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Implications of the new lease proposal

- A case study on a multinational manufacturing company and its stakeholders

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Göteborg, 2011-05-27

Martin Peters



“I have said that - we try to catch the assets, the liabilities and the villains. There are always those trying to cheat. We just put up some bars to catch the worst villains”

Jan Engström
Board member of IASB



Abstract

The current lease standard has been criticized for permitting companies to account for similar transactions in different ways, making analysts compelled to adjust for lease obligations not recognized on the balance sheet. In order to overcome this issue IASB (International Accounting Standards Board) and FASB (Financial Accounting Standards Board) released an exposure draft describing a new lease standard. This new proposal has, however, been criticized for implying high costs for companies preparing the financial reports. This paper therefore examines the main implications following the proposal and whether potential benefits will exceed its costs for a chosen company and its stakeholders. The research questions will be attended with the assistance of a model, showing five different perspectives on the proposal. Each perspective is analyzed through interviews with informed respondents which then are compared in order to arrive at a final result. Eventually we come up with the conclusion that differing opinions exist on whether the proposal can be considered as beneficial or not. However, most respondents were fairly neutral to its effects, with a slight predominance of the negative effects.

Keywords: *Lease proposal, accounting, transparency, cost of capital, comparability, off-balance sheet financing, derecognition, Volvo.*



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List of abbreviations

CI - Comment letter

CRUF - Corporate Reporting Users' Forum

D/E - Debt to equity ratio

FASB - Financial Accounting Standards Board

G4+1 - A former association consisting of the Australian Accounting Standards Board, the Canadian Accounting Standards Board, the New Zealand Financial Reporting Standards Board, the United Kingdom Accounting Standards Board and the United States Financial Accounting Standards Board. The International Accounting Standards Committee (IASC) was involved as an observer (iasplus.com).

IASB - International Accounting Standards Board

ROA - Return on assets

SEAG - Swedish Enterprise Accounting Group

SME - Small and Medium-sized Enterprise

List of definitions

A lease - is a contract calling for the lessee (user) to pay the lessor (owner) for use of an asset (IAS 17).

Contingent rentals - Lease payments that arise under the contractual terms of a lease because of changes in facts or circumstances occurring after the date of inception of the lease, other than the passage of time (Exposure draft: Leases).

Finance lease - an agreement where the economical benefits and risks associated with the ownership of the asset is transferred from the lessor to the lessee (IAS 17).

Off-balance sheet financing - A form of financing in which large capital expenditures are kept off of a company's balance sheet (investopedia.com)

Operating lease - all lease contracts that are not defined as finance lease contracts (IAS 17).

Stakeholder (corporate) - Any identifiable group or individual who can affect the achievement of an organization's objectives or who is affected by the achievement of an organization's objectives (Freeman and Reed, 1983).

1 INTRODUCTION¹

In this part we motivate and provide a brief overview of our chosen subject. Thereafter, a problem discussion is presented, forming the basis for our research questions. The chapter is concluded with an outline of how the thesis is structured.

1.1 Motivation

As yet, no earlier research has been conducted covering the possible implications of the new lease proposal in the context of a single company. Though, it has been proposed in a master thesis, investigating the impacts on the qualitative aspects of the lease proposal (Gripensvärd and Fahlén, 2010) as an area of future research. A desire has also been expressed in another thesis (Björklund, 2010) to study how companies will manage the large amount of estimates and calculations following the proposal. Other suggested aspects of interest are the perspectives of external stakeholders and investors on capital structures and credit-accessibility - potentially leading to a change in their valuation of companies.

We have however repeatedly encountered quantitative reports, (Imhoff, Lipe and Wright, 1991; Beattie, Edwards and Goodacre, 1998; Fülbier, Silva and Pferdehirt, 2008), comprehensibly demonstrating the effects on financial ratios from constructive capitalization of operating leases applied on a large sample. We also recognize limitations with the earlier efforts using methods of capitalizing since they do not cover the whole concept with the current proposal requiring companies also to estimate future obligations from options to extend and contingent rentals.

With our research we aim at contributing to the topic by collecting different perspectives on the lease proposal and its implications on seven discovered concepts that appeared relevant during our research process. This is done by interviewing informed internal and external stakeholders² to a large multinational company, Volvo Group, as well as professionals engaged directly or indirectly with the proposal. The headquarter of Volvo Group is located in Sweden, where also some of our respondents are active. A note is therefore appropriate that witnesses deriving from this environment are not necessarily applicable outside Sweden. Before discussing common issues with the current lease standard, a background to the new proposal, the importance of leasing as a finance source and the motives for companies to use leasing are presented in the background.

¹ Throughout the paper companies preparing the financial reports will be referred to as “preparers”, while stakeholders as credit institutions, analysts and shareholders using the financial reports for analyzing the companies will be referred to as “users”. The exposure draft from IASB and FASB on proposed changes in the way to account for leases will be referred to as “the proposal”.

² Our use of the concept stakeholder mainly refers to capital providers.

1.2 Background

A joint work plan between the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) was released in the beginning of 2006, described in a Memorandum of Understanding. The goal was to expedite global convergence in accounting standards including a number of milestones to be reached in the following years. The lease project is one of them and was added to their respective agendas on July 19, 2006. Short after they established an international work group (FASB website).

They identified an issue that leasing activities globally, concerning very large sums of assets and liabilities in contracts, are not fully reflected in a lessee's financial statement, mainly due to operating lease classification (Exposure draft: Snapshot leases). Confirmed by a recent study (Duke, Hsieh, and Su, 2009) carried out on the US SP500 index, the authors conclude that on certain occasions companies neglected reporting over one billion dollars in liabilities. Furthermore, they found evidence on improvements in retained earnings while key financial ratios such as ROA and $\frac{D}{E}$ were affected in a favorable way due to operating leasing.

On August 17, 2010, the IASB published an exposure draft (ifrs.org) on leases, stating that all leases should be included in the statement of financial position. Also, potential future obligations that are more probable than not to be realized should be regarded, resulting in options being included in the estimation of the period of future lease payments as well as contingent rentals. The IASB claims that this would result in the same accounting for most lease contracts by lessees - increasing the comparability of financial statements and reducing the opportunity to structure transactions to achieve a desired accounting outcome (Exposure draft: Snapshot leases). All in all resulting in *"...more complete and useful information to investors and other users of financial statements."* (ifrs.org)

An observation adjacent to what is mentioned above is discussed thoroughly by Barth and Schipper (2008), about financial reporting transparency and an absence of a well-defined concept of it in the financial reporting context. We perceive their contribution important in the way it enabled us with a benchmark that facilitates the analysis of the area where our research questions are directed. Their proposed definition of transparency in accounting houses two components *"...the extent to which financial reports reveal an entities **underlying economics** in a way that is **readily understandable** by those using the financial reports."* They further discuss these so-called "components" in relation to a number of issues that are expected to foster transparency such as disaggregation, disclosure versus recognition, measurement basis, comparability and implementation guidance. Moreover they propose a link between transparency and the cost of capital *"...theoretical research suggests that increased reporting transparency can reduce the cost of capital provided that transparency reduces information risk."* This could improve capital allocation in the economy and be regarded as a benefit to the economic system as a whole.

The content of the proposal and its elements will be discussed more in depth later on but first a brief overview of the lease market and motives why companies choose to lease will be presented.

Since leasing appeared in the UK in the 1960's derived from the USA, the outstanding value of leased assets in 2009 had reached €685.6 billion in Europe alone, comprising about 20 % of all investments of equipment (CI: Leaseurope). There are a few important factors that could help explaining why leasing has gained this substantial share of investments. The market for leasing composes a wide range of businesses, from SMEs to large enterprises, where it is used to finance a diverse range of equipment, from small contracts such as office machines to big ticket financing like airplanes. The differences in size and characteristics between these companies also have implications for the incentives to lease (Smith and MacDonald Wakeman, 1985). Leasing has emerged being an important source of finance for companies (Exposure draft: Snapshot leases) and research show that small companies with low profitability prefer leasing when lacking other available sources of funding. It appears being a possible way to finance their growth. For large companies, it is mainly driven by tax incentives and utilized as a complement to debt financing (Ameziane Lasfer and Levis, 1998; Sharpe, and Nguyen, 1995).

Apart from the practical usage of leasing in operations, mostly attributable to risk reducing advantages from higher flexibility³ (Smith and MacDonald Wakeman, 1985), it may also be a useful tool in the financial management of the firm (Ameziane Lasfer and Levis, 1998). There is extensive literature in corporate finance covering the determinants of capital structure. It often involves the early work of Modigliani and Miller (1958) that firms acting rationally will take the decisions that will maximize profits on their assets corresponding to cost of funds. Predominantly by utilizing debt to increase the interest tax shield, and thus provide a benefit for the firm. With an operating lease, debt can partially be substituted (Beattie, Goodacre, and Thompson, 2000), while kept off the balance sheet (Hepp, and Gupta, 2000). Thus leaving leverage ratios unaffected with the possibility to improve the return on existing assets by additional income generated from the newly obtained unrecognized asset (Duke, Hsieh, and Su, 2009).

1.3 Problem discussion

IASB and FASB are currently dividing leases in two different categories; operating and finance leases. In IAS 17, a finance lease is described as an agreement where the economical benefits and risks associated with the ownership are transferred from the lessor to the lessee. The legal ownership may also be transferred after the contract's termination. Operating lease is on the contrary described as all lease contracts that are not defined as finance lease contracts (IAS 17).

The distinction between operating and finance lease is important for companies' financial statements since assets financed through finance leases will be capitalized and thereby increasing both asset and liabilities. An operating lease on the other hand will not have any effect on the balance sheet since it is treated as an operating cost (Marton et al., 2008). The classification between the two types has, however, been treated rather ambiguously and criticism has been raised claiming that companies adjust their contracts in order to turn leasing, that should be considered as finance, into operating. The

³ Due to its potential of minimizing transaction costs when the equipment is found obsolescent.



motivation for this could be to exclude it from the balance sheet and thereby decrease total assets and liabilities (Exposure draft: Leases; Mintz, 2011). By reducing these items, companies are able to improve financial ratios such as return on assets and debt to assets, even though the company's financial position is unchanged. This means that if different companies treat the same kind of leases in various ways, comparability will be limited and the financial information less useful (Exposure draft: Leases). Naturally, analysts, credit agencies and banks are aware of this issue and often make adjustments to the financial statement by capitalizing the operating leases according to different "rules of thumb" (PwC 2010). These adjustments are however not optimal since they are based on estimates rather than real numbers (Exposure draft: Snapshot leases).

One of the objectives with the proposal, according to IASB and FASB, is to facilitate corporate analysis and avoid a situation where two similar transactions are accounted for in different ways. The proposal has received great attention measured by the number of respondents, attributable to the fact that it involves both the lessee and lessor side of accounting. Moreover, it covers a wide range of industries representing concerns regarding their specific industry, but many concerns are shared within different industries (Exposure draft: Comment letter summary leases).

The majority supports the effort in jointly developing a single and converged lease accounting model, and the objective of improving information to users of the financial statements through greater transparency and comparability. Thereby, the board assumes it has support that lease obligation and related assets on the lessee's statement on financial position should be recognized (Exposure draft: Comment letter summary leases).

However, due to the expected complexity and costs related to the implementation of the proposal, worries have been expressed about the consequences the proposal may have on leasing. Field-testing is recommended to be performed on elements of the proposal, assessing the costs and benefits of changes. Contradictory to one of the objects, the level of estimation and judgement required by the proposal to be carried out by preparers, regarding determination of lease term and calculation of variable lease payments may in fact give rise to reduced comparability. Other concerns regard whether all arrangements meeting the proposed definition of a lease should be accounted for in accordance with the proposal, and obscurities in direction and objectives of the proposal on lessor accounting (Exposure draft: Comment letter summary leases).

Some of the concerns stated above have been verified in a report on the proposal. PwC in collaboration with the Rotterdam School of Management made a survey to examine the reactions of European companies on the lease proposal. It revealed that a majority of the respondents expected the standard to bring additional costs for implementation and ongoing accounting as a result of increased complexity. The calculation of options and contingent rentals were particularly mentioned as factors contributing to higher complexity. These costs were also considered to exceed the benefits for users of the financial statements according to 74 percent of the respondents (PwC, Accounting and Valuation Advisory Services, 2010).



A possible scenario following the proposed standard could imply a reduced use of leasing due to increased complexity and the negative impact on debt ratios. In the survey made by PwC in 2010, the respondents were asked how changes in the standard would affect their decisions to lease. Regarding real estate, 40 percent answered that they would change the way they lease as a result of changes in the standard whereas the corresponding number for other type of leases was 40-60 percent. Shorter lease periods and a transition towards service contracts are, according to the respondents, a likely outcome from the proposal. In fact, among all respondents about 15-21 percent answered that they would try to minimize the creation of new assets if the new lease standard would be implemented (PwC, Accounting and Valuation Advisory Services 2010). This indicates that the proposed lease standard may lead to a decreased expansion rate for many companies since the ability to grow without violating debt to capital ratios would diminish. Beattie, Edwards and Goodacre (1998) made a study on how capitalization of operating leases would affect 232 UK listed companies. The study revealed that off-balance sheet financing averaged 39 percent of reported long-term debt, and came to the conclusion that capitalization would have a significant impact on key ratios such as profit margin, ROA and asset turnover.

