Implications of IFRS 16 on Maltese Listed Entities – A Qualitative Study

By

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A dissertation submitted in partial fulfilment of the requirements for the award of the Master in Accountancy degree in the Department of Accountancy at the Faculty of Economics, Management and Accountancy at the University of Malta

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Abstract: Implications of IFRS 16 on Maltese Listed Entities – A Qualitative Study

Purpose: The objective of this study is to assess the influence of implementing IFRS 16 on the levels of gearing, profitability, and lease-related disclosures, four years after implementation. Additionally, the study aims to explore any pre and post-implementation concerns raised by CFOs of locally listed entities.

Design: The objectives concerning the assessment of financial metrics and lease-related disclosures, were accomplished through a detailed content analysis of the financial statements published by local equity-listed entities. Meanwhile, the exploration of pre and post-implementation matters amongst preparers was achieved by conducting eight one-to-one semi-structured interviews with CFOs.

Findings: The substantial grossing up of the SOFP is an immediate finding, whereby certain entities experienced an increase in their total liabilities of more than 70% and as anticipated, key financial metrics mostly relating to gearing were consequently affected. Notable changes were also evident in EBITDA figures, as an APM, whereby the metric reached new highs given the revised lease expense recognition. With respect to the disclosures, their extent was directly proportional to the materiality of the changes in the key financial metrics. Naturally, MLEs that were more materially impacted by IFRS 16 have dedicated more narratives in their financial statements, including management commentary; however, MLEs that experienced a little to no impact, have correspondingly made less reference to the standard. Regarding the emerging insights from the interviews, major concerns by preparers were as to how users will interpret the new changes, especially in view of their lack of accounting knowledge. On a similar note, the preparation of internal management accounts in line with IAS 17 was another crucial finding, suggesting that IFRS 16 interpretation may be too complex for country or division managers which are not accountants by profession. Other findings related to the challenges faced by preparers in determining the discount rate for future lease payments in circumstances where the rate is not implicit in the lease contract.

Conclusions: With the availability of comparatives, IFRS 16 has now become the normality for lease accounting. Nevertheless, ongoing challenges are still being faced by preparers, more specifically by MLEs that encounter numerous lease modifications.

Value: The analysis of the implications provides value to academia, practitioners, and stakeholders by improving their knowledge and understanding of the standard. This study adds to the existing body of knowledge and may serve as a future reference for preparers in considering the effect of leases on their distributable reserves.

Keywords: IFRS 16 *Leases*, Financial Reporting, Gearing, Disclosures, APMs, Management Commentary, Professional Judgement

Dedication

To my family, and to those who were of utmost encouragement throughout all my academic years.

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List of Abbreviations

APM	Alternative Performance Measure
BOV	Bank of Valletta
CFO	Chief Financial Officer
D/A	Debt to Asset
D/E	Debt to Equity
EBIT	Earnings before Interest and Tax
EBITDA	Earnings before Interest, Tax, Depreciation and Amortisation
EEA	European Economic Area
EFRAG	European Financial Reporting Advisory Group
EPS	Earnings per Share
ESMA	European Securities and Markets Authority
FASB	Financial Accounting Standards Board
FC	Financial Controller
FL	Finance Lease
FRC	Financial Reporting Council
FS	Financial Statements
GAAP	Generally Accepted Accounting Principles
GHM	Grand Harbour Marina
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IBR	Incremental Borrowing Rate
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standard
KFM	Key Financial Metric
LL	Lease Liability
MC	Management Commentary
MIA	Malta International Airport
MLE	Maltese Listed Entity
MSE	Malta Stock Exchange
OBS	Off-Balance Sheet

OL	Operating Lease
PIE	Public Interest Entity
ROA	Return on Assets
ROU	Right-of-Use
SFAS	Statement of Financial Accounting Standards
SFC	Simonds Farsons Cisk
SOFP	Statement of Financial Position
SOPL	Statement of Profit or Loss
TAs	Total Assets
TLs	Total Liabilities

Chapter 1: Introduction

1.1 Background to the Study

IFRS 16 *Leases* has been firmly consolidated into effect as the substitute for IAS 17 *Leases* and IFRIC 4 *Determining whether an Arrangement contains a Lease* by the International Accounting Standards Board (IASB) as of the 1st of January 2019, thus paving the way into becoming “the new normal for lease accounting” (KPMG 2021).

> “One of my great ambitions before I die is to fly in an aircraft that is on an airline’s balance sheet...”
>
> *(*Sir David Tweedie 2008*)*

As noted by Tweedie (2008), this need for change had been long orbiting around the international accounting community, to the extent that efforts on IFRS 16 had already commenced during 2006. This formed part of the convergence program between the IASB and the Financial Accounting Standards Board (FASB), with the aim being to bridge the gap between both standard setters. The reason for IFRS 16’s introduction was predominantly due to the absence of transparency in lease accounting, which is a salient determinant for investors and other key stakeholders (IFRS Foundation 2016a).

1.1.1 Leasing as a Principal Financing Solution

If the need for the acquisition of an asset arises, an outright purchase could be a weighty commitment for an entity, especially if the asset is of a costly nature with high depreciation rates. On that account, an alternative financing solution is leasing, which according to the European Economic Area (EEA) is the most common business financing solution across the European sector. Leasing offers the possibility for an entity to prolong the acquisition cost of an asset throughout its utilisation and corresponding the revenue earned via the utilisation of the underlying lease asset, to its relative cost.

Findings from a statistical study conducted by Devos and Li (2021, p.456) also corroborated that leasing is utilised as a form of risk hedging; 'we find that a higher CEO vega, which discourages hedging, leads to lower operating lease (OL) intensity.' Additionally, the authors argued that parties enter into leasing agreements to benefit from operational flexibility, along with the convenient accounting treatment for operating leases allowed under IAS 17, before IFRS 16's effectiveness.

1.1.2 The Radical Overhaul in Lessee Accounting

Lessor accounting has practically remained consistent with IAS 17, however, the accounting treatment for lessees has been completely remodelled. IAS 17 allowed a dual accounting model classification for lessees between finance leases (FLs) and operating leases (OLs). IFRS 16 has directly addressed the OLs exploitation which will be delved into more depth in Chapter 2, by instigating a single lease accounting model, uniform to the previous accounting treatment of FLs under IAS 17. Thus, all leases are to be recognised in the Statement of Financial Position (SOFP) at the present value of future lease payments except for those leases to which exemptions apply. For this reason, those lessees with material off-balance sheet leases (OBS) before the issue of IFRS 16, were expected to be significantly affected by changes in the key financial metrics (KFMs), attributable to the grossing up of the SOFP (IFRS Foundation 2016a).

Changes were also present in the Statement of Profit or Loss (SOPL). The accounting treatment of OLs under IAS 17 was a straight-line operating lease expense included as an operating expense. Conversely, the accounting treatment for FLs under IAS 17 was uniform with the single lease accounting model under IFRS 16, thus rendering the effect of change less notable. Understanding the change in lessee accounting is fundamental to fully comprehend and interpret this study. Thus, this concept will be elaborated further in Chapter Two.

1.1.3 Maltese Listed Entities

Being listed on the Malta Stock Exchange (MSE) allows entities to be more visible and noticed in the public eye. Additionally, the MSE acts as an 'effective venue to raise capital finance' (MSE n.d). Apart from the continuous adherence to the Listing Rules which were published by the MFSA, listed entities are also required to publish their audited annual financial statements (FS) in full accordance with IFRS as adopted by the EU. In this lieu, listed entities had to prepare their annual FS by accounting for leases in accordance with IFRS 16 for financial periods starting 1st January 2019[1] onwards. That being said, early adoption was allowed provided that IFRS 15 *Revenue from Contracts with Customers* was applied within the same set of FS.

A paramount requirement of the Listing Rules is the publication of the audited annual set of FS to the public domain. The availability of the annual FS to the public domain played a key role in determining the study's population i.e., local equity-listed entities. Having access to the annual FS is salient for the content analysis discussed in Chapter 4 of the study.

Figure 1.1: MLEs Industry Sectors

To date, there are 32 equity-listed entities listed on the MSE, which act as a principal constituent and a fundamental cornerstone to the economic growth of Malta as an EU Member State. These 32 entities cover several industries including communications, oil & gas, financial services, maritime, technology and tourism.

[1] Depending on the reporting entity's financial year end.

1.1.4 Relevance and Key Financial Metrics

The revised Conceptual Framework published by the IASB in March 2018 states that:

> "The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity."

(IFRS Foundation 2018, par 1.2)

Despite the efforts by the IASB towards relevance as a fundamental qualitative characteristic, line entry figures such as revenue and total assets (TAs) are irrelevant for intended users when viewed in isolation. As disclosed in the Conceptual Framework (par 1.7), the intent of general purpose FS is to provide the necessary information to current and future investors, for them to ultimately assess the value of the reporting entity by using prevalent metrics such as accounting ratios, amongst other means. Hence, accounting ratios have long been considered as a performance and financial position assessment tool which can be ultimately envisaged in an entity's equity price. Despite this, the influence of certain KFMs on equity prices cannot be compared with that of major stock markets, due to the characteristics of the local stock market in terms of size and limited liquidity (Grixti 2013). More precisely, local entities mostly rely on credit markets rather than on equity markets, thus affecting the functionality and reaction of the stock exchange to changes in KFMs.

1.2 The Rationale for Research

Entities listed on the MSE are a fundamental cornerstone for the state's economic growth and an epitome of other large non-listed entities and public interest entities (PIEs) which are still mandated to report their financial information under IFRSs as adopted by the EU.

Owing to the fact that the local stock market comprises of only 32 equity-listed entities, a qualitative approach was adopted for the study. To date, no local study was carried out in investigating the effects of the new lease standard post-implementation. Four studies were carried out concerning the introduction of IFRS 16, however, none of them were able to delve deeper into the actual implications, owing to the period in which such studies were carried out. Having the IASB and other key stakeholders heavily emphasise on the significant implications prior to the effective date, and the extensive endorsement of leasing as a financing solution across all industries (Beatty et al. 2010, IFRS Foundation 2016a, Zechman 2010), fostered a sense of interest in exploring the extent to which IFRS 16 has affected Maltese listed entities (MLEs), both at FS level and at operational level.

Pinpointing and discussing the explored implications brings value to academics, accounting professionals, and other stakeholders through enhanced knowledge and understanding of the standard. Additionally, this research study will contribute towards the existing body of knowledge and will act as a point of reference for the adoption of future standards.

1.3 Objectives of the Study

The shift in the accounting treatment for leases from a financial performance approach to a financial position approach has conceivably affected the lessees' level of indebtedness and elevated the complexity for preparers in preparing a set of FS. Taking on this notion, the proposed research study aims to:

1. Determine the impact of implementing IFRS 16 on the level of gearing, and other applicable key financial metrics.
2. Determine the impact of implementing IFRS 16 on the disclosures to the financial statements.
3. Establish and analyse any pre and post-implementation matters emanating from interviews, concerning the implementation of IFRS 16, with the preparers of the set of financial statements.

1.4 Limitations

One major limitation of the study is that notwithstanding a thorough content analysis on all the 26[2] equity-listed entities was carried out, given the time constraint it was not possible to interview all of the 26 Chief Financial Officers (CFOs), let alone that in applying theoretical saturation might not have been the need to interview them all. Other limitations include that there is limited academic literature on IFRS 16 disclosures in the FS given that the standard is relatively recent, together with the word count limitation.

[2] Excluding entities which were not listed within the past 3 years.

1.5 Dissertation Overview

Figure 1.2 overleaf depicts an overview of the study, whereas the following provide a brief description of each chapter:

- **Chapter 1** has set the scene with respect to lease accounting whilst establishing the research objectives and the limitations of the study.
- **Chapter 2** will take on an analytic review of the literature available on the research topic.
- **Chapter 3** gives ground for the adopted research methodology and explains how data was collected and analysed.
- **Chapter 4** will set forth the findings of the study, together with a discussion on the formulation of emergent themes.
- **Chapter 5** will conclude the study by summarising the findings and by providing recommendations on the research findings and by suggesting areas for future research.

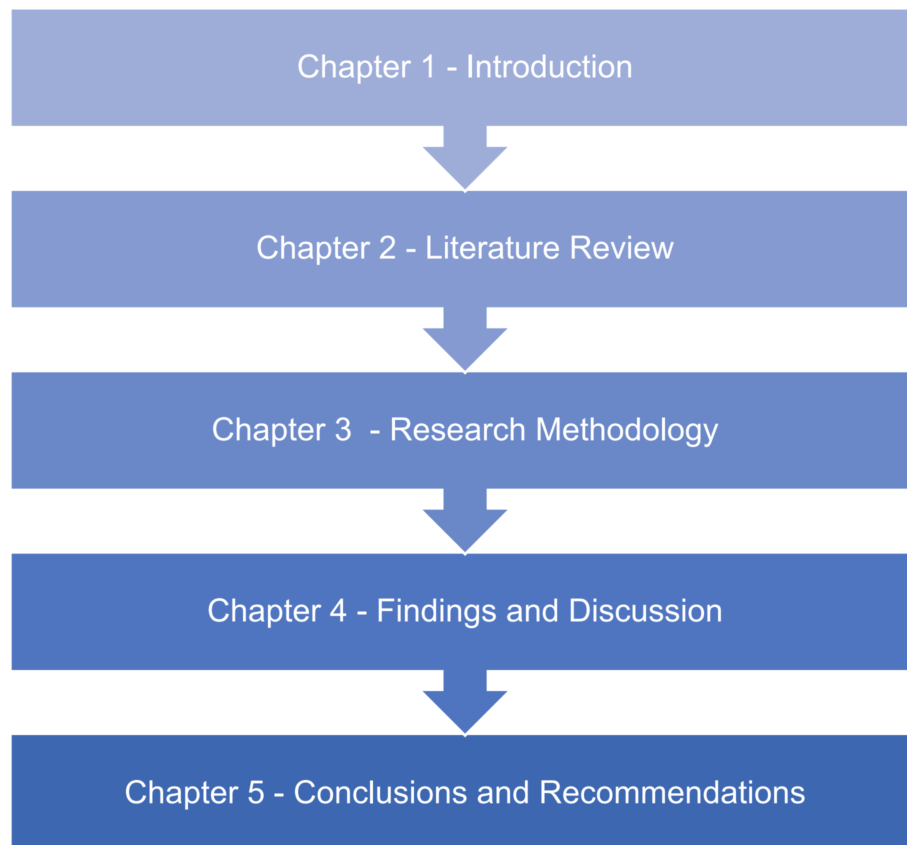


Figure 1.2: Dissertation Overview

Chapter 2: Literature Review

2.1 Introduction

This chapter will start off by briefly unravelling the history of lease accounting, as well as the exigency for issuing an accounting standard effectively requiring the capitalisation of leases. The implications of such a radical change at an international and local level will be delved into, using peer-reviewed academic articles, reports published by highly recognised authorities and firms, accounting standards and other associated books.

