Lease accounting reform and economic consequences: the views of preparers and users

Vivien Beattie, Alan Goodacre* (University of Stirling)
and
Sarah Jane Thomson (Heriot-Watt University)

December 2001

ABSTRACT

In response to perceived difficulties with extant lease accounting standards in operation worldwide, the G4+1 issued a discussion paper which adopts a 'property rights' perspective and proposes that *all* leases should be recognised on the balance sheet (ASB, 1999). This paper contributes to the ongoing debate by conducting a questionnaire survey of UK users and preparers to assess their views on the G4+1 proposals and on the potential economic consequences of their adoption. The results, based on 132 responses, indicate that both groups accept that there are deficiencies in the current rules, but they do not agree on the way forward. The preparers do not support the G4+1 proposals; they are lukewarm to the general principles and, in the main, object to the detailed suggestions. By contrast, the users are strongly supportive of the general principles of the proposals and neutral to the details. Both groups believe that the proposals would lead to significant economic consequences for company lessees, lessors and for users. The impact on respondents' views of familiarity with the proposals, level of lease usage, and company size, is also examined.

KEYWORDS: lease accounting; off-balance sheet finance; survey; economic consequences

* Corresponding author: Alan Goodacre, Department of Accounting, Finance and Law, University of Stirling, Stirling FK9 4LA, UK (e-mail: Alan.Goodacre@stir.ac.uk).

Acknowledgements
The financial support of the Centre for Business Performance of the Institute of Chartered Accountants in England and Wales and of the Carnegie Educational Trust (for Sarah Jane Thomson) is gratefully acknowledged. The contribution made by the individuals who gave freely of their time in completing the questionnaire is also greatly appreciated.

Lease accounting reform and economic consequences: the views of preparers and users

1. Introduction

Leasing represents a significant source of finance for many companies. Total lease finance used by non-financial industrial and commercial UK listed companies was estimated in 1994 to be approximately £71 billion. This was about half the level of the companies' long-term debt finance and financed about 28% of their net fixed assets.[1] In 1999, new business leasing by members of the Finance & Leasing Association represented 15.3% of the total investment in equipment (Finance & Leasing Association, 2000). In the UK, leasing is currently governed by accounting standard SSAP 21 'Accounting for leases and hire purchase contracts', which was issued in 1984 (ASC, 1984). Since its introduction, there has been a considerable growth in the use of off-balance sheet operating leases (Goodacre and Beattie, 1999) and this has encouraged accounting standard setters to review the working of the standard and to propose major changes. This culminated in a G4+1 discussion paper 'Leases: implementation of a new approach' (ASB, 1999), which adopts a 'property rights' perspective and proposes that *all* leases should be recognised on the balance sheet, rather than just finance leases.

The different accounting treatments have important implications for reported levels of indebtedness and for standard performance measures. Profit margins, return on assets and gearing measures would all be significantly affected if operating leases were required to be recognised on the lessee's balance sheet rather than merely disclosed in a footnote (Imhoff, Lipe and Wright, 1991; Beattie, Edwards and Goodacre, 1998; Goodacre, 2001). It is not surprising, therefore, that the G4+1 proposals are controversial and have already generated a significant negative response from some groups who fear that there will be major adverse economic consequences if the proposals are adopted. For example, the Finance & Leasing Association issued a press release in which they suggested that the proposals 'would have complex and dramatic effects on the financing of British business' and 'will be damaging to many companies' balance sheets' (Finance & Leasing Association, 1999). KPMG suggested that 'there seems little merit in replacing one set of arbitrary rules with another' (KPMG, 2000). The real estate industry is also concerned about the impact on their sector. It has argued that the proposals 'will increase the occupiers' reluctance to enter into long term commitments, leading to a further and more rapid demand for flexible arrangements'. It is further claimed that in the period of uncertainty surrounding discussion of the proposals 'decision making will be difficult and this may create a substantial slowdown in the letting market' (Investment Property Forum, 1999).

A major difficulty faced by accounting standard setters world-wide lies in obtaining the views of *users* of financial statements. They must then decide the appropriate weight to give to users' expressed preferences in the determination of standards. Other major interested parties, such as preparers, audit firms and other groups (here, for example, the lessor group), are well organised to lobby the standard setters to ensure that their group views are heard. However, users are generally a wider, more diverse, less organised group with less focus and often less technical knowledge for lobbying activities. This issue has been noted previously (Collins, Davie and Weetman, 1996; Jonas and Young, 1998) and is also well-illustrated in the formal responses to the G4+1 discussion paper. Of the 59 responses received by the ASB, just 3 (5%) were from users or user groups. Based on another simple measure (number of pages of response), users contributed just 7% of the overall response.

This paper contributes to the ongoing debate concerning the G4+1 proposals for lease accounting reform by reporting the results of a questionnaire survey sent to a sample of two of the primary interested parties: users (investment analysts) and preparers (finance directors). The objectives of the research are to elicit and compare the views of both groups on a comprehensive range of issues surrounding the proposals. The issues covered include the deficiencies in the current standard; the general principles underlying the G4+1 proposals; the specific proposals regarding options, contingent rentals and rentals that vary in line with prices; implementation; and alternative proposals. In addition, constituents' views regarding the potential economic consequences of the proposed changes are explored. The impact on respondents' views of familiarity with the proposals, level of lease usage, and company size, is also examined. The suggested characteristics of 'high quality' accounting standards (Imhoff, 1998) are used to provide a framework for discussing the proposed reform in lease accounting and respondents' views thereon. The study, therefore, represents policy-relevant ex ante research in support of the standard setting process of the type advocated by Schipper (1994).

The remainder of the paper is structured as follows. Section two first provides a brief discussion of the current and proposed methods of accounting for leases. It then reviews two strands of literature relevant to the debate on lease accounting reform: the quality of accounting standards and various approaches to the assessment of economic consequences. Lastly, in section two, the specific research questions addressed in the current study are presented. Section three outlines the methods employed, including sampling and data collection procedures. The results are presented in section four, while section five contains a discussion of the evidence concerning the research questions. A final short section concludes.

2. Literature

2.1 Lease accounting: extant regulations and proposals

Internationally, extant leasing standards such as IAS 17 (revised 1997), FAS 13 in the USA and SSAP 21 in the UK make a fundamental distinction between finance leases and operating leases. For example, SSAP 21 defines a *finance* lease as one that transfers to the lessee substantially all the risks and rewards of ownership. It is treated as an 'in substance' purchase by the lessee and sale by the lessor. An asset is shown on the lessee's balance sheet at the present value of the minimum lease payments and a corresponding liability is recognised. An *operating* lease is any other lease. The underlying asset appears in the balance sheet of the lessor and the lessee simply recognises the rental payments as an expense, with additional footnote disclosure regarding future lease rental commitments.

In 1996, the G4+1 published a special report entitled 'Accounting for leases: a new approach' (McGregor, 1996). Three fundamental deficiencies in existing lease accounting standards were identified. First, material assets and liabilities arising from 'off-balance sheet' operating lease contracts are omitted. Second, similar transactions do not receive the same accounting treatment since marginal differences in contractual terms can result in one lease being claimed as a finance lease and another as an operating lease. This illustrates the weakness of so-called 'bright line' standards. Third, the 'all or nothing' approach to the capitalisation of leased assets does not adequately reflect modern complex transactions. A conceptual approach to lease accounting is advocated, whereby the distinction between finance leases and operating leases is removed. Lessees would recognise as assets and liabilities *all* material rights and obligations arising under lease contracts.

Three years later, all of the G4+1 organisations published a discussion paper 'Leases: implementation of a new approach', which develops the approach recommended in the special report (ASB, 1999). It reiterates the view that all leases should be reflected in financial statements in a consistent manner and it explores the principles that should determine the extent of the assets and liabilities to be recognised by lessees and lessors. The discussion paper recommends that, at the beginning of a lease, the lessee recognises an asset and a liability equivalent to the fair value of the rights and obligations that are conveyed by the lease. This is usually the present value of the minimum payments required by the lease. Subsequently, the lease asset and liability would be treated as fixed assets and debt. The other party to the transaction, the lessor, would report financial assets (representing amounts receivable from the lessee) and residual interests as separate assets. Many lease contracts include complex features such as renewal options, contingent rentals, residual value guarantees and sale and leaseback transactions. Detailed rules for dealing with these features are proposed.

It is not clear when this issue will be progressed further. Despite strong commitment to the project, the ASB has acknowledged that 'because of the complexity of the issues arising and the concerns expressed by some respondents (to the discussion paper), it will take some time for the Board to consider all of the points raised' (ASB, 2001).

2.2 Quality of accounting standards

When speaking about the prospects of international accounting standards gaining acceptance, Arthur Levitt (former Chairman of the US Securities and Exchange Commission) identified three key objectives that must be met, one of which is that the standards must be of 'high quality'. That is, 'they must result in comparability and transparency, and they must provide for full disclosure. Investors must be able to meaningfully analyze performance across time periods and among companies' (Levitt, 1998: 81). Following this, *Accounting Horizons* published six commentaries that address the question: what are the attributes of high quality accounting standards? Commentaries were included from the AAA, representatives of auditors (a partner in Deloitte and Touche LLP), users (AIMR), professional accountants (Institute of Management Accountants, AICPA) and preparers/company managers (Financial Executives Institute) (Imhoff, 1998).

Given the wide range of constituencies represented, the considerable level of agreement on the characteristics of 'high quality' accounting standards is perhaps surprising.[2] Having undertaken a broad-based content analysis of the commentaries, we have identified nine attributes that, it is argued, an accounting standard should have:

- address and correct a current deficiency in the financial reporting model by improving financial statement users' abilities to make decisions (relevance/improvement)
- have expected benefits in excess of costs (benefits/costs)
- be consistent with 'the' conceptual framework and other standards (consistency)
- depict the economics of the transaction (substance)
- depict similar economic phenomena as such in the financial statements (uniformity)
- preferably be based on concepts, rather than arbitrary rules, but with supplementary rules to limit alternatives and provide comparability (concept-based/comparability)
- be clear, understandable and operational (clarity/operationality)
- avoid disclosure 'overload'
- be international in scope

These characteristics provide a useful framework for discussing lease accounting reform and interested parties' views thereon.

2.3 Economic consequences

For over two decades, economic consequence arguments have been used by lobbying groups and accounting regulators have explicitly considered the economic consequences of a change in accounting method on the behaviour of interested groups.[3] Standard setting bodies such as the Accounting Standards Board (UK) and the Financial Accounting Standards Board (US) now have constitutions that seek direct representation from these groups, including users. Moreover, the consultation process itself enables interested parties to contribute, formally or informally, at various stages from initial discussion paper through exposure draft to promulgation of a final accounting standard.

The principle of giving due weight to economic consequences (in addition to accounting principles) is now well established. However, the identification and measurement of economic consequences is problematic. Researchers have used four different empirical methods: the analysis of archival accounting data; market based studies; experimental studies and surveys. The approach of, and evidence relating to, each is now considered in turn.

First, the archival method either compares the accounting numbers pre- and post- a change in the accounting rules (an ex post study) or reconstructs pro-forma accounting statements based on proposed rule-changes and compares these with the statements under extant rules (an ex ante study). The ex post accounting numbers capture changes in the behaviour of preparers (although this may be in response to anticipated changes in behaviour by users). The direct impact on users' behaviour, caused by the changes in reported numbers, is then inferred. By contrast, the ex ante reconstructed accounting numbers assume that no behavioural changes occur to affect the underlying transactions being reported. Thus, the impact on the behaviour of both preparers and users must be inferred. The validity of this inference is dependent either on users being 'inefficient' in their information processing (possibly due to bounded rationality) or on managers believing them to be so. Thus, it is also necessary to have evidence of users' processing of lease accounting information and/or of managers' perceptions of this.