1.4 Research questions

The problem discussion indicates that mixed views exist on whether the proposed lease standard's costs exceed its benefits. Much of the criticism relates to the problems with predicting the value of future uncertain obligations, increased administration, the inclusion of options and the mismatch between the economic costs and benefits. The main advantage that has been emphasized is on the other hand improved financial information as a result of turning operating lease into an activity on the balance sheet rather than just an operating activity/cost. The belief of IASB and FASB is that the potential costs facing companies affected will be motivated by improved financial information. In order to examine this view and the different pro and counter-arguments we have studied how Volvo⁴ would be affected if the new lease standard was implemented. We find Volvo suitable for our purpose since it is one of Sweden's top 30 listed companies operating in a large number of countries worldwide. The company is also actively participating in the Swedish Enterprise Accounting Group (SEAG), with reviewing proposals for accounting changes and submitting appropriate comments. The group has also published a comment letter concerning the exposure draft for leases (no 200). For these reasons we believe the company is familiar with the proposed standard and with the potential effects. The fact that the company acts as both lessee and lessor contributes to making it even more interesting for our study. We would although emphasize that our main purpose is to analyze potential effects following the new standard, where Volvo makes up an example, rather than analyze Volvo itself. With this background we arrive at the following research question:

⁴ By Volvo we refer to Volvo Group (and not to Volvo Cars).

- *What are the main implications following the proposed lease standard to a multinational manufacturing company and its stakeholders⁵, and will potential benefits from the proposal outweigh potential costs?*

In order to structure this wide-ranging question we also formulate the following sub questions:

- *In what ways will the proposed change in the accounting for leases be beneficial to the company and its stakeholders?*
- *What additional costs would this bring about to the company and its stakeholders?*

1.5 Outline

The structure of this thesis is inspired by Emsley and Kidon (2007) who conducted a case study concerning the relationship between trust and control in international joint ventures. We found their applied structure appropriate to our study since it was clear and logic at the same time as apparent similarities existed between our studies. However, we chose to highlight the discussion further by making it a separate part. The thesis will therefore be structured as follows:

Chapter 1 - INTRODUCTION. Motivates and provides a background to why our chosen subject is interesting at the same time as it highlights the importance of leasing. It also contains a problem discussion which results in our research questions.

Chapter 2 - LITERATURE REVIEW. Begins with an overview of the proposal and the current lease standard. Thereafter it provides insight into earlier research and some companies' opinions concerning issues discussed in the introduction. This part also forms the foundation for the case study.

Chapter 3 - METHODOLOGY. Describes why the applied model was used and the influence from the "grounded theory". The respondents are also presented along with a description of how the interviews were performed and analyzed. The chapter continues with factors affecting reliability and validity of the study, and concludes with criticism of the sources.

Chapter 4 - CASE STUDY. In this part the respondents' answers are summarized and compared to related research from the literature review. All answers are divided among our focal points in order to facilitate comparison between the respondents. Important citations are also highlighted.

Chapter 5 - SUMMARIZING DISCUSSION OF THE CASE STUDY. Analyzes the interviews through the developed model. The respondents are also compared more in depth in order to clarify similarities and differences.

Chapter 6 - CONCLUSIONS, REFLECTIONS, LIMITATIONS AND FUTURE RESEARCH. The research questions are answered along with reflections and limitations with the study. To conclude, we provide suggestions on areas interesting for further research.

⁵ Our use of the concept stakeholders mainly refers to the capital providers.

2 LITERATURE REVIEW

The literature review begins with an overview of the proposal and a comparison with the current lease standard. Thereafter, an insight into earlier research conducted on the subject along with opinions expressed by companies in submitted comment letters is provided. The comment letters should be considered as opinions used for capturing different views on the subject rather than objective truth.

2.1 The proposal from IASB and FASB

As mentioned in the background, in August 2010 IASB and FASB released an exposure draft, a document open for comments describing a new lease standard. It was expected to be finalized in June 2011 but has, however, been delayed to the last quarter of 2011. With the proposal, a “right-of-use” accounting model is suggested, stating that both lessees and lessors record assets and liabilities arising from lease contracts. Furthermore, the assets and liabilities are calculated as the present value of the future expected lease payments, and thereafter amortized over the lease period and tested for impairment under a cost-based method. The lease cost will be divided into two parts; an amortization part and an interest expense part. For operating leases this will differ from the earlier approach where the accounting cost was equivalent to the actual payment.

A crucial difference compared to the current standard, IAS 17, is the removal of the distinction between operating and finance leases which will have the effect that all lease commitments should be reflected in the balance sheet. This is mainly motivated by the fact that investors today make these adjustments arbitrarily to be able to estimate the real financial state and comparability of a company. An additional argument in favor of this removal is to limit the possibility to account for similar transactions in different ways, that is to adjust the agreement in order to fulfill the conditions for an operating lease although the substance indicates the financial counterpart as the more proper classification (Exposure draft: Leases).

Another distinguishing difference is the proposal to include the value of contingent rentals, options to renew or terminate the lease, and residual value guarantees in the financial statement. The value of the contract should thereafter be calculated “...on the basis of the longest possible lease term that is more likely than not to occur.” (Exposure draft: Snapshot leases) An additional difference concerns the lessor accounting where two different models could be applied depending on whether significant risks or benefits are transferred or not. The most important differences are summarized in the following table:

IAS 17- Leases (Current standard)	The new proposal
Distinction between finance lease and operating lease	No distinction between operating and finance lease
The value of a lease contract is equal to its underlying commitments	The value of a lease contract should be based on the longest possible lease term that is more likely than not to occur.
The accounting costs for operating leases are equal to its periodic payment	The accounting cost for all leases should be divided into one amortization part and one interest expense part
The lessor shows the right to receive payments for finance leases and accounts for assets on operating leases based on asset classification	The lessor uses the derecognition approach and shows the right to receive lease payments if significant risks or benefits of the underlying asset are transferred to the lessee. If significant risks or benefits are not transferred, the performance obligation approach should be used, requiring the lessor to recognize the underlying asset, the right to receive lease payments and the liability to deliver the asset.

Table 1. The table shows the most important differences between the current lease standard, IAS 17, and the new proposal.

2.2 Transparency

One of the main objectives for IASB is “...to develop a single set of high quality, understandable, enforceable and globally accepted international financial reporting standards” (ifrs.org). A highlighted aspect of the new lease proposal is therefore to make the lease obligations more transparent and easier to understand. The obvious question will consequently be; what is transparency and how can the lease proposal increase it? Barth and Schipper (2008) define transparency as: “...the extent to which financial reports reveal an entity’s underlying economics in a way that is readily understandable by those using the financial reports.”

In order to get a deeper understanding of how the proposed lease standard can address components suggested to increase the transparency, we divide this part into three subparts; *Comparability*, *Effect on cost of capital* and *Adjustments*.

2.2.1 Comparability

Comparability in accounting is important to stakeholders when comparing different companies or historical performance. In order to avoid that similar transactions are accounted for in different ways, IASB is clearly expressing the importance of considering economic substance over legal form in IAS 17 (Marton et al., 2008). However, criticism has been raised arguing that lease transactions which in reality are very similar can, by making small adjustments to the contractual terms, be accounted for as either finance lease or operating lease (Barth and Schipper, 2008) and thereby violate the above mentioned principle. IASB and FASB believe the new proposal will address this problem by *“increase comparability of financial statements for investors and reduce the opportunity to structure transactions to achieve a desired accounting outcome”* (Exposure draft: Snapshot leases). Will the new proposal actually facilitate the comparison between financial information? Earlier research on the area is discussed below.

Whether operating leases should be included in the financial statements depend, according to users, on the notion what belong in the disclosures and the relative relevance of balance sheet recognition. According to IASB’s conceptual framework disclosures are not to be considered as a substitute for recognizing items in financial statements (Alfredson et al., 2005), the same holds for FASB (Davis-Friday et al., 1999). Advocates of the Efficient market hypothesis are on the contrary arguing that all public information is reflected in the stock price, implying that the form of disclosure is subordinated to the substance. Davis-Friday, Liu and Mittelstaedt (2004) found that the measurement error for disclosed PRB⁶ liabilities was significantly higher than for recognized PRB liabilities, which indicates a higher perceived reliability for recognized amounts. Their results suggest that moving from limited disclosures to audited recognized amounts supported by significant disclosures improved the perceived reliability of the PRB information. The perceived difference could, according to Al Jifri and Citron (2009), originate from the following conditions; 1) Investors undervalue the disclosed amounts in an inappropriate manner⁷ or 2) recognition itself may imply higher degree of relevance or reliability causing users to put lower weight to the disclosed amounts. Barth and Shipper (2008) comment on the same subject and discuss that information being more obvious and salient to readers should also be easier for them to understand. Therefore, they argue, this implies that transparent reports should recognize items capturing the underlying economics. So if operating leases are considered to capture underlying economics, recognition should increase transparency and thereby comparability.

In a study by Harper, Mister and Strawser (1987) 51 bankers and 82 accounting undergraduates were given one out of two hypothetical balance sheets with the task to conduct the company’s D/E . The two balance sheets were different in one aspect; the accounting for pension liabilities. In one of the reports, liabilities were recognized in the balance sheet, while the other only revealed the liabilities in a note. The aim of the study was partly to investigate if calculated debt ratios would be different depending on whether the pension liabilities were included in the balance sheet or not, and partly if undergraduates would calculate their ratios in a different way from bankers. Firstly, they concluded that significantly

⁶ Retiree benefits other than pensions.

⁷ Lack of expertise or the cost of processing the note information are mentioned as potential causes.

more of the respondents with the liabilities included in the balance sheet did include them in their calculation of D/E . A result supporting that numbers included in the balance sheet are regarded as being more important than the ones in notes, which is a conclusion in line with the result of Harper, Mister and Strawser (1991). Secondly, the study did not support that only sophisticated users of financial information, in this case bankers, would find footnotes disclosure equally useful as information in financial statements⁸.

This far, research supporting that information revealed in the balance sheet is considered more important than that disclosed in the notes have been reviewed. There are however surveys indicating the opposite, some of these will be described below.

Wilkins and Zimmer (1983) conducted a survey where they divided loan officers into three different groups. The first group was given applications with the finance lease capitalized and explained in the notes, the second group was given applications with the finance lease revealed only in the notes and the third group was given applications with the finance lease replaced by term loans. The loan officers then had the following two tasks to consider: 1) the ability of the companies to repay two different loans and 2) how much they would maximally lend to the different companies. The results were then compared in order to investigate if the difference in how to account for finance leases made any difference in the ability to receive loans. When comparing the results the authors came to the conclusion that no significant differences could be found. The study thereby supported the hypothesis that creditors' willingness to lend is independent of the method chosen when it comes to the accounting for finance leases. Similar conclusions were made by Gopalakrishnan in 1994 when examining whether investors consider pension information disclosed in notes equally important as the one recognized on the balance sheet. The study showed that investors made no difference between the two accounting models, thereby indicating the irrelevance of whether figures are on or off the balance sheet. However, a limitation of the study is its focus solely on investors who can be regarded as sophisticated users of financial reports. How other less sophisticated users consider information not recognized on the balance sheet was not examined in the study.

It seems clear that different studies have given different importance to the distinction between on- and off-balance sheet financing. A potential explanation is the uncertainty concerning what really should be included in the different items. When Berry and Robertson (2006) asked foreign bankers active in the UK what issues they found most important in order to improve the published accounting information, "Amount of 'off balance sheet' financing to be incorporated in the balance sheet" was the most prioritized area.

To what extent do users themselves then want leasing to be incorporated in the balance sheet and what positive effects do they emphasize? Beattie, Goodacre and Thompson (2006) conducted a survey in the

⁸ Even though a larger share of the bankers did add the pension liabilities to the total debt (22,2% of the bankers compared with 2,6 % for the students).

UK on the G4+1 proposal⁹ among both preparers and users. The substance of the G4+1 proposal is comparable with the one in the current proposal; in that all leasing arrangements should be recorded on the balance sheet, aiming at enhancing comparability among companies. Furthermore, it suggests that users can lower their costs by not having to devote time making adjustments to the financial statement due to operating leases. The outcome of the survey showed that the users were clearly positive to the general principles in the proposal, the preparers were in favor principally that all material leases should be recognized on the balance sheet and that one accounting method should apply to all lease transactions. They also agreed that higher gearing could be a possible outcome due to more assets put on the balance sheet and, as a result of that, debt covenants and credit ratings could be affected while comparability between firms would increase.

Comment letters - opinions from concerned organizations

The global financial service firm, J.P. Morgan Chase & Co, generally agrees with the treatment of operating leases as assets, partly since it is consistent with the way many users of financial reports make their adjustments today. The unavoidable subjectivity when estimating contingent rentals and renewal periods are, however, looked upon as weaknesses since they may require new adjustments to reflect the “true obligations” of a firm (CI: J.P. Morgan Chase & Co). A view shared by the Swedish Financial Reporting Board, Deloitte Touche, Shell International and Barclays, also criticizing the fact that asset valuation will be based on future estimates sometimes not even covered by the business plan (CI: The Swedish Financial Reporting Board; Deloitte Touche; Shell International; Barclays). UBS AG also shares this view and identifies that uncertainty and volatility in measurements will increase when taking into consideration the options to extend and cancelable options. Along with another global financial service firm, Morgan Stanley, they expect increasing risks of over-capitalization leading to false indications of lessees’ financial leverage (CI: UBS AG; Morgan Stanley). For the lessors part, UBS is concerned that the suggested performance obligation approach may result in over-statement of reported lease obligations. In general they find it appropriate to use a traditional operating lease model for “non-core” leases, defined as non-essential to the primary operations of the lessee, allowing the elimination of some of the expected administrative burdens that may occur for the preparers.