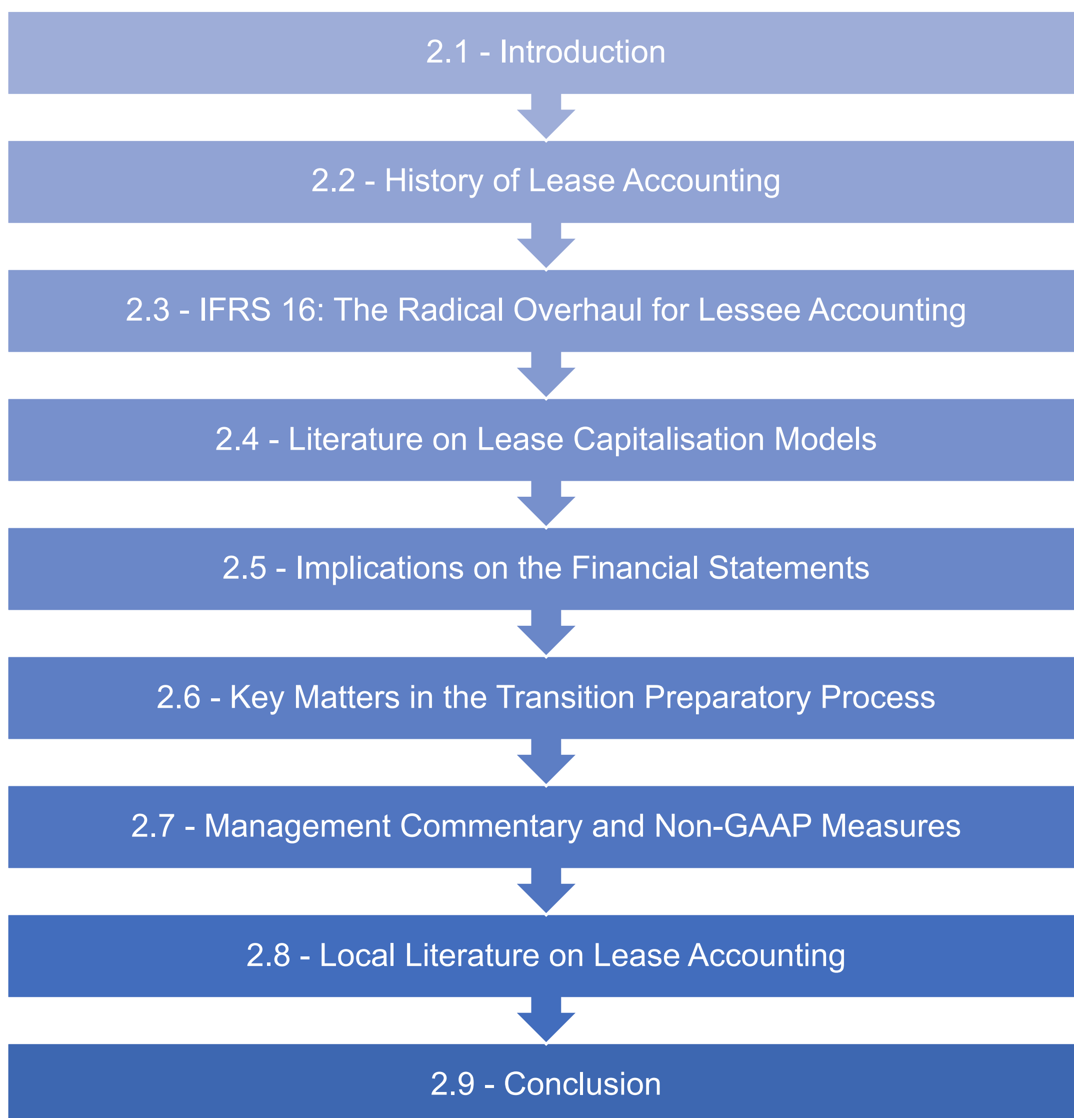


Figure 2.1: Overview of Chapter Two

2.2 History of Lease Accounting

Lease accounting has been on the agenda of the FASB and the IASB for a considerable period and has always been an area of controversy and dispute (Giner et al. 2019). More specifically, the FASB was the first standard-setter to chip into the development of an accounting standard for leases during the 1970s and through which Statement of Financial Accounting Standards (SFAS) No.13 was introduced in 1976. SFAS 13 was therefore the standard that inaugurated lease accounting standard-setting since leases were largely unregulated before SFAS 13, whereby the classification of leases between capital leases (or 'finance leases' as known under the IFRS regime) or OLs was set out (Shortridge and Myring 2004).

The International Accounting Standards Committee (IASC), which to date is known as the IASB, was coerced by its American counterpart to issue an accounting standard addressing leases. To this effect, the first issue of IAS 17 *Leases* was in 1982, practically following into the footsteps of the FASB. Following these developments, Imhoff and Thomas (1988) discovered that the application of FLs has declined in the U.S. whilst that of OLs increased, following the introduction of SFAS 13. Such a trend was by virtue of the requirement to capitalise capital leases onto the balance sheet, whereas OLs are not mandated to be capitalised, thus being OBS.

2.2.1 The Flaws of IAS 17 *Leases*

According to Beattie et al. (2006), the biggest controversy of IAS 17 was the methodological classification between FLs and OLs. Although SFAS 13 and IAS 17 were targeted to address the issue of not having lease commitments on the balance sheet, both standards failed to provide a suitable definition of what an OL actually is, since an ambiguous explanation was provided. OLs under IAS 17 were defined 'as a lease other than a finance lease' (IAS 17, par.4), thus encapsulating all remaining leases which do not meet the definition of a FL.

Furthermore, paragraph 8 of IAS 17 disclosed that:

> "A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership."

(IAS 17, par.8)

The rationale in paragraph 8 was that if a lease is formulated to circumvent the definition of a FL, it would be classified into an OL by way of elimination (Segal and Naik 2019). Such ambiguity in the classification of leases created triggered different interpretations by two different lessees on a given lease agreement, thus giving a bit too much leeway (Beattie et al. 2006). The scope of preparers was to classify leases as OLs, to naturally steer away the significant and material requirement to capitalise leases onto the balance sheet (Goodacre 2003). Academics, practitioners, and users have continuously criticised both IAS 17 and SFAS 13, arguing that reporting entities are not capitalising their leases onto their balance sheets deliberately, by virtue of the OL classification (AICPA 1994, Beattie et al. 2006, Goodacre 2003, Reither 1998), thus resulting in a lack of comparability and transparency.

According to Morales-Diaz and Zamora-Ramirez (2018), the prevalence of leasing as a financing option presents challenges in comparing FS and financial ratios (or KFMs) relating to gearing. More precisely, the balance sheet, and consequently, KFMs, will differ between an entity that funds an asset's acquisition on credit and an entity that opts to lease the asset. Despite both being essentially similar in their economic essence, a significant difference arises from their distinctive financial reporting practice (Morales-Diaz and Zamora-Ramirez 2018). In view of the deferred accounting treatment between FLs and OLs, it was challenging for a user to comprehend the OL disclosure, given that there was no asset or liability recognised in the balance sheet (Van Greuning et al. 2011).

2.2.2 The Call for IFRS 16

As suggested by Hussey (2018, p.8), ‘it does not require much ingenuity’ in piloting a lease arrangement into an OL classification. Thus, there was a lack of comparability and transparency attached to entities’ lease reporting which has consequently led to the IASB taking action. IFRS 16 was thus introduced in 2016, entailing a single lease accounting model for lessees and thus eliminating the highly controversial classification between FLs and OLs. Conversely, lessor accounting has remained practically unchanged (IFRS Foundation 2016a).

During the standard-setting process, there were numerous objections raised against the revised lease accounting model, particularly by preparers, as indicated by the feedback letters submitted in response to the exposure drafts (Barone et al. 2014, Molina and Mora 2015). In fact, in its Project Summary and Feedback Statement of IFRS 16 *Leases*, the IASB stated that ‘some preparers questioned the usefulness of presenting all leases on the balance sheet’. (IFRS Foundation 2016b, p.8). The IASB however concluded that through lease capitalisation, benefits for investors and other users would exceed the costs. The IASB’s argument was that through the single lease model:

> “(a) The need for investors and analysts to make adjustments to the lessee’s published results is lowered; (b) Comparability is improved; and (c) A more level playing field to all market participants is created, through increased transparency.”
>
> (IFRS Foundation 2016b, p.8)

2.3 IFRS 16: The Radical Overhaul for Lessee Accounting

IFRS 16 now requires the capitalisation of leases via the single lease accounting model applying to all lease arrangements except for short-term leases of one year or less and for low-value leases whose reportable amounts do not exceed USD 5,000 (IFRS 16, par.5). Therefore, lessees are mandated to recognise a right-of-use (ROU) asset and a respective lease liability (LL) for those leases which fail

to meet the exemption criteria, being the biggest shakedown emanating from the standard. This insight was also substantiated by Segel and Naik (2019) by arguing that IFRS 16 will cause ‘substantial differences to the FS of almost all lessees.’

2.4 Literature on Lease Capitalisation Models

Motivated by the existence of significant, non-cancellable OL commitments, Imhoff et al. (1991, p.1) adopted a methodological approach that constructively capitalised OL commitments in the US, as if they were capitalised at inception. Their findings indicated that OBS leases (or OLs), have a considerable impact on risk and return metrics such as return on assets (ROA) and debt-to-equity (D/E) ratios. They also revealed that the extent of such impacts varies in accordance with the lessee's lease intensity.

Giner et al. (2019) argued that Imhoff et al’s (1991) constructive lease capitalisation model was amongst the most sophisticated and advanced. To this effect, Mulford and Gram (2007) replicated Imhoff et al's (1991) model on the US retail sector, which is known for its extensive use of OLs, whereby findings established ‘a material distortion of the financial position of companies.’

As illustrated in Figure 2.2 below, their sampled population of firms experienced a median increase in TAs of 14.6%, and a median 26.4% increase in total liabilities (TLs), which consequently resulted in a corresponding median increase in the D/E metric of 26.4%, consistent with findings from Imhoff et al. (1991). An increase in earnings before interest, tax, depreciation, and amortisation (EBITDA) and a reduction in earnings per share (EPS) were also discovered. Furthermore, interest coverage ratios such as EBITDA / interest expense declined, as expected, by a median of 46.3%, arguing that for certain firms ‘the decrease was dramatic’ (Mulford and Gram 2007, p.8).

Company	Total Assets Before	After	Total Liabilities Before	After	Liabilities / Equity Before	After
Belk	$ 2,848,615	$ 3,250,881	$ 1,522,593	$ 1,924,859	114.8%	145.2%
Big Lots	1,720,526	2,331,957	590,823	1,202,254	52.3%	106.4%
BJ's Wholesale	1,992,811	3,325,320	972,924	2,305,433	95.4%	226.0%
Costco	17,495,070	18,586,619	8,288,273	9,379,822	90.6%	102.6%
Dillards	5,408,015	5,562,002	2,821,062	2,975,049	109.0%	115.0%
Dollar General	3,040,514	4,223,568	1,294,767	2,477,821	74.2%	141.9%
Dollar Tree	1,873,300	2,835,095	705,600	1,667,395	60.4%	142.8%
Family Dollar	2,523,029	3,487,433	981,435	1,899,421	108.8%	188.6%
Federated	29,550,000	31,375,854	17,296,000	19,121,854	141.1%	156.0%
JC Penney	12,673,000	13,814,097	8,385,000	9,526,097	195.5%	222.2%
Kohls	9,041,177	13,676,881	3,437,782	8,073,486	61.4%	144.1%
Maidenform Brands	244,853	269,234	169,952	194,333	226.9%	259.5%
PriceSmart	359,043	420,738	121,752	183,447	51.9%	78.2%
Retail Ventures Inc	1,267,217	2,280,666	1,037,169	2,050,618	1132.0%	2238.2%
Saks	2,544,303	2,909,088	1,448,164	1,812,949	132.1%	165.4%
Sears Holdings	30,066,000	34,461,459	17,352,000	21,747,459	136.5%	171.1%
Target	37,349	38,961	21,716,000	23,327,577	138.9%	149.2%
Tuesday Morning	393,134	563,161	149,257	319,284	61.2%	130.9%
Wal Mart	151,193,000	158,308,324	87,460,000	94,575,324	142.0%	153.6%
Median % Change		14.6%		26.4%		26.4%

Figure 2.2: Effect of Lease Capitalisation on Total Assets, Total Liabilities and Gearing (Mulford and Gram 2007, p.6)

Several other researchers applied Imhoff et al’s (1991) model as a fundamental basis and applied it to different contexts and economic environments. For instance, Duke et al. (2009) conducted this method in the US, while Beattie et al. (1998) and Goodacre (2003) employed it in the UK. Bennett and Bradbury (2003) applied it in New Zealand, Durocher (2008) in Canada, Fülbier et al. (2008) in Germany, whereas Fitó et al. (2013) and Wong and Joshi (2015) applied it in the Spanish and Australian context respectively.

Meanwhile, Giner et al. (2019) utilised a Monte Carlo simulation to analyse the effect of the standard, employing a dynamic approach rather than the static approach used in previous research studies. By utilising the Monte Carlo Simulation method, which enables consideration of complex situations for which data is unavailable, they went beyond previous studies with their findings. Results from Giner et al. (2019) supported the notion that from the year of adoption onwards, KFMs would not be furtherly impacted, presupposing that lease portfolios remain constant.

Although the above studies were conducted in different periods, countries, and industries, the general consensus was that the capitalisation of OLs affects leverage and profitability ratios, with retail sectors being the most prevalent. However, the degree of impact varies amongst companies and industries, as it

depends on the magnitude of leases within the lessee's operations, as suggested by Imhoff et al. (1991). As a consequence of the negative impact on ratios, preparers strongly lobbied against the single lease accounting model for lessees contained within IFRS 16.

2.5 Implications on the Financial Statements

The following subsections will discuss the implications of the standard's adoption on the premier components of the FS, namely the SOFP, SOPL and the disclosures, from the existing literature. A subsection tackling the consequential effects on KFMs is also included.

2.5.1 Effects on the Financial Position

As discussed in the literature, lease capitalisation was expected to significantly 'bloat' the SOFP for lessees with significant OL commitments, by recognising a ROU asset and a corresponding LL. A study by PwC (2016) found that out of 3,199 EU-listed companies, the median increase in debt and leverage was 21% and 0.23 times, respectively. The European Financial Reporting Advisory Group's (EFRAG) (2016) ex-ante analysis of the standard on a sample of listed entities in the EEA, revealed a 'simulated lease liability' equivalent to 4% of total debt. However, by excluding financial services entities, the 'simulated lease liability' amounted to 16% of total debt (EFRAG 2016, p.3).

Meanwhile, EY (2021) conducted a post-implementation analysis on the FS of 58 companies from the 2020 Fortune Global 500, and as depicted in Figure 2.3 below, companies from the airline, retail, telecommunications, and energy (oil and gas) were affected the most whereas entities from the financial services sector and real estate (commercial property) had a little to no impact.

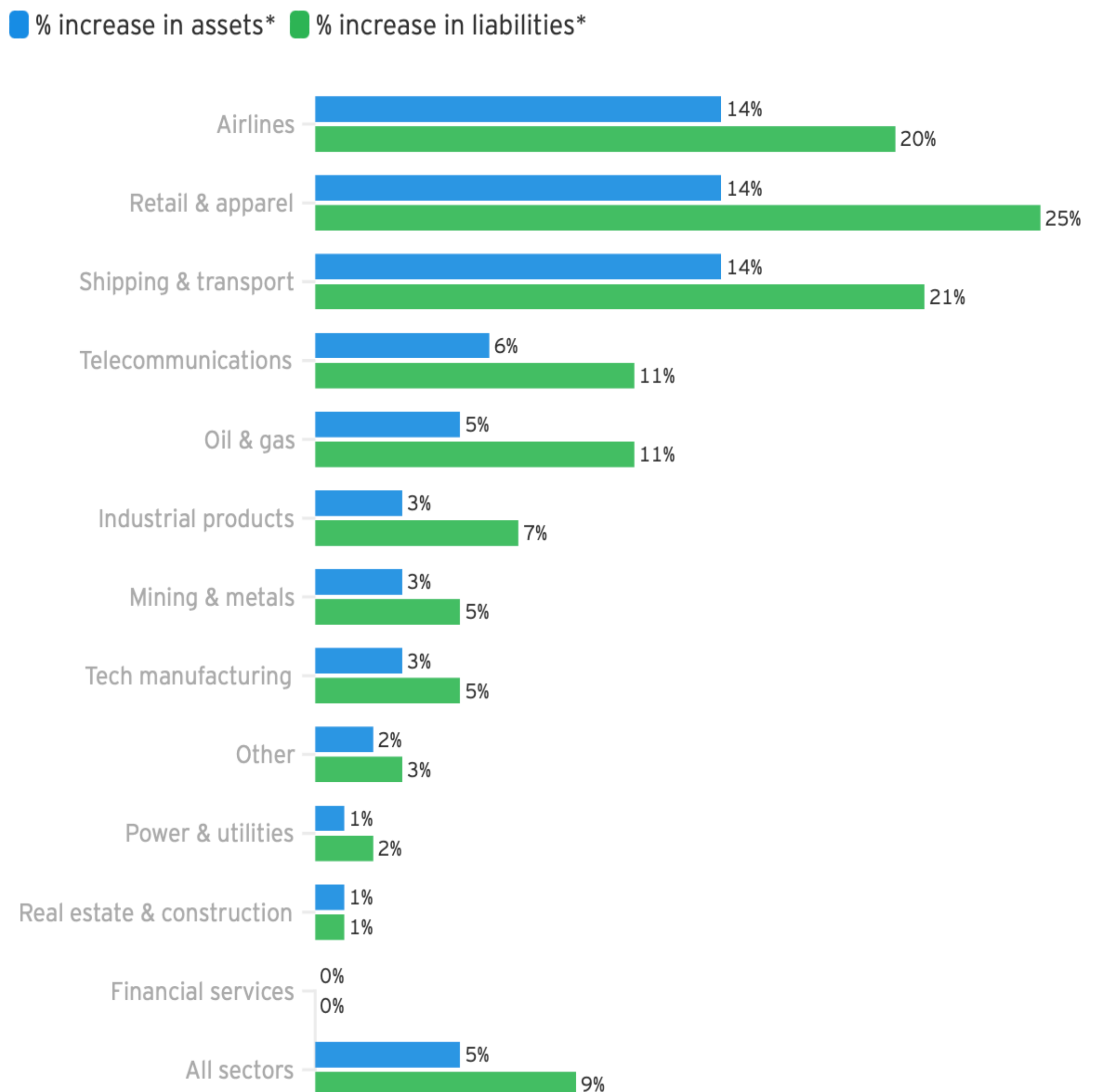


Figure 2.3: Increase in Assets and Liabilities upon Transition to IFRS 16 (EY 2021)

The implementation of IFRS 16 is also expected to reduce reported equity due to the higher carrying amount of LL compared to the ROU asset as at reporting date. This is because the ROU assets will be depreciated, while the LL will be reduced by lease payments but increases with finance costs (IFRS Foundation 2016a). These effects on the 3 major pillars of an entity's SOFP, viz. TAs, TLs, and equity will be consequentially envisaged in their financial metrics.

