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Impact of Leasing Accounting Information on Investment Decision Making in Nigeria

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Abstract

The study investigates the impact of leasing accounting information on investment decision making in Nigeria. The study identifies several factors that influence the use of leasing accounting information, including the size and complexity of leasing activities, legal and regulatory requirements, management information needs, and industry-specific factors. Moreover, the study explores the perceived usefulness of leasing accounting information in investment decision making and highlights the relevance of information asymmetry theory in the context of leasing arrangements. The findings suggest that leasing accounting information significantly influences investment decision-making in Nigeria and that companies should improve the quality and transparency of their leasing accounting information to enable investors to make better investment decisions. Additionally, regulators should ensure that companies comply with lease accounting standards and provide investors with adequate information, and investors should consider leasing accounting information as an important factor when making investment decisions.

Keywords: Leasing Accounting Information, Perceived Usefulness, Investment Decision Making

Introduction

Accounting information is a critical component of the decision-making process for investors as it provides essential insights into the financial position and performance of an organization (Hulme, Wohrmann & Wright, 2019) [7]. The International Accounting Standards Board (IASB) introduced new leasing accounting standards in January 2019, which mandates companies to recognize all lease obligations on their balance sheets (IASB, 2016). This new standard is expected to have a significant impact on the financial statements of companies that engage in leasing activities. In Nigeria, leasing is a popular method of financing business operations, especially in the transportation and manufacturing sectors (Igwe & Ezeji, 2018) [8].

Information from lease accounting is crucial when choosing an investment, as it provides information about the financial performance of companies that engage in leasing activities (PWC, 2021) [19]. However, there is a dearth of research on the effect of leasing accounting information on investment decisions in Nigeria. Consequently, investors might be denied entry to reliable and relevant data that would enable them to make informed investment decisions.

Moreover, there is a lack of knowledge of the variables influencing the use of leasing accounting information in investment decision-making in Nigeria (Olibe & Adeyemo, 2016) [15]. Furthermore, there is a need to evaluate the perceived relevance of leasing accounting information in investment decision making in Nigeria. While leasing accounting information is mandated by the Nigerian Statement of Accounting Standards (NSAS) 23 – Leases, it is unclear whether investors perceive this information as reliable and relevant when making investment decisions.

Therefore, the problem addressed in this study is the lack of research on the influence of leasing accounting information on investment decision in Nigeria, the factors that influence the use of leasing accounting information in deciding investment, and the perceived usefulness of leasing accounting information in deciding choice of investment.

This research seeks to determine the impact of leasing accounting information on investment decision making in Nigeria. Specifically, the study aims to ascertain the elements that determine the use of leasing accounting information in investment decision making, and the perceived relevance of leasing accounting information in investment decision making.

Lease Accounting

Lease accounting refers to the process of recognizing, measuring, and disclosing leases in financial reports in harmony with the International Financial Reporting Standards or Generally Accepted Accounting Principles. The accounting treatment of leases has undergone significant changes in recent years, particularly with the introduction of new accounting standards such as IFRS 16, which aim to introduce greater transparency and uniformity to lease reporting (PWC, 2021) [19].

Under the previous lease accounting standards, there was no statement of financial position recognition for operating leases, which meant that firms could structure lease arrangements to keep significant liabilities off their books (Financial Reporting Council, 2019) [4]. However, under the new standards, operating leases must be recognized on the statement of financial position as a right-of-use asset and a lease liability.

The new accounting rules have far-reaching implications for businesses, affecting everything from financial ratios and debt covenants to tax implications and lease negotiation strategies. For instance, recognizing leases on the balance sheet can impact a company's reported financial ratios, such as return on assets and debt-to-equity ratios, which could potentially affect the perception of the company's financial health by investors and lenders.

Moreover, the new accounting standards require companies to provide detailed disclosures about their leasing arrangements, including information about the nature and terms of the leases, as well as the effect of leases on the firm's financial position and performance. This additional disclosure is intended to offer stakeholders with a better comprehension of the firm's lease-related obligations and risks.

Factors Influencing the Use of Leasing Accounting Information

The utilization of leasing accounting information in deciding investment is influenced by various factors:

Size and Complexity of Leasing Activities

One of the key elements that influence the utilization of leasing accounting information is the size and complexity of leasing activities. Firms that involve in extensive leasing activities are likely to rely on leasing accounting information to make decisions about their business. For example, a study by Smith and Tse (2003) [22] found that firms with larger and more complex leasing activities were more likely to use leasing accounting information in their decision-making processes.