There is mounting evidence that suggests capital markets might be informationally inefficient (Kothari, 2001: 208). There is also a large body of literature that specifically examines whether the market is mechanically fixated on reported earnings. The conclusion from this literature is that the market rationally discriminates between non-cash earnings effects arising from the use of different accounting methods (Kothari, 2001: 197). However, the evidence that *individual* users, such as bank-lenders and investment analysts, may not be informationally efficient (see experimental evidence below) suggests that company capital-raising may be affected by the proposed accounting changes. Further, there is strong evidence that company managers do not believe that users, either in aggregate or individually, process information efficiently (e.g., Mayer-Sommer, 1979; Abdel-khalik, 1981; Taylor and Turley, 1985; Beattie, Goodacre and Thomson, 2001). This suggests that managers' decisions will be affected by the expected change in performance measures if all leases are required to be recognised on lessees' balance sheets, as a result of information inductance (Prakash and Rappaport, 1977).

In an early ex post study, Abdel-khalik (1981) found that company management responded to the introduction of SFAS 13 by structuring new lease contracts, and renegotiating existing lease contracts, to avoid capitalisation of leases. There was evidence that more assets were bought, or constructed, instead of being leased and also evidence of changes in capital structure. He proposed three possible reasons for this reaction by company managers: managers' belief that users are informationally inefficient, the impact on managers' compensation, and the avoidance of debt covenant violation. Imhoff and Thomas (1988) also examined capital structure changes in response to SFAS 13 and found that the standard had a significant impact on lessees. They document a systematic substitution from finance (capital) leases to operating leases and non-lease sources of finance, suggesting that re-negotiation of lease contracts is a relatively low-cost alternative for mitigating the financial statement effects. In addition, lessees appeared to reduce book leverage by increasing equity and reducing conventional debt. In an Australian study, Godfrey and Warren (1995) found that firms responded to the new lease accounting rules by reducing their reliance on finance leasing and increasing their use of non-lease debt and equity. However, in contrast with the US, they did not appear to have renegotiated finance lease contracts to operating leases. In the UK, Garrod (1989) found that managers reacted to the introduction of SSAP 21 by reducing their non-lease debt prior to first disclosure of their lease information.

There are also several ex ante studies based on accounting numbers, specifically accounting ratios that are used as key performance indicators. Nelson (1963) and Imhoff, Lipe and Wright (1991; 1997) examined US data, while Ashton (1985), Beattie *et al.* (1998), Dresdner Kleinwort Benson (1998) and Goodacre (2001) analysed UK data. With the exception of Ashton (1985), which may be subject to sample selection bias, all studies reported large impacts on ratios, especially on gearing measures. For example, Beattie *et al.* (1998) reported that the mean operating profit margin would increase from 8.7% to 9.8% and that there would be a dramatic increase in the gearing ratio (net debt to equity) from 20% to 72% for the sample as a whole and from 24% for 141% in the services sector. Further, the relative ranking of companies would change markedly both within and across different sectors. They concluded that 'significant changes in the magnitude of key accounting ratios and a major shift in company performance rankings suggest that interested parties' decisions and company cash flows are likely to be affected' by a policy change requiring operating lease capitalisation.

Second, market based studies are confined to the ex post study of rule changes. The market reaction to a change in the accounting rules is usually explored using the event study methodology, although it can be difficult to separate the impact of the event of interest from that of other confounding events. The market reaction captures changes in the behaviour of users (exclusively the shareholder group) in aggregate, conditional upon the change in behaviour of preparers.

Ro (1978), El-Gazzar (1993) and Garrod (1989) examined the market price reaction to lease accounting changes. Ro (1978) found that the US market did not react to the balance sheet impact of capitalising operating leases and only reacted to the income effect when material (over three percent). El-Gazzar (1993) reported increased market reaction for US companies likely to experience increasingly tight debt covenant restrictions. In the UK, Garrod (1989) found that the market reacted to the new information available post-SSAP 21. By contrast, Abdel-khalik (1981) found no reaction in market price or in market-based risk measures and Finnerty *et al.* (1980) found that lease accounting changes had little impact on market risk measures. Thus, there is mixed evidence of market reaction to lease accounting information, and this derives from tests using rather old data (from the late 1970's and early 1980's).

Other market-based studies, using cross-sectional regression models, explore the equivalence of lease recognition versus footnote disclosure. There is quite strong evidence for both the UK (Beattie, Goodacre and Thomson, 2000b) and the US (Bowman, 1980; Ely, 1995; Imhoff, Lipe and Wright, 1993) that the market already incorporates footnote operating lease disclosures in its assessment of equity risk.[4]

Third, experimental studies explore how individual users process lease accounting information, in particular, whether they appear to be influenced by whether the information is recognised in the financial statements or merely disclosed in the footnotes to the accounts. The evidence from experimental studies is mixed. Most studies found a different user perception based on recognised or disclosed lease accounting information (Wilkins and Zimmer, 1983b; Munter and Ratcliffe, 1983; Hartman and Sami (1989), Breton and Taffler (1995); Gopalakrishnan and Parkash, 1996), but some studies did not (Wilkins and Zimmer, 1983a; Wilkins, 1984).

Finally, surveys are perhaps the most flexible and comprehensive method of investigating economic consequences. They can be used to investigate rule changes both ex post and ex ante; they can elicit responses from a range of interested groups; and they can explore the attitudes and views that underpin changes in behaviour as well as asking directly about behavioural changes. For example, asking about possible future changes to lease accounting based on a property rights perspective that capitalised all non-cancellable leases, Abdel-khalik (1981) found that users responded positively, while company managers responded negatively.

We are aware of only one other survey of lease accounting rules. Taylor and Turley (1985) investigated the opinions of UK management on lease accounting following ED29, the exposure draft that preceded SSAP 21. They found that only a minority of managers believed that internal financing or investment decisions would be significantly affected by the proposed accounting standard. However, managers believed that users' decisions, including risk assessment, were likely to be affected, suggesting that managers' behaviour could be influenced by information inductance (Prakash and Rappaport, 1977). Managers also anticipated that future lease contracts would be structured as operating leases to avoid capitalisation.[5]

Each of these various methods of assessing likely economic consequences offers unique insights, though each also has its own inherent limitations. For this reason, the use of multiple methods is to be recommended (Jick, 1979). The present survey of interested parties' views on the likely economic consequences of adopting the G4+1 proposals complements the methods used in prior studies.

2.4 Research questions

The accounting standards quality literature suggests a range of issues on which to elicit the views of interested parties. These can be grouped into three broad categories:

RQ1. What are interested parties' views on the current accounting standard (SSAP 21)?
RQ2. What are interested parties' views on the general principles of the G4+1 proposals?
RQ3. What are interested parties' views on the specific details of the G4+1 proposals?

Research question 4 explores views regarding a range of potential economic consequences, identified from the literature:

RQ4. What are interested parties' views on the likely economic consequences of adopting the G4+1 proposals?

Research questions 5 and 6 concern broader issues:

RQ5. What are interested parties' views on alternative proposals?
RQ6. What are interested parties' views on implementation of a new standard?

Research questions 7 through 10 address factors that could explain (some of) the views expressed. The most obvious factor is constituency membership (i.e., user vs. preparer):

RQ7. Do the views of preparers and users differ significantly?

Three other potential explanatory factors are explored:

RQ8. Are interested parties' views related to their familiarity with the G4+1 proposals?
RQ9. Are preparers' views related to the level of company lease usage?
RQ10. Are preparers' views related to company size?

3. Methods

3.1 Sample selection

The sample of account preparers was based on the population of industrial and commercial UK listed companies contained in the UKQI list on Datastream in June 2000. The questionnaire was sent to finance directors of a systematic sample of one-third (415) of this population. The Institute of Investment Management and Research (now the UK Society of Investment Professionals) agreed to provide a mailing list of their London-based Associate members (totalling 1,640); from this, a systematic sample of 400 was selected. A further sample was identified from a listing of leading fund management firms published in *CA Magazine* (1999) and 72 individuals from these firms were identified. Thus a total of 472 user questionnaires were mailed. Given that non-response is a significant, and increasing, problem in the survey method, a relatively large initial sample was used to provide a satisfactory absolute number of responses to support meaningful statistical analysis.

3.2 Questionnaire design and administration procedures

The first stage in designing the questionnaire was to review the (fairly limited) theoretical and empirical literature in the area, including previous surveys. This, together with the ASB (1999) discussion paper, was used to produce a draft questionnaire that was sent out for piloting. Useful comments were received from several finance directors, the ASB and the Finance & Leasing Association and the questionnaire content and terminology was revised accordingly.

The questionnaire generally used closed-form questions and adopted a five-point Likert scale with verbal anchors. It contained five sections. Section A included four broad questions relating to accounting standards generally, familiarity with the new lease accounting proposals, suggested deficiencies of the current lease accounting standard and the principles underlying the proposed changes. Section B elicited views on specific detailed proposals in the 1999 discussion paper concerning the accounting treatment of renewal/purchase options, contingent rentals and rentals that vary in line with prices (e.g., upwards-only rent reviews). Views on potential economic consequences were addressed in two multi-part questions in Section C, and alternative proposals and implementation issues were explored in Section D. The final section asked for brief information about the respondent. In total, the questionnaire was 8 pages long (including covers) and asked for responses to 76 question elements. It was accompanied by an explanatory covering letter that assured the confidentiality of responses and a one-page summary of the G4+1 proposals.

Many of the standard response-enhancing techniques were adopted including: designing a clear questionnaire layout; piloting; addressing the covering letter to a specific named individual (all finance director details were individually checked by telephone); covering letters signed individually by researchers; follow-up letters approximately 10 and 20 days after the initial request; stamped reply envelopes (rather than reply-paid envelopes); requesting non-respondents to return the questionnaire.

3.3 Factors affecting respondents' views

The impact of three factors on respondents' views was investigated: familiarity with the lease accounting proposals, the level of company lease usage and company size.

In most circumstances, more weight is attached to opinions expressed by knowledgeable individuals. Given the technical, somewhat specialised, nature of lease accounting, it was considered important to check whether the mean response reflects the opinions of those who understand the technicalities. The impact of respondents' self-reported familiarity with the lease accounting proposals on views held was investigated for both the finance director (FD) and the investment analyst (IA) groups, by splitting the groups into 'familiar' and 'less-familiar' sub-groups.

It could be argued that companies with high levels of lease usage will anticipate a greater impact on their financial statements and more significant economic consequences. Since the G4+1 proposals tend to have an unfavourable impact and potentially adverse economic consequences, high lease usage companies might be more opposed to the G4+1 proposals than low lease usage companies. For the FD group, a test was carried out to see whether the level of lease usage might have influenced their views. The companies were split into high and low lease usage groups based on the level of operating leases indicated by the profit and loss account expense, scaled by company size. In particular, high and low lease usage sub-groups were defined as companies with total operating lease rentals/sales above and below the median level, respectively.

FD response might also be associated with company size. Large and small companies typically have different financing mixes (Lasfer, 1999; Bevan and Danbolt, 2000), different negotiating power and different administrative capabilities. For the FD group, a test was carried out to identify whether responses were company size-related. Responding companies were split into large and small sub-groups by comparison with the median size based on total assets.[6]

4. Results

After describing response rates and tests for bias, respondents' views are described under seven headings: accounting standards generally; deficiencies in the current lease accounting standard; general principles of the new proposals; specific issues; economic consequences; lease accounting alternatives; and implementation. Any differences in response associated with familiarity with the proposals, lease usage or company size are identified under the relevant heading and then brought together in the discussion section.

4.1 Response rates and tests for bias

For the FD group, 78 usable responses were received representing a response rate of 19%.[7] An additional 13 responses were received from those who requested a copy of the questionnaire when replying to a questionnaire on a related topic,[8] giving a total of 91 usable responses. For the IA group, 41 usable replies were received representing a response rate of 9%, similar response rates being obtained from both the IIMR and *CA Magazine* sources. Recent research studies involving similar subjects have obtained response rates of between 9% and 35%.[9] The FD response rate is in line with recent studies and, given the length of the questionnaire, can be considered good. However, for the IA group the response rate is less good. The reasons given for non-completion suggest that the technical complexity of the lease accounting issue was a significant factor.[10]

Three tests for response bias were performed, two relating only to the FD group and the third relating to both respondent groups. First, the companies of the finance directors responding were compared with the population of UKQI companies on the basis of size (measured as total assets); a 2-tail t-test confirmed no difference between the sample mean total assets and the population mean, even at the 10% significance level.[11] Second, the respondent companies were formed into seven broad industrial categories based on Stock Exchange groups and a chi-squared test goodness-of-fit test confirmed that the sample companies were distributed similarly to companies in the UKQI population (chi-squared = 5.92; p= 0.4321).