2.5.2 Effects on Performance

Due to the deferred cost recognition emanating from IFRS 16, both Earnings before Interest and Tax (EBIT) and EBITDA were anticipated to rise. Previously under IAS 17, OL expenses were included in the operating profit figure, however, expenses such as depreciation and amortisation on the ROU asset, as well as finance costs on the LL are recognised below the operating profit line under IFRS 16. Such an effect was observed in previous lease capitalisation literature such as Mulford and Gram (2007), where an increase in EBITDA and EBIT was observed, supported by several pieces of literature including PwC's (2016) study, which discovered a median increase of 13% in EBITDA.

The timing of cost recognition is also another theme attached to performance. According to Chambers et al. (2015, p.39), profit for the year is likely to be lower during the early years of a lease term, as the new standard incurs an effective interest rate on the LL, resulting in front-loaded finance costs. The IASB supported this claim in their 2016 effects analysis, stating that the combined interest expense and depreciation charges during the first half of a lease term are expected to exceed the historic straight-line OL expense that applied for OBS leases under IAS 17. However, as shown in the Figure 2.4 below, the opposite is expected to occur in the second half of the lease term. This is because the interest expense is expected to decrease over the lease term as the LL decreases. Nonetheless, the impact on the full lease term is expected to be neutral (IFRS Foundation 2016a).

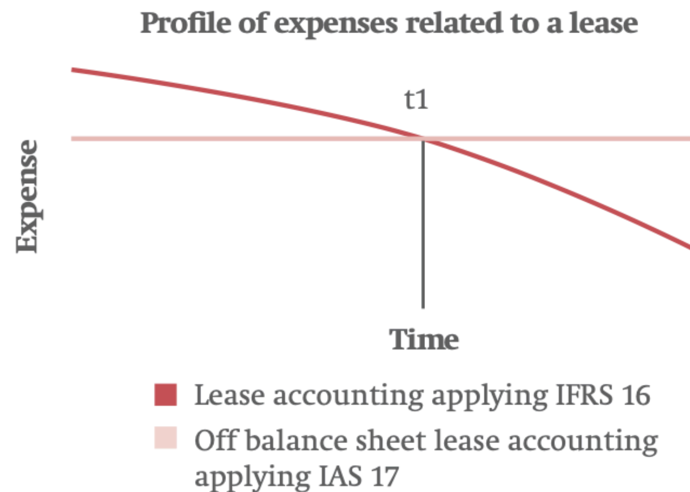


Figure 2.4: Timing of Cost Recognition between IFRS 16 and IAS 17 (IFRS Foundation 2016a)

2.5.3 Effects on Financial Metrics

Literature on lease capitalisation models together with the IFRS Foundations' 2016 effects analysis suggest that lessees with a material amount of OLs will experience significant changes in their financial gearing and leverage metrics following the transition to IFRS 16 (IFRS Foundation 2016a, Segel and Naik 2019). This has been further substantiated by a study conducted by Qatawneh et al. (2021), in which the impact of IFRS 16 on the annual FS of Royal Jordanian Airlines was investigated and discovered statistically significant changes in the debt-to-asset (D/A) ratio, D/E ratio, equity ratio, and liquidity ratios such as the current ratio.

Raoli (2021) conducted an empirical analysis of the impact of IFRS 16 on the FS of Italian-listed companies. The study found statistically significant effects on the financial position and performance metrics of the companies, particularly on operating profitability. EBITDA increased while the ROA ratio decreased, consistent with the findings of Imhoff et al. (1991), Mulford and Gram (2007) in the US, and Wong and Joshi (2015) in Australia, as well as with analyses conducted by EFRAG (2016), EY (2021) and PwC (2016). Raoli's (2021) study

also revealed an increase in the mean of the D/E ratio, demonstrating an increase in TLs over shareholders' equity, and an increase in the D/A ratio, in line with the findings of Morales-Díaz and Zamora-Ramírez (2018), noting that the impact of the standard varies across different industry sectors.

2.5.4 Effects on Disclosures to the Financial Statements

From their survey, EY (2021) discovered a positive correlation between the impact of IFRS 16 on a company's FS and the level of disclosures and explanations in the management commentary (MC) sections of the FS. IFRS 16 (par.51) mandates that disclosures must enable a proper evaluation and comprehension of the effect of leases on the FS, thus involving a considerable degree of subjectivity and professional judgment by the preparer in determining the appropriate information to provide. This was substantiated by KPMG (2017c), suggesting that preparers shall not approach the IFRS guidance as a fixed checklist, but rather focus on the disclosure objective.

Li and Yang (2016) noted that accounting practices, such as disclosures, are heavily influenced by entity governance and incentivised by improved earnings quality, as well as greater shareholder and analyst demand. Meanwhile, from a user perspective, Giner and Pardo (2018) sought to determine the impact of the change in lease accounting and whether FS users examined lease disclosures under IAS 17. Findings indicated that users, at least for entities in the retail sector, already treated OBS leases as liabilities and that these ‘as-if liabilities’ are not omitted or valued differently from other liabilities recognised on the balance sheet.

Previously, IAS 17 only mandated a general description of existing lease agreements, but the new standard, in addition to requiring more information on lease assets, expenses, and cash flows, it also demands the presentation of specific items in a tabular format, as outlined in paragraph 53 of the standard. Consequently, the volume of lease-related disclosures is expected to increase, particularly for lessees that experience significant changes in their KFMs (EY

2021), hence aligned with the objective of providing a more understandable view of their leasing arrangements through more relevant and detailed notes (IFRS 16, par.51).

2.6 Key Matters in the Transition Preparatory Process

The following subsections will consider the literature compiled by practitioners with respect to key subjective matters in applying IFRS 16 principles, as well as the enhancement of existing IT processes for lease accounting.

2.6.1 Lease Definition

Defining whether a contractual arrangement is in the scope of IFRS 16 or not is a highly critical topic, as it essentially warrants whether it shall be capitalised or not onto the SOFP. To this effect, KPMG (2017b) suggested that ‘assessing whether an arrangement is, or contains, a lease will be one of the biggest practical issues when applying IFRS 16 Leases.’ This is since certain arrangements which were not interpreted as leases under IFRIC 4, ‘may now be subject to being capitalised for meeting the definition of a lease, or vice versa’ (Grant Thornton 2018). Such a claim opposed the opinion of the IFRS Foundation (2016a), whereby it was argued that the revised lease definition would not alter any contracts which were deemed to be a lease under IAS 17 and IFRIC 4. Whether the preparer has control over the use of the underlying asset, for a specified period of time, is the dominant factor in determining whether a contract shall be considered as a lease arrangement or otherwise, thus entailing high judgement.

KPMG (2017b) added that such an interpretational matter will in most circumstances be straightforward, however, it may be significantly more complex in circumstances where the notion of control over the use of the underlying asset may be more challenging to determine. It is to be noted that on transition, preparers had the option to grandfather the definition for existing lease contracts.

This allows for cost savings; however, preparers may end up capitalising arrangements which concretely would not have met the definition of a lease.

2.6.2 Determination of the Discount Rate

The determination of the discount rate is a major component that is highly central to the valuation of the LL. Its derivation does not entail an intricate process in circumstances where such a rate is implicit in the contract. Conversely, preparers must determine the incremental borrowing rate (IBR) if a discounting rate is not readily available within the arrangement (IFRS 16, par.26). The IBR must be company-specific and must reflect factors that are commensurate to the borrowing of a similar asset, at a similar lease term, and in a similar economic environment, thus rendering such an exercise a key area of judgement (KPMG 2017a). As a matter of fact, the IFRS Interpretations Committee (2019) issued a staff paper specifically on the IBR matter and disclosed that:

> "A lessee's incremental borrowing rate reflects what the lessee would have to pay, not what it has paid. Judgement is involved in estimating the rate."
>
> (IFRS Interpretations Committee 2019, par.18)

2.6.3 Improvement of Existing Systems and Processes

As a result of the expected increase in lease information processing, emphasis on the need for improved IT systems and processes was made by Attard (2017), Chambers et al. (2015), Deloitte (2018), PwC (2019) as well as by Segel and Naik (2019), for higher efficiency in the management of lease data. Preparers are expected to handle significant quantities of lease data under IFRS 16, particularly for entities with a significant number of leases and material OBS lease obligations (IFRS Foundation 2016a). More precisely, Segel and Naik (2019) disclosed that acquiring or modifying IT systems will be a leading implementational cost, whereas Chambers et al. (2015) proposed that the use of a lease information system will be suitable not only for financial reporting practices but an additional by-product for 'providing lease data for existing lease negotiations.'

Accordingly, PwC (2019) in a post-implementational survey discussed how preparers ‘underestimated the IFRS 16 implementation efforts’ and that over a third of the survey’s respondents are ‘likely to implement’ new IT solutions specifically for IFRS 16 in the foreseeable future. The figure below shows that 46.5% of preparers opted for IT solutions, but according to the survey's respondents, these solutions were deemed inadequate as 70% reported that they lacked ‘full functionality’ to comply with IFRS 16 accounting and reporting requirements.

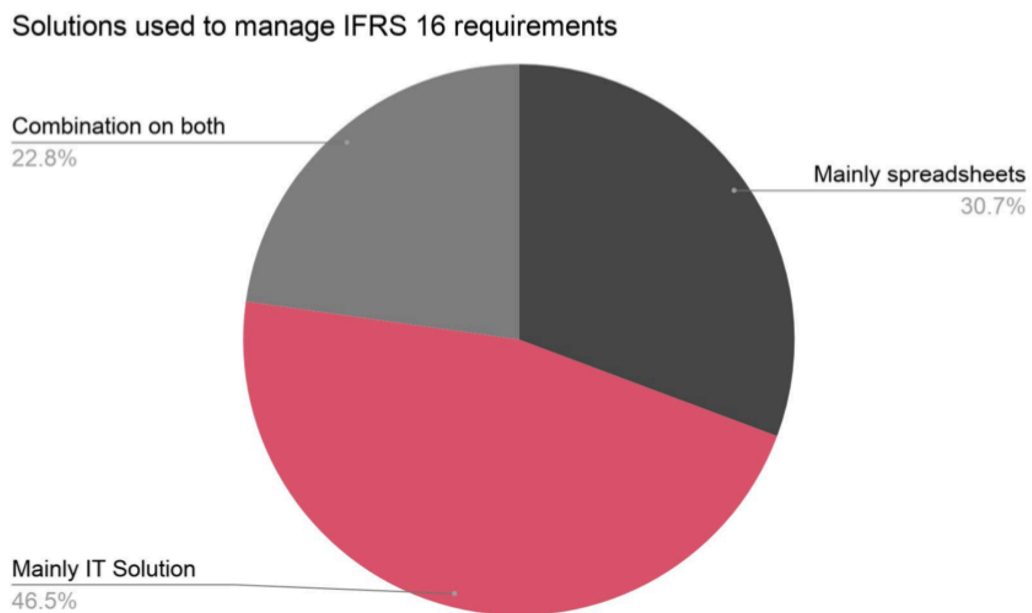


Figure 2.5: Solutions used by survey respondents to meet IFRS 16 requirements (PwC 2019)

2.7 Management Commentary and Non-GAAP Measures

The implementation of IFRS 16 has brought about a substantial alteration to the balance sheet structures of entities that have substantial lease portfolios. As a consequence of this change, several performance indicators and financial ratios that are commonly reported both internally and externally have been directly affected (PwC 2019). Consequently, preparers may choose to disclose or revise certain financial information which is not in line with Generally Accepted Accounting Principles (GAAP), with the aim being for better clarity and understandability.

In view of the expected favourable impact on certain non-GAAP measures or Alternative Performance Measures (APMs) such as EBITDA and EBIT, their importance may potentially increase following IFRS 16 adoption. Such a claim is supported by D'Angelo et al. (2018), as cited in Moscariello et al. (2020, p.59), suggesting that companies may use non-GAAP measures to opportunistically conceal unfavourable business performance or to inflate performance. Accordingly, a local study by Mallia (2016) found that preparers utilise APMs since:

> “(a) Extracted figures are more attractive than IFRS reported figures, thus marketing the firm better; (b) IFRS figures are too complex; (c) when an entity utilises an APM, other entities follow such a trend; and (d) they can manipulate a negative result into a positive one.”

(Mallia 2016, p.97)

In a thematic review of the disclosures of a selected sample of companies issued in September 2020 by the Financial Reporting Council (FRC), the use of APMs featured as a salient theme (FRC 2020). However, the FRC failed to discuss the topic at a higher level, since a policing approach to whether such APMs are in line with the European Securities and Markets Authority (ESMA) guidelines was taken.

Meanwhile, an EY (2021) survey has also indicated that the use of non-GAAP measures changed and that:

> "The more significant the effects of IFRS 16 on the financial statements, the greater the level of disclosure and explanation in the management commentary about the first-time adoption of the standard."
>
> (EY 2021)

PwC (2019) also suggested that entities that opted for the modified-retrospective approach upon transition, will find it more challenging to communicate the impact of the new lease standard, especially in the earlier years, given that comparatives were not restated.

2.7.1 Disseminating the Standard to Stakeholders

According to the IFRS Foundations' 2016 effects analysis, companies with significant OBS leases are expected to face difficulties and costs related to educating their peers internally, as well as their internal procedure updates due to the standard's technicality. However, these costs are expected to be incurred only during the initial implementation of IFRS 16, when communicating the changes (IFRS Foundation 2016a).

2.8 Local Literature on Lease Accounting

Despite this study being the first to tackle the true implications of IFRS 16 following its adoption, ex-ante analyses of the standard were already tackled in Malta. Borg (2016) and Abdilla (2016) focused on the banking industry, with the former gaining insights from both sides of the coin. More specifically, Borg (2016) found that banks as lenders are in favour of having leases capitalised onto the SOFP and that the lease information found in the FS at the time was insufficient. Moreover, respondents from Borg (2016) added that OLs were already considered in credit assessments by banks as lenders.

However, findings from banks as preparers suggested that implications on regulatory capital requirements will be insignificant, congruent with Abdilla (2016) and that the most notable challenge will be the increased 'complexity and administrative and compliance burdens', because of the standards technicality and 'increased extent of disclosures' (Borg 2016). Despite this, the researcher added that such burdens will be most significant during transitional periods. Abdilla (2016) additionally substantiated that although costs will be more significant during the transitional period, these will not be recurring for most lessees since monitoring costs will persist for the most part.

Meanwhile, Attard (2017) investigated the shortcomings of IAS 17 as well as the expected impacts of IFRS 16 on Maltese licensed gaming companies, with the headlining discoveries being the grossing up of the SOFP, anticipated changes in KFMs, internal staff training, debt covenants breaches and upgrading of existing systems. Moreover, respondents from Attard (2017) showed mixed opinions as to whether IFRS 16-specific benefits will exceed the costs, by arguing that lease accounting is 'too costly and fails in adding any value since it is not expected to alter users' interpretations', agreeing with Borg (2016). Findings from Attard (2017) also demonstrated that gaming operators lacked awareness and preparedness in terms of the standards' implementational process, however, argued that the popularity of leasing as a financing solution will not drop as a consequence of IFRS 16.

Correspondingly, the findings by Carabott (2019) touched upon how the number of leases concerning the SOFP is directly proportional to the effect of the standard on KFMs, thus depending on the materiality of leased assets on the FS. The researcher's study population leased a small number of fleet vehicles, thus disclosing that no severe implications are anticipated from the standard's adoption.

2.9 Conclusion

This chapter commenced by covering the biggest shortcoming of the antecedent lease accounting standard, IAS 17, which led to the introduction of IFRS 16. Subsequently, reference to existing literature on lease capitalisation models was made, whereby the relevant effects on the FS and KFMs were discussed. Remarks with respect to the local context were also made, were possible, allowing for a solid basis on which a more rigorous analysis can be made using primary data. The next chapter will set out the justification for the selected research methodology to conduct the study.