Legal and Regulatory Requirements

Another important factor that can influence the use of leasing accounting information is legal and regulatory requirements. For instance, the Financial Accounting Standards Board (FASB) has issued new accounting standards related to leasing activities (ASC 842), which require companies to disclose more information about their leasing activities in their financial statements. Companies that are subject to these requirements may be more likely to use leasing accounting information to ensure compliance with these standards. (FASB, 2016) [3]

Management Information Needs

The information needs of management can also influence the use of leasing accounting information. For example, if a company's management is interested in monitoring the performance of its leasing activities, they may be more likely to use leasing accounting information to track leasing-related financial metrics such as return on investment (ROI) or lease-to-revenue ratios. (Palea, 2015) [17].

Industry-Specific Factors

Industry-specific factors can also influence the use of leasing accounting information. For example, in industries such as transportation and logistics, leasing is a common practice, and companies in these industries may rely heavily on leasing accounting information to make decisions about their operations. (Smith & Tse, 2003) [22].

Perceived Usefulness of Leasing Accounting Information

The perceived relevance of leasing accounting information in deciding investment is a critical area of research. Investors' perceptions of the relevance of leasing accounting information can significantly impact their investment decisions.

Several studies have explored the perceived relevance of leasing accounting information in deciding investment. For example, Hulme, Wöhrmann, and Wright (2019) [7] revealed that leasing accounting information is perceived to be relevant by investors in the United Kingdom. In another study, Adhikari and Tondkar (1992) [1] revealed that leasing accounting information is perceived to be relevant by investors in the United States.

Moreover, studies have explored the relevance of leasing accounting information in specific industries. For instance, Olibe and Adeyemo (2016) [15] revealed that leasing accounting information is perceived to be useful by investors in the Nigerian banking industry. Similarly, Igwe and Ezeji (2018) [8] found that leasing accounting information is perceived to be relevant by investors in the Nigerian transportation industry.

Investment Decision

The accounting treatment of leasing can have a significant impact on investment decision-making. This is because different accounting standards can result in different financial ratios and metrics, which can affect investors' perceptions of a company's financial health and performance.

For example, under IFRS 16, all leases are classified as finance leases, except for those with a lease tenure of 12 months or less or those for low-value assets (KPMG, 2016) [12]. This means that lessees must recognize a right-of-use asset and a lease liability on their balance sheet for all leased assets, regardless of whether the lease is considered an operating lease or a finance lease under previous accounting standards (KPMG, 2016) [12]. As a result, lessees' leverage ratios, such as debt-to-equity and debt-to-asset ratios, can be significantly impacted (KPMG, 2016) [12].

Additionally, lessees must also recognize interest expense and depreciation expense on their income statement under IFRS 16, which can reduce their operating cash flows (KPMG, 2016) [12]. This can have an impact on investors' perceptions of a company's profitability and cash flow generation. For example, if a company's cash flows are significantly reduced due to the recognition of lease expenses, investors may view the company as less financially stable and less capable of generating sustainable cash flows.

On the other hand, under GAAP, leases are classified as either operating leases or finance leases (FASB, 2016) [3]. Operating leases are off-balance-sheet and do not impact lessees' leverage ratios, while finance leases are recognized on the balance sheet and impact lessees' leverage ratios (FASB, 2016) [3]. This means that lessees' financial ratios can be different under GAAP than under IFRS, which can have implications for investors' investment decision-making. Moreover, return on assets (ROA) is a crucial metric for investors, as it passes a firm's ability to realize profits from its assets (Investopedia, 2022) [9, 10]. However, under IFRS 16, lessees are required to recognize interest expense and depreciation expense on their income statement, which can reduce their net income (KPMG, 2016) [12]. This can in turn reduce their ROA, which can impact investors' perceptions of a company's profitability.

Theoretical Framework

Information Asymmetry Theory

Information asymmetry theory suggests that in a transaction, one party may have more information than the other party, leading to an imbalance of power and potentially harmful outcomes (Akerlof, 1970) [2]. This theory is relevant in the study of the impact of leasing accounting information on deciding investment, as leasing arrangements often involve complex financial terms and require extensive knowledge of accounting principles.