Finally, the responses of early responders were compared to those of late responders for both the FD and IA groups, on the assumption that late responders are similar to non-responders (Oppenheim, 1966).[12] As there were no particularly 'key' questions in the questionnaire, a series of tests (Wilcoxon-Mann-Whitney) was conducted for each of the 74 closed-form question elements. Very few significant differences (at the 5% level) emerged. For the FD group, no significant differences were observed. For the IA group, 6 differences were observed.[13] Generally, these suggested that late IA respondents have a greater perception of some of the difficulties for companies associated with a change in lease accounting. Consequently, their views on the changes may be a little less radical, illustrated by their greater support for a transition period in implementing any change. Overall, these results suggest that the sample of respondent FD's is likely to be representative of the population of UKQI companies, that responses are not biased according to lease usage and that non-response is unlikely to be a major issue in interpreting the results of the survey.[14]

A further factor that can affect the validity of responses is the suitability of individual respondents, in terms of knowledge about the issues under investigation. For the finance director group, virtually all of the respondents were senior financial personnel likely to be knowledgeable about the lease accounting issue. Based on job title, the respondent was: finance director (51%), financial controller (15%), accounting/finance manager (9%), accountant (8%), director (7%), treasurer (2%) company secretary (1%) and other/not stated (7%). All of the investment analysts were either professionally qualified (IIMR members) or senior fund management personnel, so are likely to be representative of expert investment professional users. However, as might be expected, there were significant differences between the FD and IA groups' declared familiarity with the lease accounting proposals. 65% of the FD group were 'moderately' or 'very' familiar with the new proposals compared with 34% of the IA group (difference significant at the 1% level).[15]

4.2 Accounting standards generally

It has been argued that respondents' views on lease accounting reform might be affected by their opinion of accounting standards in general (Taylor and Turley, 1985). Opinions on accounting standards are, therefore, reported in Table 1. The general need for accounting standards is almost universally supported, with 95% of both FD and IA respondents reacting negatively to standards being an undesirable and unnecessary intrusion into company activities, giving mean scores of 1.51 and 1.34, respectively (row 1).[16] However, not surprisingly, FDs are more keenly aware of the burden that accounting standards impose on companies (row 3 mean = 3.70) than IAs (mean =3.27). The FD results are very similar to the means of 1.81 (our study: 1.51) and 3.55 (our study: 3.70), implied in the responses reported by Taylor and Turley (1985, Table 1:61).

[TABLE 1]

It appears, therefore, that the responses to questions concerning lease accounting are unlikely to be coloured by a disagreement with accounting standards in general. Any difference in the perceived burden imposed on companies arising from the existing standard and the new proposals could, however, be an issue.

4.3 Deficiencies in the current lease accounting standard (SSAP 21)

In the development of high quality accounting standards, new proposals should, in addition to possessing certain other attributes, address a current deficiency (Imhoff, 1998). The G4+1 special report argued that current lease accounting standards were indeed deficient (McGregor, 1996). The second question in the questionnaire asked whether respondents agreed with ten suggested deficiencies of SSAP 21, taken mainly from the G4+1 special report. Their views, in descending order of agreement by the FD group, are shown in Table 2.

[TABLE 2]

Both the FDs and IAs agreed that the current standard was open to manipulation, lacked uniformity, did not portray the substance of transactions, was incomplete, inconsistent and lacked clarity (rows 1 to 7). The primary deficiency that lease transactions could be deliberately structured for classification as operating leases was recognised more keenly by FD's familiar with the G4+1 proposals ('familiar' group mean = 4.26; 'less familiar' group mean = 3.82, row 1; difference significant at the 5% level). While FD's did not agree that users' decision-making was impaired by these deficiencies, the users themselves did feel that estimations and comparisons between companies were impaired (rows 8 to 10). The IA group also felt much more strongly than the FD group about the difficulty of estimating the balance sheet impact of operating leases (row 5), and was more concerned about the subjectivity of lease classification (row 7).

In summary, responses suggest that SSAP 21 is deficient in that it cannot be rigorously interpreted and applied as it enables similar transactions to be accounted for in different ways. On this basis, SSAP 21 falls short of the suggested criteria of a high quality accounting standard (Imhoff, 1998). Therefore, the introduction of new proposals to rectify current deficiencies appears to be justified.

4.4 Lease accounting proposals: general principles

The G4+1 discussion paper seeks to outline proposals that its authors believe would correct some of the deficiencies in current lease accounting standards. Whether the proposals meet all of the criteria identified for a high quality accounting standard is beyond the scope of the present paper. However, the approach certainly seems to be concept-based (grounded on the agreed definitions of assets and liabilities) and seeks to improve information for users' decision-making. The general principles of the proposals focus on recognising the substance of leasing transactions and the application of uniform methods across all leases. Respondents were asked the extent of their agreement with these general normative principles and a summary of their views is presented in Table 3, ranked by FD group mean response. Row 1 deals with the general principle that there should be one accounting method for all leasing transaction. This is amplified to confirm that the method should apply to land and buildings (row 3) and to intangible assets (row 4). Rows 2 and 5 focus on whether a de minimis threshold should apply to leases or whether the general concept of materiality is sufficient.

[TABLE 3]

The IA group was strongly in favour of the general principles in the G4+1 proposals. However, the FD group was far less positive. There was a high variability in the FD responses to each question (as indicated by the high standard deviations) and there was relatively moderate agreement, on average, with just two of the principles (rows 1 and 2). Indeed, while FDs in companies with low lease usage favoured the application of a single method to all tangible assets, including land and buildings (row 3; mean = 3.44), FD's in companies with high lease usage opposed this (mean = 2.68). Perhaps FDs with few property leases are more concerned with administrative simplicity than balance sheet impact (and vice versa for those with high exposure to property leases).

Thus, while recognising the deficiencies of SSAP 21, the FD group was not particularly supportive of the general principles of the proposals. As the questionnaire did not seek to identify the reasons for this response, it is impossible to say whether it stems from opposition to the G4+1 proposals *per se*, or aversion to any form of change, a manifestation of the status quo bias (Samuelson and Zeckhauser, 1988). It would, of course, be a perfectly rational response if the FD's anticipate adverse consequences for their companies should the new proposals form the basis of a new lease accounting standard. By contrast, the IA group seems more acutely aware of the difficulties of the current standard and believes that the proposals would improve the information available to them for decision-making.

4.5 Lease accounting proposals: specific issues

While high quality accounting standards should preferably be based on concepts rather than arbitrary rules, supplementary rules are usually necessary to limit alternatives, increase comparability and consistency of application. Having outlined the conceptual basis and general principles of the proposals, the G4+1 discussion paper considers and recommends ways of dealing with some of the complexities of lease contracts. In particular, it considers the treatment of renewal/purchase options, contingent rentals and rentals that vary in line with prices. The questionnaire asked for respondents' opinions on the proposals in respect of each of these areas.

4.5.1 Renewal/purchase options

Under SSAP 21, a *renewal* option (if it is reasonably certain of being exercised) is included in determining the lease term for classifying agreements as finance or operating leases. For a finance lease in which the exercise of a renewal option is reasonably certain, the present value of lease rentals payable in the initial period and the renewal period would generally appear on the balance sheet. If the exercise of a *purchase* option is reasonably certain, the present value of additional purchase rentals would also appear on the balance sheet.

While the G4+1 proposals would require the present value of all material lease agreements to be recorded on the balance sheet, they suggest that renewal/purchase options should *not* be anticipated.[17] Therefore, in contrast to SSAP 21, only the present value of rentals payable in the initial period or for fixed usage would appear on the balance sheet. Under the new proposals, therefore, shorter guaranteed terms or low levels of guaranteed usage could actually reduce balance sheet obligations for leases that are currently classified as finance leases because renewal/purchase options are likely to be exercised.

When lease agreements contain renewal/purchase options, the value of the option and the right to use the asset are both reflected in the present value of the minimum lease rentals. Under SSAP 21 no distinction is made between the renewal/purchase option and the value of the right to use the asset, but the G4+1 document proposes that the two should be recorded separately on the balance sheet. The aim is to highlight the flexibility of different lease agreement arrangements. It is proposed that option values could be ascertained through direct comparison with similar lease agreements without options.

Table 4 provides a summary of responses concerning renewal/purchase option. Rows 1 through 4 deal with details of the proposed treatment, row 5 with costs of implementation and row 6 with the potential to use the rules for manipulating balance sheet obligations.

[TABLE 4]

Both the high- and low-lease usage FD sub-groups agreed that the exercise of renewal/purchase options should not be anticipated (row 1), with high users in stronger agreement (mean = 3.91 (high users), 3.49 (low users)). However, the FD group as a whole did not agree that the value of the option should be recorded separately (row 3), nor with the suggestion that the option value could be determined by comparison with similar agreements without option clauses (row 4). While FDs were neutral, on average, to the recording of option assets and liabilities at the start of the lease (row 2: mean = 2.83), small company FDs were against the suggestion (mean = 2.54) but large company FDs were neutral (mean = 3.05).

By contrast the views of the IA group were generally more neutral, though they differed from the FD group by moderately supporting the idea of separate recording of option and usage elements (row 3). Both FD and IA groups considered that valuing the options would involve significant compliance costs (row 5), an opinion held strongly by the FD group (mean = 4.03). The potential for using renewal/purchase options to minimise balance sheet obligations was recognised by both groups of respondent (row 6).

Overall, the FD group liked the idea of not anticipating the exercise of renewal/purchase options and did not support the suggestion of showing the value of the option separately from the usage benefit. The latter view may arise from the perceived difficulties of valuing the option and the significant compliance costs involved. The technical complexity of the treatment of renewal/purchase options may be contributing to the general neutrality (uncertainty) of the IA group opinions. However, they did appreciate the difficulties of valuing the option element and were most concerned at the potential for 'disinformation' that the proposals might engender.

4.5.2 Contingent rentals

Under SSAP 21, lease rentals contingent on asset usage or lessee profits/revenues are not included in the minimum lease payments used for lease classification. In the case of finance leases, they are also not included in the capitalised value recorded in the balance sheet.

Under the new proposals, contingent rentals would not generally be anticipated but would be charged as an expense when the contingency arises (i.e., turnover or usage increases). An exception to this general rule would be when the minimum lease payments are unrepresentative of the value of property rights conveyed, in which case a greater amount reflecting the value of such rights would be recognised. The proposals suggest that the value of property rights conveyed by a lease agreement with contingent rentals might be determined by comparison with lease payments for a similar agreement without contingent rentals. These elements represent an attempt to include an anti-avoidance provision (to borrow a tax term) to reduce the possibility of gross obligation minimisation using contingent rentals. Respondents' views on the proposed accounting treatment of contingent rentals are shown in Table 5. Row 1 represents the view that, generally, contingent rentals should not be recognised on the balance sheet, with the 'unrepresentative' exception to the non-recognition rule in row 3; row 2 is the opposing view that estimated contingent rentals should be recognised. The suggested comparison for obtaining the fair value of 'contingent' property rights is covered in row 4, with an alternative view that this comparison would be incorrect in row 5.

[TABLE 5]

The FD group agreed with the G4+1 proposal that contingent rentals generally should not be recognised on the balance sheet (row 1), and disagreed with the opposing view that estimated contingent rentals should be recorded on the balance sheet (row 2). They were neutral to the suggestion that the fair value of property rights should be recorded when minimum lease rentals are unrepresentative (row 3). The latter may reflect the difficulty associated with estimation of fair value, as the FD group did not believe that the G4+1 method of comparison with non-contingent agreements is valid (rows 4 and 5). The views of the IA group were again essentially neutral (rows 1 to 4), but there was a wide variation (i.e., high standard deviation) in opinions on the basic principle of non-recognition (row 1). However, IAs did agree with FDs that using non-contingent agreements to estimate fair value of contingent agreements is incorrect (row 5).