2.2.2 Effect on cost of capital

Barth and Schipper (2008) discuss how the quality of accounting information can have positive effects on the cost of capital by “...increasing the extent to which the information reflects the underlying economics and by reducing information asymmetry.” They show that both theoretical and empirical research indicate that increased transparency in financial reporting can lower the cost of capital through reducing the information risk and thereby stimulate investments. Lambert, Leuz and Verrecchia (2007) examined whether and how accounting information about a firm manifests in its cost of capital, despite

⁹ G4+1 was an association consisting of the Australian Accounting Standards Board, the Canadian Accounting Standards Board, the New Zealand Financial Reporting Standards Board, the United Kingdom Accounting Standards Board and the United States Financial Accounting Standards Board. The International Accounting Standards Committee (IASB) was involved as an observer (iasplus.com).

the forces of diversification with a model consistent with the capital asset pricing model (CAPM). They demonstrated that the quality of accounting information can influence the cost of capital, both directly and indirectly. The direct effect appeared as a reduction of the assessed variance of a firm's cash flow which is a diversifiable risk. Interestingly, they also found that the quality of accounting information influenced a firm's cost of capital through its effect on a firm's real decisions such as production or investments. This suggests that a firm's beta factor is a function of its information quality and disclosures.

Easley and O'Hara (2004) compared the cost of capital between companies with a high degree of private information to those with a low degree of private information. Their results showed that investors require a higher return for companies with a high degree of private information since the risk is perceived as higher. Private information thereby contributes to the systematic risk, which indicates that by improving transparency in the reporting companies can lower their cost of capital. Similar to these findings, an extensive amount of research has analyzed how betas are affected by the amount of available information. Barry and Brown (1985) found that the systematic risk was higher for securities with relatively little information depending on the higher risk for estimation errors. These findings were confirmed by Clarkson and Thompson (1990) and Handa and Lin (1993). Clarkson and Thompson also showed that risk measured as beta declined when information increased, whereas Handa and Linn explained the relation between beta and information with the conclusion that the estimation risk is impossible to diversify away when information varies across assets.

Increased accounting quality can be reached not only by improving the financial statement; also disclosures can play an important role. Sengupta (1998) examined the relationship between a firm's overall disclosure quality and its cost of debt. His survey showed a significant negative relation between the two, implying a potential gain for companies if they are able to increase their disclosure quality. Similar conclusions were drawn by Botosan (1997) when analyzing the relationship between the disclosure level and the cost of equity. The relationship between greater disclosures and lower cost of equity was however true only for companies with relatively low analyst coverage. This research emphasizes the possibility to decrease cost of capital by improving disclosures.

2.2.3 Adjustments

Since lease activities can make up a large part of a company's total financing many investors find it appropriate to adjust for the leases, include them in the financial statements and treat them as capital expenses (Exposure draft: Leases; Damodaran, 2002). If not making these adjustments the analysts may understate the financial leverage (Exposure draft: Leases). According to IASB and FASB, the proposal will make these adjustments unnecessary and increase the numbers' accuracy since they no longer will be based on analyst estimates but rather on companies' internal information (Exposure draft: Leases). Earlier research discussing to what extent adjustments are made and some affected companies' views on the proposed adjustments are presented below.

Durocher and Fortin (2009) investigated how often private business bankers in Canada make adjustments for operating leases in the financial statements when processing a loan application. The survey showed that approximately 30 % of the respondents made formal adjustments to some of the financial reports. The bankers adjusting for operating leases in Durocher's and Fortin's study were also the ones putting most attention to this information in their analyzes of capital structure, risk rating, ability to repay and other key figures. Furthermore, the respondents agreed with the statement that all material leases should be accounted for as both assets and liabilities, which would result in a higher degree of leverage. This is believed to improve the information, but also to increase the risk associated with lessees and maybe lower some of the companies' credit ratings. The authors interpret this as some sort of evidence that bankers in fact consider information recognized in the balance sheet as more important than information in the notes, when for example looking into capital structure, ability to repay and credit rating. If this is the case, capitalization of operating leases would probably result in higher interest costs for lessees.

Comment letters - opinions from concerned organizations

When looking among users supporting the proposal, the credit rating agency Standard & Poor's can be found. Although they do not totally agree they share large parts of IASB's and FASB's point of view. They explicitly support the proposition to eliminate the difference between operating and finance leases, something they argue is in accordance with their own model for leasing adjustments (CI: Standard & Poor's). One of the world's largest banking and financial services firms, HSBC, also supports the view of today's leasing standard as inadequate (CI: HSBC). They agree with the principle that lease obligations should be accounted for as liabilities. However, they assume the proposal will incur excessive costs to preparers; costs which they think will outweigh the benefits to the users.

2.3 Compliance costs

According to the study mentioned earlier by Beattie et al (2006), the preparers expressed concerns on the administrative burdens following the detailed implementation guidance and that more considerations should have been placed on cost-benefit and the suitability in operations. They also observed a significant division between users and preparers in their views and argue that this depends on a conflict of interest between the two groups. Their explanation is that preparers are the ones bearing the initial costs whereas users are more likely to collect the direct benefits of the improved financial information. Parfet (2000), an active member and former director of the financial accounting foundation¹⁰, discusses these (mis)conceptions about corporate preparers and their reactions to accounting proposals, suggesting that a view exists that this group is conservative and think that accounting progress limits their flexibility. He criticizes this as lack of understanding of the business perspective. The business environment is hectic where time-constrained managers choose between devoting time fulfilling obligations to improve results from operations or to prepare reports that describe these happenings, something which is merely regarded as value-creating. They question why

¹⁰ The foundation is the independent, private sector organization that is responsible for the oversight, administration, and finances of the FASB.

changes are needed, what the problem is that is to be correct or mitigated, if this is a real problem that justifies commitment of resources and in the end if the proposed action will in fact correct and lead to real improvement of information. Parfet (2010) emphasizes that preparers' view accounting standards as "...overhead, and not something a customer consumes and pays for". According to Beattie, Goodacre and Thompson (2006) they thereby ignore a potential (indirect) long-term advantage that may develop from improved market confidence and by this - a possible lower cost of capital due to the improved information.

Comment letters - opinions from concerned organizations

When looking into the comment letters many preparers also claim that the proposed change would result in large additional costs for administration. The Confederation of British Industry believes the proposed standard would imply increased costs for the gathering and maintenance of information (CI: Confederation of British industry). The German company BMW agrees and believes that the proposal will cause higher costs than can be motivated by the generated benefits, mainly due to substantial implementation costs when adapting IT systems and financial processes, and at the preparation of financial statements (CI: BMW). The fast food chain McDonald's estimated a cost of \$ 100 million for adapting their technology and staff to the new standard (Aubin D - Reuters News, 2011). Beyond the administration and implementation issues, BMW also criticizes the way IASB and FASB want to account for the cost of leasing. A model with interest based on assets' book value will result in higher costs the first years which badly reflects the consumption of economical benefits. Along with for example the Swedish Bankers' Association/Association of Swedish finance houses and the global leasing industry associations, BMW would rather see a straight line depreciation of the assets (CI: BMW; Swedish Bankers' Association/Association of Swedish finance houses; The global leasing industry associations).

2.4 Implications for the lease product and total investments

In this section potential structural effects to the lease contracts will be discussed. The impact on the propensity to lease, as well as the effects on total investments will also be discussed. In order to make the structure more clear, we divide this part into the three subparts; *Effects on the propensity to lease*, *Effects on sales* and *Effects on lease terms*. One should notice that the part "*Effects on sales*" discusses opinions from organizations' why the section should be considered as an insight to potential consequences rather than conducted research.

2.4.1 Effects on the propensity to lease

If the proposal results in a more transparent accounting the resource allocation may be more efficient. An increasing amount of research indicates that liquidity-constrained companies with low accounting quality are restricted in their access to capital for investments. Lessors' superior control rights allow them to provide capital to financially constrained companies with low-quality accounting reports. Beatty, Liao and Weber (2010) investigated the financial reporting quality on the lease-versus-buy decision in the manufacturing industry. They found that leasing propensity is declining with better accounting quality. Further, low-quality accounting companies that choose not to purchase assets when

liquidity constrained, are more likely to lease assets - indicating that poor accounting quality may not result in lower total investment. Companies with poor accounting quality, leading to information asymmetries, will probably lease their assets. This suggests that accounting quality is important in mitigating financing constraints that lead firms to lease rather than buy assets. This can then be interpreted as companies that dedicate more resources to improving their accounting information will benefit from better access to capital markets. Sharpe and Nguyen (1995) join into this view and argue that a company's propensity to lease is substantially influenced by the financial contracting costs associated with information problems. When controlling for company size and other factors, their estimates suggest that the total lease share of a low-rated company that pays no cash dividends is about 25 percentage points higher than that of a highly rated dividend-paying company.

The new standard aims to improve accounting quality and the opportunity for companies with low accounting quality to buy rather than lease may be increased based on the research above.

Besides poor accounting there are other factors that can help to explain some companies' propensity to lease.

Ameziane Lasfer and Levis (1998) investigated the determinants of leasing decision among small and large companies. They mention several rationales for leasing, for instance preserving debt capacity, asset type and salvage value, conservation of working capital, ease of obtaining credit by companies with poor credit ratings, flexibility and convenience and resolution of agency conflicts. These benefits of leasing could make previously rejected projects based on the purchase of the asset acceptable. Evidence was also found that SMEs use leasing as a substitute for debt financing whereas for large companies leasing is a complement to debt financing. Smith and MacDonald Wakeman (1985) investigated the determinants of corporate leasing policy. They found a number of non-tax related incentives to lease instead of purchase: 1) Corporate bond contracts contain specific financial policy covenants, 2) if the lessor has a comparative advantage in asset disposal, 3) if the lessor has market power.

2.4.2 Effects on sales

Leaseurope¹¹ questions the analysis conducted on the cost impact of the new lease proposal. Their arguments are based on the expected burdens laid on preparers to comply with the new proposal, which may give rise to a number of economic consequences. Furthermore, they believe that the intention of the new proposal is missing realities of the leasing market and the real reasons why businesses choose to lease. They mention that lease contracts provide effective and flexible solutions for the use of an asset without in many cases bearing the asset's risk. Moreover, it is accessible to businesses, such as SMEs or startups, when other means of financing assets are not available leaning on the study made by Sharpe and Nguyen (1995). They argue that the new proposal brings accounting complexities and requires large efforts into collecting data so immense that it would rise barriers for the decision to lease. *"It is not generally assumed that changes to an accounting framework have any influence on businesses' economic decision making processes."* (CI: Leaseurope) They fear that the

¹¹ The European federation of leasing company association composed of 45 Member Associations in 33 countries.

“unjustified” complexity is going to hit plain vanilla leasing¹², and may have significant impact on making assets unavailable to businesses and in a broader term negative impacts on the levels of European investment. The additional steps that will have to be taken by preparers to handle lease contracts under the new proposal could be 2-5 times more than today. The simplified method for short-term leases proposed in the exposure draft is dismissed as no relief to preparers. Following the cost and complexity of the proposals they refer to the survey by PwC, where “evidence” shows that preparers would not continue to lease to the same extent. About 38 % of lessees of equipment involving plant and machinery are expected to abandon leasing whereas the corresponding number for transportation is 32 %. As shown in the figure to the right.

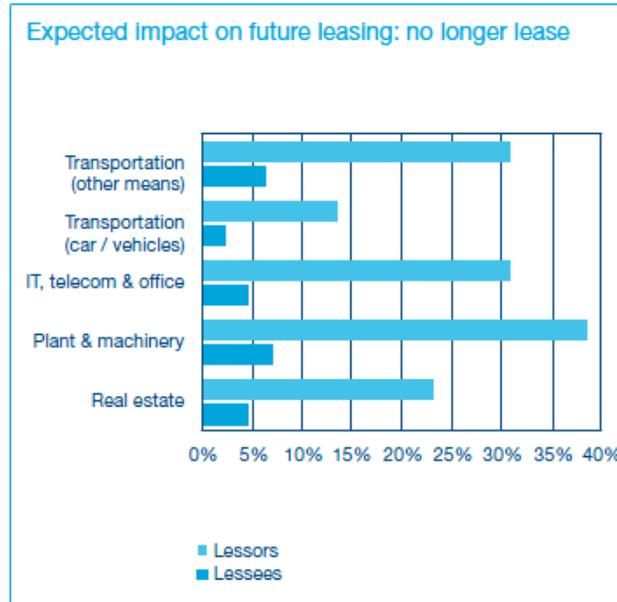


Figure 1. The table illustrates the proportion of respondents representing different sectors that expect to abandon lease as a consequence of the proposed standard.

¹² Refers to the simplest standard contracts.



2.4.3 Effects on lease terms

When Durocher and Fortin (2009) investigated the view of Canadian bankers, the respondents believed that capitalizing operating leases would not lead to shorter contracts and they did not agree with the statement that changed leasing practices would result in additional administration costs¹³ or compliance costs for the lessees¹⁴. Further the bankers were neutral about the consequences the proposal would have on companies' decisions to use operating leases as a finance source. In contrast to what Canadian bankers expect, Beattie et al. (2006) in their questionnaire found that consequences as shortened lease terms in order to minimize lessees' balance sheet obligations could arise, suggesting a transfer of risk to lessors from lessees, which could be viewed as a sort of benefit to lessee companies. This was particularly evident among large companies due to their bargaining power.

¹³ 7 out of 65 respondents did not answer this question.

¹⁴ 12 out of 65 respondents did not answer this question.

3 METHODOLOGY

In this chapter our chosen methods for data collection and data analysis are motivated along with a presentation of our respondents. The chapter continues with a discussion covering reliability and validity of the study and is concluded with some criticism of the sources.

3.1 Choice of method

In our research questions we are focusing on several aspects in one single company, what can be called an intensive approach. When taking this approach the study goes to the bottom of the chosen phenomena and includes a number of different variables compared to the extensive approach where fewer variables are investigated but among more units. The major advantage with the intensive approach is a large internal validity, resulting from a detailed in depth survey, while a drawback is the problem with generalizing information generated from a single or a few number of units to a whole population (Jacobsen, 2002).