Chapter 3: Research Methodology

3.1 Introduction

This chapter aims in laying out the foundations on which the adopted research method was determined, in attaining the research objectives. Research objectives one and two were tackled via a qualitative content analysis whilst research objective three was addressed via one-to-one semi-structured interviews. These will be subsequently discussed in more depth throughout this chapter.

Figure 3.1: Overview of Chapter Three

3.2 Preliminary Research

The establishment of the research topic emanated from formal discussions held between the researcher and his tutor during the preliminary stages of the study. In the quest for a reasonable extent of endorsement prior to committing to the study, an interview with a local stockbroker was carried out to test and assess the validity and relevance of the research topic in the local scenario. An extensive review of both academic and professional literature on the research topic was also conducted as a form of preliminary research.

3.3 The Methodological Debate

The research continuum consists of 2 predominant research methods, these being either a quantitative or a qualitative methodological stance. Researchers also combine the two methods into a mixed methods approach. Salient to mention is that there is no research method that is of supremacy over the other, or that is directly applicable to all research questions. The researcher adopts the research method with which he believes that the research questions will be optimally reached, whilst simultaneously considering the research topic, its limitations, and the nature of the study itself. More specifically, the selection of the research method goes *Pari passu* with the philosophical foundations of the research study, which will be tackled in the following subsection.

3.3.1 Research Philosophy

Research philosophy was defined by Saunders et al. (2019, p.130) as ‘a system of beliefs and assumptions about the development of knowledge’, that is ultimately contributing towards increased knowledge. Any piece of research is contributing towards increased knowledge, even if the explored knowledge may not overhaul how the world is viewed. Guba and Lincoln (1994) argued that queries relating to research paradigms must not be secondary to queries relating to the research method to be chosen. As accounting researchers, awareness about the adopted research philosophies is key to the understanding of what is

being investigated, as well as the research method through which the research questions will be addressed (Johnson and Clark 2006).

In view of the dissertation's research questions, the researcher aims to qualitatively comprehend and interpret the implications introduced by IFRS 16 on the local listed entities, both at the financial statement level and the operational level. For this reason, an interpretive research philosophy was endorsed. Interpretivism prescribes the exigency for the researcher to consolidate or differentiate between interviewees. A further exigency is that the researcher must embrace an empathetic stance toward the research participants, however, it may not be straightforward to 'understand their world from their point of view' (Saunders et al. 2019, p.149).

3.3.2 Research Approach

The researcher's engagement in interpretivism as a philosophical research foundation, as well as the study's qualitative nature, have formulated an inductive approach rather than a deductive approach. Apart from the ideology that a deductive approach pertains more to research related to natural sciences in objectivism, an inductive approach would not fit a high volume of research participants, as it is more concerned with the contexts in which events are occurring (Saunders et al. 2019). The study was more concerned with the conceptualisation of the rationale behind certain insights rather than simply describing or stating them. In the following subsection, the motive behind the selection of the research design will be delved into.

3.4 Research Design

The research objectives of the study set out in subsection 1.3 fundamentally concern the impact assessment of the new lease standard post its implementation. In connection with the nature of accounting principles and their inherent need for a research tool that allows for an in-depth exploration of the problem, a multi-method qualitative methodological choice was opted for. A

qualitative content analysis was carried out for the first two research objectives, whereas one-to-one semi-structured interviews were carried out for the third research objective. The rationale for this decision was to bridge the research gap from solely performing a content analysis to a more robust and complete investigation of the topic.

With respect to the time horizon of the research design, the first two research objectives were achieved by analysing the annual report of equity-listed companies immediately preceding the adoption of IFRS 16, as well as, the annual reports from the year of adoption thereon. The third research objective was achieved by conducting one-to-one semi-structured interviews at a specific point in time. Thus, the time horizon approach taken for the first two objectives was a longitudinal one, given that the observation was carried out over several financial years. Conversely, a cross-sectional time horizon approach was taken for the latter objective, since interviews were carried out between November 2022 and February 2023, thus insinuating the collection of data within a specified timeframe.

3.5 Data Collection

The study made use of both types of data, namely secondary data and primary data. Both have contributed to permit the researcher in obtaining a rigorous understanding of the research topic.

3.5.1 Secondary Data

Continuous reference was made to secondary data, as early as the preliminary stages of the study, to quickly get up to terms with the standard's technicalities and terminologies. Secondary data consisted of the listed entities' annual reports, reputable reports published by practitioners and authoritative bodies such as the IFRS Foundation and the EFRAG, as well as, academic literature including local and foreign dissertations, books, and institutional reports.

3.5.2 Primary Data

The collection of primary data entailed a multi-method qualitative approach. For research objectives one and two, primary data was collected by principally analysing the annual reports of all the local listed entities[3], these being the population for the qualitative content analysis. This was subsequently followed by one-to-one semi-structured interviews carried out with CFOs from MLEs. Given that the study primarily deals with an accounting standard, one-to-one semi-structured interviews were indispensable to obtain a thorough, high-level exploration of themes and insights that underpin the annual report content.

3.6 Financial Metrics and Disclosures Analysis

Towards the fulfilment of the first two research objectives, a qualitative content analysis of the listed entities' annual reports was carried out. This involved a rigorous examination of the content found in annual reports, each including an audited set of FS providing reasonable assurance that they are free from any material misstatements, thus addressing any data quality threats.

3.6.1 Content Analysis

The Official List of the MSE which to date includes 32 equity listings, was utilised as the researcher's point of departure for executing the content analysis. Consequently, the analysis was carried out on 26 listed entities' annual reports, whereby MLEs which were not listed on the MSE within the past 3 years were excluded. This decision was attributable to the rationale that these entities did not fully experience the transition, in order to achieve the common factor for the benefit of improved comparability. Furthermore, the financial year in which annual reports were published varied due to early adoptions of the standard, as well as, dissimilar financial year ends. An informative list concerning the examined MLEs' financial year ends can be found in Appendix A.

[3] Excluding entities which were not listed on the MSE within the past three years.

3.6.2 Accounting Ratios Analysis

The calculation of accounting ratios was determined to be the most appropriate mechanism in establishing the changes in gearing (solvency), operating and profitability levels attributable to the standard's adoption. The selection of the computed ratios, compiled in Table 3.1 below, was majorly based on the expectations of the IASB ahead of adoption, disclosed within their '*effects analysis'* (IFRS Foundation 2016a).

Table 3.1: Analysed Financial Metrics

Metric:	***Measurement:***
Debt-to-Asset (%)	Gearing (Solvency)
Debt-to-Equity (%)	Gearing (Solvency)
Equity Ratio (%)	Gearing (Solvency)
Interest Coverage Ratio	Gearing (Solvency)
Current Ratio	Liquidity
Return on Assets (%)	Profitability
EBIT Ratio (%)	Profitability
EBITDA (€)	Profitability

The ratios were computed on Microsoft Excel and subsequently made graphically presentable for the intended users' interpretation. The set of computed ratios can be found in Appendix B whilst the encountered limitations during such analysis can be found in subsection 3.8.

3.6.3 Analysis of the Disclosures to the Financial Statements

Disclosure analysis entailed the examination of annual reports of the pre-adoption year, as well as, annual reports from the adoption-year thereon, up until the latest available publication. The reporting dates varied from entity to entity, reasons being due to the different reporting periods along with an early adoption by MedservRegis p.l.c. Annual report sections and comments in which IFRS 16 *Leases* featured, were located by using keywords within the annual report itself. Consequently, qualitative and quantitative disclosures were scrutinised

thoroughly, to ultimately determine to what extent, if any, disclosure appropriateness, robustness, and usefulness was enhanced.

3.7 One-to-One Semi-Structured Interviews

Following the detailed content analysis, a set of interviews were carried out. Interviews as a research instrument were considered to be an indispensable and value-adding supplement to bridge the research gap from the content analysis. More specifically, one-to-one semi-structured interviews were carried out as opposed to standardised interviews.

3.7.1 Research Participants

The CFO is exclusively charged with the prime responsibility of producing the set of financial statements in accordance with IFRS as adopted by the EU, over and above the governance of other intrinsic commitments required by the finance function. Therefore, CFOs were regarded to be the research participants that would best fulfil this research objective, owing to their expertise and abundant knowledge readily contributable to the study. However, Financial Controllers (FCs) were interviewed in cases where the CFO was unavailable.

Table 3.2: Interviewed Research Participants

Interviewee ID	***Role***	***Listed Entity ID***	***Listed Entity's Industry***
Interviewee MLE01	CFO	MLE01	Other Services
Interviewee MLE02	CFO	MLE02	Other Services
Interviewee MLE03	CFO	MLE03	Manufacturing
Interviewee MLE04	CFO	MLE04	Financial Services
Interviewee MLE05	FC	MLE05	Other Services
Interviewee MLE06	CFO	MLE06	Other Services
Interviewee MLE07	FC	MLE07	Commercial Property
Interviewee MLE08	CFO	MLE08	Other Services

Table 3.2 above lists the interviewees that participated in the one-to-one semi-structured interviews. For anonymity purposes, personal details about research participants were not disclosed.

3.7.2 Interview Population

The qualitative content analysis of the annual reports acted as the groundwork for the selection of the interviewees. Thereby, an element of judgement was applied in determining the listed entities which were ought to be furtherly investigated. Due to the study's exploratory nature, non-probability sampling was recommended by Saunders et al. (2019), whereby importance must be given to the rationale between the sample selection and the research objective.

Purposive sampling or judgemental sampling is a type of non-probability sampling technique that requires 'the use of judgement in selecting cases, that will ultimately enable the researcher to meet the objectives in the most optimal way' (Saunders et al. 2019, p.321). More specifically, theoretical sampling was used, which is a sub-type of purposive sampling, where 'sample selection is dictated by the needs of the emerging theory and the evolving storyline' (Saunders et al. 2019, p.323). The emerging theory and the evolving storyline were subject to judgement by the researcher, through the detection of theoretical saturation.

Interviews were carried out up until theoretical saturation was reached. Theoretical saturation refers to the point at which 'no new properties' emerge within collected data, whilst simultaneously having well-developed data categorisations which have been validated (Strauss and Corbin 1998 cited in Saunders et al. 2019, p.207). This was also referred to as reaching "conceptual density" by Glaser (1992 cited in Saunders et al. 2019, p.207).

3.7.3 The Interview Guide

Miller and Glassner (1997 cited in Silverman 2016, p.62) suggested that 'the strength in qualitative interviewing lies in the opportunity it provides to collect and rigorously examine narrative accounts of social worlds.' Given that qualitative research is driven by analysis, the interview guide changed as research progressed. The interview guide is provided in Appendix E.

3.7.4 Analysis of Interview Data

Interviews were recorded under the interviewees' authorisation, in order to permit the researcher in carrying out a more in-depth exploration, rather than compromising interview depth by jotting down notes concurrently. The emergent themes identified from the transcribed audio recordings were compiled and grouped. This is referred to as thematic analysis, which encompasses a structured yet adaptable and accessible methodology for analysing qualitative data (Braun and Clarke 2006). Saunders et al. (2019, p. 652) were congruent with Braun and Clarke (2006) in arguing that due to its abundant analytical capability, thematic analysis is so flexible that it can be utilised in various research philosophies and approaches, as it is 'a standalone analytical technique.'

In essence, the collected data is conceptualised such that concepts are identified to obtain an explanation of the problem rather than merely mentioning it (Onen 2016). Thus, its basic premise is in determining the phenomena behind the collected data rather than simply citing interviewee statements and remarks.

3.8 Research Limitations

Although the selected research instruments were deemed to be the most optimal for achieving the research objectives, research limitations were still inherently present. A major constraint was that despite a detailed content analysis was carried out, interviews with all 26 CFOs were not conducted due to the time constraint. Nevertheless, the extent of theoretical saturation was gauged, determining whether additional interviews shall be conducted or not. Another limitation was also the word count restriction. Concerning data quality issues, these were addressed by conducting interviews with top management personnel, as these were perceived to contribute valuable insights to the study.

Due to the diverse financial reporting nature of banks and insurance entities, the researcher had to apply judgement in determining certain figures which were necessary for the computation of certain metrics. In obtaining the figures for credit institutions, reference was made to the contractual maturity ladders found in the FS whereas for insurance entities, a compiled list classifying assets and liabilities into current and non-current is provided in Appendix C. Moreover, certain accounting ratios are not standardised within the accounting community. This was addressed by calculating the aforementioned metrics in Table 3.1 above uniformly, in the interest of comparability and consistency (Leach 2010).

3.9 Conclusion

Following a thorough evaluation of the existing literature relating to research methodologies, the research method opted for was deemed to be the most appropriate for the attainment of the study's research objectives, despite the research limitations set out in subsection 3.8. The next chapter will present the research findings, partnered with a fruitful discussion concerning the relevant discoveries.

Chapter 4: Findings and Discussion

4.1 Introduction

This chapter will examine and discuss the findings that emanated from the research. Subsection 4.2 presents and discusses the overall grossing up of the balance sheet and changes in KFMs, wherein rich, informative cases were selected. Consequently, subsection 4.3 considers how preparers have communicated the standard's implications on the FS, as well as the extent to which reference to IFRS 16 was made in the MC of MLEs. Lastly, subsection 4.4 sets out and examines the findings explored from the interview data. All throughout the chapter, findings will be analysed by taking into account the literature, and conclusions will be drawn up wherever practicable.

