Final Report for AFAANZ Grant received for 2017-2018

1. Name, Position, Contact Details of Applicants

a. Developing researcher: Dr Tricia Ong (Lecturer, s.ong@ecu.edu.au)
b. Established researcher – Mentor: Associate Professor Hadrian Djajadikerta (Associate Dean Research, h.djajadikerta@ecu.edu.au)

2. Project Title

Measuring and forecasting impact of new leases accounting standard on the airline industry

3. Updated Project Summary

The new accounting standard on leases was issued in 2016 after a long period of discussion since 2009 when the first discussion paper for a change in the existing standard was raised. The new standard was a joint effort initiated by the International Accounting Standard Board (IASB) and the Financial Accounting Standard Board (FASB) to address the increasing use of off-balance sheet disclosures through the use of operating leases. The new standard requires all leases to be classified as finance leases, except for those with lease period of less than 12 months and for assets with low value. Unlike the previous standard where operating leases are expensed off, companies are now required to capitalise leases as assets and liabilities. The resulting effects are significant increases in lease assets and financial liabilities and decreases in lease expenses, and consequently changes in profitability and leverage ratios. Particularly, companies with material amount of operating leases are expected to have significant changes in their financial statements and ratios that are likely to affect their market performances, resulting in volatility of their stock prices. This project has chosen to focus on companies in the airline industry as they generally have majority of their air fleets accounted as operating leases. Specifically, this study conducts a longitudinal study that investigates the impact of implicit operating lease capitalisation on company stock price volatility of the listed airline companies.

We selected our sample using the Bloomberg Industry Classification System, which is a proprietary hierarchical classification system that captures companies' general business activities registered across the global financial markets. There were altogether 118 listed airline companies in this initial selection. To further satisfy the criteria for our longitudinal study over 10 years from 2007 to 2016, companies that were listed after 2007 and those that were de-listed during this period were excluded. In addition, because we do not have access to the actual leasing contracts, we have also excluded those companies that did not disclose leasing payments in their annual reports during the analysed period. After the various rounds of elimination, our final sample consists of 47 listed airline companies. A panel data set over the studied period was collected using the Bloomberg Terminal real time financial market database. A total of 470 observations were collected.

Our dependent variable is defined as the volatility of stock prices and the independent variables include the main seven financial ratios in the Standard and Poor's (S&P) credit rating methodology when evaluating credit risk. These financial ratios are adjusted to reflect the impact of the implicit operating leases capitalisation standards. To provide cross-monitoring among the established relationships, we have also included two control variables, firm size and systematic risk, which have been consistently found by prior literature to have significant impact on market return volatility. To testify whether the implicit operating leases capitalisation has been considered by market participants, we compared the two alternative models – unadjusted and adjusted models - developed using regression with the panel data collected. The unadjusted model was developed based on the S&P methodology with the main seven financial ratios, and this is compared to the adjusted model that included the same financial ratios after adjusting for the impact of the new accounting standard for leases.

Our study found that the unadjusted model was a better measure to determine the stock price volatility than the adjusted model, hence suggesting that the market participants have not incorporated the recognition of implicit operating leases capitalisation into their decisions on equity investment.

4. Funds Granted

$4,000

5. Detailed Report on Expenditure of Funds against Budget Items

Please refer to the financial acquittal report as attached which indicates that the majority of the fund is used for the engagement of a research assistant.

6. Outcomes

Currently, there are two working papers in progress. The first paper focuses on the empirical results from the longitudinal study and we plan to finalise the paper by early next year for submission to Accounting, Auditing and Accountability Journal. The second paper investigates the implications of the new leasing standard to company's credit risk. For this paper, we are revising on the theoretical framework and the literature review before preparing to submit to Journal of Risk and Insurance.

7. Future Intentions

a. Conference submissions: We plan to submit one to two papers to 2019 AFAANZ conference at Brisbane.

b. Journal submissions: We are preparing our papers for submission to Accounting, Auditing and Accountability Journal, Journal of Risk and Insurance and Accounting and Finance.

c. Grant applications: There are plans in place to submit applications to AFAANZ and CPA in 2019 to expand the project to apply the developed model to study the impact of the new leasing accounting standard on other industry such as the retail industry.

d. Projects: To build on this project, we plan to compare our results with companies' actual financial disclosures by collecting more data when companies implement the new accounting standard by 2019.

8. Summary of Outcomes and Benefits

We acknowledge and appreciate the funding from AFAANZ to support this research project. The funding has made it possible for us to engage a research assistant to assist in data collection. With the data collected, we were able to develop a model used in our study that can be further applied to future research studies. The results from our study have provided useful empirical evidence for practical implications for accounting practice and disclosures relating to the impact from the new leasing standard.

Submitted by: Tricia Ong & Hadrian Djajadikerta