In addition, the intensive approach is divided into two different subcategories; case studies and studies with more than one, but although a small number of units (Jacobsen, 2002). Since our study concerns a single company we have conducted a case study. A case study is convenient if the purpose of the study is to get a deeper understanding of a particular incident, describing what is characterizing a special unit and when developing a theory (Jacobsen, 2002). Criticism against the use of case studies includes lack of stringency, biased analyses and the difficulty of generalizing the results in a scientific manner (Yin, 2007). Robert K. Yin (2007) argues that researchers must address these issues since they are essential when conducting scientific studies. However, he does not find them unique for case studies.

3.2 Data collection

When gathering data for a case study the main sources are documents, archival material, interviews, direct observations, attending observation and physical artifacts (Yin, 2007). In our study we have primarily relied on interviews and documents as sources for finding data. Interviews make it possible to put immediate attention to the research questions as well as providing insights to relationships between different areas and events. Pitfalls with interviews are however risk for biases due to poorly formulated questions, lapse of memory and that the respondent adapts the answers to what he or she believes the interviewer wants to hear. Documents provide the researcher with stable, reviewable data that often covers large parts in terms of time, events and the surrounding environment. Nevertheless, the researcher has to be careful in order to not choose documents based on his/her preconception or to include only one side of the story following an incomplete gathering of data. (Yin, 2007)

A great deal of our study is based on interviews, which implies the importance of conducting them in a scientific and objective manner. Yin (2007) divides interviews into three different subcategories; open, focused and structured. The open approach allows more broad questions while the focused method



often is shorter and may have the purpose of verifying facts. The structured approach is conducted more similar as a survey and results in quantitative data rather than qualitative (Yin, 2007). Since our intention was to ask questions regarding both personal reflections and pure facts, an open interview approach has been used.

In order to meet the requirements stated above we have conducted our data collection with inspiration from the “Grounded theory” (Corbin and Strauss, 1990) procedure. The key idea of grounded theory is that the processes of data collection and data analysis are intimately connected, each informing and guiding the other. Grounded theory involves a procedure of immediate analysis of the data collected from the start. This is necessary because it is used to direct the next interview and observations. The researcher enters the field with some questions or areas for observation, or will soon generate them. Then the researcher must analyze the first bits of data for cues in order to not miss anything that may be salient. By carrying out the procedures of data collection and analysis systemically and sequentially it enables the research process to capture all potentially relevant aspects of the topic as soon as they are perceived. The research process itself guides the researcher toward examining all of the possibly rewarding avenues to understanding. Every concept brought into the study or discovered in the research process is at first considered provisional. Each concept earns its way into the theory by repeatedly being present in interviews, documents, and observations in one form or another - or by being significantly absent. One way to guard against bias according to grounded theory is to require a concept’s relevance be demonstrated to an evolving theory (condition or consequence).

At an early stage we learnt that the proposal had drawn a lot of attention from the business community, reading the responses in the form of comment letters. To be able to understand these reactions we had to gain insight into the motivations behind the proposal as well as the primary concerns in the business community. With an early set of questions that evolved, we concluded that an interesting area to observe these consequences would be a company large enough to cover most of the aspects and one that is well aware about accounting issues. We also considered it beneficial to learn the view from the people engaged in the standard setting process and their main constituents; the capital providers. The research process started with this background and has repeatedly involved analyzing data precedent entering the next step of the process. As encouraged by the grounded theory to guard against bias, the analysis has been conducted in collaboration between the authors of this thesis in testing concepts and their relationships (Corbin and Strauss, 1990). This method manifested itself both in our interviews as well as in the literature review, assisting us in addressing the concepts appearing to be relevant due to its repetitive occurrence and form the categories (focal points) which were later on incorporated into our model.

3.3 Choice of respondents

This study is mainly focusing on two groups; users and preparers of financial reports. Among users IASB considers the investors¹⁵ as their main constituents and align the objectives in accordance with the framework. The users are consequently the group where you will find most notably advocates of their efforts to transform accounting in order to fulfill their needs. The preparers are represented by members from a wide range of businesses; affected in a more indirect way by contributions made by the IASB. Their responsibility lies in their capacity to interpret standards and provide reports in accordance with the guidelines. It could then be suggested that changes create uncertainty in their day-to-day activities and their response will possibly emanate from here.

According to Corbin and Strauss (1990), a project begins with the researcher bringing some idea of the phenomenon he or she wants to study. Based on this knowledge, groups of individuals, an organization, or community representative of that phenomenon can be selected for studying. Throughout our interview processes, we have been recommended professionals that may contribute on our topic. Corbin and Strauss (1990) refers to this as letting *"...the research process itself guide the researcher toward examining all of the possibly rewarding avenues to understanding."*

Our respondents have been chosen or recommended in respect to their profession and knowledge to complete the picture from the five different perspectives that have proven contributive within our research area. They have given their views on the changes that IASB and FASB intend to make on lease accounting and their perceived costs/benefits following the proposal. The preparers of financial statements are represented by a person in charge of financial reporting at Volvo, along with a senior director of the company's financial services. The standard setters have representation through a board member of IASB, and in order to capture the financial market's view concerning the proposed standard, we have been in contact with one equity analyst following Volvo and one credit analyst active in the transportation sector. We also chose to include a person interpreting new accounting standards, as the lease proposal, on behalf of one of the largest banks in Sweden.

¹⁵ The term 'investors' generally means investors, analysts and others that use financial statements of a company to make investment decisions (IFRS).

Respondent	Role/Perspective	Title and Company/Organisation
Jan Engström	Standard setter	Board member, IASB
Göran Albertson	Preparer of financial reports ¹⁶	Senior Director, Corporate Finance, AB Volvo
Mikael Hagström	Preparer of financial reports	Vice President, Head of Financial Reporting, AB Volvo
Peter Reilly	User of financial reports	Head of Industrial Research/European Equity Research, Deutsche Bank
Christian Moberg	User of financial reports	Industry and Corporate analyst/Credit analysis, SEB Merchant Banking
Eva Sterner	Interpreter of new standards	Senior Accounting Expert, SEB Group Finance.

Table 2. The table contains the respondents, their role in the study, their titles and employers

Jan Engström was chosen due to his extensive knowledge when it comes to accounting and his involvement in IASB and the development of the new lease proposal. He has also held various senior positions during his thirty years at Volvo; for example chief financial officer and chief executive officer of Volvo Bus Corporation. When interviewing Mr. Engström he recommended us to contact the senior director of corporate finance at AB Volvo, Göran Albertson. Mr. Albertson worked for the Swedish bank Skandinaviska Enskilda Banken, SEB, for twenty years before joining Volvo in 1995. During his years at AB Volvo he has spent much time on structuring financing for customers in emerging markets.

After contacts with people at AB Volvo we were recommended Mikael Hagström as being able to provide the best picture of how the proposal would affect AB Volvo. Mr. Hagström is vice president and head of Volvo's financial reporting and is fully up to date with new proposals, being active in a forum called the Swedish Enterprise Accounting Group (SEAG) comprising chief accountants from the largest Swedish listed companies. Since Mr. Hagström is frequently in contact with different analysts during stakeholder gatherings, we asked him to recommend an analyst familiar with both Volvo and the lease proposal. He recommended an equity analyst at Deutsche Bank called Peter Reilly. Mr. Reilly is head of industrial research at Deutsche Bank and has written several reports on accounting issues, focusing on helping investors with analyzing unusual or unclear accounting items. He also submitted CRUF's¹⁷ comment letter on the new lease proposal.

¹⁶ Preparer since he represents AB Volvo.

¹⁷ Corporate Reporting Users' Forum.

Through a contact at the Swedish bank SEB, we were recommended to speak with a credit analyst called Christian Moberg. Mr. Moberg is specialized in the transportation sector which we found closely related to our chosen company Volvo. During our interview with Mr. Moberg he recommended a colleague called Eva Sterner as a person with great knowledge in how the lease product will be affected by the new proposal. Eva Sterner is a senior accounting expert and interprets new standards at SEB and has therefore been engaged in discussions concerning the lease proposal and its potential effects for different companies.

3.4 Performing the interviews and processing the data

As far as practicable we tried to arrange personal meetings with the respondents in order to make the interviews more personal with better possibility for the respondents to develop their answers and for us to explain our questions. This was possible with Mr. Engström, Mr. Hagström, Mr. Moberg and Mr. Albertsson. In general we asked for approximately one hour, which according to Jacobsen (2002) is an optimal time for this kind of interviews. None of the interviews were shorter but some lasted for about ninety minutes. We sent out the questions one week in advance in order to give the respondents opportunity to prepare themselves. The questions were in accordance with our model designed dependent on which perspective the respondent represented, and were fairly open to avoid biased formulations. During the interviews we used a recorder to make sure we did not miss or misunderstand anything. Besides, this helped us concentrating on possible attendant questions instead of focusing on writing down the answers. The recorded material was then transcribed and structured in order to refresh the memory and ease the composition of the case study part.

The interview with Eva Sterner was made over telephone and lasted for about thirty minutes. Just as with the personal interviews, questions were sent beforehand and the whole interview was recorded and then transcribed. In the case of Mr. Reilly, the situation was, however, a bit special. Since he had already expressed a great deal of his opinions in CRUF's comment letter, the communication could be carried out through mail. In order to get his personal view we asked which parts of the comment letter he agreed upon and which parts he did not agree upon.

3.5 Data Analysis

In our study we have taken a holistic approach by looking at our chosen company from different stakeholders' perspectives according to our primary research question:

"What are the main implications following the proposed lease standard to a multinational manufacturing company and its stakeholders, and will potential benefits from the proposal outweigh potential costs?"

The seven focal points; **Comparability**, **Adjustments**, **Cost of capital**, **Compliance costs**, **Sales**, **Propensity to lease**, and **Lease terms**, have evolved during the interviews and the literature review being notably relevant for the case study. This process of discovering relevant concepts has been

inspired by the earlier mentioned grounded theory invented by Corbin and Strauss (1990). These focal points make the foundation for the five perspectives in the developed model.

Volvo as a preparer of financial reports was placed in the middle since they create the context where the implications are applied in the research question. They participate in their context by providing an internal view on the implications from the lease proposal. The board member of IASB belongs to the organization behind the lease proposal, contributing from the motivations behind the proposal. The accounting expert is dedicated in the work interpreting new accounting standards. Users of financial reports are placed on each side and relate to the aspects out of their profession. In the discussion the corresponding arrow or field to each focal point will be highlighted with green, red, grey or white. Green represents an improvement/benefit, red represents a drawback/cost, grey represents no effect, and white means that no input was received. The opinions from the credit analyst and the equity analyst are illustrated by arrows since their opinions are highly related to the central object in our study, AB Volvo. The views from the board member of IASB and the accounting expert are however more general for all companies following the directions from IASB and FASB. To illustrate this point we have chosen to use boxes meaning that they act in the context where Volvo is operating, even though their opinions are not particularly related to Volvo. The model forms the basis for the data analysis conducted in the discussion and is illustrated by the picture below:

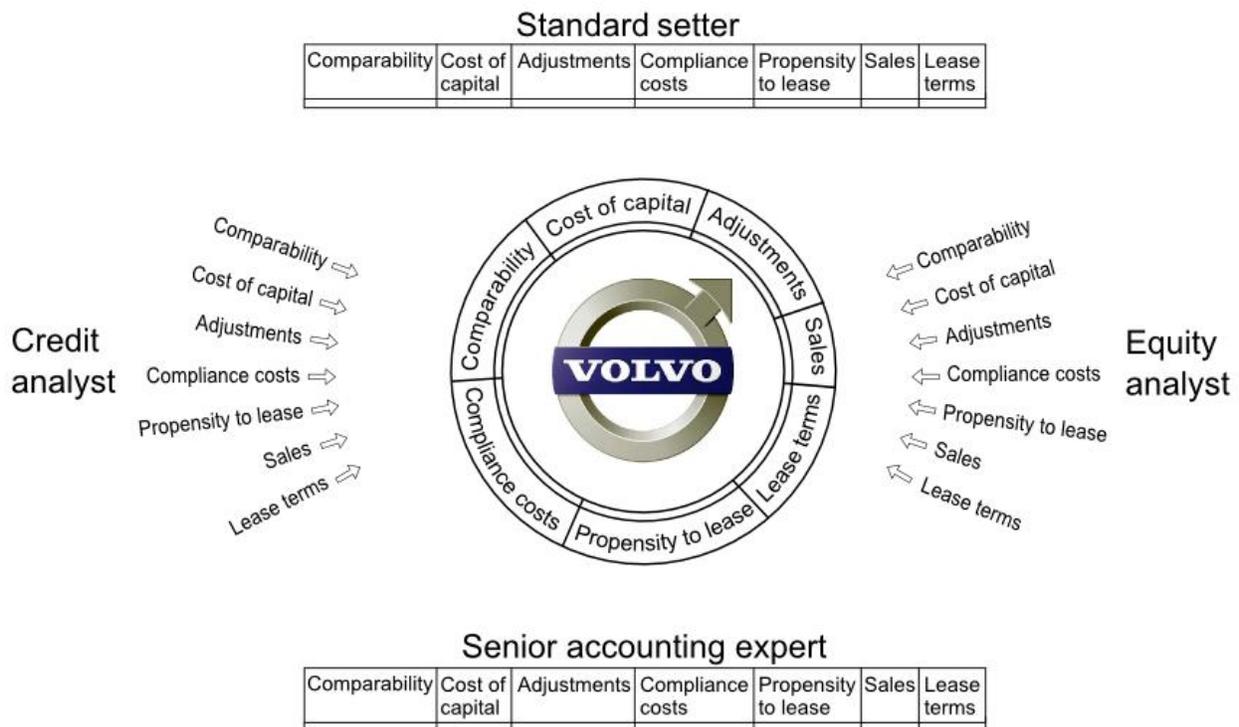


Figure 2. The figure shows the model applied when analyzing our data. The six respondents are placed with regard to their relations to Volvo and depending on whether their answers are specific for Volvo or more general for all companies following IFRS or GAAP.