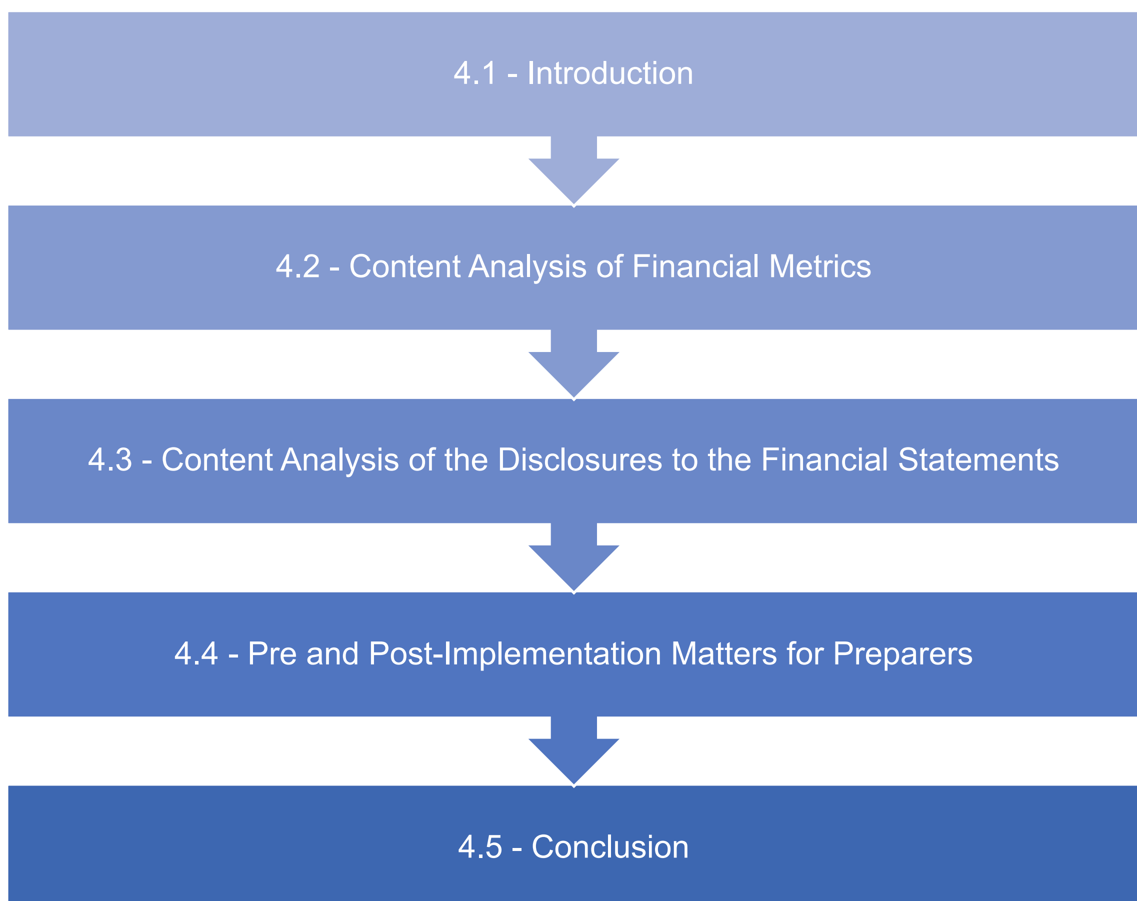


Figure 4.1: Overview of Chapter Four

4.2 Content Analysis of Financial Metrics

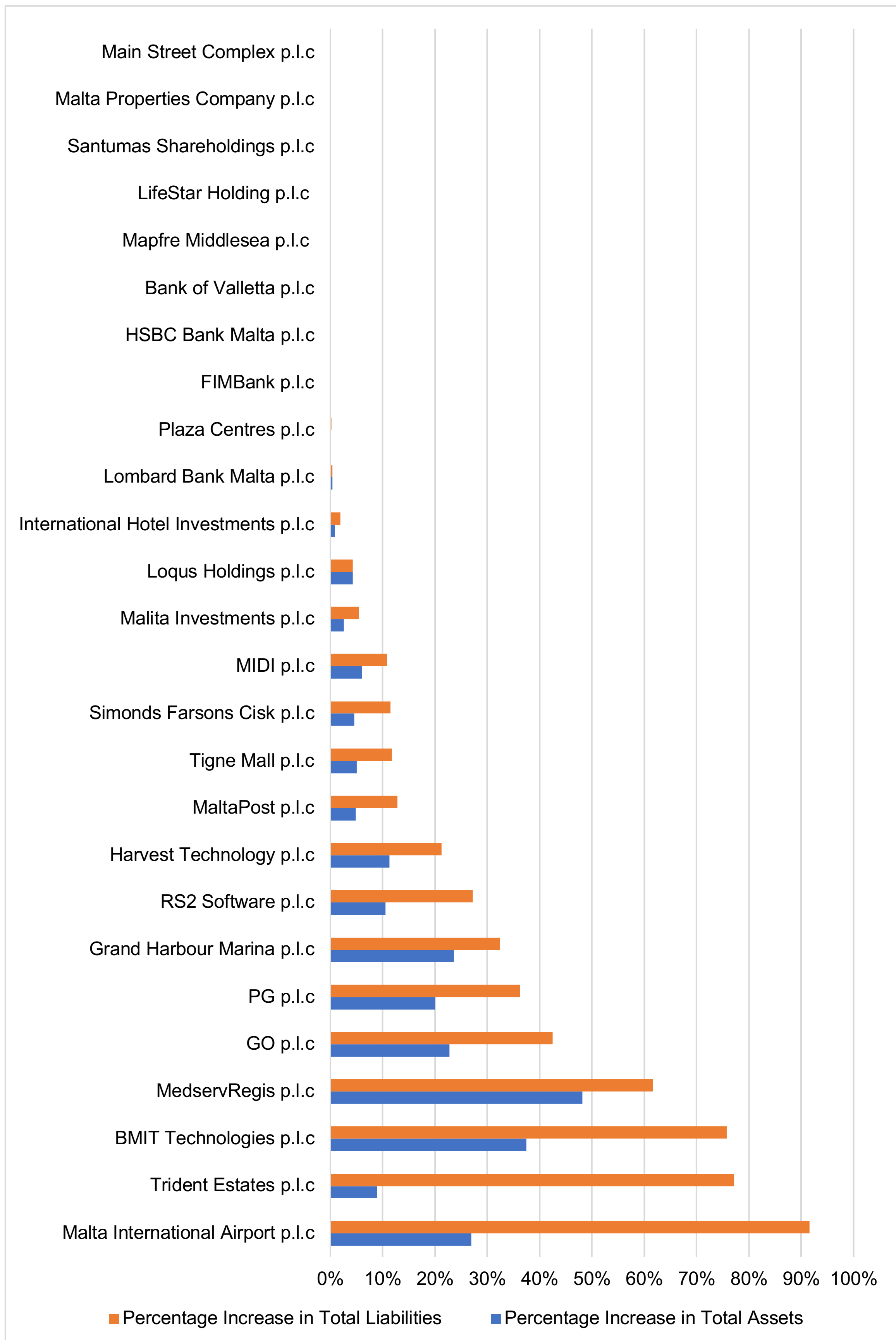
As a fulfilment of research objective 1 set out in subsection 1.3, a content analysis of all of the listed entities' annual reports[4] published between the year which preceded the standard's adoption up to the latest available annual report was carried out. The majority of the examined annual reports were dated between financial year 2018 and financial year 2021, both inclusive, given that most reporting entities have a December financial reporting year-end. Annual reports dated between financial year 2018/2019 to financial year 2021/2022 were examined for MLEs whose year-end was not in December. Additionally, MedservRegis p.l.c. was the sole early adopter of IFRS 16, and therefore the examined annual reports include those from financial year end 2016 up to 2021.

The annual reports of 26 MLEs over a four-year period were examined, and data was collected and inserted into a Microsoft Excel model developed by the researcher to compute the accounting metrics listed in subsection 3.6.2, above, of the study. Considering the limited word count and to permit the researcher to discuss other findings of the study, the discussion pertaining to the analysis of accounting metrics was narrowed down to selected rich cases. Nevertheless, all of the MLEs computed metrics can be found in Appendix H.

Table 4.1 overleaf illustrates the effect of the recognised ROU assets and LLs on TAs and TLs respectively on the transition date, which for most reporting entities was the 1st of January 2019. The 26 equity-listed entities, being the population of the study, were categorised by ascending order in terms of the % increase in TLs, triggered by the initial recognition of LLs on the transition date to IFRS 16.

[4] Excluding MLEs which were not listed on the MSE within the past three years.

Table 4.1: Percentage Increase in Total Assets and Total Liabilities on Initial Recognition



Noticeably, the standard's effect on the balance sheet was more prominent for certain MLEs and less for others, predominantly attributable to the industry sector in which the MLE operates as suggested by Morales-Díaz and Zamora-Ramírez (2018). MLEs operating in the financial services sector had a very minimal to minuscule effect on their reported total assets and liabilities, as a result of the low proportional use of leases concerning their ordinary business activities. Such a finding was accordant with EFRAG (2016) and EY (2021). The ramifications on MLEs operating in the commercial property industry varied from one entity to another, and such a variation was by virtue of the nature of lease arrangements. For instance, most commercial property entities had a minimal effect on their balance sheet, similar to MLEs in the financial services sector, however Trident Estates p.l.c. experienced a 77% increase in its TLs following the initial recognition of €3,801,000 in LLs. MIDI p.l.c. with an 11% increase and Malita Investments p.l.c. with a 5% increase were categorised second and third respectively within the commercial property cluster.

As illustrated in Table 4.1 above, the largest impact was on Malta International Airport (MIA) p.l.c., whereby it sustained a 92% increase in TLs following the recognition of €52,400,000 in LLs on transition date, as a result of their heavy reliance on lease arrangements which are vital yet inevitable for their business operations. Other rich cases, some of which will be subsequently discussed in more depth were; BMIT Technologies (BMIT) p.l.c. (76%), MedservRegis p.l.c. (62%)., GO p.l.c. (42%), PG p.l.c. (36%), and Grand Harbour Marina (GHM) p.l.c. (32%).

Such grossing up of the SOFP as a consequence of adopting IFRS 16 is therefore accordant with findings from existing literature on the subject matter such as PwC (2019) and EY (2021). Ex-ante analyses by EFRAG (2016) and IFRS Foundation (2016a) were also accurate in predicting such a sizeable bloating of the financial position. Consequently, this grossing up had a premier influence on KFMs, especially for those MLEs whose total asset base was materially composed of

ROU assets. Selected rich cases will be therefore discussed in further detail on an entity-by-entity basis with the respective metrics, in the following subsections.

4.2.1 Malta International Airport p.l.c.

Table 4.2: MIA p.l.c. 2018-2021 KFMs

Malta International Airport p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	34%	46%	47%	46%
Total Liabilities/Total Equity	51%	84%	88%	84%
Equity Ratio	66%	54%	53%	54%
Interest Coverage	365.51	30.37	2.68	12.03
Liquidity				
Current Ratio	0.86	1.14	0.88	1.06
Profitability				
Return on Assets	18%	14%	-2%	3%
EBIT Ratio	51%	55%	-12%	28%
EBITDA (€000)	54,430	63,157	5,608	24,079

As reported in their 2019 annual financial statements, MIA p.l.c. capitalised €45,700,000 in ROU assets and €52,400,000 in LLs on 1st January 2019. Such a high proportionality of ROU assets and LL brought about a massive increase in the entity's financial gearing from 2018 to the 2019 adoption year, which can be noticed through the first four metrics in Table 4.2 above. Moreover, such results were not a one-off but rather remained relatively constant throughout 2020 and 2021. More specifically, the ratio of TLs-to-TAs jumped by more than 10% while the interest coverage ratio dropped by a staggering 335.13 times, primarily ought to the significant increase in finance costs up to €2,079,535 from the €148,915 prior-year figure, despite the increase in EBITDA by over €8m. The 2020 interest coverage result was however then severely impacted by lower profitability due to the adverse impact on the tourism sector during the pandemic.

Following IFRS 16 adoption, the IFRS Foundation (2016a) expected the current ratio to decrease whereas Qatawneh et al. (2021) discovered statistically significant changes in the current ratio, however, this was not the case for MIA p.l.c. as there was an increase in current assets which silenced the standard's effect on the ratio.

Concerning profitability metrics, the ROA metric decreased as expected by the IASB and was consistent with foreign literature on Italian listed companies by Raoli (2021). Profitability was expected to decrease following the adoption of IFRS 16, keeping everything unchanged, ought to the charge against earnings of higher interest expenses and depreciation or amortisation expenses on the LLs and ROU assets respectively. For this reason, EBIT[5] and EBITDA[6] 2019 figures were expected to be higher than prior year and such was the case for the entity, as can be observed via the EBIT and EBITDA metrics in Table 4.2, above.

[5] Operating Profit was interpreted as EBIT across all MLEs, to ultimately allow for ratio standardisation.
[6] EBITDA was computed by reversing back depreciation and amortisation expenses from EBIT.

4.2.2 Trident Estates p.l.c.

Table 4.3: Trident Estates p.l.c. 2018/19 - 2021/22 KFMs

Trident Estates p.l.c.				
	2018-19	**2019-20**	**2020-21**	**2021-22**
Gearing				
Total Liabilities/Total Assets	12%	18%	23%	37%
Total Liabilities/Total Equity	13%	22%	30%	59%
Equity Ratio	88%	82%	77%	63%
Interest Coverage[7]	-	3.11	2.49	2.27
Liquidity				
Current Ratio	1.85	4.93	0.33	0.31
Profitability				
Return on Assets	2%	0%	1%	0%
EBIT Ratio	27%	42%	32%	29%
EBITDA (€$_{000}$)	298	570	456	413

Whilst still being cognizant of the fact that Trident Estates p.l.c. is a relatively young, listed entity and that its financial statements are still in a commensurately volatile position, the standard's effect was highly notable, especially on account of the industry sector cluster it pertains to. Overall, gearing and solvency levels have deteriorated in the financial year 2021-2022, due to significant borrowings and changes in the fair value of investment property under development. Before IFRS 16 adoption, the entity did not charge any interest expenses against its earnings, however, following adoption, the entity had to incur €183,000 in finance costs on LLs, raising its interest coverage ratio to 3.11 times.

With respect to the current ratio, a non-IFRS 16 related figure, being an increase in cash and cash equivalents has silenced the standard's impact on adoption. Had an increase in cash reserves not occurred, the current ratio would have deteriorated to 1.38 times.

[7] Trident Estates p.l.c. did not report any finance costs / interest expenses for financial year 2018-19.

As to profitability, net profit has significantly decreased despite higher revenue, but its cause was not fully attributable to IFRS 16. This has consequently reduced the ROA metric due to the lower reported net profit and higher total assets during the earlier years of existing lease arrangements. Similarly, the EBIT and EBITDA metrics are higher following the implementation of IFRS 16 despite lower reported revenues, given that finance, depreciation, and amortisation costs are added back.

4.2.3 BMIT Technologies p.l.c.

Table 4.4: BMIT Technologies p.l.c. 2018-2021 KFMs

BMIT Technologies p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	49%	51%	54%	58%
Total Liabilities/Total Equity	98%	104%	119%	137%
Equity Ratio	51%	49%	46%	42%
Interest Coverage	-	72.99	34.79	40.06
Liquidity				
Current Ratio	0.53	1.19	1.10	0.97
Profitability				
Return on Assets	33%	19%	19%	20%
EBIT Ratio	33%	33%	33%	33%
EBITDA (€000)	9,300	10,000	10,508	10,655

BMIT p.l.c., being the 3rd most affected MLE in terms of the % increase in TLs, has consequently experienced a decrease in the equity ratio and an increase in the remaining gearing metrics ought to the grossing up of the financial position. Similar to Trident Estates p.l.c., BMIT p.l.c. incurred no finance costs in 2018 but following IFRS 16, the entity started recognising finance costs for the first time, and this has elevated the interest coverage metric for 2019 to 72.99 times. The standard's impact on the current ratio metric was again silenced after an increase in the entity's cash and cash equivalents offset the increase in current LLs.

ROA dropped by 14% despite profitability having dropped by a slight 1%, thus indicating that the drop was on account of an increase in total assets emanating mainly from the recognition of ROU assets but was conjoined with an increase in cash and cash equivalents. EBITDA has also increased, as projected by the IASB (IFRS Foundation 2016a), PwC (2016), and EY (2021), whilst the EBIT metric has remained substantially the same, notwithstanding increases in revenue throughout the examined financial years.

4.2.4 MedservRegis p.l.c.

Table 4.5: MedservRegis p.l.c. 2016-2021 KFMs

MedservRegis p.l.c						
	2016	**2017**	**2018**	**2019**	**2020**	**2021**
Gearing						
Total Liabilities/Total Assets	78%	82%	88%	91%	96%	58%
Total Liabilities/Total Equity	360%	445%	739%	998%	2737%	140%
Equity Ratio	22%	18%	12%	9%	4%	42%
Interest Coverage	1.90	1.00	1.36	2.23	1.10	2.22
Liquidity						
Current Ratio	3.18	2.14	1.36	1.45	1.73	2.36
Profitability						
Return on Assets	2%	-5%	-6%	-2%	-7%	-5%
EBIT Ratio	0%	-14%	-10%	4%	-17%	-25%
EBITDA (€$_{000}$)	5,401	4,434	7,318	12,718	5,565	5,304

The timeframe for the metric analysis on MedservRegis p.l.c. varied compared to other MLEs since an early adoption was executed, two financial years ahead of its actual effective date. Thus, financial periods from 2016 up to 2021 were analysed. At the adoption year end (2017), the entity reported €75,895,472 in ROU assets and €25,896,480 in LLs, causing material changes in the gearing metrics. Disregarding 2021 figures[8], gearing metrics have not recovered since the inception of ROU assets and LLs in the SOFP.

[8] In 2021, MedservRegis p.l.c. carried out a reverse acquisition exercise, thus rendering the 2021 metrics incomparable.

The current ratio for MedservRegis p.l.c. has indeed dropped from 3.18 times to 2.14, thus in line with what was anticipated by the IASB (IFRS Foundation 2016a), under all else unchanged conditions (IFRS Foundation 2016; Qatawneh et al. 2021). Nevertheless, such an outstanding drop was assisted by slight drops in trade receivables and cash reserves.

Throughout the majority of the analysed time horizon, the entity has however experienced an unstable industry sector in terms of costs incurred to sell, although the recognition of an additional €1,507,778 of finance costs which were fully attributable to LLs have contributed to lower overall profitability. As illustrated in the above table, ROA results have all dropped and remained within limits. As per the EBIT ratio and EBITDA metric, such results would have been significantly lower had IFRS 16-related finance costs, depreciation, and amortisation not been incurred. In fact, by adding back depreciation and amortisation, EBITDA resulted in a positive metric from a negative EBIT metric, thus showing the significant increase in IFRS 16 expensing by reason of the revised lease costs recognition.

4.2.5 General Observations on the Impact of IFRS 16 on KFMs

As discussed in the previous subsections, the impact of IFRS 16 on certain KFMs was significant, which is consistent with what was predicted in ex-ante studies by the IASB (IFRS Foundation 2016a) and EFRAG (2016), as well as post-implementation studies conducted by Raoli (2021). MIA p.l.c., Trident Estates p.l.c., BMIT p.l.c., and MedservRegis p.l.c. have all experienced a rise in their gearing levels, as a result of being required by the new lease standard to capitalise their leases rather than just disclosing them in the notes to the FS, as was the case for leases classified as OLs.