In summary, the difficulties associated with estimating the value of future contingent rentals seem to have contributed to the view that contingent rentals should not be recognised on balance sheet.

4.5.3 Rentals that vary in line with prices (e.g., upwards-only rent reviews on leased land and buildings)

A further issue relates to the treatment of rentals that rise in line with prices. The most common, and important, occurrence is in the upward-only rent review lease, typical of many commercial property leases in the UK. Under SSAP 21, any variation in lease rentals arising from price changes is not anticipated at the beginning of the lease term, but treated as an increase/decrease in liability in the period in which the price change occurs. The line of reasoning that supports this treatment is that until a rent review takes place, there is no liability to pay beyond the minimum lease payments. Even if there were a liability, it could only be recognised if it could be measured reliably.

The G4+1 consensus is that the likely future price changes should be estimated at the start of the lease contract and incorporated in the calculation of the present value of minimum lease payments. This treatment is theoretically sound since a nominal interest rate (which incorporates the market's inflation expectations) is used to discount the cash flows. Further, the difference in values for lease agreements with and without rent reviews could be misleading if no recognition is made for future rent rises. However, the ASB dissented from this view on the grounds that estimates of future price increases would be unreliable. The G4+1 discussion paper also suggests that estimates should be reviewed (and restated if necessary) at each balance sheet date, irrespective of rent review dates.

Respondents' views on the accounting treatment of lease rentals that vary in line with prices are shown in Table 6. The ASB dissenting view that rent increases should not be anticipated is in row 1, with the 'misleading' criticism of this in row 2 and the consensus anticipation of rent increases in row 3. Rows 4 and 5 cover alternative dates for reviewing estimates (balance sheet: row 4; rent review: row 5). The ASB view that estimated liabilities are unreliable is in row 6, with the cost implications of obtaining estimates in row 6.

[TABLE 6]

This topic generated a high variation in responses as evidenced by the high standard deviations. There was strong support from the FD group for recognising assets and liabilities on the basis of rentals applicable at the beginning of the lease term (row 1),[18] rather than on the basis of estimated future rentals (row 3). FD respondents who were more familiar with the new proposals strongly disagreed with recognising rental estimates ('familiar' group mean = 2.36; 'less familiar' group mean = 2.83, row 3; difference significant at the 5% level). The FD group was essentially neutral as to whether the non-recognition of future rises could be misleading (row 2). The main arguments seem to be that future rent increases cannot be measured reliably (row 6) and will also be costly (row 7). While the IA group's opinions usually differed from the FD group, once again the IAs were, with the exception of review dates (rows 4 and 5), fairly neutral to the proposals. It should be noted, however, that IA respondents who were more familiar with the proposals disagreed with recognition based only on rentals at the beginning of the lease ('familiar' group mean = 2.50; 'less familiar' group mean = 3.40, row 1; difference significant at the 5% level). The one area of strong opinion by the IA group was that they supported the view that estimates should be reviewed at each balance sheet date rather than at the time of rent review (rows 4 and 5), presumably since this will improve the reliability of information for decision-making.

This completes the analysis of responses of the finance directors and investment analysts to the G4+1 proposals for lease accounting reform. The previous four sub-sections have reported and discussed the opinions of the two groups on the general principles of the G4+1 approach and on the three specific issues of renewal/purchase options, contingent rentals and rentals that vary in line with prices. In summary, finance directors do not support the G4+1 proposals. They are lukewarm to the underlying principles and, in the main, object to the detailed proposals. By contrast, investment analysts are supportive of the general principles of the proposals but are less clear on the detailed suggestions, presumably at least partly because they may not fully appreciate the technical aspects of these.

4.6 Economic consequences

One of the challenges faced by accounting standard setters is to identify the economic consequences that may result from a change in accounting standards, estimate their magnitude and then take them into account. Potential economic consequences were identified from the G4+1 discussion paper (ASB, 1999), from published responses to this (Finance & Leasing Association, 1999) and from prior research (Taylor and Turley, 1985; Beattie *et al.*, 1998) and respondents' views on these were requested using two multi-part questions. The first question covered all leased assets and the second focused specifically on land and buildings. The second question was included partly to deal with some consequences that are specific to land and buildings, but also to ensure that respondents recognised that 'rented' land and buildings were 'captured' by lease accounting standards.

4.6.1 Consequences of adopting the lease accounting proposals: all assets

Respondent's views regarding sixteen possible consequences of recording the fair value of the rights and obligations conveyed by all material lease agreements on the balance sheet are shown in Table 7, in descending order of FD group agreement.

[TABLE 7]

Both respondent groups fully recognised that many operating leases would give rise to assets and liabilities on the balance sheet (row 1) and that this would lead to an increase in reported measures of gearing (row 2), consistent with prior empirical research (Beattie *et al.*, 1998). Of the eight consequences that would be mainly adverse as far as companies are concerned, the FD group agreed that five were likely to occur. In particular, gearing measures would increase (row 2), borrowing covenants would have to be renegotiated (row 3), compliance costs (row 4) and administrative burdens (row 5) would increase, and some firms' credit ratings would reduce (row 10).[19] They disagreed that estimates of lessee companies' ability to pay future dividends would be reduced (row 16) and were neutral about impacts on users' assessment of risk (row 11) and lessees' debt paying ability (12).

Technical violation of accounting-based debt covenants is costly. Beneish and Press (1993) estimate that the average costs range between 1.2% and 2% of equity market value, or between 4.4% and 7.3% of the outstanding balances of the violated debt agreements. The need for re-negotiation of borrowing covenants, arising from increases in reported gearing, was more acutely perceived by FDs than IAs (row 3: FD group mean = 3.96; IA group mean = 3.43; difference significant at the 1% level).

Five of the consequences impact primarily on lessors. Of these, FD's agreed that lease terms would shorten to minimise lessees' balance sheet obligations (row 6).[20] This suggests a transfer of risk to lessors from lessees, so would be of some benefit to lessee companies. They also agreed that lease finance would be less attractive (row 8)[21] but were not convinced (i.e., neutral) that this would affect UK investment and leasing volumes (row 13), and disagreed that new assets would be purchased (or constructed) rather than leased (row 14). This might suggest that, although less attractive, lease finance would still compare favourably with alternative sources of finance. Alternatively, it might suggest that companies don't always have the choice between purchase/construction and leasing. The use of specific assets may only be available in one form or the other. General comments made by the respondents provide some indication of this being the case (for example, "the alternative to leasing isn't always available" and "the properties we operate from are only available on lease"). Finally, they disagreed that the proposals would reflect the financial flexibility of different leasing arrangements (row 15).

The FD group agreed with both consequences suggesting that users' assessments of companies would be improved (rows 7 and 9) if the proposals were adopted. These latter two responses are somewhat inconsistent with the FD's rejection that the current accounting standard impairs users' assessments (Table 2, rows 8 and 9).

The IA group, on the other hand, placed greater emphasis (significantly higher mean scores) on the improvements in users' assessments of companies (rows 7, 9 and 11). They were also not convinced (i.e., neutral) that compliance costs and administrative burdens would increase or that lease finance would be less attractive (rows 4, 5 and 8); indeed, they disagreed, moderately, that there would be a short-term adverse effect of UK investment and leasing volumes (row 13). In contrast with the FD group, the IA group did feel that the G4+1 proposals would reflect the financial flexibility of different lease arrangements (row 15).

In summary, FD respondents acknowledged that lease agreements currently classed as operating leases are material, and would, therefore, appear on the balance sheet under the new proposals. While they recognised the cost-related consequences to account preparers, they perceived only a limited benefit to account users. Thus, FD's do not seem to accept that the expected benefits of the new proposals would exceed the expected costs. On the other hand, users recognise the expected benefits in terms of improved company evaluations but are less concerned about the costs of implementing the proposals. Standard setters will have to arbitrate such conflicts.

4.6.2 Consequences of adopting the lease accounting proposals: land and buildings

The proposed new approach to lease accounting would have a major impact on property leases (i.e., land and buildings). These are typically long-term leases in which rentals (in the UK) are increased to prevailing market prices at regular intervals. Under SSAP 21, such leases are generally treated as off-balance sheet operating leases, since the landlord lessor retains a significant residual interest in the property. Under the G4+1 proposals, the present value of future rentals and an estimate of future increases would be recorded on the lessee's balance sheet. The views of respondents on various potential consequences of the new proposals being applied to the leasing of land and buildings are shown in Table 8, in descending order of FD group agreement. Some of the consequences have been addressed generally in previous tables but are reiterated here in the specific context of land and buildings (rows 1, 2, 4, 5 and 10). The other potential consequences are peculiar to land and buildings.

[TABLE 8]

Previous empirical studies (Beattie *et al.*, 1998; Dresdner Kleinwort Benson, 1998) have shown that the capitalisation of operating leases relating to land and buildings would have a marked effect on reported gearing. Both respondent groups appear to recognise that this would happen (row 1). The FD group recognised that the combined profit and loss expense of depreciation and interest would exceed market rent in the early years of the lease agreement (row 3); perhaps surprisingly, the IA group did not appreciate (i.e., was neutral to) this fact.

Consistent with the general trends observed in Table 7, the difficulty and costs involved in estimating the present value of future property rent increases (row 2) were appreciated by the FD group. Overall, the IA group were neutral to this suggested consequence, but the IA respondents who were more familiar with the proposals disagreed that it would be difficult/costly ('familiar' group mean = 2.54; 'less familiar' group mean = 3.28, row 2; difference significant at the 5% level). The G4+1 discussion paper notes that a reliable estimate cannot be derived simply from a forecast of general trends of future property prices. The price applicable to a specific property might diverge significantly from prices in general. It is suggested that an estimate of the fair value of a property lease subject to rent reviews might be obtained by comparison with a similar property lease that was not subject to rent reviews. However, according to the Finance and Leasing Association (FLA) in their response to the new proposals, virtually no such leases exist in the UK.

In addition to improving comparisons between companies purchasing and leasing property, the new proposals suggest that the balance sheet recognition of the rights and obligations to occupy leased property would have other advantages. It would enable any loss on leased property to be written off when it occurs rather than on vacation of the property, and any increase in value arising from sub-leasing at a higher rent to be shown. Both groups of respondents appear to support these arguments (rows 5, 6 and 7).

In their response to the new proposals, the FLA predicted that the property market would undergo substantial change, with shorter lease terms to minimise balance sheet obligations and/or increased purchasing. The FD group (but not the IA group) responses appear to support the predictions of shorter-term property leases (row 4). However, on average, the purchase of property instead of leasing was considered unlikely by both groups (row 10).[22] The choice to purchase specific properties may not be an option, as they are already owned by institutions or property companies who wish to retain them for renting to tenants.

The FLA suggests that it may be difficult to fund new property development without the security of long-term tenants, and that rent yields may rise to reflect an increase in lessors' risk. On average, both the FD and IA groups were neutral to these possible property market consequences (rows 8 and 9);[23] their views on rent yields are surprising and may not be shared by landlords.

In summary, both groups of respondents appreciated some benefits from adopting the G4+1 proposals, but the FD group was particularly concerned with the implementation costs that they would expect to incur. Neither group expected a substantial change in the UK property market, but the FD group anticipated the negotiation of shorter lease terms to minimise the balance sheet impact.

4.7 Lease accounting alternatives

The G4+1 discussion paper identifies deficiencies in current lease accounting standards and offers a new approach. They must believe that the future benefits to be obtained from such a radical change will outweigh any costs of implementation. However, the standard setting process involves consultation with the various interested parties and their representatives. In anticipation of the negative response that the proposals might receive from some of these parties (discussed above), the questionnaire sought views on various alternative approaches. These included: increased footnote disclosure, rather than recognition on balance sheet; maintenance of the current distinction between operating and finance leases; and a change in the threshold for finance lease classification (suggested by the FLA in its response to the discussion paper).[24] A summary of responses is shown in Table 9, in descending order of FD group agreement.