3.6 Reliability and validity

Reliability and validity are important factors when evaluating the quality of a research project (Bryman, 2011). Below the terms will be explained and applied to our study.

3.6.1 Reliability

Reliability is a measure of the study's dependability in terms of the probability that the results will be the same if the study was performed once more, and the influence of random or temporary aspects (Bryman, 2011). If a new study would obtain the same results, the study is said to have high reliability. The term can be divided into external and internal reliability. External reliability depends on to what extent a survey can be replicated, while internal reliability represents how the researchers have interpreted their obtained data (LeComte and Goetz through Bryman, 2011).

In qualitative¹⁸ studies high external reliability is often hard to achieve due to dynamic social contexts (LeComte and Goetz through Bryman, 2011). In addition to this we find the personal contact and social climate when performing the interviews, as factors reducing the possibility to replicate the study. These are factors deciding to what extent the respondents are willing to develop and exemplify their answers. Depending on our personal interests and experience, special attendant questions were also asked which are not included in the interview guides, resulting in less possibility to replicate the study. These are aspects hard to eliminate when conducting qualitative studies (Bryman, 2011). In order to increase the external reliability we have however recorded the interviews and transcribed them in their entirety so that those interested in attendant questions are able to reach them.

To keep high internal reliability we tried to formulate open questions in order to avoid potential biases. After the interviews we endeavored to express the answers similar to the respondents, without too much interpretation and adjustments, even though some of the information had to be excluded. The recorded material and the transliteration are, also in this aspect, resources that can be used for those interested in investigating potential interpretations of the data.

Elements that we really believe increase the reliability of this study are the respondents. We have chosen our respondents very carefully and followed the motto: "quality before quantity". As representatives from the studied company we have chosen high executives with extensive experience and knowledge. As users of the financial reports we have interviewed persons familiar with both the proposal and our chosen company, or a closely related industry. From the regulators we have been in contact with a board member of IASB who also has worked about thirty years for our chosen company. In addition to these people we have also been in contact with a person working with interpreting accounting policies, including the lease proposal. A potential weakness could however be the fact that the proposal is currently under consideration by IASB and FASB, which could imply some elements of lobbying in the respondents answers.

¹⁸ As for this thesis, case studies are often assorted as qualitative studies.

3.6.2 Validity

Validity is a measure used when evaluating if conclusions from a study can be considered as coherent or not. As with reliability it can be divided into external and internal validity. A study is said to have high external validity if the results can be generalized to a wider context than only for the analyzed objects. Internal validity is on the other hand dependent on whether the causal relation between two or more variables, which makes up the basis for the conclusion, can be considered as solid. (Bryman, 2011)

According to LeCompte and Goetz (through Bryman, 2011), a problem with qualitative research methods is the rather low external validity. They base their argument on the tendency for this research category to use case studies and limited numbers of respondents (Bryman, 2011). This is a problem we recognized and consider as one of the main weaknesses with this report; of course it is hard to generalize six respondents' opinions to a whole population. We have however chosen our respondents with this in mind and therefore tried to get in touch with people representing more than their own views. Mr. Hagström for example is a member of the accounting forum SEAG, which comprises representatives from the largest Swedish listed companies, and Mr. Reilly is an important member of CRUF. By contacting persons active in this kind of forums we believe the external validity can be increased since they are aware of their colleagues' opinions and thereby can give a broader and hopefully more generalizable picture. The selection of company was also made with respect to the external validity. Our aim was to find a company with many attributes similar to other Swedish companies and thereby make it possible to generalize the results to a wider context. We chose Volvo since they act as both lessee and lessor in different sectors, are involved in SEAG and acts rapidly in interpreting and adapting to new standards¹⁹. In summary we are well aware that the external validity is a problem when conducting qualitative studies, however, we believe our chosen respondents mitigate this problem and that the results are therefore representative for a larger population than just for our sample.

Internal validity is according to LeCompte and Goetz (through Bryman, 2011) in general a strength with qualitative studies since the researcher is able to spend more time to secure a high congruence between concepts and observations. In this study we tried to keep high internal validity through interviewing experienced respondents and comparing their arguments in order to find casual relations. According to Bryman (2011) the credibility is of vital importance for the internal validity, hence we asked control questions during the interviews when something was unclear. We also returned the answers to the respondents for a validity check in order to avoid any misunderstandings.

Out of our six respondents, three submitted remarks on the content whereas the other three accepted it in its entirety. The remarks included aspects on their business titles, clarifying interpretations and suggesting appropriate translations from Swedish to English. None of the remarks influenced the significance of the content.

¹⁹ They were for example the first company in Sweden to employ an IFRS-specialist.



3.7 Criticism of the sources

When conducting a literature review, one needs to be careful with the information gathered; who submitted the information, where it was collected and when it was published; all of which may give an undesirable bias. In order to manage these issues, trustworthy databases such as Business Source Premier, Science Direct and J-Store were used as sources for journal references. We believe that the selection of such well known data bases, improve the reliability of the information and thus enhance the quality of the information extracted. To further strengthen this contribution, we addressed acknowledged and well cited authors in our selection of results. Other valuable sources were inevitably the websites of IASB and IFRS where information about the new proposal, as well as comments on them, are updated regularly. The review also covers a few organizations' view on the new standard received from their submitted comment letters. These comment letters can of course not be considered as science since the authors may have self-interest in the final outcome of the standard. Therefore these letters should be considered as opinions used for capturing different views on the subject rather than objective truth.

The PwC survey (2010), was done by one of the largest international professional accounting firms, in cooperation with Rotterdam School of Management. The survey was made to clarify the views on the new proposal; conducted with an initial number of 500 listed European companies invited, 125 finally participated, in respect of lessee accounting. We acknowledge that the survey lack complete objectiveness with the participation of the firm PwC, that may have interests relating to their business that could have influenced the outcome of the survey.

4 CASE STUDY

In the case study the results from our interviews are divided on the seven focal points; Comparability, Effect on cost of capital, Adjustments, Compliance costs, Effects on the propensity to lease, Effects on sales and Effects on lease terms. In cases where suitable, the results are attended with relevant research to make it more comprehensible.

4.1 Transparency

In order to be consistent with the structure in the literature review this category is divided into the three subparts; *Comparability, Effect on cost of capital and Adjustments.*

4.1.1 Comparability

In the earlier discussed research by Beattie, Goodacre and Thompson (2006), they arrived at the conclusion that users were positive to the former proposal²⁰ to recognize all lease arrangements on the balance sheet, whereas preparers were in favor that all material leases should be recognized. The study revealed a possible effect on debt covenants and credit ratings, but also expectations on a higher comparability.

The convergence project by the IASB and FASB aims to reach more consensus in accounting, where comparability is mentioned as a prioritized area among consistency and quality. The board member of IASB is not impressed with the way analysts adjust for leases with different “rules of thumb” since comparisons will lack stringency. He summarizes the ongoing efforts by IASB quite clearly to address this issue:

“I have said that - we try to catch the assets, the liabilities and the villains. There are always those trying to cheat. We just put up some bars to catch the worst villains” (The board member of IASB)

The preparers, who in this study are represented by the head of financial reporting at AB Volvo and the senior director at AB Volvo, do not believe that the change will provide a more unbiased and true picture of Volvo. The head of Volvo’s financial reporting is thus of the opinion that questions concerning the company’s leasing activities will increase;

“Analysts and users of the financial reports may very well wonder about some of the underlying assumptions when estimating the value of lease contracts. A typical example could be the time used to estimate a rental contract which can give signals about future plans.” (The head of AB Volvo’s financial reporting)

²⁰ The G4+1 proposal discussed in the literature review.

He questions, however, the relevance of such information and is of the opinion that such information should be clear from the company's presentation and business plan, if not, it should be enough to reveal it with disclosures. In addition, he believes the reliability of the information would be rather low since he does not find it feasible to conduct individual estimations of what will happen to all lease contracts 15-20 years from now. Instead he believes models based on certain assumptions will be used.

The users, here represented by the credit analyst, do not always take it for granted that a lease should be regarded as a liability. Factors that need to be considered are differences among firms, or, of even more importance, the extent of their lease commitments. It is necessary to consider them when the commitments are substantial in size and stand out in the context. Furthermore, the capital-structure with cash flow-to-debt may be affected quite considerably since many firms have a large chartered fleet, but the question rises what it will end up with. Although, he hesitates to conclude that the changes in accounting policies will lead to a lot of problems in this context; *"This is something you will have to approach pragmatically in collaboration with the clients through discussions and work out a solution."* (The credit analyst) About the potential for unpleasant surprises when recognizing earlier off-balance sheet items he reasons:

"There may be reasons for worries in some industries where they have not communicated in an open manner what they actually have off-balance sheet. But I do not consider this a big issue since we have a good estimate what commitments our clients have. Even if formal adjustments have not been performed, it has been communicated in the credit committee and conclusions made about what effects the amounts may have and then registered in a record. However, in cases where a bank or someone else has neglected to investigate it in a correct manner; it could lead to an unexpected effect." (The credit analyst)

The respondent underlines that he cannot speak for all industries, but his opinion is that in industries where they have an involvement, they maintain a good supervision through discussions with the companies about their commitments.

As discussed in the literature review the opinions diverge whether disclosures should be considered equivalent to information in the balance sheet. Advocates of the Efficient market hypothesis argue that all public information is reflected in stock prices indicating no difference between the two, a standpoint supported by Wilkins and Zimmer (1983) and Gopalakrishnan (1994). Davis-Friday, Liu and Mittelstaedt (2004), among others, found on the contrary evidence indicating the opposite. Another aspect raised by Harper, Mister and Strawser (1987) was a potential difference in the use of disclosures between sophisticated users of financial reports and non-sophisticated users. This hypothesis was, however, not supported. The senior director at AB Volvo is although convinced that an inclusion of the commitments in the balance sheet will ease the reading. He thinks it will make the reading less demanding and more comprehensible, especially from the public's point of view. For an experienced analyst he believes the difference to be modest;



“They know where to find the right information. Of course it will always be easier to find if it is harder to hide, unfortunately there are loads of non-correct reports everywhere, regardless of the applied standard. So you have to spend time to go through this.” (The senior director at AB Volvo)

The equity analyst requests a better disclosure of companies' overall leasing policy and structure where relevant. He argues that companies active in the same sector with similar business often make very different use of leasing and therefore it is important to understand the business implications due to leasing arrangements by a certain company. For example, a company utilizing short-term renewable leases implies a different investment proposition to one using fixed long-term leases, therefore the former has a lower financial risk but on the other hand, a higher business risk. Information in the notes should, according to the respondent, reveal the financial and business dynamics in a way that makes it understandable to users. Further he argues that today's standard makes it very difficult (on occasions impossible) to trace the impact of leasing arrangements in the cash flow and is something that should be paid attention, especially for lessors; *“As many investors will treat future capitalized contracted lease payments as debt, a reconciliation between the cash flow and movement in net debt becomes even more important.” (The equity analyst)*

Criticism raised in a number of comment letters, for example from J.P. Morgan Chase & CO and UBS AG concerns the proposal to include contingent rentals and options to extend. They argue that this jeopardizes the comparability between companies, which they motivate with the risk of overestimating financial leverage in companies with long contracts and/or a high amount of options to extend. The senior director at AB Volvo agrees partly with this criticism but, at the same time, he wants to move focus from the balance sheet to the underlying committed cash flows. He agrees with the effect of rising debt levels compared to equity (D/E) but he does not consider it a major problem. He argues that analysts should look at the underlying cash flow commitments rather than the balance sheet when deciding about the company's ability to meet its obligations. Furthermore, he understands the notion a company seems more sensitive to interest rate changes if the financial leverage increases, but again, the underlying commitments have not changed and thereby nor the financial risk. The importance he puts to committed cash flows can be illustrated by the following citation:

“A company without cash flow has no blood flow” (The senior director at AB Volvo)

The head of Volvo's financial reporting is more on the same lines as J.P. Morgan Chase & CO and UBS AG and expresses concerns that the inclusion of options to extend and contingent rentals can harm the relevance of financial statements and ratios. He illustrates this point with the example of a company making the decision whether to stay in their current property or to move to another, more expensive one. If the company decides to stay, they have to put future rental obligations on their balance sheet, if they, on the contrary decide to move to the other property no obligations will be capitalized. Put together, the company's D/E would initially be higher if they chose to stay in the existing property than if they decided to move to the other, more expensive building in the coming years. Therefore he believes analysts and other users of the financial reports would have to adjust for this “noise” in order to reach a

fair comparison between companies. A belief supported by the equity analyst who thinks an inclusion of capitalized options and contingent rentals in total debt could result in unusable information:

“Restricting the capitalized liability to the contracted lease payments would mean that users could treat the liability as analogous to debt. This leading to higher leverage, if assuming that most users treat the liability as debt, but it would be a useful number. While, including capitalized options and contingencies in total debt could result in a meaningless debt number resulting in meaningless debt ratios.” (The equity analyst)

There have been discussions concerning both a fundamental and practical viewpoint, and generally the equity analyst prefers balance sheet assets and liabilities to be as “real” as possible, thereby referring to only contractual lease liabilities. Also the credit analyst is somewhat sceptical to the inclusion of options to extend and the subjective estimations this would result in. If the standard is implemented as it looks today he would question the information based on companies’ own estimates if it clearly understates or overestimates the commitments in relation to what is fair in his own view.