As indicated by both lease capitalisation models such as Imhoff et al. (1991) and Mulford and Gram (2007) and existing foreign literature on actual sets of FS that demonstrate the impact of IFRS 16, such as Qatawneh et al. (2021), these MLEs now have higher levels of indebtedness. Similarly, changes in the profitability

metrics such as the ROA and EBITDA were in line also with several literature such as Raoli (2021).

4.3 Content Analysis of the Disclosures to the Financial Statements

Moving on to the second research objective, this study will analyse and discuss how MLEs carpeted the anticipated transitional changes in their pre-adoption year FS, how they communicated the standard's effect on the FS, whether reference to IFRS 16 in the MC section was made to clarify certain changes and ultimately by what means have lease disclosures under the new standard developed progressively.

4.3.1 Announcing the Transition

As with any transition to a new accounting standard, changes in accounting policies arise. For some, alterations may be little to immaterial whilst, for others, these may radically overhaul their financial reporting practices as well as the way they disclose their financial information. As suggested by Imhoff et al. (1991) and by several other research studies based on constructive lease capitalisation models, the effect of the standard is more prominent on lessees that had and still have a substantial amount of lease arrangements in relation to their total asset base.

This can be envisaged in the local context, in the way that reporting entities carpeted the anticipated changes. More precisely, MLEs that anticipated substantial changes to their FS have indeed dedicated more notes and references for the incoming lease standard at the time, in comparison to other MLEs which expected no material adjustments. However, such variation was not on an entity-to-entity basis, but rather on an industry-to-industry, with an exception for certain MLEs.

Taking on two extremes, one being the MIA p.l.c. which experienced the largest reported increase in their TLs[9] and the other being Main Street Complex p.l.c. which practically did not recognise any ROU asset onto its SOFP given that the entity acted only as a lessor, their respective announcements of the upcoming standard in their pre-adoption annual report were matchless. The latter simply communicated the matter in the '*Basis of Preparation*' section of their FS that:

> "The company's directors are of the opinion that there are no IFRS requirements which will have a possible significant impact on the company's financial statements in the period of initial application."

(Main Street Complex p.l.c. 2018, p.35)

Conversely, MIA p.l.c. provided highly extensive announcements by first explaining the new requirements under IFRS 16, followed by the transitional approach that was planned to be adopted, being the modified-retrospective approach[10], and the entity's setting in both lessor and lessee scenarios, through which the quantifiable, foreseeable implications were disseminated. Under the lessor subsection, the entity firmly asserted that '*lessor accounting under IFRS 16 remains largely unchanged*' (MIA p.l.c. 2018, p. 114). However, under the lessee subsection, MIA p.l.c. explained all of the expected implications and quantified such anticipated implications were possible, nearing transition. Their clarifications firstly appertained to the substantial increases in both the TAs and TLs figures and then continued weighing up the effects on the SOPL, touching upon the change in the timing of the cost recognition as well as the elimination of the operating lease expense, which consequently directed their narrative to increases in EBIT and EBITDA: *'thus resulting in an increase in EBIT and an even greater increase in EBITDA'* (MIA p.l.c. 2018, p. 114).

Aside from the drastic differences between both entities, the communication of anticipated implications towards transition was also different amongst MLEs operating within the same industry sector. Within the financial services sector, Lombard Bank Malta (Lombard) p.l.c. (2018) and HSBC Bank Malta (HSBC) p.l.c.

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[9] Refer to Table 4.1

[10] All MLEs applied the modified-retrospective approach upon transition to IFRS 16.

(2018) have both disclosed that the standard will be considered as a major change but not as paramount to quantify the impact of IFRS 16 ahead of the transition. This is since both MLEs disclosed that they were still in the process of quantifying the impact.

Meanwhile, Mapfre Middlesea p.l.c. (Mapfre) (2018, p. 55) communicated that from their preliminary impact assessment, *‘results indicate that the impact is not material’* on the Group’s FS. Similarly, LifeStar Holding p.l.c. (formerly GlobalCapital p.l.c.) also took a similar approach to Mapfre p.l.c. in immediately declaring the standard’s insignificant impact.

Contrarily, Bank of Valletta (BOV) p.l.c. disclosed the most ahead of transition amongst MLEs in the financial services sector. This is since for the minor impact BOV p.l.c. experienced, management still quantified the anticipated ROU asset and LL recognitions. Moreover, BOV p.l.c. has also provided further information on the type of asset being leased, by disclosing that:

> “The Group's lease arrangements comprise long-term leasehold properties, other immovable property leaseholds, equipment leases and property space for ATMs which were classified as operating leases under IAS 17. As at 31 December 2018, the Group has non-cancellable operating lease commitments amounting to EUR €10.6 million.”

(BOV p.l.c. 2018, p. 66)

Although the materiality of IFRS 16 to BOV p.l.c. was relatively on par or lower than its fellow counterparts, determinants such as the entity’s internal governance systems and financial reporting culture, which may be more oriented towards increased corporate transparency may influence disclosure preparation, as suggested by Li and Yang (2016).

4.3.2 Deciphering the Impact on the Financial Statements

As suggested by existing literature on lease capitalisation models such as those of Imhoff et al. (1991), Mulford and Gram (2007), Morales-Diaz and Zamora-Ramirez (2018), and Giner et al. (2019), the impact of the new lease accounting standard was not uniform for all entities. Naturally, it depended on the magnitude of OLs upon transition, with the entities' current financial position. Thus, the connotation and presentation of the standard's ramifications varied amongst MLEs. Upon examining the FS of MLEs which encountered significant changes in their financial position, as well as in SOPL terms, due to the deferred cost recognition, it is highly visible that there was a significantly greater extent of effort and attention given to the presentation of the discussion on the implications of the standards.

As illustrated in Table 4.6 overleaf, 19 (73.08%) out of the study's total population of 26 MLEs included a section within their annual report designated to summarise the standard's direct and indirect impact on the FS. As required by paragraph 28 of IAS 8, entities are required to disclose the amount of an adjustment caused by a new standard, to the practicable extent. Effectively, all MLEs have provided remarks on the new additions within their assets and liabilities however, their extensiveness deferred. MLEs such as Lombard p.l.c., Harvest Technology p.l.c., and HSBC p.l.c. did not provide as much information as the rest of the MLEs, excluding those MLEs unmarked by an 'X'. More specifically, Harvest Technology p.l.c. for instance within the *'Changes to Significant Accounting Policies'* section has simply provided a reconciliation of the total OL commitments to the LL recognised upon adoption.

Table 4.6: The Dedication of a Section to Explaining the Impact of IFRS 16

	Section Dedicated to Explain the Impact of IFRS 16
Trident Estates p.l.c.	X
Tigne Mall p.l.c.	X
Malita Investments p.l.c.	X
Loqus Holdings p.l.c	X
Santumas Shareholdings p.l.c.	-
Malta Properties Company p.l.c.	-
Main Street Complex p.l.c.	-
Plaza Centres p.l.c.	-
GO p.l.c.	X
Lombard Bank Malta p.l.c.	-
FIMBank p.l.c.	X
HSBC Bank Malta p.l.c.	-
Bank of Valletta p.l.c.	X
Mapfre Middlesea p.l.c.	X
LifeStar Holding p.l.c.	X
Simonds Farsons Cisk p.l.c.	X
Grand Harbour Marina p.l.c.	X
MesdervRegis p.l.c.	X
MaltaPost p.l.c.	X
MIDI p.l.c.	X
PG p.l.c.	X
BMIT Technologies p.l.c.	X
RS2 Software p.l.c.	X
Harvest Technology p.l.c.	-
Malta International Airport p.l.c.	X
International Hotel Investments p.l.c.	X

Conversely, MLEs affected most by way of SOFP grossing up, vide Table 4.1 in subsection 4.2 above, provided an abundant volume of information on all affected areas of the FS. Taking an in-depth look into the section of MIA p.l.c., their description commenced by firstly describing the lease arrangements which were in scope of IFRS 16, including also their respective lease terms.

Subsequently, their impact narration delved into how the standard substantially affected specific areas of their FS, by providing quantitative tabulations, as displayed in Figures 4.2 and 4.3 below. Such tabulations were accompanied by a brief but pertinent narrative, including the IBR and its determination, as well as the reconciliations from OL commitments to the respective ROU assets and LL figures (Figure 4.2). Meanwhile, Figure 4.3 was complemented by a narrative on the revised cost recognitions of lease accounting which piloted the narrative into how EBIT and EBITDA increased.

The Group & The Company (in EUR million)	**Impact as at 1 January 2019**
ASSETS	
Tangible assets	45.7
Total Assets	**45.7**
LIABILITIES	
Lease liability	52.4
Trade and other payables	(6.7)
Total Liabilities	**45.7**

Figure 4.2: Tabulated Impact on the Statement of Financial Position (MIA p.l.c. 2019, p.94)

The Group & The Company (in EUR million)	**Impact in 2019**
Other operating expenses	2.2
Depreciation	(1.0)
Finance costs	(2.1)
Profit before tax	**(0.9)**
Income tax expense	**0.3**
Profit for the period	**(0.6)**

Figure 4.3: Tabulated Impact on the Statement of Comprehensive Income (MIA p.l.c. 2019, p.96)

The approach of BMIT p.l.c. was part and parcel with that of MIA p.l.c., whereby their impact narrative commenced by disclosing the IBR which applied to the LLs for each asset class:

> "The lessee's incremental borrowing rate applied to the lease liabilities on 1 January 2019 was 3.05% for properties and a range between 4.6% to 5.7% for motor vehicles and IT equipment."

(BMIT 2019, p.39)

Figure 4.4 overleaf presents the reconciliation from IAS 17 accounting to IFRS 16 figures, and the disclosure of ROU assets and LLs recognised on transition, which materially grossed up the SOFP of BMIT p.l.c. As can be noted in the same figure, BMIT p.l.c. have also dedicated a section to present the specific depreciation charges on each asset class, as well as the interest expense in the SOPL, through which the narrative was steered into the EBITDA increase, thus analogous with the line of action of MIA p.l.c.

The recognised right-of-use assets relate to the following types of assets:

	As at 1 January 2019 €'000
Properties	5,087
Motor vehicles	23
IT equipment	14
Total right-of-use assets	**5,124**

Measurement of lease liabilities

	As at 1 January 2019 €'000
Operating lease commitments disclosed as at 31 December 2018	1,485
Add: adjustments as a result of different treatment of extensions	4,465
Discounted using the incremental borrowing rate at the date of initial application	(820)
Less: short-term leases not recognised as a liability	(6)
Lease liabilities recognised as at 1 January 2019	**5,124**
Of which are:	
Current lease liabilities	4,556
Non-current lease liabilities	568
	5,124

Practical expedients applied

In applying IFRS 16 for the first time, the Group has used the following practical expedients permitted by the standard:

- the use of a single discount rate to a portfolio of leases with reasonably similar characteristics;
- reliance on previous assessments on whether leases are onerous;
- the accounting for operating leases with a remaining lease term of less than 12 months as at 1 January 2019 as short-term leases; and
- the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

(c) Amounts recognised in profit and loss

The income statement reflects the following amounts relating to leases:

	2019 €'000
Depreciation charge of right-of-use assets	
Properties	686
Vehicles	20
IT equipment	8
	714
Interest expense (included in finance costs)	**137**

Operating lease charges to be reflected within profit and loss, utilising the accounting principles of IAS 17 Leases had IFRS 16 not been adopted, during the period from 1 January 2019 to 31 December 2019 would have amounted to €719,000. Hence, EBITDA for the year ended 31 December 2019 has been impacted favourably by an amount of €719,000 in view of the adoption of the requirements of IFRS 16.

Figure 4.4: Tabulated Impact of IFRS 16 on the Financial Statements (BMIT p.l.c. 2019, p.40)

Taking a glance at two entities from the financial services sector, their explanation of the standard's ramifications on their FS was relatively superficial when compared to those MLEs which went the extra mile by providing an in-depth explanation of the impact, such as MIA p.l.c., to allow a proper understanding and interpretation for users. For instance, HSBC p.l.c. in its 2019 annual report did not provide a full description of the impact on its FS, but rather plainly disclosed the amounts recognised as ROU assets and LL in the SOPL and included all of the remaining lease information in Note 34 of their FS. In contrast, Mapfre p.l.c. presented the emergent changes via a tabulation, as illustrated in Figure 4.5 below, with the reason being possibly ought to a more robust reporting

NOTES TO THE FINANCIAL STATEMENTS

4. CHANGES IN SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

(e) Impact on financial statements

(i) Impact on transition

On transition to IFRS 16, the Group recognised additional right-of-use assets and additional lease liabilities, recognising the difference in retained earnings. The impact on transition is summarized below.

	Group 1 January 2019		
	Property €'000	Motor vehicles €'000	Total €'000
Right-of-use Asset	609	357	966
Lease Liabilities	806	357	1,163
Retained Earnings	(197)	-	(197)

	Company 1 January 2019		
	Total €'000	Motor vehicles €'000	Total €'000
Right-of-use Asset	609	155	764
Lease Liabilities	806	155	961
Retained Earnings	(197)	-	(197)

When measuring lease liabilities for leases that were classified as operating leases, the Group discounted lease payments using its incremental borrowing rate at 1 January 2019. The weighted average rate applied is 2.96% for property and 9.08% for motor vehicles.

Figure 4.5: Disclosure of the Impact on the Financial Statements (Mapfre p.l.c. 2019, p.74)

4.3.3 The Link between MC and Changes in KFMs

As discovered by EY (2021), the higher the significant impact of IFRS 16 on the FS, the higher the level of disclosure and explanation in the MC section of the annual report, and such a direct relationship is applied in the local context. As can be seen in Table 4.7 below, 11 (42.31%) out of the 26 examined adoption year annual reports referred to IFRS 16 in their MC section, and notable is the theory that the 11 MLEs which warranted certain implications to the standard were amongst those affected most in terms of higher gearing.

Table 4.7: Management Commentary by MLEs on IFRS 16

	IFRS 16 MC Reference	***MC Section/s***
Malta International Airport p.l.c.	X	Directors' Report
Trident Estates p.l.c.	X	Directors' Report; Chairman's Statement
BMIT Technologies p.l.c.	X	Directors' Report
MesdervRegis p.l.c.	-	-
GO p.l.c.	X	Directors' Report
PG p.l.c.	X	Operating Review; Directors' Report
Grand Harbour Marina p.l.c.	X	Chairman's Statement
RS2 Software p.l.c.	X	CEO's Statement
Harvest Technology p.l.c.	-	-
MaltaPost p.l.c.	-	-
Tigne Mall p.l.c.	X	CEO's Review
Simonds Farsons Cisk p.l.c.	X	Directors' Report; Chairman's Statement
MIDI p.l.c.	-	-
Malita Investments p.l.c.	-	-
Loqus Holdings p.l.c.	X	CEO's Review
International Hotel Investments p.l.c.	-	-
Lombard Bank Malta p.l.c.	-	-
Plaza Centres p.l.c.	-	-
FIMBank p.l.c.	X	Directors' Report
HSBC Bank Malta p.l.c.	-	-
Bank of Valletta p.l.c.	-	-
Mapfre Middlesea p.l.c.	-	-
LifeStar Holding p.l.c.	-	-
Santumas Shareholdings p.l.c.	-	-
Malta Properties Company p.l.c.	-	-
Main Street Complex p.l.c.	-	-

References to the standard varied from one MLE to another. Case in point, Trident Estates p.l.c. set into motion their 2020 FS by highlighting the standard's heavy impact on their annual results in the Chairman's Statement:

> "The newly adopted accounting treatment for leases held by the Group regulated by IFRS 16 has resulted in a different method of recognising the value of such leases as "Right of Use Assets" and the related liability. Amortising the value over the terms of the leases and an interest charge over the leases' liability is also a new feature that has impacted our results."

(Trident Estates p.l.c. 2020, p.2)

Furthermore, MIA p.l.c. dedicated a fully-fledged subsection within their 'Financial Performance' section, as illustrated in Figure 4.6 below. The standard was also referred to under the subsection namely, *'Other Operating Expenses'*:

> "Marginal increases in operating costs, as a result of an increasing number of passengers passing through the airport, were offset by reductions due to effects from the initial application of IFRS 16 Leases in the current reporting period."

(MIA p.l.c. 2019, p. 37)

Changes as a result of the adoption of IFRS 16

With effect from 1 January 2019, the Group has mandatorily adopted IFRS 16 Leases, which requires lessees to recognise most operating leases on-balance sheet. The initial application of IFRS 16 led to an increase of the balance sheet by EUR 45.7 million, due to the recognition of new right-of-use assets and lease liabilities. Within the income statement, there was a shift out of other operating expenses into depreciation and finance cost in the reporting period, with a total negative effect on net profit of EUR 0.6 million. A full explanation of the effects upon initial application of IFRS 16 Leases can be found in Note 4.