[TABLE 9]

Both FD and IA groups agreed with the fairly innocuous suggestion of analysis of lease commitments by asset type, as already practised in the UK, but not in all countries (row 1). On the other hand, both groups disagreed with a rather extreme suggestion that all leases should be recorded in the balance sheet without footnote disclosure of other material aspects (row 7). However, the groups differed significantly in their views on preferred alternatives. The FD group was neutral to increased disclosure of either cash flows (row 2) or asset/liability values (row 3), to the G4+1 approach (row 5) and even to the status quo (row 4)! They disagreed with the FLA's suggestion of an 'improved' version of SSAP 21 (row 6). In contrast, the IA group was much clearer in its preference. They agreed with the G4+1 proposed approach (row 5) and disagreed with the status quo (row 4). While the overall IA response to other suggestions was neutral (rows 2, 3 and 6), respondents who were more familiar with the proposals disagreed.[25]

In summary, the IA group seems quite strongly to favour the G4+1 proposals over alternative approaches. The FD group responses provided no real indication of the approach that they would prefer.

4.8 Implementation of the lease accounting proposals

The G4+1 discussion paper does not address implementation issues. However, the FLA, in its response to the new proposals, noted that there is no computer software currently available in the UK market that would come close to offering the service required in order to implement the new approach. Immediate implementation could, therefore, be difficult on practical grounds. The FLA also predicted a switch in commercial behaviour in order to mitigate the impact of operating lease capitalisation on reported measures of financial performance. A phasing in of the new proposals would no doubt assist.

Respondents were asked their opinion on four alternatives for implementing the new proposals. Responses are summarised in Table 10, ordered by FD group mean response.

[TABLE 10]

The IA group favoured immediate implementation to new and existing leases (row 1), and disagreed with the suggestion of a transition period in which operating lease capitalisation would be required for new leases only (row 3). Analyst users seem to favour a clean break over the phasing in of changes, perhaps to minimise the disruption and uncertainty associated with multiple change points and also to benefit immediately from the improved information. In sharp contrast, the FD group disagreed with all four alternatives, perhaps reflecting their general disagreement with the proposals rather than the implementation alternatives.

5. Discussion

In this section, the evidence concerning the specific research questions is summarised and discussed. The questions are addressed in the same order as originally described in section two, with the exception that user and preparer views are contrasted throughout.

The current lease accounting standard, SSAP 21, was recognised as deficient by both preparers and users. They agreed that the current standard was open to manipulation, lacked uniformity, did not portray the substance of transactions, was incomplete, inconsistent and lacked clarity. In particular, they agreed that it allows transactions to be deliberately structured for classification as off-balance sheet operating leases, thereby enabling similar transactions to be accounted for in different ways. However, finance directors did not believe that this impaired comparison between companies, evaluation of firms' long term financial commitments or estimation of the risks involved in providing finance to lessee firms. Thus, both groups recognised that SSAP 21 fails to meet the criteria for a high quality accounting standard and, while finance directors did not believe that users' decision-making was impaired by the deficiencies, users themselves did feel that the deficiencies cause problems.

Users were strongly in favour of the general principles in the G4+1 proposals. However, the preparers were far less positive, showing only moderate support for just two of the principles (that all material leases should be recognised on the lessee's balance sheet and that one accounting method should apply to all lease transactions). The G4+1 discussion paper makes specific proposals for the treatment of renewal/purchase options, contingent rentals and rentals that vary in line with prices. While the views of users were generally neutral, preparers were against the proposals, instead favouring the treatment of these issues in the current standard. The main arguments against the detailed proposals seemed to be based on cost-benefit considerations and concerns about their operationality.

Overall, the finance directors did not support the G4+1 proposals. They were lukewarm to the general principles and, in the main, objected to the detailed suggestions. By contrast, investment analysts were supportive of the general principles of the proposals but were less supportive on the detailed suggestions, perhaps because they may not fully appreciate the technical aspects of these. Given that the preparers (companies) bear the costs and users (analysts and others) are more likely to reap the direct benefits from improved financial information, the differing responses from preparers and users is understandable. However, preparers' expressed views may ignore any potential, indirect, long-term benefits that companies may enjoy from improved user/market confidence as a result of the improved information (e.g., reduced costs of finance). A widely agreed attribute of a high quality accounting standard is that the expected benefits should exceed the costs of implementation. One of the tasks of accounting standard setters is to act as arbiter between those who might benefit from the improved information and those who will incur the costs of providing the information.

Another challenge faced by accounting standard setters is to identify the economic consequences that may result from a change in accounting standards, estimate their magnitude and then take them into account. The current paper contributes by asking key interested parties what they believe will be the consequences if the G4+1 proposals are adopted. There was an acceptance by both preparers and users that additional assets and liabilities would be brought on to the balance sheet under the new proposals and that this would impact on reported gearing. This was considered likely to lead to the need to re-negotiate borrowing covenants, and to a reduction in credit ratings for some companies. It was also accepted that this would improve the evaluation of long-term financial commitments and company comparisons. Additional compliance costs and administrative burdens relating to lease accounting were anticipated by preparers (particularly from smaller companies), but not by users.

Both groups believed that lease terms would become shorter to minimise balance sheet obligations and some preparers (from low lease usage companies), but not users, also believed that the proposals would make lease finance less attractive. However, neither group believed that the proposals would adversely affect UK investment and leasing volumes in the short-term, nor that they would substantially change the UK property market. In particular, the purchase of property rather than leasing was considered unlikely, probably because the purchase alternative is not always available. Overall, respondents anticipated significant economic consequences if the proposals are incorporated in a new lease accounting standard. These findings are consistent with the evidence that 'interested parties' economic decisions are likely to be affected' by adoption of the G4+1 proposals, obtained using the complementary 'impact on performance measure' studies discussed earlier (Beattie *et al.*, 1998; Goodacre, 2001). This process of triangulation increases the confidence in evidence provided by the consistent findings.

Users recognised the expected benefits in terms of improved company evaluations but were less concerned about the costs of implementing the proposals. On the other hand, preparers tended to recognise the cost-related consequences to companies but perceived only a limited benefit to account users, suggesting a belief that the proposals fail on cost-benefit grounds. The attitude of preparers is entirely consistent with the arguments put forward by Parfet (2000) who suggests that accounting standards 'are overhead, not something a customer consumes and will pay for' (p. 483). Consequently business responds toward new accounting rules with a 'healthy negative bias', which is 'one of the healthy checks and balances in the great standard setting system we have' (p. 483; p. 484).

Some alternatives to the new proposals were explored but none appeared to be favoured by the preparers. They were neutral to the current SSAP 21 treatment and to disclosure (rather than recognition) approaches. They opposed both the Finance & Leasing Association proposal for an improved version of SSAP 21 based on a 75% threshold for finance leases, and the suggestion of capitalisation of leases in the balance sheet without footnote disclosure of other material aspects. By contrast, the users clearly favoured the G4+1 proposals over all alternatives.

Given the early stage in the consultation process, the discussion paper does not address implementation issues. However, the questionnaire found that immediate implementation of the new proposals to new and existing leases was favoured by the user group, implying that a 'clean break' would be preferred over a transition period. Preparers disagreed with all four of the alternative suggestions for implementation, probably reflecting general disagreement with the new proposals rather than the implementation suggestions.

5.1 Other factors affecting respondents' views

Generally, familiarity with the new proposals did not greatly affect respondents' views, but the few significantly different responses (six, in total) are potentially important. For the preparer group, the only different response was that 'familiar' respondents felt more strongly that estimated future lease rental increases should not be recognised within lease assets and liabilities. The other five differences were in user group responses. Two of these also related to future rental increases. In direct contrast with preparers, 'familiar' users were unhappy with recognition based only on rentals at the beginning of the lease and they did not believe that companies would find it difficult and expensive to estimate the present value of rental increases. Three differences related to lease accounting alternatives (Table 9), with 'familiar' users having positive views on the G4+1 proposals and negative views on all of the alternatives; by contrast, 'less familiar' users were neutral on the alternatives. Thus, 'familiar' users were significantly more strongly supportive of these new proposals.

There was surprisingly little evidence that companies with high levels of lease usage anticipated a greater impact on their financial statements and so were more opposed to the G4+1 proposals than low lease usage companies. Only two responses indicated significantly greater opposition. First, FDs in companies with high lease usage opposed the application of a single method to all tangible assets, including land and buildings and, second, they argued more strongly that the exercise of renewal/purchase options in leases should not be anticipated. There were two other significant differences associated with the level of lease usage, both relating to the likely impact of adopting the proposals on the attractiveness of lease finance. High lease usage companies did not believe that companies would buy rather than lease property or that lease finance would become less attractive. There are two possible, non-mutually exclusive, explanations for these different opinions. High lease usage companies may believe that they have chosen lease finance for good commercial reasons, reasons that will not be greatly affected by the change in accounting treatment. Nevertheless, they would still prefer to keep their leased assets, particularly land and buildings, off-balance sheet. Or, in contrast with low lease usage companies, high lease usage companies may perceive that they are in a relatively strong bargaining position with lessors. Thus, they may expect to be able to negotiate relatively favourable terms (such as shorter leases with renewal options or break clauses) in response to any new accounting requirements. In other words, they expect leasing to continue to be an attractive form of finance but would like flexibility within any new accounting standard to enable them to minimise the impact on their financial statements.

A similar 'negotiating power' argument might account for some of the seven differences between the views expressed by large and small company FDs. Large firm FDs believed that lease terms for all assets, including land and buildings, would shorten if the proposals were adopted. Similarly, they thought that companies would be reluctant to enter long property leases. Another feature of size-related responses concerned implementation costs that may be a greater issue for small companies with more limited administrative resources. Small company FDs expressed greater concern over administrative burdens and compliance costs, and also opposed the recording of estimated values of options implicit in leases. An issue of greater concern for large than for small companies was the likely need to renegotiate bond covenants, perhaps because large companies have greater exposure to securitised long-term debt (Lasfer, 1999; Bevan and Danbolt, 2000).

6. Conclusions

The views of preparers (finance directors) and expert users (investment analysts) on the proposed reform of lease accounting and its potential economic consequences were investigated using a postal questionnaire.

Overall, the results indicate that both preparers and users agree that there are difficulties with the current lease accounting standard but they disagree on the resolution of these difficulties. Both groups recognise that the G4+1 proposals would bring about major changes and would lead to significant economic consequences for company lessees, lessors and for users. However, they have differing views on the balance between costs and benefits of the proposals and, therefore, also on whether the proposals are acceptable. This divergence of opinion provides a further illustration of the need for accounting standard setters to investigate thoroughly the views and needs of users. Reliance on users' formal responses to discussion papers and exposure drafts is unlikely to be sufficient. A more informal process of user consultation, which appears to be used currently in the UK, may be more successful but it creates challenges in maintaining the overall transparency of the standard setting process.

Notes

[1] These figures are derived from data reported by Beattie, Edwards and Goodacre (1998) and Beattie, Goodacre and Thomson (2000a). The mean total lease finance was estimated at £54.6m (£3.8m finance leases, £50.8m operating leases) giving a total lease liability of £71 billion (£54.6m $\times$ 1300) for the total of approximately 1300 companies in the Datastream UKQI list for 1994. Total lease finance to long-term debt = 51% (£54.6m/£108.1m). The ratios of total leases to total assets (LR_C) and net fixed assets to total assets (faprop), after adjustment for operating lease capitalisation in the former ratio, allow the calculation of 28% for leases to net fixed assets.

[2] One area of disagreement between company managers and other commentators concerned the desirability of flexibility. While most argued that an accounting standard should narrow alternative accounting choices to improve comparability, the Financial Executives Institute suggested that 'standards should have a certain degree of flexibility'.

[3] For an early discussion of these issues, see Zeff (1978). For a review of the early empirical work, see Holthausen and Leftwich (1983), who discuss the predictions of economic consequence theories in terms of contracting and monitoring costs.