The equity analyst is not in favor of the proposed way of accounting for the lease expense, which implies a higher cost the first years and thereafter declining as time passes. He bases his opinion on the mismatch between cash costs and income statement expenses, and the risk of some managers using the slope to “massage” profitability. He thinks the proposed model would distort reality, particularly for long leases, and therefore he prefers to use a simple straight line expense. In a broader sense, he believes comparisons between firms in some cases would be more difficult and thinks the proposal will create opportunities for companies to influence reported profitability whilst leaving cash flow unaffected. To be able to track what really are cash elements, he would like to see detailed notes of the lease item where interest and amortization are broken out so that analysts will be able to determine the relative component of each. The head of Volvo’s financial reporting is, on the contrary, on the same lines as IASB and FASB. He thinks leasing should be considered as a form of financing and therefore it is logical to treat the lease in the same way as a bank loan - that is with one interest expense part and one amortization part. As a lessor, he would like to see a straight revenue. The reason for this, he argues, is that you earn from the lease contract, not from the asset. However, altogether, he finds the proposal proper and logic.

4.1.2 Effect on cost of capital

The literature review showed that both the theoretical and empirical research indicate that increased transparency in financial reporting can reduce the cost of capital. This relation was true not only for items in the financial statements, but also for disclosures. When interviewing the board member of IASB we were given a similar picture. He emphasized the importance of transparency and common regulation for reducing the cost of debt, a causality he hopes the proposed standard will strengthen. He admits that it will result in additional costs for companies with too low equity in relation to their debt, since they will have to increase the amount of equity. On the other hand he considers this a transparency cost that would only hurt companies hiding lease obligations from their stakeholders;



“Of course it can hurt ‘bad’ companies, whereas the more transparent will gain, but altogether this will result in a more efficient resource allocation. After the implementation the real situation will therefore be more obvious for the interested parties not inside the company, in helping them to calculate a proper risk premium. So even if it would increase costs to owners it could be considered a benefit to the lender since the cost of debt will be a better reflection of the risk undertaken by the lender. Again, this would improve the function of the economic system.” (The board member of IASB)

Among others, Easley and O’Hara (2004) showed a positive relation between the degree of private information and the required rate of return, implying that private information contributes to the systematic risk. By improving the transparency in the reporting, companies can therefore lower their cost of capital, an objective also highlighted by the regulators. However, the respondents in our study did not believe this reduction in cost of capital to be substantial.

One reason, if looking from the creditors’ point of view, is the ability to access information not revealed in the reports. The credit analyst admits that they do not solely rely on the information in the financial reports. They have extensive dialogs with clients, which play an essential role in their risk assessment during a credit analysis process that may last for weeks. These dialogs provide them with very good information, not always possible to be extracted from the financial statements. He points out that in some cases the financial reports lack the necessary information, since the reports are not prepared in an ongoing based context - assuming the lease proposal does not only consider the current status but also the probability that changes will be made in the future. Such estimates are not available in the annual reports of today. Furthermore, he believes that it could be relevant information in businesses that make extensive use of operating leases, such as land based transportation companies. If they immediately stopped taking on more leases, they would not be able to manage their commitment operating a route network. Also applicable if they have a growth plan and intend to defend their market position, to uphold this an adequate number of buses are required. Moreover they need continuously to update their fleet to keep the average age in line on their routes according to agreements and hence renewals would have to be made. In this respect he considers it wise to include this information although one also has to look upon the specific basis of each company; where it belongs in the investment-cycle; how mature the investments are.

These reflections are in line with Barth and Schipper (2008), proposing that an entity’s underlying economics also includes the risks it faces, so that financial reporting transparency also includes information about those risks and how the entity manages them. To sum up, due to his unique advantage accessing detailed information, the credit analyst finds it hard to see any transparency effects leading to lower costs of debt in the long run. This condition should be adequate to analyze the clients or as he chose to formulate it:

“If you have missed out on this, then you have done something really wrong. It is of course something one needs to keep an eye on” (The credit analyst)

Exceptions could however be large corporations enjoying high credit ratings and appearing very strong financially. Under those circumstances it may be that the credit analyst needs to rely more on public information. Large public corporations have a lot of listing rules to comply with before meeting his request. In addition, he believes professions more dependent on public information, will have better use of this information as a result of the proposal.

The senior director at AB Volvo shares the credit analyst's view and does not expect the proposal to result in a large amount of new, unexpected information about companies' financial obligations. Although he admits that some information most likely will be useful to Volvo when analyzing a customer, since it would be naive to think that they know all of their customers' commitments. Unlike the credit analyst, he is of the opinion that most information is already available in today's reports, and the most important contribution of the new proposal would rather be to clarify this information.

4.1.3 Adjustments

Important reasons for changing the standard are according to IASB and FASB to ease corporate analyses and make adjustments for leases unnecessary. In the literature review research investigating whether bankers actually make adjustments for operating leases and the importance they put to it, where discussed. Further, a couple of companies' view on the proposal and how it corresponds to their current adjustments were presented.

The board member of IASB points out that rating agencies routinely attend companies where they have an engagement, questioning them about their larger commitments and then adds it to a record. But it differs in the way analysts handle this. He thinks they often carelessly treat these commitments by using "rules of thumb"; multiplying them by a factor. Which he does not find very wise and now view an opportunity to reform.

According to the credit analyst in our study, adjustments are made depending on whether the effects are expected to be considerable. If that is the case, adjustments are made with established methods involving both the balance sheet, income statement and to some extent cash flows in order to reach a fair and true picture. In addition they also consider where the specific firm belongs in the investment cycle. A young or older fleet in comparison to an industry peer would for example lead to an acceptance that it expects to change. Generally, he adds, they make adjustments but it depends on the industry and mentions that in the airline industry it is a more or less established practice. He also refers to external rating agencies that perform credit ratings; having well worked out methods with industry-related multiples used to adjust for leases;

"They are not just arbitrarily put in place but are estimated to reflect an approximate average. Many firms in fact use these recommendations when they communicate their capital structure with investors and creditors. In many cases covenants for firms implicitly take into account their adjusted lease obligations." (The credit analyst)



Moreover he underlines that they keep an extensive communication with their clients and rely on their own judgement what they find reasonable concerning lease commitments. He does not expect this communication to decrease as an effect of the new accounting for leases. The same apply to costs involved in the credit rating procedure. This is explained by the fact that his organization is well functioning and does not expect any noticeable changes in the day-to-day work. Maybe some extra comment on the client or a simple adjustment of the model they use. Concerning the potential effects on companies' key figures he reasons:

“EBITDA will rise, due to the rise in the margin when you remove the lease charge. The balance sheet is expected to rise on the liability side. This will lead to a reported weakening of the capital structure. Cash flow to debt will also look weaker. But this will not be received as news, this is only pure reporting.” (The credit analyst)

Nor does he expect that corrections of key figures and debt ratings will be a big issue for the business that he represents. They will probably follow the same procedures when making estimations of a company. However, it depends on the final version of the standard and if there are differences in how the estimations are made today, but he still thinks they will need to make adjustments even after the proposal is implemented. In the complete view of a specific company they although have a clear picture of their commitments at least five years ahead.

The senior director at AB Volvo tones down the importance of the balance sheet and the possible adjustments to the existing numbers. He argues that balance sheets are only secondarily when conducting a credit analysis; the most important thing is the committed cash flows. Instead of focusing on making adjustments to the financial statements he thinks it is more important to consider different types of stress tests:

“What happens for example to the cash flow if fuel prices rise by 30 %, if the load factor declines from 80 to 60 % or if a large contract is lost? As lessor this is more relevant aspects than what will happen to the balance sheet and the debt ratio.” (The senior director at AB Volvo)

Altogether, the senior director at AB Volvo believes the proposal will have a minor effect on creditors' ability to make proper credit analyses. He thus believes the commitments will be clearer even though they have existed all the time. The equity analyst is concerned that a move away from cash accounting will create additional concerns to analysts. He mentions the proposed way to account for lease costs as a potential source for new adjustments. This since implementing the standard will cause a sudden and temporary drop in profitability, which will later be followed by a steady increase as the income statement cost falls. He does not appreciate this part of the proposal and is of the opinion that earnings adjustments should be limited as much as possible.

4.2 Compliance costs

As indicated by the comment letters the preparers identify several costs associated with the implementation of the new standard, partly due to more administration. Beattie et al. (2006), also observed this “administrative burden” in their study among reactions by preparers, mostly due to detailed implementation guidance and a lack of suitability in operations. Parfet (2000) gave a corporate preparer’s perspective where accounting is often viewed as over-head and mentions common questions such as; why the change is needed and what it will solve.

From the perspective of the head of Volvo’s financial reporting, the proposal is expected to be extremely expensive for companies preparing the reports. Initially, implementing the change will incur huge costs related to informing and educating the employees as well as conforming the business systems to meet the requirements that the new standard will bring. He believes a change like this will be extraordinarily difficult to implement among employees since it affects people on all levels, not only the accounting team. This implies that also non-economists must be educated in order to be able to handle the rules. In addition the knowledge must also be spread across business units all over the world, which is regarded much too expensive since Volvo has more than 300 business units in approximately 60 different countries. He questions whether the potential benefits from the proposal will cover the costs to inform and educate employees in all these units. At the initial stage, the distinction between service and leasing of all contracts must be decided as well. This is believed to be an issue since there are currently no existing routines on how to make this distinction. He also expresses concerns on how to decide which interest rate to use in different countries.

Concerning the criticism of including low value leases in the proposal and the extra cost this would mean to companies tracing the contracts, the board member of IASB reckons this is something companies ought to do anyway. He argues that contracts have to be kept in order independent of accounting standards, thereby indicating that worries concerning the work with tracing all contracts are unfounded. If the proposal would lead to increased administration resulting in a better overview of existing assets, it actually should not be considered as a cost but rather a necessity for a well-managed company.

Another expected administrative cost according to the head of Volvo’s financial reporting is the work to estimate the options to extend and the contingent rentals. When performing the calculations people involved in drawing up contracts must participate, something that would probably require resources from a number of different units for each estimation.

“As a fast approximation of the cost for finding and calculating all lease contracts, Volvo currently has somewhere around 50 000 contracts, each contract may require four hours of work. This would result in 200 000 working hours and thereby around 125 people working only with the conformation to the standard for an entire year.” (The head of Volvo’s financial reporting)

After the initial phase, when information and education are provided and all contracts are calculated and categorized according to the new standard, he fears that the costs for the ongoing work complying

with the standard will continue to be high. He makes his point by comparing with today's standard. *"With the new standard, companies have to estimate the probability of renewing all individual contracts each quarter compared with the rules applied today where the accounting of the contract only requires work initially."* (The head of Volvo's financial reporting)

The board member of IASB agrees with the criticism of the calculations concerning options and rentals based on revenues, considering them unnecessary with no value adding function. He both hopes and expects these aspects to be excluded from the proposal, since he looks upon them as nothing but costs. Increased auditing is also mentioned as a potential cost for preparers as a result of the proposal.

When comparing large companies with SMEs, the board member of IASB believes the SMEs will have more problems with adapting to the change. This is attributable to larger companies probably having more comprehensive registers for their assets compared with smaller companies where the accounting for low value assets is perhaps more ad hoc and unsystematic²¹.

Barth and Schipper (2008) discuss transparency in financial reporting depicted as an entity's underlying economics and to be understandable to users. This is done with enough details to be helpful to users in making economic decisions, but not so many details that it would make it difficult for users to discern the entity's underlying economics.

The equity analyst argues that some information reflected on the balance sheet such as options to extend and rentals would be useless to users. The utility of the balance sheet would not be improved with subjective items appearing as concrete liabilities. It would be better to disclose them in a note. Admitting that not requiring lessees to capitalize other than contractual liabilities may create opportunities to structuring²², but this is preferable to having potentially large and meaningless assets and liabilities. Potential liabilities such as options to extend would have to be treated subjectively and thus forcing companies to recognize a liability that does not actually exist. More preferably the liability should be limited to the committed amount payable and the options would more correctly be disclosed in the notes with other contingent liabilities.

"It would also be both onerous and subjective for preparers to estimate multi-year future liabilities." (The equity analyst)

The equity analyst believes that requiring companies to estimate and capitalize contingent lease payments such as revenue-based payments creates uncertainty. Contingent liabilities should be regarded as future operating expenses since they depend on how the business performs in amount and timing. It can be argued from a fundamental perspective to be inconsistent to capitalize contingent lease payments whereas other costs such as cost of goods or wages are not.

²¹ This is however speculations from Mr. Engström.

²² Arrange the balance sheet in order to achieve a preferred composition that could be rewardable.

4.3 Implications for the lease product and total investments

In this chapter we present the respondents' answers concerning *Effects on the propensity to lease*, *Effects on sales* and *Effects on lease terms*.

4.3.1 Effects on the propensity to lease

Several explanations have been given why companies lease their assets, in particular tax incentives have been emphasized. However, other more specific rationales for leasing depend on industry, company size and profitability. Fast growing companies with low dividends have a higher use of leasing than larger companies that pay dividends or are assumed to have better redeployment of assets. The control rights for a lessor are mentioned as to why finance through leases can be more easily obtained than a purchase. Other observations have shown that low accounting quality companies lease more than companies with high accounting quality, suggesting that companies with low accounting quality suffers from discrimination in their access to capital markets. An additional argument for using operating lease is according to earlier research (Smith and MacDonald Wakeman, 1985) its neutral effect on companies' balance sheets. When studying leasing companies' sales arguments (nordea.se; volvofinans.se; swedbank.se), it is often mentioned as an advantage with leasing compared to debt finance. How important is then this argument in companies' finance decisions? If it really is vital, will the new proposal reduce the propensity to lease?

