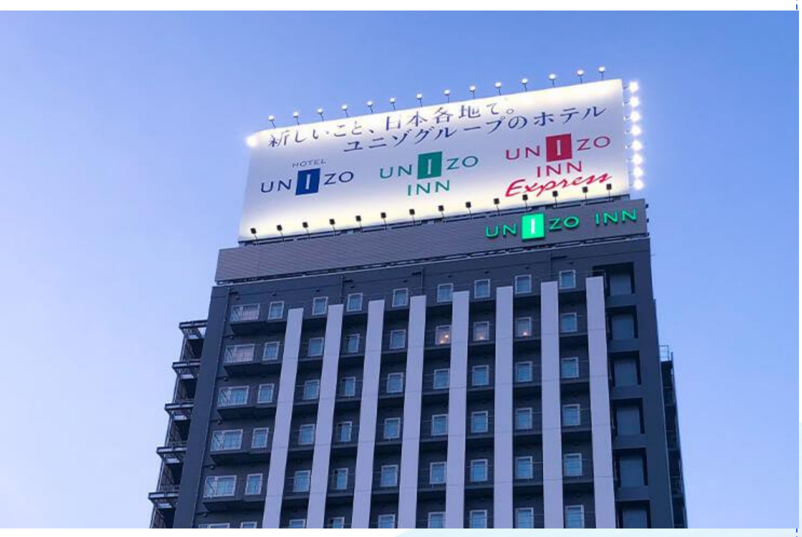

The Spring Storm

Another year is passing without seeing the cherry blossoms. On the other hand, the state of emergency will be lifted on the 21st and there are reports overseas that the vaccine is effective.

Besides Covid news, Unizo Holdings, which is a real estate firm affiliated with the former Industrial Bank of Japan (currently Mizuho Financial Group) has gained a lot of attention. Starting with the attempted TOB(tender offer bid) by travel giant HIS, 8 companies including Fortress, Blackstone, Elliott, and Ichigo subsequently began a bidding war for the undervalued stock comparative to the unrealized gain from property holdings. The deal ultimately settled as an EBO (employee buyout) with Loan Star as the sponsor.

Meanwhile, in the real estate market, Unizo had accelerated the sales of their properties in the past one or two years. The move was a complete 180 of the company’s previous position of actively buying. There is speculation that the property holdings were hastily sold to make repayments on the 200 billion yen debt from Loan Star and the tens of billions in premium. It seems that the rush to sell in combination with capital outflows resulted in the company becoming insolvent and their corporate bonds being downgraded to junk (non-investment-grade bonds).

Currently, the focus is on the “agreement” between the SPC “Chitocea Investment” for EBO use and Unizo Holdings. Simply put, the agreement states that “if Unizo Holdings decides to repay any specific creditors back, the other creditors should be protected by receiving collateral or be repaid before maturity.” However, the issue is that repayment to Loan Star is regarded as a violation of this agreement.

One investor that took advantage of this agreement was ARCM, a Hong Kong hedge fund that purchased these corporate junk bonds in bulk and demanded reorganization of Unizo Holdings while suing Loan Star to receive their capital back. Of the creditors, regional banks make up a large portion of the 88 financial institutions and corporate bond holders. The Financial Services Agency has concerns that the Unizo bankruptcy would adversely impact regional banks and the local economy.

There will certainly be continued interest in the “Spring Storm” that has taken over the financial and real estate industries. Unizo Holdings will face maturity on 10 billion yen of corporate bonds on May 26th.

by Shigeru Hirai, Client Relations Group

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Japan Tax Update

Overview and key points of the electronic invoice (digital invoice)

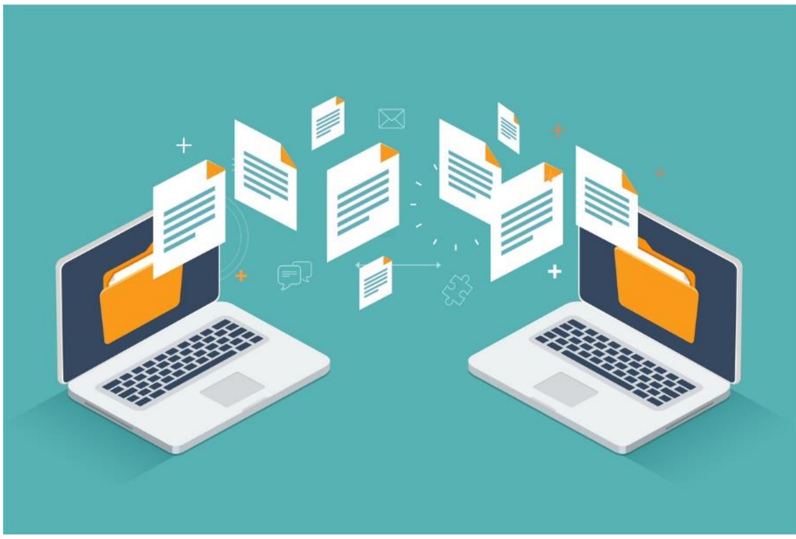
As mentioned in Vol. 16 of our newsletter, the "electronic invoice (digital invoice)" will be a key component the workflow changes with the start of the invoice system on October 1, 2023, and the electronic record retention law on January 1, 2024. In this volume, we will explain in further detail about the electronic invoice.

In general, an electronic invoice is defined as all invoices or related documents that have been prepared as digital data. This includes both data files created on a computer to be printed out, or paper documents that are scanned. Of these documents, the term "digital invoice" represents a standardized and structured document.

Under Japan's Digital Agency, the standard format was selected as "JP PINT" which is based on the international standard format Peppol. To comply with the retention of qualified invoices for consumption tax, the "qualified invoice" uses the format "Peppol BIS Standard Invoice JP PINT (referred as Standard Invoice JP PINT) and "purchase statements" will use the format "JP BIS Self-Billing Invoice (referred as JP Self-Billing)."

However, solely creating digital invoices will not be sufficient in meeting the requirements to apply purchase tax credits for consumption tax. They must be saved in compliance with the electronic record retention law.

Currently, many vendors of accounting software and electronic bookkeeping are developing software to be released by Fall 2023 to meet the requirements for digital invoices and electronic record retention law.



Another point worth noting is that under the qualified invoice retention method for consumption tax, the qualified invoice issuer must oblige to the taxpayer's request to receive a qualified invoice. However, there is no requirement to issue a qualified invoice in an electronic (digital) invoice format.

Thus, a fixed portion of transactions are expected to still be delivered as paper invoices. In conclusion, when considering workflows for the invoice system and electronic record retention law, companies should utilize both the digital invoice for automation and efficiency and in conjunction make preparations to manage paper documents and electronic invoices not in digital invoice format.

by Keiko Ikeda, Executive Manager