[4] Further, there is evidence that at least some investment analysts and credit rating agencies recast financial statements by calculating the assets and liabilities implicit in off-balance sheet operating leases (e.g., Dresdner Kleinwort Benson, 1998).

[5] A similar response was reported by Drury and Braund (1990) in their (post-SSAP 21) general survey of the leasing decision.

[6] Data for these additional tests were all extracted from *Datastream*.

[7] Including 104 negative responses from the finance directors, the overall response rate was 44%. The major reasons for negative response were lack of time/staff availability/too busy (50%), and company/individual policy not to respond to questionnaires (19%). Just 7% said they had no knowledge of, or opinion on, the issue of lease accounting.

[8] A questionnaire investigating 'leasing and corporate financing decisions' was sent out over a similar time period to the remaining two-thirds of the UKQI population. Respondents to this survey were invited to request the 'lease accounting reform' questionnaire and 13 requested and completed the questionnaire.

[9] To give an indication of comparable response rates, three journals (*Accounting and Business Research*, *British Accounting Review* and *Accounting Horizons*) were reviewed for the three years 1998-2000 to identify postal questionnaire studies using similar groups and other relevant studies were identified from other journals. Response rates obtained for preparers/finance directors in the UK have been: 18% (Bebbington *et al.*, 1994); 6% and 35% (Nixon, 1997); 32% (Arnold and Hatzopoulos, 2000); 30% (Manson and Zaman, 2001). Studies in other countries report the following: US: 12% (Trahan and Gitman, 1995); 27% (Ashbaugh *et al.*, 1999); 9% (Graham and Harvey, 2001); Australia: 25% (Deegan and Rankin, 1999); New Zealand: 25% (Milne and Chan, 1999). Illustrative response rates for expert users/investment analysts have been UK: 22% (Solomon, 1999); 20% (Clatworthy, 2000); 23% (Manson and Zaman, 2001); Australia: 35% (Yap, 1997); 25% (Deegan and Rankin, 1999); New Zealand: 21% (Milne and Chan, 1999). In the US, Hermanson (2000) obtained an overall 28% across nine user-groups, preparers and auditors. The simple means across the wide range of environments and natures of the studies listed are 22% for preparers and 24% for users. Response rates are influenced by a diverse set of factors such as questionnaire fatigue of the population; interest in and knowledge of the topic; the attractiveness and professionalism displayed in the design and presentation of the questionnaire; the length of the questionnaire; and the thoroughness of the administration procedures.

[10] Including 136 negative responses from the investment analysts, the overall response rate was 38%. Interestingly, the major reasons for negative response were insufficient knowledge of lease accounting (47%) and lack of time/too busy (40%).

[11] The 91 companies of the responding finance directors ranged in size (total assets) from £27,962 million down to £642,000 with a mean and median of £1,082 million and £68 million, respectively. The annual operating lease rentals of the companies totalled £1,596 million. Lease usage (operating lease rentals/sales) ranged between 0% and 20.4%, with a mean and median of 3.4% and 1.8%, respectively. The correlation between lease usage and size was negative (-0.126) but not statistically different from zero.

[12] Recourse had to be made to this surrogate method as key characteristics of the population and sample were unavailable, particularly for the investment analyst group. For consistency, the method was applied to both FD and IA groups.

[13] Late respondents agreed more strongly than early respondents with two statements: 'significant compliance costs involved in obtaining option valuations' (Table 4, row 5); 'many operating leases would give rise to assets and liabilities on the balance sheet' (Table 7, row 1). Late respondents agreed with four statements that early respondents disagreed with: 'review of estimates that will be paid at rent revision dates' (Table 6, row 5); 'estimates of liabilities arising through rising prices can only be obtained at a significant cost by requiring expert advice' (Table 6, row 7); 'transition period with capitalised value of leases disclosed and only incorporated at end of transition period' (Table 10, row 2); and 'transition period with capitalisation of new leases and disclosure of value for existing leases' (Table 10, row 4).

[14] These tests suffer from a number of well-known limitations; see Wallace and Mellor (1988) and Wallace and Cooke (1990) for discussions.

[15] The test between early and late respondents showed no differences for the question seeking information on the respondents' level of familiarity with the G4+1 proposals. This suggests that the lower familiarity observed for the IA group is probably indicative of a general lower appreciation of the issues in the wider IA population.

[16] Opinion varies regarding whether it is better to use parametric or non-parametric statistical tests on responses from Likert-type scales. Strictly, a Likert scale is not an interval scale and so the more conservative non-parametric tests should be used. In practice, however, the results of both forms of test are very similar and so the more familiar and tractable parametric versions are commonly used. Studies involving Likert scales that use parametric tests include Bebbington *et al*. (1994), Yap (1997) and Hermanson (2000), while Deegan and Rankin (1999) use non-parametric tests exclusively.

[17] The use of 'break clauses' is more common in the UK commercial property market than 'renewal options' but the effect is very similar. These break clauses can be used to give the lessee an option to exit the lease contract at various stages during the contract (e.g., every five years). It is, in effect, an option to 'not renew'.

[18] This treatment is currently used for finance leases under SSAP 21.

[19] FDs in large companies were more acutely aware, than those in small companies, of the need to renegotiate bond covenants (mean = 4.13 (large); 3.79 (small)), perhaps because large companies are likely to have greater exposure to securitised long-term debt (Lasfer, 1999; Bevan and Danbolt, 2000). On the other hand, small company FDs showed greater concern over the expected increase in administrative burdens (mean = 3.83 (small); 3.42 (large)) and compliance costs (mean = 3.86 (small); 3.51 (large)). Presumably, small companies have a smaller administrative team over which to spread such matters.

[20] In particular, both here and in the equivalent question element concerning property leases (Table 8, row 4), large firm FDs agreed that lease terms would shorten (mean = 3.62) rather than small firm FDs (mean = 3.15), presumably reflecting the relative bargaining power that large firms have in contract negotiations.

[21] The view that leasing will become less attractive is driven by low lease usage company FDs (mean = 3.57) rather than high lease company FDs (mean = 3.18).

[22] Of the FD group, the disagreement observation relates mainly to high lease usage companies (mean = 2.58) rather than low lease usage companies, who were essentially neutral (mean = 2.97).

[23] Large company FDs tended to agree that 'companies would be reluctant to enter long property leases making it difficult to fund new property development' (row 8: mean = 3.37) in contrast to small company FDs who disagreed (mean = 2.77). This may reflect large company views on the first, rather than the second, part of the statement. There is anecdotal evidence that companies may wish to negotiate shorter lease contracts for commercial rather than accounting reasons. Large companies may find this easier to accomplish than small companies in view of their stronger negotiating position.

[24] The Finance & Leasing Association suggested an 'improved' version of SSAP 21 in which the arbitrary 90% classification test for finance leases of SSAP 21 would be reduced to 75%. They argue that this would bring the vast majority of UK operating leases onto the balance sheet while retaining the existing principles that are widely understood.

[25] For rows 2, 3 and 6 respectively, the group means for the 'familiar' ('less familiar') IA groups were 2.46 (3.24), 2.38 (3.24), and 2.50 (3.13); the differences were significant at the 5% level.

References

Abdel-khalik, A.R., (1981). *The economic effects on lessees of FASB Statement No. 13, accounting for leases*. Stamford, CT: Financial Accounting Standards Board.

Arnold, G.C. and Hatzopoulos, P.D. (2000). 'The theory-practice gap in capital budgeting: evidence from the United Kingdom'. *Journal of Business Finance & Accounting*, 27(5&6), June/July: 603-626.

ASB (1999). *Leases: implementation of a new approach, Discussion Paper*. London: Accounting Standards Board.

ASB (2001). *2000 Annual review of the Financial Reporting Council*. London: Accounting Standards Board.

ASC (1984). *Accounting for leases and hire purchase contracts, Statement of Standard Accounting Practice No. 21*. London: Accounting Standards Committee.

Ashbaugh, H., Johnstone, K.M. and Warfield, T.D. (1999). 'Corporate reporting on the internet'. *Accounting Horizons*, 13(3), September: 241-257.

Ashton, R.K. (1985). 'Accounting for finance leases: a field test'. *Accounting and Business Research*, 15(59), Summer: 233-238.

Beattie, V.A., Edwards, K. and Goodacre, A. (1998). 'The impact of constructive operating lease capitalisation on key accounting ratios'. *Accounting and Business Research*, 28(4), Autumn**:** 233-254.

Beattie, V.A., Goodacre, A. and Thomson, S. (2000a). 'Operating leases and the assessment of lease-debt substitutability'. *Journal of Banking & Finance*, 24(3): 427-470.

Beattie, V.A., Goodacre, A. and Thomson, S. (2000b). 'Recognition versus disclosure: an investigation of the impact on equity risk using UK operating lease disclosures'. *Journal of Business Finance & Accounting*, 27(9&10), November/December: 1185-1224.

Beattie, V.A., Goodacre, A. and Thomson, S. (2001). *Leasing and corporate financing decisions*. unpublished manuscript.

Bebbington, J., Gray, R., Thomson, I. and Walters, D. (1994). 'Accountants' attitudes and environmentally-sensitive accounting'. *Accounting and Business Research*, 24(94), Spring: 109-120.

Beneish, M.D. and Press, E. (1993). 'Costs of technical violation of accounting-based debt covenants'. *Accounting Review*, 68(2) April: 233-257.

Bevan, A.A. and Danbolt, J. (2000). 'Dynamics in the determinants of capital structure in the UK'. Working Paper 2000/9, University of Glasgow.

Bowman, R.G. (1980). 'The debt equivalence of leases: an empirical investigation'. *Accounting Review*, 55(2), April: 237-253.

Breton, G. and Taffler, R.J. (1995). 'Creative accounting and investment analyst response'. *Accounting and Business Research*, 25(98), Spring: 81-92.

CA Magazine (1999). 'Who's who in fund management 1999'. December: 31-70.

Clatworthy, M. (2000). 'Transnational equity analysis – an evaluation'. *Professional Investor*, September: 22-24.

Collins, W., Davie, E., and Weetman, P. (1996). 'Lobbying on accounting issues: preparer/user imbalance in the case of the operating and financial review'. *Accounting, Auditing and Accountability Journal*, 9(1), Spring: 59-76.

Deegan, C. and Rankin, M. (1999). 'The environmental expectations gap: Australian evidence'. *British Accounting Review*, 31(3), September: 313-346.

Dresdner Kleinwort Benson (1998). *Operating leases: the retail house of cards*. London: Dresdner Kleinwort Benson Research.

Drury, C. and Braund, S. (1990). 'The leasing decision: a comparison of theory and practice'. *Accounting and Business Research*, 20(79), Summer: 179-191.

El-Gazzar, S.M. (1993). 'Stock market effects of the closeness to debt covenant restrictions resulting from capitalization of leases'. *Accounting Review*, 68(2) April: 258-272.

Ely, K.M. (1995). 'Operating lease accounting and the market's assessment of equity risk'. *Journal of Accounting Research*, 33(2), Autumn: 397-415.

Finance & Leasing Association (1999). *Think again Sir David: lease accounting reform is not as simple as you think*. Press Release, 17 December, London: Finance & Leasing Association.

Finance & Leasing Association (2000). *Annual survey of business finance 2000*. London: Finance & Leasing Association.

Finnerty, J.E., Fitzsimmons, R.N. and Oliver, T.W. (1980). 'Lease capitalization and systematic risk'. *Accounting Review*, 55(4), October: 631-639.

Garrod, N. (1989). 'Regulation and response: the case of lease disclosure in the UK'. *Research in Accounting Regulation*, 3: 69-92.

Godfrey, J.M. and Warren. S.M. (1995). 'Lessee reactions to regulation of accounting for leases'. *Abacus*, 31(2), September: 201-228.

Goodacre, A. and Beattie, V.A. (1999). 'Operating leases get the treatment'. *Professional Investor*, October: 24-27.

Goodacre, A. (2001). 'The potential impact of enforced lease capitalisation in the UK retail sector'. paper presented at the Financial Reporting and Business Communication Conference, Cardiff University, 5-6 July.