Figure 4.6: IFRS 16-Specific Subsection within the MC of MIA p.l.c. (2019, p.70)

MC from GO p.l.c. was particularly distinct, in the sense that Directors at GO p.l.c. firstly provided an adjusted EBITDA measure without the effect of IFRS 16. Subsequently, they warranted the decline in profit for the year of €1.2m being

directly attributable to IFRS 16's revised cost recognition, as well as a reduction in equity as a result of adopting the accounting standard under the financial position subsection, by commenting that:

> "The Group's total asset base stands at €327.7 million (2018: €255.4 million), an increase of €72.3 million over the prior year. The introduction of IFRS 16 saw the Group capitalise €50.1 million in right-of-use assets. The Group's total asset base is 38.3% (2018: 47%) funded through equity. The reduction is also due to the adoption of the new accounting standard IFRS 16."

(GO p.l.c. 2019, p. 7)

Simonds Farsons Cisk (SFC) p.l.c. also accredited certain incidents to the standard's adoption. The Group Chairman of SFC p.l.c. has partly elected the increase in gearing by declaring that:

> "Our gearing ratio increased from 23.42% to 25.86% reflecting the increased cash borrowings and the implementation of IFRS 16 relating to lease liabilities."

(SFC p.l.c. 2020, p. 2)

Similarly to GO p.l.c., SFC p.l.c. has also disclosed a metric within the Directors' Report by precluding the standard's effect on the gearing ratio:

> "The Group's net borrowings (excluding impact of IFRS 16) increased by €1 million, whilst following the inclusion of the liabilities in accordance with IFRS 16, the gearing ratio increased to 25.9% as compared to 23.4% for 2019."

(SFC p.l.c. 2020, p. 42)

Directors of PG p.l.c. have also followed suit by disclosing that *'the group's financial statements have been materially impacted by IFRS 16'*, dealing with OLs enjoyed by the group at the Pama site in Mosta (PG p.l.c. 2020, p.22) and that *'excluding the IFRS 16 adjustment, net finance costs amounted to €586,000, compared to €632,000 in the previous financial year'* (PG p.l.c. 2020, p.23).

The revised cost recognition of IFRS 16 was also documented in GHM p.l.c. Chairman's Statement whereby lower profitability was partially accredited:

> "With net finance costs primarily made up of the bond interest cost of €0.7 million, IFRS 16 related costs of €0.5 million and depreciation of €0.4 million, the Company achieved a €0.4 million profit before tax (2018: €0.6 million)."

(GHM p.l.c. 2019, p. 2)

The Directors at FIMBank p.l.c., which as can be recalled from Table 4.1 in subsection 4.2 above, only experienced a mere 0.13% increase in its TLs, have nonetheless decided to announce the standard's adoption within their MC, by disclosing the respective ROU assets and LLs recognitions. To this effect, FIMBank p.l.c. was the only MLE within the financial services sector that included the standard's adoption within their MC, thus permitting one to take notice of the inverse relationship between minimal changes in KFMs and IFRS 16 MC.

4.3.4 The Evolution of the Lease Disclosure

Differences in how lease disclosures have evolved from being prepared under IAS 17 to being prepared in accordance with IFRS 16 will be analysed and discussed in selected rich cases.

The informational intensity within the lease disclosures amongst certain MLEs before the adoption of IFRS 16 differed, given that certain entities already disclosed more than the former standard dictated. Viz., MIA p.l.c., being the MLE that suffered the highest percentual spike in terms of TLs, was ahead of the standard in terms of transparency within their lease disclosures. MIA p.l.c. (2018, p.138) already disclosed ample information on major lease arrangements such as those related to the leasing of the airfield and the aerodrome license fee, by exhibiting the lessor as well as the associated lease terms. Nonetheless, IFRS 16-specific revisions can be noticed with the inclusion of more information on motor vehicles, such as their respective lease term and whether MIA p.l.c. is expecting to exercise an extension option or not.

Comparably, GHM p.l.c. also had a relatively high notion of transparency within their disclosures, however, notable adjustments can be noticed under IFRS 16. For instance, GHM p.l.c. in their 2019 lease disclosure assigned subsections to explain in higher detail each asset class being leased, as well as any applicable variable lease payments and extension options, as illustrated in Figures 4.7 and 4.8 hereunder.

21.1.3 Water space lease

On the 2 June 1999, the Government of Malta entered into a deed of emphyteusis with a consortium, by virtue of which, the consortium was granted rights over parcels of land measuring 1,410 square metres and situated at Cottonera Waterfront Vittoriosa, Malta, for an initial period of 99 years. On the 4 September 2001, a deed of sub-emphyteusis was entered into between the Company and the consortium, whereby, by virtue of one part of this deed, the Company acquired, by the same title, immovable rights over such property for the unexpired period of the 99 years, subject to the payment of an annual sub-ground rent.

Figure 4.7: Specific Water Space Lease Disclosure (GHM p.l.c. 2019, p.77)

21.1.5 Variable lease payments based on sales

Under the terms of a Development and Operations Agreement dated 30 June 2000 entered into with the consortium, the Company is required to pay the consortium a yearly fee equivalent to 10% per annum of adjusted revenue, subject to minimum and maximum limits. While the minimum lease payments of the lease are included in the lease liability and the right-of-use asset, the variable lease payments depending on sales are recognised in profit or loss in the period in which such sales are recognised.

	Fixed payments €000	**Variable payments €000**	**Total payments €000**
At 31 December 2019:			
Leases with lease payments based on sales	**254**	**104**	**358**
	====	====	====

21.1.6 Extension options

With respect to water space lease, the Company has the option to terminate the Development and Operations Agreement during the 29th year from the date of the publication of the deed of sub-emphyteusis (being the year 2030) by giving the consortium at least 12 months' prior written notice. The extension options are exercisable only by the Group and not by the lessor. The Group is reasonably certain not to exercise this option and as such the full term was taken in the calculation of the lease liability as at 1 January 2019.

	2019 €000
Water space	
Lease liabilities recognized for period until extension date (discounted)	**2,390**
Future lease payments included in lease liabilities for period after extension date (discounted)	**2,828**

Total discounted lease liabilities at 1 January 2019	**5,218**
	======

Figure 4.8: Variable Lease Payments & Extension Options Lease Disclosures (GHM p.l.c. 2019. p.78)

However, MLEs to whom OLs were not a fundamental component of their ordinary business activities or were immaterial at the FS level, provided limited information about their current lease arrangements compared to the MLEs mentioned earlier (MIA p.l.c. and GHM p.l.c.). As depicted in Figures 4.9 and 4.10 overleaf, the lease disclosures of HSBC p.l.c., which were prepared in accordance with IAS 17 and subsequently with IFRS 16, respectively, have significantly increased the amount of information provided.

(b) Operating leases

At 31 December 2018, the local group and the bank were party to non-cancellable operating lease agreements for properties used by the local group for operational purposes, in respect of which the future minimum lease payments extend over a number of years. The leases run for an initial period of up to one hundred and fifty years. Specific lease arrangements include an option to renew the lease after the original term but the amounts presented in the tables below do not reflect lease charges applicable to the renewal period.

Total future minimum lease net payments under non-cancellable property operating leases

	Group/Bank	
	2018	2017
	€000	€000
Less than one year	**1,163**	1,233
Between one year and five years	**1,065**	1,085
More than five years	**2,359**	2,732
	4,587	5,050

Lease payments recognised in profit or loss under 'General administrative expenses' amounted to €1,111,000 (2017: €1,108,000). This amount includes a payment of €82,000 (2017: €79,000) in respect of rent paid on one property which is subject to a sub-lease agreement for the same amount.

Figure 4.9: OLs Disclosure under IAS 17 (HSBC p.l.c. 2018, p.138)

34 Right-of-use assets

The local group leases various offsite ATMs, offices and branches as well as low value items such as IT equipment. Rental contracts are typically made for fixed periods but may have extension options. Extension and termination options are included in a number of property leases across the local group. These are used to maximise operational flexibility in terms of managing the assets used in the local group's operations. The majority of extension and termination options held are exercisable only by the local group and not by the respective lessor.

Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants other than the security interests in the leased assets that are held by the lessor. Leased assets may not be used as security for borrowing purposes.

Until the 2018 financial year, leases of property, plant and equipment were classified as operating leases. From 1 January 2019, leases are recognised as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the group.

	Group/Bank
	2019
Right-of-use assets	**€000**
At 1 January 2019	
Impact of application of IFRS 16	**5,624**
Additions	**124**
Depreciation	**(1,063)**
At 31 December 2019	**4,685**
Lease liabilities at 31 December 2019	
Current	**1,051**
Non-current	**3,601**
	4,652

	Group/Bank
	2019
	€000
The income statement reflects the following amounts relating to leases:	
Depreciation charge of right-of-use assets	**1,063**
Interest expense	**51**
Expense relating to short-term leases (included in administrative expenses)	**103**
Expense relating to leases of low-value assets that are not shown above as short-term leases (included in administrative expenses)	**492**

The total cash payments for leases, including short-term and low-value leases, in 2019 was €1,742,000.

Figure 4.10: ROU Assets Disclosure in accordance with IFRS 16 (HSBC p.l.c. 2019, p.135)

Notably, the lease disclosure in Figure 4.10 following the application of IFRS 16 has been considerably revisited in contrast to Figure 4.9. HSBC p.l.c. provided more information to the general user by disclosing the type of assets being leased, as well as the purpose of such lease arrangements. Moreover, whether or not any extension or termination options are implicit and their exercisability at the discretion of the group was also added, together with the total cash payments related to leases and quantitative tabulations to allow for better comprehension.

Another observation concerning lease disclosures was how two particular MLEs fine-tuned their lease disclosures in the FS following the year of adoption, that is, the second set of FS prepared in accordance with IFRS 16. GO p.l.c. and BMIT p.l.c. have revisited their lease disclosures by providing a quantitative tabulation as illustrated in Figures 4.11 and 4.12 below, allowing for better representation and comparability of lease information which was deemed useful for users by preparers.

Group Right-of-use assets	No of ROU assets leased	Range of remaining lease term (years)	Average remaining lease term (years)	Average extension option considered (years)	No of leases with extension options	No of leases with option to purchase	No of leases with termination options
Properties	36	1 - 26	12	5	27	5	9
Equipment and motor vehicles	166	1 - 5	3	-	4	-	-
Spectrum licences	8	2 - 12	5	-	-	-	-

Company Right-of-use assets	No of ROU assets leased	Range of remaining lease term (years)	Average remaining lease term (years)	Average extension option considered (years)	No of leases with extension options	No of leases with option to purchase	No of leases with termination options
Properties	16	1 - 23	11	5	13	5	1
Equipment and motor vehicles	12	1 - 5	3	-	4	-	-
Spectrum licences	8	2 - 12	5	-	-	-	-

Figure 4.11: Addition of a Tabulation by Type of Assets (GO p.l.c. 2020, p.102)

ROU asset	No of ROU assets leased	Range of remaining lease term (years)	Average remaining lease term (years)	Average extension option considered (years)	No of leases with extension options	No of leases with option to purchase	No of leases with termination options
Properties	3	2 - 14	7	6	3	-	3
Motor vehicles	4	2 - 5	3	-	-	-	-
IT equipment	5	1 - 3	2	-	-	-	-

Figure 4.12: Addition of a Tabulation by Type of Assets (BMIT p.l.c. 2020, p.67)

Nonetheless, to be considered is the fact that both MLEs are related parties since GO p.l.c. is the immediate parent of BMIT p.l.c. Such a matter highly explains how the same approach was taken in tweaking their 2020 lease disclosures, thus

consistent with how group governance highly influences disclosure preparation, amongst other determinants (Li and Yang 2016).

4.4 Pre and Post-Implementation Matters for Preparers

This section is aimed to address research objective three of the study; exploring any other pre and post-implementation matters from interviews carried out with CFOs. Captivating insights from interviews will be therefore presented and discussed hereunder.

4.4.1 The Constitution of a Radical Overhaul

Given that lessees are now required to capitalise their leases onto their SOFP, *Interviewee MLE08* asserted that the standard has brought about a complete change for *MLE08* in the way the SOFP is regarded, as well as the SOPL, arguing that the IASB tried to reflect the economic reality of an asset acquired on credit. In agreement with *Interviewee MLE08* was *Interviewee MLE06* in contending that IFRS 16 has changed many things, including *'the way we look at profitability, EBITDA, as well as gearing ratios, besides producing quite some disruption.'*

Nonetheless, *Interviewee MLE03* claimed the standard has only affected *MLE03* in terms of preparatory work and that it had no material impact on their operations and financial stability of the MLE but was material enough to receive the corresponding importance. Similarly, *Interviewee MLE04* claimed that the standard was something to be crossed off the compliance checklist, but *'not as material as IFRS 9 was for us from a bank perspective.'* These counterpoints thus indicate that the magnitude of the standard's implications depends on the materiality context in terms of FS figures as suggested by Morales-Díaz and Zamora-Ramírez (2018).

4.4.1.1 Approaching the Transition

The approach towards the implementation of IFRS 16 varied amongst MLEs. The standard was introduced in January 2016 with its effective date being from January 2019 thereon, thus giving preparers three years to prepare for a smooth transitionary process. Nevertheless, this was not the case for the interviewed MLEs since the majority of their finance functions postponed their IFRS 16 preparatory work up to the final year, except for certain MLEs which commenced their IFRS 16 transitionary process earlier, as illustrated in Table 4.8 below.

Table 4.8: Transitional Approach by Interviewed MLEs

	MLE01	*MLE02*	*MLE03*	*MLE04*	*MLE05*	*MLE06*	*MLE07*	*MLE08*
Full 3-yr Transition Period	Yr 3 (2018)	Yr 1 (2016)	Yr 2 (2017)	Yr 3 (2018)	Yr 3 (2018)	Yr 3 (2018)	Yr 3 (2018)	Yr 1 (2016)
3rd Party Professional Advice	Yes	No	No	No	Yes	Yes	Yes	Yes

With respect to the contracting of external, professional lease accounting advice, most of MLEs sought guidance and assistance on areas of higher subjectivity and professional judgement. This was substantiated by *Interviewee MLE01, MLE05*, *MLE06,* and *MLE08* whereby their consensus for seeking advice was due to the highly technical areas of the standard, viz., the determination of the IBR and whether a contract meets the definition of a lease.

Interviewee MLE08 asserted that the finance function perceived the standard to be significantly more complex during the preliminary study stages than it came out to be, thus possibly resulting in a determinant for seeking professional guidance. On a similar note, the response of *Interviewee MLE07* stood out arguing that for certain assumptions, '*a professional opinion is required to withstand the audit test*', as there are areas that entail high subjectivity and judgement by the preparer, whereas *Interviewee MLE01* claimed that *'we are not IFRS specialists, we are general practitioners.'*

Conversely, *Interviewee MLE02* argued that given the high quotation fees for professional lease advice, a decision was taken to conduct the groundwork fully in-house, which resulted in *'literal bedtime reading'* of the standard. The interviewee added that *MLE02* was advantaged by having two Board members who are highly knowledgeable within the field of Accountancy, not to mention the Audit Committee, thus corresponding to some degree to external professional advice. On another note, *MLE04* is a global group and thus has the economies of scale of affording a team specifically designated for accounting policies and internal discussions for standard adoptions. *Interviewee MLE04* added that unless the adoption is not majorly substantial, as was the case with IFRS 9, *MLE04* does not opt for external advice.

4.4.1.2 Interpretation of the External and Internal Accounts

As suggested by PwC (2019) in their IFRS 16 post-implementation survey, preparers are facing difficulties in communicating changes that originated from the standard's adoption, especially for those preparers that did not restate their comparatives. This was also the case in the local scenario since *Interviewee MLE05 and Interviewee MLE08* disclosed the concern about how users will interpret the FS once IFRS 16 was adopted. More specifically, *Interviewee MLE08* argued that such a concern was more oriented towards the SOPL rather than the SOFP, which revolved around the idea that the users might believe that KFMs such as EBITDA are being manipulated.

In line with this was also *Interviewee MLE06*, stating that *'in the earlier years there was the issue with the comparatives'* which has consequently created issues with internal performance management and renegotiations of debt covenants. The interviewee, however, added that by now everything has stabilised since *'we now have 3 to 4 years of actual comparatives, and everything has stabilised.'* Furthermore, the interviewee explained that when referring to significant changes caused by the standard, the reference was primarily to how their profitability is evaluated. Prior to transitioning, the internal management accounts of *MLE06*

were relatively aligned with external IFRS reporting in terms of profitability. However, given that leases are an *‘integral part of our operating cost base’*, the SOPL of *MLE06* prepared in accordance with IFRS 16 is reconverted into IAS 17 OL expensing, *‘to obtain a true and fair view of our operating cost as it was under IAS 17’* (*Interviewee MLE06*).