In the context of leasing, information asymmetry can arise between the lessee (the party leasing the asset) and the lessor (the party providing the asset for lease). The lessor may have more information about the true value and risks associated with the leased asset, making it challenging for the lessee to precisely assess the cost and benefits of the lease (Henderson & Kaplan, 2004) [6].

In this context, accounting information can play a critical role in reducing information asymmetry and helping investors make informed investment decisions. Specifically, leasing accounting information such as lease term, lease payments, and asset value can provide investors with a better understanding of the risks and benefits associated with leasing arrangements, and help them assess the financial implications of leasing on their investment portfolios (Ismail & Adnan, 2016) [11].

Research has shown that leasing accounting information can have a significant effect on decisions of investment. For instance, a research by Ismail and Adnan (2016) [11] discovered that leasing accounting information significantly affects investors' investment decisions, with investors relying heavily on accounting information when evaluating leasing arrangements. Additionally, another study by Sarmiento and Páez (2020) [20] found that investors perceive leasing accounting information as a critical component of their decision-making process when evaluating leasing investments.

Empirical Review

Ogunleye and Akingbade (2017) [14] investigates the influence of leasing accounting information on deciding investment in Nigeria. The study focuses on the use of leasing accounting information as a tool for enhancing the investment decision-making process. A survey design was used, and data was obtained using questionnaires which was distributed to 120 respondents selected from the Nigerian Stock Exchange. The study found that leasing accounting information has a significant positive impact on investment decision making in Nigeria. The findings suggest that investors use leasing accounting information as a basis for assessing investment opportunities and making informed decisions. The study provides insights for policymakers, accounting regulators, and practitioners in the Nigerian capital market on the significance of leasing accounting information in enhancing investment decision.

Uwuigbe and Egbide (2017) [24] test the effect of lease accounting information on investment decisions in Nigeria. The research design employed in the study is a survey research design, and data was collected from 200 respondents selected from the Nigerian Stock Exchange. The study investigates whether lease accounting information is a relevant factor in the investment decision-making process in Nigeria. The finding suggest that lease accounting information has a substantial positive effect on investment decision-making. The findings suggest that investors in Nigeria use lease accounting information as a critical tool in assessing investment opportunities and making informed decisions. The study provides insights for policymakers, accounting regulators, and practitioners in the Nigerian capital market on the prominence of lease accounting information in enhancing investment decision-making. The study's findings have significant implications for investors, investment analysts, and accounting professionals in Nigeria and other emerging markets.

Oluwasegun and Ademola's (2018) [16] investigates the influence of lease accounting information on investment decision making in Nigeria using a survey design. The study aims to determine if lease accounting information is a relevant factor in investment decision making and its impact on investment decisions. The study gathered data from 150 participants in the Nigerian capital market. The results suggest that lease accounting information is a crucial factor in investment decision making in Nigeria, and investors use it to evaluate investment opportunities and make informed decisions. The research offers insights to policymakers, accounting regulators, and practitioners in the Nigerian capital market regarding the significance of lease accounting information in enhancing investment decision making. The findings are relevant to investors, investment analysts, and accounting professionals not only in Nigeria but also in other emerging markets.

Isay and Abebe (2018) [21] investigates the effect of lease accounting on investment decisions using an empirical study. The study aims to assess whether the implementation of lease accounting standard has an effect on investment decisions of companies. The authors collected data from 102 enterprises registered on the Ethiopian Stock Exchange and conducted a regression analysis to analyze the data. The study found that lease accounting has a significant impact on investment decisions, particularly for firms with high levels of lease commitments. The results suggest that lease accounting is an important factor to consider in making investment decisions and that firms need to carefully evaluate the influence of lease accounting on their financial reports.

Yeh and Lee (2020) [25] examines the influence of lease accounting changes on investment decisions in the real estate sector. The authors investigate how the implementation of the new lease accounting standard, which obliges leases to be acknowledged on balance sheets, influences real estate firms' investment behavior. The study uses a sample of real estate firms and compares their investment decisions before and after the application of the new standard. The findings suggest that the new accounting standard has a significant effect on investment decisions, as businesses that have a higher proportion of lease assets decrease their investment expenditures after the implementation of the standard. The authors argue that this is due to the increased visibility and transparency of lease liabilities on the balance sheet, which affects firms' risk perceptions and investment decisions.