According to the senior director at AB Volvo the proposal may affect the finance decision, however, he expects the effects to be marginal. He believes the reason for including off-balance sheet arrangements in the communication, is due to the way of speaking, a thing you should include in your offer. Furthermore, he believes the whole thing with off-balance sheet arrangements has reached its best-before date since sound creditors know and take this into consideration when making credit decisions²³. On the contrary, he emphasizes another reason for using off-balance sheet financing; the possibility to make amortizations. If a company is not profitable they are not able to use amortizations to reduce tax, in that case it could be beneficial to lease the asset and allow another company to exploit the tax advantage. In summary, he still believes it only to have a marginal effect on the choice of finance source.

The board member of IASB expects a shift from leasing towards debt financing, a shift he believes can be beneficial to companies since you often pay a premium for leases compared to debt financing;

"If the premium depends on the possibility to keep assets off the balance sheet, it does not add any shareholder value and thereby nothing the company should really pay for." (The board member of IASB)

In addition, he does not think that more transparent reporting would only benefit stakeholders outside the company; the company itself will gain from understanding how the financial situation really looks like. This can be obvious if top managers lack specific knowledge in finance and therefore may have

²³ Although there might be creditors not considering lease obligations when approving loans and leases.

difficulties in understanding the lease obligations; *“If obligations are treated similarly to debt, and thereby can be compared to debt financing when it comes to costs etcetera, managers are better informed and can make better decision whether to lease or buy assets.”* (The board member of IASB) This is a benefit not only to managers but to all users that cannot be considered specialized, normal users do probably not even notice the lease obligations.

A potential loser is according to the board member of IASB the lessors. When there is no difference in the accounting of assets, companies may choose to buy rather than lease, making a shift away from leasing towards financing investments with debt a possible scenario. On the other side, lessors are often connected to a bank, which would imply different types of revenues rather than reduction of revenues, he explains.

Lease terms may include an opportunity for the lessee to return the asset. The credit analyst thinks it often concerns industry specifics and to a great extent what the lease market looks like for the certain asset in mind. He describes the airline industry as a good example of a well-working lease structure and suggests that it would be almost foolish for a carrier not to keep a part of their fleet on lease. This allows the managers to build in flexibility in their capacity to meet different economic conditions, where they otherwise could be forced to sell assets at below normal market values during periods of weak demand. The share of the fleet kept on lease can therefore be regarded as a buffer to handle variations in customer demand.

The choice of finance source can also depend on different regulations in different countries. What finance solution to be used is, according to the senior director at AB Volvo, depending on which one will lead to the highest safety to creditors in terms of ability to repossess the asset. Generally, leasing is the safest type of arrangement but in some countries the lease regulation is somewhat neglected and traditional debt finance brings more safety to creditors. In these cases the choice of finance is therefore more dependent on regulations and the possibility for the creditor to repossess the asset than whether it is capitalized on the lessees balance sheet or not. He also emphasizes the fact that finance will still be required when making large investments²⁴; only a small minority can afford to make investments on their own. As the proposal appears right now he cannot see reasons for companies to shift their finance from leasing to debt, for this to happen he believes more drastic changes are required.

The accounting expert at SEB regards leasing as a product designed to avoid the more expensive unsecured loans and to provide operating flexibility. It also opens up the opportunity to use equipment as collateral for the loan and can be viewed as a substitute to borrowing money. The majority of the lease contracts are finance leases, treated as loans, and are not expected to be affected considerably. However, if the operating leases are recognized on the balance sheet as assets and liabilities, it may have implications on the attractiveness. Since she expects the lease complexity to rise with the new proposal, a potential scenario is increased propensity to purchase assets rather than lease. She also

²⁴ As for the products Volvo is selling.

considers the higher value for leases in comparison to an outright purchase²⁵ as something possibly making clients prefer a purchase to a lease. This is, however, not considered a big issue since the bank has many available options to offer besides leasing.

4.3.2 Effects on sales

Leaseurope in their comment letter expresses grave concerns on the negative implications the proposal may bring to investments in Europe. They argue that leasing is an important and flexible finance solution to companies today, especially the ones that may lack other available options.

According to the head of Volvo's financial reporting, leases make up a large share of Volvo's total sales. Last year (2010) Volvo's total sales amounted to 264.7 billion Swedish crowns (Volvo annual report 2010). Their own customer finance equaled somewhere around 100 billion, where finance and operating leases represented approximately 80 %. For trucks and buses the senior director at AB Volvo believes approximately 60-70 % are in one way or another, financed through leasing²⁶. Despite the large share of leases, he does not believe the proposed standard will have any important impact on Volvo's sales. He builds his arguments on the fact that it is a common European proposal that affects all companies in the same manner. He also believes that most creditors are aware of their customers lease obligations, which should imply no difference in the ability to receive credits.

The accounting expert at SEB reasons similarly to the respondent above and does not expect any significant effects on investment ratios as a consequence of the new proposal;

"Companies will also in the future require the equipment that is on lease today, in one way or another, therefore the investment ratio will be left unaffected... If it leads to higher leverage ratios, constraining firms' ability to finance themselves - that would seem awkward. Accounting rules should not affect investment decisions." (The accounting expert at SEB)

4.3.3 Effects on lease terms

The comment letters indicate that the overhaul being done by IASB and FASB on lease accounting has created a lot of uncertainty to companies involved in one way or another in leasing. Lessees fear large costs due to complexities with the proposal whereas lessors fear that this concern might make their clients turn to other options. Some critics have argued that the new lease standard would bring changes to the lease contracts, for example the length, in order to avoid some of the rules in the proposal. The senior director at AB Volvo does not consider this a major issue, sooner a "hygiene question" in order to keep up with the regulation. He is of the opinion that new regulation often brings adaptations to standard agreements and general conditions, this is, however, more dependent on the regulation itself. The accounting expert at SEB is on the same lines:

²⁵ Due to the inclusion of options to extend.

²⁶ A majority in the form of finance leases.



“In general when rules change one has to look over the contracts to avoid breaking any laws or regulations.” (The accounting expert at SEB)

She explains this is made with the clients in mind and how they will be affected. Furthermore, she believes the contracts will be affected due to the inclusion of options to extend since it has implications on the size of the liability. Contracts with options may lead to more liabilities than those without options; therefore clients may prefer to exclude this opportunity. In addition, services would need to be distinguished from leases, which is not an issue with today’s standard as they are treated the same way.

Moreover, the accounting expert at SEB reasons that if the lease-terms are shorter than one year it will be easier to achieve simplifications according to the proposal, leading to more clients possibly preferring to engage in short-term leases. If this assumption proves to be correct, and the economic life of the asset considerably exceeds more than one year, the residual value risk increases and probably leads to more expensive leases. She believes the contracts will have to be much more detailed in distinguishing between leases and purchases as well as leases and services. This will have to be done before the proposal is implemented. The board member of IASB can see a potential desire from lessees to engage in short-term leases in order to avoid some regulation and administration. On the other hand, he also emphasizes the lessors’ risk in this kind of agreement. As an example he mentions the aircraft industry where he finds it difficult to see any lessors willing to engage in leases shorter than twelve months. If this was the case, they would take on a huge risk whereas the lessee would enjoy a large benefit in terms of increased flexibility. This new distribution of risks and benefits would probably be reflected by higher lease fees.

5 SUMMARIZING DISCUSSION OF THE CASE STUDY

In this part we analyze our respondents' answers through our developed model and compare them for each of our seven focal points; Comparability, Cost of capital, Adjustments, Compliance costs, Propensity to lease, Sales and Lease terms. The completed model will be presented next, followed by motivations for each category separately.

The model is now processed - showing a summarized picture of the five different perspectives.

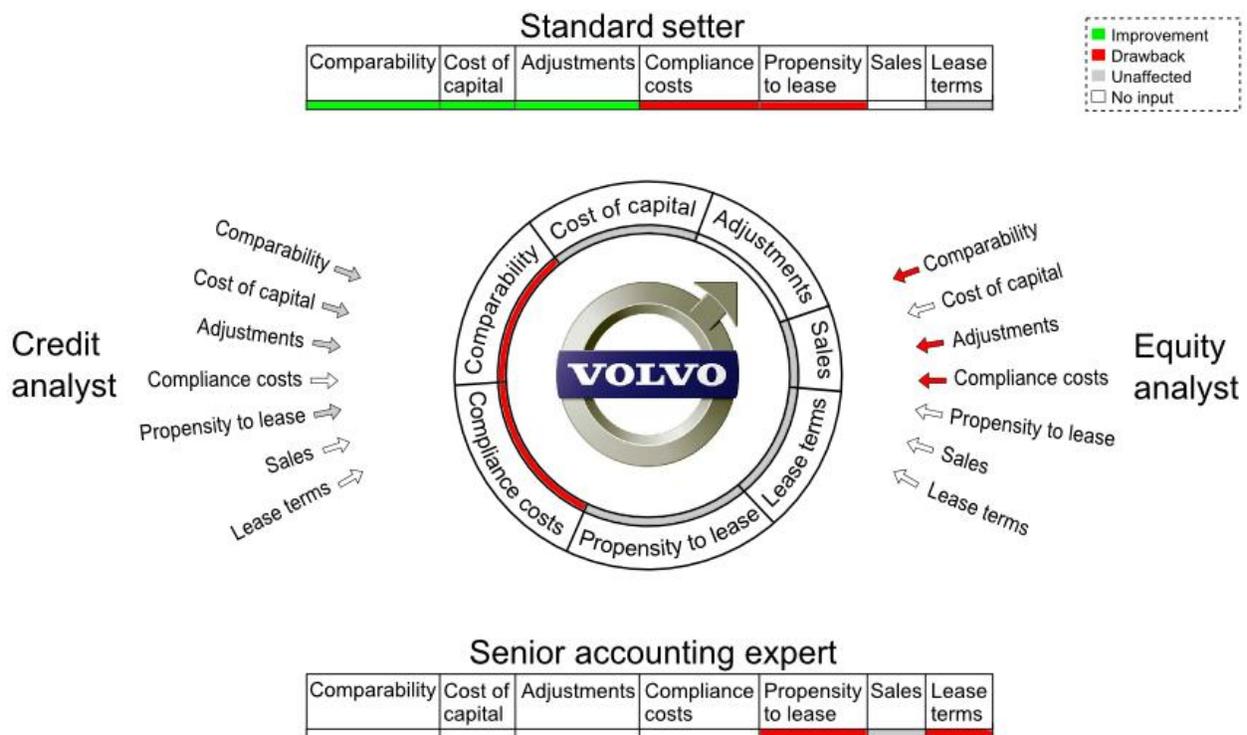


Figure 3. The figure shows our model with colors representing the respondents' opinions concerning each of our seven focal points.

Comparability

The preparers in our study, represented by the head of Volvo's financial reporting and the senior director at AB Volvo, do not believe that the standard provides a more fair view of Volvo's financial situation. They are, however, not totally in agreement whether the new standard makes comparability between companies easier than earlier. The head of financial reporting emphasizes the inclusion of options to extend as something reducing the reliability of the reports. He bases his argument on difficulties in performing individual estimations of what will happen to all lease contracts 15-20 years ahead from now. The senior director at AB Volvo is more positive towards the proposal and thinks the reports can become more comprehensible. However, he does not find this information really important,



instead he wants to put more focus on companies' committed cash flows. Altogether, we find the preparers rather negative to the comparability aspect, much depending on the opinions expressed by the head of Volvo's financial reporting.

The board member of IASB believes the proposed standard will be helpful to analysts and others when comparing companies. This was, in fact, an important factor behind the proposal. The credit analyst does not always regard leases as equal to debt. He is of the opinion that the use of leases is different between both industries and companies. Furthermore, he does not think it will affect the comparability to a large extent since he believes that they have good estimates of their clients' commitments. Our second user of financial reports, the equity analyst, believes the comparability to decrease if the standard is accepted as it is formulated in the proposal. The reason for this is the inclusion of options to extend and contingent rentals, which he thinks will reduce the connection between accounting and cash flow and could result in unusable information. Instead he wants to capitalize only contractual liabilities. He is also skeptical to the new way to account for the lease fee, which he thinks will lead to a mismatch between cash costs and income statement expenses. In addition he is afraid that it will create an opportunity for managers to influence reported profitability even though the cash flow is unaffected.²⁷

Effect on cost of capital

Naturally, the most obvious advocate of the proposal is the board member of IASB. He also believes the proposal will have a positive effect on cost of capital due to increased transparency and a common international regulation. However, this positive effect will only apply to "good" companies whereas "bad" companies will probably see an increased risk premium. All together, he hopes this will lead to a more efficient resource allocation improving the function of the economic system and providing more fair risk premiums to capital providers. The credit analyst finds it, however, hard to see a realization of these benefits and is more neutral to the proposal's effect on transparency and cost of capital²⁸. On the other hand, he bases this opinion on his role as creditor, and brings out their unique advantage to access information not revealed in the financial reports, as the main reason for his standpoint. The senior director at AB Volvo is on the same lines as the credit analyst and does not expect any large effects on the cost of capital. Unlike the credit analyst, he does, however, find that most of the necessary information is already available in today's reports, and that the most important role of the proposal is to clarify this information.²⁹

²⁷ The accounting expert did not comment the comparability aspect.

²⁸ Which in his case mainly constitutes of cost of debt.

²⁹ No input was received from either the head of Volvo's financial reporting, the equity analyst or the accounting expert.

*Adjustments*³⁰

The credit analyst said that adjustments are made dependent on whether the effects are considered to be essential. In that case established methods are used which he believes will be modified to adapt to the new proposal rather than disappear. So given its current design, the credit analyst does not believe the proposal will reduce his work-load in terms of making adjustments to the financial reports. The senior director at AB Volvo tones down the importance of the balance sheet and considers adjustments to the balance sheet to be only secondary to committed cash flows. Therefore he does not comment whether the number of adjustments will be reduced as a result of the proposal or not. The most negative respondent in this respect is the equity analyst. He is afraid that the inclusion of options to extend and rentals will require new adjustments from the analysts in order to capture a company's "real"³¹ obligations. Furthermore, he believes additional adjustments will be required if the new way to account for lease fees is accepted, since initially it would have a negative impact on accounting profit, which will later decline and turn positive.