Gopalakrishnan, V. and Parkash, M. (1996). 'The debt-equivalency of recognized vs. disclosed obligations: an examination of borrower and lender perceptions'. *Research in Accounting Regulation*, 10: 63-77.

Graham, J.R. and Harvey, C.R. (2001). 'The theory and practice of corporate finance: evidence from the field'. *Journal of Financial Economics*, 60(2-3), May: 187-243.

Hartman, B.P. and Sami, H. (1989). 'The impact of the accounting treatment of leasing contracts on user decision making: a field experiment'. *Advances in Accounting*, 7: 23-35.

Hermanson, H.M. (2000). 'An analysis of the demand for reporting on internal control'. *Accounting Horizons*, 14(3), September: 325-341.

Holthausen, R.W. and Leftwich, R.W. (1983). 'The economic consequences of accounting choice: implications of costly contracting and monitoring'. *Journal of Accounting and Economics*, 5(2), August: 77-117.

Imhoff, E.A. (1998). 'Six commentaries on characteristics of high quality accounting standards'. *Accounting Horizons*, 12(2), June: 160-191.

Imhoff, E.A. and Thomas, J.K. (1988). 'Economic consequences of accounting standards: the lease disclosure rule change'. *Journal of Accounting and Economics*, 10(4), December: 277-310.

Imhoff, E.A., Lipe, R.C. and Wright, D.W. (1991). 'Operating leases: impact of constructive capitalization'. *Accounting Horizons*, 5(1), March: 51-63.

Imhoff, E.A., Lipe, R.C. and Wright, D.W. (1993). 'The effects of recognition versus disclosure on shareholder risk and executive compensation'. *Journal of Accounting, Auditing and Finance*, 8(4), Fall: 335-368.

Imhoff, E.A., Lipe, R.C. and Wright, D.W. (1997). 'Operating leases: income effects of constructive capitalization'. *Accounting Horizons*, 11(2), June: 12-32.

Investment Property Forum (1999). 'Proposed capitalisation of operating leases – what impact on the UK property market?'. *Forum Review*, Issue No. 3, October: 2-3.

Jick, T.D. (1979). 'Mixing qualitative and quantitative methods: triangulation in action'. *Administrative Science Quarterly*, 24, December: 602-611.

Jonas, G.J. and Young, S.J. (1998). 'Bridging the gap. Who can bring a user focus to business reporting?, *Accounting Horizons*, 12(2), June: 154-159.

Kothari, S.P. (2001). 'Capital markets research in accounting'. *Journal of Accounting and Economics*, 31(1-3), September: 105-231.

KPMG (2000). 'Approach with caution'. *Financial Reporting Update*. January/February: 1-2.

Lasfer, M.A. (1999). 'Debt structure, agency costs and firm's size: an empirical investigation'. Working Paper, City University Business School.

Levitt, A. (1998). 'The impact of high quality accounting standards'. *Accounting Horizons*, 12(1), March: 79-82.

Manson, S. and Zaman, M. (2001). 'Auditor communications in an evolving environment: going beyond SAS 600 auditors' reports on financial statements'. *British Accounting Review*, 33(2), June: 113-136.

Mayer-Sommer, A.P. (1979). 'Understanding and acceptance of the efficient markets hypothesis and its accounting implications'. *Accounting Review*, 54(1), January: 88-106.

McGregor, W. (1996). *Accounting for Leases: A New Approach*, Stamford CT: Financial Accounting Standards Board.

Milne, M.J. and Chan, C.C.C. (1999). 'Narrative corporate social disclosures: how much of a difference do they make to investment decision-making?'. *British Accounting Review*, 31(4), December**:** 439-457.

Munter, P. and Ratcliffe, T.A. (1983). 'An assessment of user reactions to lease accounting disclosure'. *Journal of Accounting, Auditing and Finance*, 6(2), Winter: 108-114.

Nelson, A.J. (1963). 'Capitalising leases - the effect on financial ratios'. *Journal of Accountancy*, July: 49-58.

Nixon, B. (1997). 'The accounting treatment of research and development expenditure: views of UK company accountants'. *European Accounting Review*, 6(2): 265-277.

Oppenheim, A.N. (1966). *Questionnaire Design and Attitude Measurement*, Heinemann.

Parfet, W.U. (2000). 'Accounting subjectivity and earnings management: a preparer perspective'. *Accounting Horizons*, 14(4), December: 481-488.

Prakash, P. and Rappaport, A. (1977). 'Information inductance and its significance for accounting'. *Accounting, Organisations and Society*, 2(1): 29-38.

Ro, B.T. (1978). 'The disclosure of capitalised lease information and stock prices'. *Journal of Accounting Research*, 16(2), Autumn: 315-340.

Samuelson, W. and Zeckhauser, R. (1988). 'Status quo bias in decision making'. *Journal of Risk and Uncertainty*, 1(1), March: 7-59.

Schipper, K. (1994). 'Academic accounting research and the standard setting process'. *Accounting Horizons*, 8(4), December: 61-73.

Solomon, J.F. (1999). 'Do institutional investors in the UK adopt a dual strategy for managing foreign exchange risk'. *British Accounting Review*, 31(2), June: 205-224.

Taylor, P. and Turley, S. (1985). 'The views of management on accounting for leases'. *Accounting and Business Research*, 16(61), Winter: 59-67.

Trahan, E.A. and Gitman, L.J. (1995). 'Bridging the theory-practice gap in corporate finance: a survey of chief financial officers'. *Quarterly Review of Economics and Finance*, 35(1), Spring: 73-87.

Wallace, R.S.O. and Cooke, T.E. (1990). 'Nonresponse bias in mail accounting surveys: a pedagogical extension'. *British Accounting Review*, 22(3), September: 283-288.

Wallace, R.S.O. and Mellor, C.J. (1988). 'Nonresponse bias in mail accounting surveys: a pedagogical note'. *British Accounting Review*, 20(2), August: 131-139.

Wilkins, T. (1984). 'A behavioural investigation of alternative methods of financing capital acquisitions and lease capitalization'. *Accounting and Business Research*, 14(56), Autumn: 359-366.

Wilkins, T. and Zimmer, I. (1983a). 'The effect of leasing and different methods of accounting for leases on credit evaluations'. *Accounting Review*, 58(4), October: 749-764.

Wilkins, T. and Zimmer, I. (1983b). 'The effect of alternative methods of accounting for leases - an experimental study'. *Abacus*, 19(1), June: 64-75.

Yap, C. (1997). 'Users' perceptions of the need for cash flow statements – Australian evidence'. *European Accounting Review*, 6(4): 653-672.

Zeff, S.A. (1978). 'The rise of "economic consequences"'. *Journal of Accountancy*, December: 56-63.

Table 1: Attitudes towards accounting standards generally

Question asked (abbreviated)	Mean [1,2] (std. dev. below) Finance Directors	Investment Analysts	Diff. between groups[3]
To what extent do you agree with the following general statements regarding accounting standards?			
Accounting standards are:			
1. an undesirable and unnecessary intrusion into company activities	1.51*** (0.80)	1.34 *** (0.83)	ns
2. desirable and impose no significant burden on companies	2.67 ** (1.19)	3.34 (1.24)	0.01
3. desirable but do impose a significant burden on companies	3.70*** (1.10)	3.27 (1.15)	0.05

Notes

1. Response categories are: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, 5 = strongly agree
2. Significance of t-test of whether mean response is significantly different from 3 = neutral; *** and ** = significant at 1% and 5% levels, respectively (2-tail test)
3. P-value from a Wilcoxon-Mann-Whitney test for significant difference between respondent group medians; significance levels of 5% and 1% are reported (2-tail test); ns = not significant.

Table 2: Views regarding suggested deficiencies in the current lease accounting standard (SSAP 21)

	Question asked (abbreviated)	Mean [1,2] (std. dev. below) Finance Directors	Investment Analysts	IA rank[3]	Diff. between groups[4]
	To what extent do you agree with the following suggested deficiencies in SSAP 21?				
1.	Permits leasing transactions to be deliberately structured for classification as operating leases	4.12*** (0.85)	4.16*** (0.72)	1	ns
2.	Substantially similar leasing transactions can be accounted for in different ways	3.91*** (0.82)	4.08*** (0.62)	3	ns
3.	No balance sheet recognition of material operating lease assets and liabilities	3.81*** (1.04)	3.98*** (0.89)	4	ns
4.	No single accounting method applicable to all leases	3.61*** (0.98)	3.90*** (1.01)	5	ns
5.	Requires estimation of balance sheet impact of operating leases based on limited information	3.42*** (0.85)	4.13*** (0.70)	2	0.01
6.	Lease classification requires difficult and subjective judgements	3.28*** (0.98)	3.68*** (0.86)	8	0.05
7.	Inconsistency with FRS 5 (substance over form)	3.26** (1.08)	3.53*** (0.80)	9	ns
8.	Impairs users' comparison between companies	3.21 (1.11)	3.73*** (1.01)	6	0.05
9.	Impairs users' evaluation of lessees' financial commitments	3.07 (1.05)	3.72*** (0.97)	7	0.01
10.	Impairs users' estimation of risks involved in providing finance to lessee companies	2.77** (1.00)	3.38** (0.92)	10	0.01

Notes

1. Response categories are: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, 5 = strongly agree
2. Significance of t-test of whether mean response is significantly different from 3 = neutral; *** and ** = significant at 1% and 5% levels, respectively (2-tail test)
3. Table is ranked by mean response of finance director group; IA rank = rank of investment analysts' mean response
4. P-value from a Wilcoxon-Mann-Whitney test for significant difference between respondent group medians; significance levels of 5% and 1% are reported (2-tail test); ns = not significant.

Table 3: Views on the general principles in the G4+1 lease accounting proposals

	Question asked (abbreviated)	Mean [1,2] (std. dev. below) Finance Directors	Investment Analysts	IA rank[3]	Diff. between groups[4]
	To what extent do you agree with the following principles in the proposed approach to lease accounting?				
1.	One accounting method should be applicable to all leasing transactions	3.32** (1.25)	3.72*** (1.07)	3	ns
2.	All *material* leases should give rise to an asset and liability on the lessee's balance sheet	3.27** (1.23)	3.95*** (0.81)	1	0.01
3.	A lease accounting method should apply to all types of tangible asset, including land and buildings	3.07 (1.27)	3.74*** (1.02)	2	0.01
4.	A lease accounting method be equally applicable to leases of intangible and tangible assets	3.01 (1.13)	3.33** (0.96)	5	ns
5.	A lease accounting method should not contain a threshold to exclude short leases; this should be addressed by the concept of materiality	2.96 (1.15)	3.67*** (0.86)	4	0.01

Notes

1. Response categories are: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, 5 = strongly agree
2. Significance of t-test of whether mean response is significantly different from 3 = neutral; *** and ** = significant at 1% and 5% levels, respectively (2-tail test)
3. Table is ranked by mean response of finance director group; IA rank = rank of investment analysts' mean response
4. P-value from a Wilcoxon-Mann-Whitney test for significant difference between respondent group medians; significance levels of 5% and 1% are reported (2-tail test); ns = not significant.

Table 4: Views on the accounting treatment of renewal/purchase options in lease contracts

	Question asked (abbreviated)	Mean [1,2] (std. dev. below) Finance Directors	Investment Analysts	Diff. between groups[3]
	To what extent do you agree with the following statements concerning the accounting treatment of renewal/purchase options?			
1.	Exercise of renewal/purchase options should not be anticipated	3.71*** (0.86)	3.31 (1.04)	0.05
2.	Estimates of probable amounts paid under options should be recording as an asset and liability at beginning of lease	2.83 (1.06)	3.14 (0.86)	ns
3.	Renewal/purchase options of significant value should be recorded as a separate asset and liability	2.57*** (1.01)	3.29** (0.83)	0.01
4.	Renewal/purchase option value can be reliably ascertained by comparison with similar agreements without options	2.66*** (1.00)	3.14 (0.81)	0.01
5.	Significant compliance costs would be involved in obtaining option valuations	4.03*** (0.84)	3.38** (1.09)	0.01
6.	Negotiation of short terms of limited asset usage that incorporate renewal and purchase options could ensure future requirements and minimise balance sheet obligations	3.46*** (0.76)	3.52*** (0.78)	ns

Notes

1. Response categories are: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, 5 = strongly agree
2. Significance of t-test of whether mean response is significantly different from 3 = neutral; *** and ** = significant at 1% and 5% levels, respectively (2-tail test)
3. P-value from a Wilcoxon-Mann-Whitney test for significant difference between respondent group medians; significance levels of 5% and 1% are reported (2-tail test); ns = not significant.