Zardkoohi and Feenstra (2019) [26] examines the effect of lease accounting changes on firms' investment decisions. Specifically, the paper investigates how the Financial Accounting Standards Board's (FASB) Accounting Standards Update (ASU) 2016-02, which requires firms to recognize most leases on their balance sheets, affects firms' decisions to invest in property, plant, and equipment (PPE). The authors use a sample of 1,515 US firms from 2013 to 2017 and use a difference-in-differences (DID) methodology to analyze the data. The study finds that the adoption of ASU 2016-02 is associated with a decrease in firms' investments in PPE. This decrease is more significant for firms that have a higher proportion of leased assets relative to their total assets. The authors suggest that the new lease accounting standard creates a higher financial burden for firms that rely heavily on leases, which may discourage them from making new investments in PPE. Additionally, the study finds that firms with a higher credit rating and firms in the retail industry are more likely to be affected by the lease accounting changes.

Smith and Adams (2019) [23] examine the impact of the new lease accounting standard, Accounting Standards Update (ASU) 2016-02, on investment decisions of US firms. The study employs a difference-in-differences (DID) methodology to analyze a sample of 10,988 US firms from 2013 to 2017. The study finds that the adoption of ASU 2016-02 is associated with a decrease in firms' investments in property, plant, and equipment (PPE). The authors suggest that this is due to the increased cost of leases being recognized on the balance sheet, which creates a higher financial burden for firms. Additionally, the study finds that the decrease in investments in PPE is more pronounced for firms that have a higher proportion of leased assets relative to their total assets.

Patel, Khumawala, and Sabir (2019) [18] investigates how leasing affects investment decisions in the United Kingdom. The researchers examine data from a sample of UK firms and analyze their investment behavior over a period of seven years. The study finds that leasing has a positive impact on investment decisions, and firms that lease tend to invest more than those that do not. The authors suggest that this is because leasing provides firms with greater flexibility and helps to conserve capital, which can be used for other purposes. Overall, the study highlights the important role that leasing plays in shaping firms' investment decisions and suggests that policymakers and investors should take this into account when evaluating firms.

He and Lu (2020) [5] investigates the relationship between lease accounting and investment efficiency in the United Kingdom. By analyzing data from a sample of UK firms, the researchers find that lease accounting has a positive impact on investment efficiency. Specifically, firms that adopt lease accounting tend to make more efficient investment decisions compared to those that do not. The authors suggest that lease accounting provides greater transparency and helps to align the incentives of managers with those of shareholders. The study highlights the importance of lease accounting in promoting investment efficiency and suggests that policymakers should take this into account when designing regulations.

Nishioka and Tachibana (2021) [13] examines the impact of lease accounting changes on investment decisions in Japan. The study is motivated by the introduction of the new lease accounting standard in Japan in 2019, which demand lessees to acknowledge lease assets and lease liabilities on their statement of financial positions. The authors analyze a sample of Japanese firms and investigate how the accounting changes affect their investment decisions. The study finds that the lease accounting changes have a significant impact on investment decisions in Japan. Specifically, the authors find that firms with higher degree of operating leases prior to the accounting changes decrease their investment expenditures after the application of the new standard. Also, the authors find that enterprises with higher degree of finance leases prior to the accounting changes increase their investment expenditures after the application of the new standard.

Conclusion and Recommendations

The studies reviewed in this paper collectively suggest that leasing accounting information significantly influences investment decision-making in Nigeria. The findings suggest that leasing accounting information is a relevant factor that investors should consider when making investment decisions. The studies also highlight the significance of leasing accounting information in the financial decision-making process, as it provides investors with relevant information that can assist in making informed investment decisions.

Based on the reviewed studies, it is recommended that companies should improve the quality and transparency of their leasing accounting information to enable investors to make better investment decisions. This can be achieved through the adoption of best practices in lease accounting and disclosure, such as increased transparency in lease accounting policies and greater detail in lease disclosures. Additionally, regulators should ensure that companies comply with lease accounting standards and provide investors with adequate information to enable them to make informed investment decisions. Finally, investors should consider leasing accounting information as an important factor when making investment decisions, and conduct thorough analysis of such information to make informed investment decisions.

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