As a board member of IASB and advocate of the proposal, Mr. Engström assumes that the arbitrary adjustments made by analysts will decrease as a result of a more transparent accounting. One of the proposal's main objectives is according to the exposure draft also to facilitate the corporate analysis by reducing the necessity to make subjective adjustments. These adjustments should instead be made by the companies in order to decrease analysts' estimation errors and thereby increase the accuracy in their analyses.³²

*Compliance costs*³³

The costs for conforming to the proposal were absolutely the most highlighted implications by the head of Volvo's financial reporting. He finds these costs extremely high if the company has to work through all their contracts in all of their global business units. In addition they must also adapt their business systems, educate employees and estimate the value of options to extend and contingent rentals each quarter. Mr. Hagström questions whether the potential benefits actually will outweigh these enormous costs. The equity analyst is not convinced and agrees with the extensive work this would imply to companies, especially when it comes to the estimations of options to extend and contingent rentals. The board member of IASB agrees with the criticism against the costs resulting from estimating the value of options and contingent rentals, and expects them to be excluded from the final standard. He does, on the other hand, not agree with the criticism of additional costs for tracing all lease contracts. This is something he thinks a well-managed company should do anyway, independent of accounting rules.³⁴

³⁰ A reduction in total adjustments is here represented with the color green while an increase in adjustments is represented by red.

³¹ Here referring to contractual obligations.

³² Whether the head of Volvo's financial reporting and the accounting expert believe the proposal to reduce adjustments are however unclear since no input was received on this subject.

³³ Increasing costs as a result of the proposal are here represented by the color red while a reduction is represented by green.

³⁴ No input was received from the senior director at AB Volvo, the credit analyst or the accounting expert.

Effects on the propensity to lease

The senior director at AB Volvo does not think the proposal will affect companies' propensity to lease more than marginally. He instead highlights other reasons for determining which finance source to use, as for example the one providing the highest safety to creditors. Concerning the discussion with the importance of off-balance sheet financing he finds it overblown and believes it has reached its best-before date. The credit analyst also believes other factors to have more impact on propensity to lease than to exclude it from the balance sheet. He mentions specific industries where the use of leases is an established way of financing your business in order to maintain high flexibility. Since most analysts are aware of this, he cannot see any reasons for these companies to reduce their amount of leases.

However, the board member of IASB expects a shift from leases towards debt financing. He finds this to be a natural and profitable step for companies when the more expensive lease will be accounted for in the same way as the cheaper purchase. This view is shared by the accounting expert who thinks a shift, at least from operating leases, toward purchases to be likely. She emphasizes increased complexity and recognition of operating leases as important factors for this shift.³⁵

Effects on sales

The senior director at AB Volvo does not believe that the proposal will have any effect on Volvo's total sales. The main reason for his opinion is the fact that it is a common European proposal, which has the same implications to all of their competitors. The accounting expert at SEB does neither find any effects on sales as probable, and believes that investments are independent of changes in accounting regulation.³⁶

Effects on lease terms³⁷

The respondent expecting the largest effects to lease terms is the accounting expert. She assumes more customers will exclude options to extend from their contracts and prefer contracts that are shorter than twelve months in order to avoid some of the new regulations. In addition, she expects new terms in the contract in order to distinguish leases from services. The board member of IASB is not sure whether lessors will accept short-term leases since it implies a much higher risk to renew the lease every twelfth month. In that case a higher lease fee would be required to cover the higher risk. The senior director at AB Volvo tones down potential effects to the lease terms and derives them to pure regulation adaption rather than strategic reasons.³⁸

³⁵ No input was received from the head of Volvo's financial reporting and the equity analyst.

³⁶ No input was received from the other respondents.

³⁷ On this aspect white has the same meaning as before, gray stands for no effect except from adapting to regulation, red represents that important adjustments, rather than just complying with the new regulation, will be made to the contracts, whereas green is excluded.

³⁸ No input was received from the other respondents.

6 CONCLUSIONS, REFLECTIONS, LIMITATIONS AND FUTURE RESEARCH

In this section we intend to answer our research questions and make some reflections, state the limitations with the study and provide some proposals for future research related to this subject.

6.1 Conclusions

In the introduction we formulated the following research question:

“What are the main implications following the proposed lease standard to a multinational manufacturing company and its stakeholders, and will potential benefits from the proposal outweigh potential costs?”

When looking at our developed model the most prominent aspect is cost for complying with the standard. This area was also the most discussed during our meeting with the head of Volvo’s financial reporting. The general expectations were otherwise that the effects from the proposal would be quite modest, which can be seen in the model where a majority of the fields are gray or white representing “unaffected” and “no input”. Naturally, the board member of IASB was the respondent being most positive to the proposal. An interesting aspect was the answers from the credit analyst and the equity analyst concerning comparability, cost of capital and adjustments. IASB and FASB mainly develop new proposals with regard to capital providers and one of the main objectives with this proposal was to reduce the number of adjustments made by analysts. This effort was, however, not highly appreciated by our respondents and the equity analyst even thought it could incur additional adjustments. Furthermore, some of the respondents believed the propensity to lease could decrease as more companies choose to finance their purchases with debt. Total sales and investments were, however, not expected to change. The accounting expert expected important changes to the lease terms, whereas the other respondents were more neutral to potential effects.

The head question was also divided into the following sub questions:

“In what ways will the proposed change in the accounting for leases be beneficial to the company and its stakeholders?”

“What additional costs would this bring about to the company and its stakeholders?”

The most important benefit highlighted in the study was clarification of the lease commitments. Even though most commitments have existed in the reports before, the new standard would, according to some of our respondents, make them clearer. The board member of IASB also emphasized better internal overview and more well-grounded investment decisions as potential benefits for owners and management. On the other side large costs were highlighted for adapting to the proposal. Most criticism came from the head of Volvo’s financial reporting who was truly disturbed by the administrative burden following the current proposal. Cost for identifying all lease contracts, adapting business

systems, estimate options to extend and contingent rentals, classify contracts as either leases or services, estimate discount rates and educate staff in performing these tasks were mentioned as costs following an implementation of the proposal.

To conclude, the question whether potential benefits from the proposal will outweigh potential costs is somewhat unclear and depending on whom one is asking. However, this study indicates that most respondents are fairly neutral to the proposal's actual effects, with a slight predominance of the negative effects.

6.2 Reflections

Much research support the notion that transparent accounting reduces information risk and makes the financial statements more understandable to users, either in the use of disclosure or rather by recognizing items on the balance sheet, having positive effects on the cost of capital and risk premiums of companies.

However, according to the majority of our respondents including, both users and preparers, the proposal fails to deliver on this objective. This is probably due to a disagreement on what is a true reflection of a company's financial situation. Because the transparency objective will suffer if its means result in a "noise" that the users of financial statements will have to discern and adjust for. Moreover, failing by not taking into consideration the requested information such as committed cash flows add to this shortcoming. On the other hand, the preparers will protest against the unacceptable amount of resources that needs to be dedicated in order to fulfill the guidelines. Compromises are necessary to address the interests of both groups to reach a consensus on how a better transparency and more understandable reports on a global level can be achieved. The sacrifices by the preparers may actually be motivated if their cost of capital decreases as a result of improved accounting quality - translated into more reliable financial statements. This implies a better access to capital markets due to the more effective allocation of capital, when the screening process is allowed to rely on financial statements on a global competitive level. Furthermore, it could actually pose a threat to the financial institutions that specialize in making local screening information available on a global basis to reduce the information risk for long distance investors. This may not appear in the environment of the company immediately.

Leaseurope raises concerns over the implications with the proposed standard, implying that it may remove an important financing source or that it makes it less available for companies, especially the SMEs or start-ups. According to them it could translate into lower total investments by companies when they lack few other options. This reasoning seems far-fetched, although it challenges the current practice. Still, it seems unlikely that the businesses that provide credit or products which are undergoing the very same changes would not adapt and thus avoid the risk of missing business opportunities.

6.3 Limitations

The most obvious limitation with this study is to generalize it to other contexts, mainly due to the small number of respondents and our focus on only one company. For a deeper explanation on how we have tried to address this issue, we refer to the chapter “3.6.2 Validity” and the discussion concerning external validity. Furthermore, one has to be critical to respondents’ answers concerning their own profession and related job assignments. An example from this study is the answers from the credit and equity analysts concerning the effect on cost of capital. Answers indicating a changed cost of capital as a result of the proposal can in a way be interpreted as a rejection of their own analyses. Similar reasoning holds for the representatives from Volvo which may not want to risk a higher cost of capital by admitting that the standard would increase transparency and affect cost of capital. Readers must be aware of the specific interest belonging to each respondent, which could result in biased answers.

6.4 Future research

When conducting this case study we identified several areas that could be further investigated. Firstly, even though we have been looking at Volvo as both lessee and lessor, most efforts have been spent to address potential impacts on the company as lessee. It would be interesting to pay more attention to the lessor side in order to get a deeper understanding of potential effects on aspects as sales and propensity to lease. In order to get a clear view on these issues a finance company acting solely as lessor would be appropriate, even though it may be hard to locate.

Secondly, a comparison between companies from different sectors would contribute to a wider perspective on the implications of the proposal. These studies should preferably analyze qualitative aspects, as those in this study, since impacts on financial statements and key figures are already covered by the existing research.

Thirdly, after the implementation it would be interesting to look at how well the objectives from IASB and FASB were reached. This could be done by comparing companies’ cost of capital pre-implementation with cost of capital post-implementation. If there has been a reduction, it could be interpreted as the information to capital providers has indeed been improved. This would of course require a large sample in order to allow for individual elements at the same time as exogenous factors need to be considered. On the same theme it would also be interesting to compare the numbers of adjustments made by capital providers since a reduction of these was one of the main objectives with the new standard.



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APPENDIX

Exhibit 1. Interview guide, Göran Albertson - Senior Director at AB Volvo

1. What proportion of your total sales are made through leasing?
2. Why are companies leasing from you?
3. What kind of adjustments do you have to make with respect to the new proposal?
 - Costs?
 - Advantages?
4. Effects on sales?
5. Change the lease terms?
6. Alternatives to leasing?
 - Effect on the propensity to lease?
7. Effect on the buy vs lease decision?
8. What kind of customers do you think will be affected?



Exhibit 2. Interview guide, Eva Sterner – Senior Accounting Expert, SEB Group Finance

1. Why do you think companies use leases?
2. Do you think the proposal will have any effects on sales? If so, what effects?
3. What role do you think the derecognition of operating leases has in the lease decision?
4. Do you think the lease product will change? The contracts' design?
5. What kind of companies do you believe will be affected?
6. Do you think the lease vs buy decision will be affected?
7. Do you think the investment ratio i certain companies will be affected?
8. Other advantages or disadvantages?



Exhibit 3. Interview guide, Jan Engström – Board member of IASB

1. Why change the standard? Why now? Who has requested the change? What parties have you had in mind?
2. Do you think the proposal will cause any costs for concerned companies? If so, what costs?
3. In which industries do you believe we will see the biggest effects? Effects on the engineering sector?
4. What are the main advantages with the change?
5. Which parties will enjoy these benefits?
6. How do you evaluate costs vs benefits?
7. How is accounting reliability affected when including options to extend and rentals in the balance sheet?
8. Do you think we will see any effects on stock prices and credit ratings when the new standard is implemented?
9. In our study we look into potential effects on Volvo in terms of costs and benefits. What effects do you think are likely for a company as Volvo? That is costs and advantages both for Volvo and its stakeholders.



Exhibit 4. Interview guide, Christian Moberg – Industry and Corporate analyst/Credit analysis, SEB Merchant Banking

1. How do you consider leasing today? Equal to debt?
2. Do you adjust for leases?
3. Do you think the new proposal facilitates credit analyses? Cost and time-savings?
4. Do you think the change is needed or is all necessary information already in today's reports?
5. Are there any weaknesses in the proposal?
6. Do you think your credit analyses will be affected if the new standard is implemented? Can increased transparency reduce the cost of debt?
7. What effects do you assume for companies in the transportation sector?



Exhibit 5. Interview guide, Mikael Hagström – Vice President, Head of Financial Reporting, AB Volvo

1. How would you “roughly” describe your composition of operating leases?
2. Why do you make use of leasing?
3. Do you consider leasing a means to achieve a certain capital structure - if so, what importance would you attribute it?
4. Do you expect the lease-contracts to be affected in terms of length with the new proposal?
5. Do you think that you can estimate the value of your lease-contracts in a reliable way?
6. According to the proposal, the operating lease cost shall be divided into a interest and an depreciation part, suggesting a higher initial cost that will decrease over the period. How does this reflect the consumption of the economical benefits of assets compared to today’s standard?
7. What kind of products do you sell through operating lease?
8. What proportion does operating lease consitute of your total sales?
9. Do you expect that the proposed standard will affect Volvo’s sales in any way?
10. What are the primary changes that the proposal will have on your financial statements? Have you conducted any tests on key financial ratios?
11. How would you describe the interest among external stakeholders concerning you lease obligations?
12. Do you receive questions about your lease commitments today? Do you expect these questions to change in number in response to the new accounting for leases?
13. Do you think that the financial reports will reflect a more fair picture of Volvo after the proposal has been implemented?
14. Do you see any benefits for Volvo as a consequence of the new standard?
15. Do you expect the proposal to give rise to any costs?



16. Do you appreciate possible incremental costs can be motivated by that information in the financial reports will improve?

17. Do you think that the changes proposed are needed?

18. Do you think that the IASB have considered your opinion during the standard setting process?