Table 5: Views on the accounting treatment of lease rentals that are contingent on revenue or profits derived from asset use

	Question asked (abbreviated)	Mean [1,2] (std. dev. below) Finance Directors	Investment Analysts	Diff. between groups[3]
	To what extent do you agree with the following statements concerning the accounting treatment of lease rentals which are contingent on revenue/profits?			
1.	No balance sheet recognition of contingent lease rentals; they should be expensed when revenue/profits arise	3.69*** (1.00)	3.08 (1.21)	0.01
2.	Estimates of probable amounts paid should be recorded on the balance sheet	2.48*** (1.00)	3.08 (1.01)	0.01
3.	If minimum lease rentals are unrepresentative, the fair value of property rights conveyed should be recognised on the balance sheet	2.94 (0.94)	3.28 (1.00)	ns
4.	Fair value of property rights conveyed can be ascertained by comparison with similar lease agreement excluding the contingency	2.77** (1.01)	2.97 (0.86)	ns
5.	It is incorrect to compare with similar agreements excluding contingency; contingent element restricts asset use making the lease less valuable	3.29*** (0.88)	3.58*** (0.83)	ns

Notes

1. Response categories are: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, 5 = strongly agree
2. Significance of t-test of whether mean response is significantly different from 3 = neutral; *** and ** = significant at 1% and 5% levels, respectively (2-tail test)
3. P-value from a Wilcoxon-Mann-Whitney test for significant difference between respondent group medians; significance levels of 5% and 1% are reported (2-tail test); ns = not significant.

Table 6: Views on the accounting treatment of lease rentals that vary in line with prices (e.g. upwards-only rent reviews for land and buildings)

	Question asked (abbreviated)	Mean [1,2] (std. dev. below) Finance Directors	Investment Analysts	Diff. between groups[3]
	To what extent do you agree with the following statements concerning the accounting treatment of lease rentals that vary in line with prices? (e.g., upward-only rent revision on land and buildings)			
1.	Assets and liabilities should be recognised on basis of rentals applicable at beginning of lease term	3.71*** (1.08)	3.08 (1.20)	0.01
2.	Initial rentals for a lease with rent reviews will be lower; this could be misleading if no recognition is made for future rent rises	2.87 (0.98)	3.26 (1.06)	ns
3.	Assets and liabilities should be recognised on basis of estimates of rentals that will actually be paid	2.52*** (1.09)	3.00 (1.07)	0.05
4.	If estimated rentals are recognised, estimates should be reviewed at each balance sheet date	3.05 (1.20)	3.64*** (1.07)	0.05
5.	If estimated rentals are recognised, estimates should be reviewed at rent revision dates only	2.95 (1.10)	2.61 (1.12)	ns
6.	Estimates of liabilities arising through rising prices cannot be measured reliably	3.81*** (1.08)	3.13 (1.17)	0.01
7.	Estimates of liabilities arising through rising prices could be obtained but only at a significant cost due to requirement of expert advice	3.28** (1.21)	2.82 (1.23)	ns

Notes

1. Response categories are: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, 5 = strongly agree
2. Significance of t-test of whether mean response is significantly different from 3 = neutral; *** and ** = significant at 1% and 5% levels, respectively (2-tail test)
3. P-value from a Wilcoxon-Mann-Whitney test for significant difference between respondent group medians; significance levels of 5% and 1% are reported (2-tail test); ns = not significant.

Table 7: Views on the consequences of adopting the G4+1 lease accounting proposals: all assets

	Question asked (abbreviated)	Mean [1,2] (std. dev. below) Finance Directors	Investment Analysts	IA rank[3]	Diff. between groups[4]
	To what extent do you agree that the following are direct or indirect consequences of recording all material leases on the lessee's balance sheet?				
1.	Many operating leases would give rise to assets and liabilities on the balance sheet	4.36*** (0.59)	4.16*** (0.55)	1	ns
2.	Reported measures of gearing would increase	4.18*** (0.83)	4.13*** (0.66)	2	ns
3.	Lessee companies may need to renegotiate their borrowing covenants	3.96*** (0.81)	3.43*** (0.77)	6	0.01
4.	Significant additional compliance costs	3.70*** (0.95)	3.21 (1.08)	11	0.05
5.	Significant additional administrative burden	3.64*** (0.99)	3.26 (1.14)	10	ns
6.	Lease terms would become shorter to minimise obligations	3.41*** (0.95)	3.33** (0.79)	9	ns
7.	Users' evaluation of long term finance commitment of lessees would improve	3.38*** (1.00)	3.89*** (0.69)	3	0.01
8.	Lease finance would become less attractive	3.37*** (0.90)	3.21 (1.04)	11	ns
9.	Users' ability to compare companies would improve	3.27** (1.02)	3.76*** (0.79)	4	0.05
10.	Some lessees would experience a reduction in credit rating	3.25*** (0.83)	3.40** (1.01)	8	ns
11.	Users would increase their estimates of risks involved in providing finance to lessees	3.01 (0.93)	3.51*** (0.76)	5	0.01
12.	Users' assessments of debt paying ability of lessees would not be affected	3.01 (0.84)	3.10 (0.97)	13	ns
13.	Significant short-term reduction in UK investment and leasing volumes, to reduce perceived high gearing	2.85 (1.03)	2.63** (1.06)	16	ns
14.	New assets would be purchased/constructed rather than leased	2.81** (0.77)	2.91 (0.98)	14	ns
15.	Financial statements would reflect the financial flexibility provided by different leasing arrangements	2.77** (0.96)	3.41** (0.98)	7	0.01
16.	Shareholders would reduce their estimates of lessees' ability to pay future dividends	2.62*** (0.75)	2.80 (0.76)	15	ns

Notes

1. Response categories are: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, 5 = strongly agree
2. Significance of t-test of whether mean response is significantly different from 3 = neutral; *** and ** = significant at 1% and 5% levels, respectively (2-tail test)
3. Table is ranked by mean response of finance director group; IA rank = rank of investment analysts' mean response
4. P-value from a Wilcoxon-Mann-Whitney test for significant difference between respondent group medians; significance levels of 5% and 1% are reported (2-tail test); ns = not significant.

Table 8: Views on the consequences of adopting the G4+1 lease accounting proposals: land and buildings

	Question asked (abbreviated)	Mean [1,2] (std. dev. below) Finance Directors	Investment Analysts	IA rank[3]	Diff. between groups[4]
	To what extent do you agree with the following suggested consequences of the new approach applied to the leasing of land and buildings?				
1.	Substantial assets and liabilities on balance sheets so would have a marked effect on reported gearing	4.17*** (0.74)	3.90*** (0.91)	1	ns
2.	Companies would find it difficult and expensive to estimate the present value of future property rent increases	3.94*** (0.95)	3.03 (1.05)	6	0.01
3.	Combined P&L expense (depreciation and interest) in the early years of a new property lease would substantially exceed market rent	3.55*** (0.88)	3.00 (0.86)	7	0.01
4.	Negotiation of shorter term property leases to minimise balance sheet obligations	3.38*** (1.04)	3.17 (1.01)	5	ns
5.	Users' ability to compare companies leasing and purchasing property would improve	3.26** (0.97)	3.55*** (0.76)	2	ns
6.	Advantage of showing increase in value arising from lessee sub-leasing at a higher rent	3.24*** (0.78)	3.46*** (0.69)	4	ns
7.	Recording leased asset brings it within the scope of impairment. This has the advantage of writing off any loss when it occurs rather than when the decision is taken to vacate the property.	3.22** (0.96)	3.50*** (0.71)	3	ns
8.	Companies would be reluctant to enter long term property leases making it difficult to fund new property development	3.10 (1.08)	2.81 (1.02)	9	ns
9.	Property rental yields may rise to reflect higher risk arising from loss of security of long term tenants	3.07 (0.97)	2.84 (0.99)	8	ns
10.	Companies would purchase property rather than lease	2.77** (0.85)	2.63*** (0.77)	10	ns

Notes

1. Response categories are: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, 5 = strongly agree
2. Significance of t-test of whether mean response is significantly different from 3 = neutral; *** and ** = significant at 1% and 5% levels, respectively (2-tail test)
3. Table is ranked by mean response of finance director group; IA rank = rank of investment analysts' mean response
4. P-value from a Wilcoxon-Mann-Whitney test for significant difference between respondent group medians; significance levels of 5% and 1% are reported (2-tail test); ns = not significant.

Table 9: Views on lease accounting alternatives

	Question asked (abbreviated)	Mean [1,2] (std. dev. below) Finance Directors	Investment Analysts	IA rank[3]	Diff. between groups[4]
	To what extent do you agree with the following statements regarding lease accounting alternatives?				
1.	Note disclosure to be accompanied by analysis of lease commitments by asset type	3.75*** (0.93)	3.76*** (0.85)	1	ns
2.	Note disclosure of amount and timing of future lease cash flow commitments *without* any capitalisation	3.16 (1.19)	2.97 (1.03)	3	ns
3.	Note disclosure of all lease commitments and asset values *without* any capitalisation	3.13 (1.20)	2.95 (1.01)	4	ns
4.	Current distinction between finance and operating leases should be maintained	3.05 (1.23)	2.46*** (1.14)	6	0.05
5.	Capitalised value of all leases recorded on balance sheet *with* other material aspects disclosed in a note (G4+1)	2.95 (1.23)	3.62*** (0.91)	2	0.01
6.	Introduction of 75% threshold in finance lease classification	2.73** (0.97)	2.92 (0.94)	5	ns
7.	Capitalised value of *all* leases recorded on balance sheet *without* note disclosure of other material aspects	2.27*** (0.95)	2.46*** (0.82)	6	ns

Notes
1. Response categories are: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, 5 = strongly agree
2. Significance of t-test of whether mean response is significantly different from 3 = neutral; *** and ** = significant at 1% and 5% levels, respectively (2-tail test)
3. Table is ranked by mean response of finance director group; IA rank = rank of investment analysts' mean response
4. P-value from a Wilcoxon-Mann-Whitney test for significant difference between respondent group medians; significance levels of 5% and 1% are reported (2-tail test); ns = not significant.

Table 10: Views on implementation of the G4+1 lease accounting proposals

	Question asked (abbreviated)	Mean [1,2] (std. dev. below) Finance Directors	Investment Analysts	IA rank[3]	Diff. between groups[4]
	To what extent do you agree with the following statements regarding implementation of new proposals for lease accounting?				
1.	Immediate implementation of proposals to new and existing leases	2.61***	3.36**	1	0.01
		(1.25)	(1.01)		
2.	Transition period with the capitalised value of (new and existing) leases disclosed and only incorporated in balance sheet at end of transition period	2.56***	2.72	3	ns
		(1.12)	(1.02)		
3.	Transition period with operating lease capitalisation required for new leases only	2.55***	2.54***	4	ns
		(1.19)	(0.97)		
4.	Transition period with operating lease capitalisation required for new leases and disclosure of capitalised value required for existing leases	2.52***	2.85	2	ns
		(1.14)	(0.99)		

Notes

1. Response categories are: 1 = strongly disagree, 2 = disagree, 3 = neutral, 4 = agree, 5 = strongly agree
2. Significance of t-test of whether mean response is significantly different from 3 = neutral; *** and ** = significant at 1% and 5% levels, respectively (2-tail test)
3. Table is ranked by mean response of finance director group; IA rank = rank of investment analysts' mean response
4. P-value from a Wilcoxon-Mann-Whitney test for significant difference between respondent group medians; significance levels of 5% and 1% are reported (2-tail test); ns = not significant.