Interviewee MLE07 and *Interviewee MLE08* pointed out certain matters relating to the complexity of explaining the standard to their internal peers, with the former respondent claiming that *‘the biggest challenge, beyond theory and everything, is explaining it to accountants, let alone to non-accountants.’* Comparably, *Interviewee MLE08* mentioned that IAS 17 lease accounting is used for their internal management accounts, simply because country managers fail to understand the IFRS 16 accounting treatment of leases in the SOPL given that they are not accountants by profession, but engineers. Such a finding is therefore consistent with suggestions made by the IFRS Foundation (2016a) regarding the education of the standard to internal peers.

This was also the case with *MLE06* since *Interviewee MLE06* described how explaining the change in accounting treatment under IFRS 16 to division managers who are non-accountants was a major challenge. Moreover, *Interviewee MLE06* asserted that the business plan of 2019 was *‘particularly challenging’* as there were variances that were fully attributable to IFRS 16, however, the interviewee culminated the discussion by stating that ‘*transitions create noise, at least for a couple of years and then eventually everything normalises.’*

4.4.1.3 Subjective and Judgemental Areas

Interviewee MLE02 asserted that *'whenever there is subjectivity in a standard, it causes issues and uncertainties.'* Such an assertion being claimed by a CFO is quite perturbing, given that IFRSs entail high subjectivity and are principles-based. Applying an accounting standard forming part of the IFRS framework necessitates a greater extent of professional judgement, as noted by Schipper (2002), due to the nature of principles-based standards which allow for a higher level of discretion for the preparer, compared to rules-based standards. On such account, all interviewees alluded to concerns about the subjective areas of IFRS 16, which however were not all interrelated. A predominant area of high subjectivity was the determination of the IBR, but this was not challenging for preparers whose rate was implicit within lease arrangements. This finding was consistent with remarks made by the IFRS Interpretations Committee (2019) and KPMG (2017b), suggesting that in most circumstances the determination of the IBR is straightforward, however, it is a key challenging area of judgement for preparers in cases where the rate is not readily available.

The CFO of *MLE02* disclosed that the overall IFRS 16 implementation was *'relatively straightforward'*, however *'there was one subjective issue attached to the determination of the IBR, as there was disagreement on how to determine it.'* *Interviewee MLE05* also discussed the IBR as being *'a main concern, since it can be interpreted differently by other practitioners, including auditors.'*

Conversely, *Interviewee MLE06* argued that the determination of the discount rate yields a challenge if the rate is not included within the lease arrangement. For *MLE06* this was not an issue as the CFO expressed that the rate was determined by working back through the contractual cash flows of the agreement. To this effect, *Interviewee MLE08* contended that once they came to grips with what the IASB was after, the IBR is a rate that can be obtained externally and internally with ease.

Interviewee MLE05 stated that whether an arrangement falls in the scope of IFRS 16 or not is another subjective and judgemental matter, which has indeed led to the preparers disclosing such a matter under the *'Key Estimates and Judgements'* section of their FS. *Interviewee MLE06* also shared that certain discussions regarding a set of industry-specific lease arrangements took months to understand whether they shall be considered as a lease or not. Meanwhile, *Interviewee MLE03* argued that the finance function did not experience any issues in agreeing on the rates and defining whether an arrangement falls under lease scope, but rather referred to it as being *'part of the job'*. However, the fact that the nature of lease arrangements of *MLE03* were of a fixed nature shall be noted, as it significantly reduces the possibility of any grey areas. Such insights provided by interviewees show that the challenge was case-specific, thus consistent with KPMG (2017b) in arguing that the lease definition interpretation is significantly more complex in circumstances where establishing the notion of control over the use of the underlying asset is more laborious.

It is worth noting that there were variations in subjective areas among preparers due to differences in the contractual lease arrangements they were party to. Therefore, this elevates the contention that preparatory work, and consequently internal efforts and challenges were not uniform for all.

4.4.1.4 Ongoing Challenges

Concerning ongoing challenges, findings suggest deferred insights that are again, ought to the different nature of lease arrangements and entity contexts. More precisely, *Interviewee MLE08* suggested that the main challenge for *MLE08*'s finance function was *'to comply with IFRS 16 going forward in terms of lease modifications',* given the onerous process to re-account for the lease term as well as the re-determination of the discount rate. Due to the industry sector in which *MLE08* operates, the interviewee asserted that on average a lease modification arises every month, to which consequently are allocated approximately 40 hours per annum, 24 hours of which being CFO hours. As a

matter of fact, these hours are cyclically allocated to the annual budget, ever since the adoption of IFRS 16.

Relatively aligned was also *Interviewee MLE06* in arguing that the biggest cost over and above IFRS 16 consultancy fees was management time to create lease schedules. The interviewee continued that such time and effort spent on lease accounting shall not be underestimated, especially in view of having a substantial amount of lease arrangements to account for. Therefore, apart from the aforementioned special cases related to *MLE08* and *MLE06*, the remaining interviewees reported no ongoing challenges whatsoever following the adoption year FS, thus envisaging that the impact varied and still is, on an entity-by-entity basis.

4.4.1.5 Systems and Processes

Existing literature from Chambers et al. (2015), and PwC (2019) indicated the need for having appropriate IT systems in place, to ultimately allow the efficient processing of lease data and accounting. *Interviewee MLE04* reported that an intra-group accounting tool was specifically implemented by *MLE04* for IFRS 16-specific purposes. This system was developed by the Group's IT team which continuously discussed with accountants for them to give the classifications they require, to ultimately ensure that it would substantially simplify and ease the overall lease accounting onerousness. The interviewee added that such a tool was no state-of-the-art system but was more than the generic spreadsheet which was used by their other counterparts.

In fact, *MLE04* was the only MLE that inaugurated an IT system dedicated to IFRS 16, whilst the rest kept on processing and administering their leases on classic, Microsoft Excel spreadsheets. Having said so, *Interviewee MLE06* argued that upon transition they considered investing in an IFRS 16 accounting model since their biggest scare was the management of all those spreadsheets at that time. Effectively, *MLE04* had a spreadsheet for each lease, therefore

amounting to approximately four hundred spreadsheets solely for leases, thus in line with the predictions of the IASB regarding the handling of significant quantities of lease data under IFRS 16 (IFRS Foundation 2016a). Irrespectively, *Interviewee MLE04* continued that they did not opt for an accounting model tailored for IFRS 16 since around 2018-2019, *MLE04* was already on the verge of a migration towards a new IT system that was of higher precedence.

Therefore, although the IASB was correct in predicting the abundant processing of lease data, literature by Attard (2017), Chambers et al. (2015), Deloitte (2018), PwC (2019) and by Segel and Naik (2019) was not accurate in forecasting the use of robust IT systems by MLEs to process lease data. *Interviewee MLE02* asserted that the rationale behind the need for a specific IT system cannot be comprehended. Nevertheless, *MLE02* did not have as many leases as *MLE04* and *MLE06* in terms of quantity to process, therefore bringing back the discourse on how each MLE had different circumstances and conditions.

4.4.1.6 Drop in Distributable Reserves

Ought to the forward-induced nature of IFRS 16 accounting for lessees, IFRS 16-specific expenses are higher in the earlier years of lease arrangements. For this reason, profitability levels may thus be lower in the early years, keeping everything else unchanged. As a matter of fact, this was the case for *MLE02*, *MLE 07,* and *MLE08* whereby the respective interviewees disclosed that a drop in distributable reserves was sustained. More specifically, *Interviewee MLE02* referred to the drop as an unintended consequence that failed to come up to his attention at the drawing board stage, since his attention was mainly on the SOPL, SOFP, and disclosures during the impact assessment stages. The interviewee additionally claimed that the reason for this was due to the significant adverse effect on profitability during the first half term of the lease, with the situation restabilising itself in the second half; consequently, the overall net impact would be nil. Although the impact is nil overtime, having a substantial drop in

distributable reserves, accompanied by a possible economic downturn could effortlessly drain out an entity's distributable reserves.

Similarly, *Interviewee MLE08* disclosed that the entity suffered a drop of €15m in distributable reserves, *'which consequently affected our dividend distribution.'* The interviewee has indeed added that although EBITDA improved, profitability and consequently retained earnings took a substantial hit, far more than it would have been had IAS 17 still applied. *Interviewee MLE08* was also consistent with *Interviewee MLE02* in claiming that to date, the entity is still in the stage whereby depreciation and finance costs are materially higher than the actual lease expense. Meanwhile, although the distributable reserve for *MLE07* did decrease a bit, *Interviewee MLE07* attested that the entity already had a sizeable reserve and thus the reduction was of no material concern.

4.4.2 Non-GAAP Measures

Following the content analysis carried out for research objectives one and two, interviewees were asked whether the changes in KFMs, which for certain MLEs were far more striking than for others, played a role in the different articulation of MC and other investor communications. The common rationale which emerged orbited around the lack of comparatives for the earlier years, especially for the preparation of the adoption year annual report. A prominent response was provided by *Interviewee MLE02*, stating that an exigency to specify that certain material adjustments were entirely merited to IFRS 16 was called for, especially for adoption year FS due to the absence of comparable comparatives. To this effect, the same interviewee added that MC included remarks which were also accompanied by figures, intended to present what would the same lease arrangements result in, had IAS 17 accounting still applied. The inclusion of figures accounted under a former accounting standard is considered as a non-GAAP measure, and such a theme was congruous amongst all twenty-six MLEs, except for those which were immaterially affected due to industry-specificness or being on the lessor side of the arrangements.

Another interesting emerging insight was how interviewees centrally placed the increase in EBITDA in their standard's impact discussion. *Interviewee MLE02* started off by discussing the increase in a non-GAAP measure, namely, EBITDA, before discussing the lower profitability, and such has not only occurred throughout the interview but was also notable in the FS. In the adoption year (2019), reference to the increase in EBITDA was made in the Chairman's Statement, yet EBITDA was not included within MC, despite increases in 2018. Such an insight is substantiated by D'Angelo et al. (2018) cited in Moscariello et al. (2020, p.59) that 'lower profitability and GAAP losses were associated with concealing unfavourable business performance through the opportunistic use of non-GAAP measures.'

Conversely, *Interviewee MLE08* was concerned that users may fail to understand the *'logic'* of the standard on providing an EBITDA figure which was cosmetically uplifted by IFRS 16:

> "We were concerned about how users will perceive the lease accounting treatment. Although this was not within our control, we were still concerned that users may ponder that we are manipulating our KPMs, more specifically EBITDA, for favourable reporting, whilst simultaneously having a loss for the year."
>
> (*Interviewee MLE08*)

In relative agreement with *Interviewee MLE08* were also *Interviewee MLE03* and *Interviewee MLE07*. The former claimed that *'in our case EBITDA shot up'* and thus felt the need to explain that this was an accounting change rather than an operational one, *'to avoid giving a potentially wrong indication to our users.'* *Interviewee MLE07* discussed that a major challenge was to explain at the Board level the reason for profitability decreasing when really and truly it did not, *'and hence the use of EBITDA as a non-GAAP measure and the extensive disclosures concerning IFRS 16.'* Such an insight highly corresponds with PwC's (2019) statement regarding the difficulty preparers faced in communicating such circumstances to investors, especially those with no accounting background, which consequently resulted in the substantial use of non-GAAP measures.

4.4.3 Preparers' Remarks on the Standard

4.4.3.1 Lease or Buy?

In their 2016 effects analysis, the IASB claimed that a change in the accounting treatment for leases might act as a determinant to decide whether an asset shall be acquired or leased (IFRS Foundation 2016a). After raising this viewpoint, 7 out of 8 respondents affirmed that IFRS 16 did not act as a determinant whatsoever in terms of operational decision-making and will never do. Interviewees from *MLE03* and *MLE04* have indeed responded that for them the impact of leases was immaterial at the operational level, and thus did not carry out any deliberate alterations to their existing lease portfolios, as a result of the new standard.

MLEs which were materially affected by the standard were still harmonious with *Interviewees MLE03* and *MLE04*, despite the significant implications of the standard at the FS level. According to *Interviewee MLE07*, the lessor's willingness to sell the asset would be a more important factor in the decision to buy, rather than considering the impact of IFRS 16 on the company's FS, thus in agreement with Attard (2017), whereby other factors such as taxation, were found to be more dominant reasons to buy.

On an aligned yet dissimilar note were Interviewees *MLE02*, *MLE05* and *MLE08*. This is since notwithstanding the possibility of leasing or buying in financing capital expenditure certain listed entities are indifferent given that from the way they are set up, they can only enter into lease agreements. Nevertheless, *Interviewee MLE05* has additionally disclosed that for future lease or buy decisions related to smaller assets such as motor vehicles or other equipment of a similar calibre, buying would be the option to go with, the reason being to circumvent the burdensome and cumbersome IFRS 16 accounting process, besides the evaded benefit of OBS OLs. In line with *Interviewee MLE05* was also *Interviewee MLE06* by asserting that *'IFRS 16 has become one of the deciding factors'* when considering whether to buy or to sell. Thus, the perception on

leasing for those MLEs which were more materially impacted has indeed perished, however, not to the extent that lease portfolios were modified at all.

4.4.3.2 Cost Benefit Analysis from the Preparers' Standpoint

Predominantly, the general consensus throughout the interview responses opposed the standard's overall adoption, namely that the standard called for a highly laborious process with merely any direct benefits, if any, therefore agreeing with Attard (2017) and Borg (2016). Additionally, *Interviewee MLE07* disclosed that had one Board member of *MLE07* been asked whether any benefits were endowed by IFRS 16, his response would have been that such a standard was issued for the sake of audit firms to ultimately charge additional auditing and consultancy fees. *Interviewee MLE07* highly opposed IFRS 16, to the degree that *'reverting back to IAS 17 would be better'* and recommended that the standard should be industry specific since it is too generic at the moment. Meanwhile *Interviewee MLE03* argued that the scope of the IASB was definitely not focused on manufacturing companies, but rather on entities operating in the aviation or marine industry. These insights asserted by preparers further substantiate the findings of Abdilla (2016) and Borg (2016), on how IFRS 16 is predominantly viewed as an additional administrative and compliance burden from the preparers' point of view.

Having said so, *Interviewee MLE06* went off on a tangent from the rest of the respondents, arguing that:

> "IFRS 16 gave more focus and importance to the lease commitment side of the balance sheet, which management did not previously give any importance and attention to."
>
> (*Interviewee MLE06*)

Precisely, the Interviewee claimed that by having leases on the SOFP, preparers must now consider the effect of capitalising such leases, as well as their impact on the FS over the lease term. The possession of better long-term visibility over

lease arrangements is another benefit that was mentioned by *Interviewee MLE06*, thus enhancing the management of lease commitments and timing of cash flows, as opposed to a blinker of profit at a given time period. Nevertheless, the interviewee later on during the interview remarked that for *MLE06*, the introduction of IFRS 16 was not required to shed light on their existing leases, since they were already considered an integral part of their operating cost base.

Meanwhile, *Interviewee MLE04* touched upon the benefit of IFRS 16 from the other side of the spectrum. More precisely, the interviewee disclosed that from a preparer's perspective, no inspections were made on the FS of the entity's competitors in terms of their IFRS 16 reporting. Nonetheless, the interviewee claimed that as a bank giving credit, *'we have more information at hand with respect to our customers' lease commitments.'* This demonstrates that despite OLs were already accounted for under IAS 17 (Borg 2016), credit institutions now have more information on lease commitments at their disposal.

4.5 Conclusion

This chapter presented the research findings identified from the data analysis, commensurate with the research objectives. Throughout, the findings were intertwined with relevant literature reviewed in Chapter 2, above. The next chapter will bring this dissertation to a close by, primarily, recapitulating the findings followed by a set of recommendations on those same findings and identifying possible areas for further research.

Chapter 5: Conclusions and Recommendations

5.1 Introduction

This chapter aims to conclude the study by systemising and encapsulating the key findings from the study, wherefrom a set of recommendations to improve the current situation are provided in subsection 5.3. Subsequently, further areas of study related to the research topic are also provided in subsection 5.4.

5.2 Summary of Study and Findings

The objective of this study was to establish the implications of IFRS 16 on MLEs, more specifically on the extent to which gearing levels and other relevant KFMs varied, as well as, on the size and magnitude of disclosures on leases and lastly to explore any IFRS 16-related matters highlighted by preparers. For the first and second research objectives, a detailed content analysis of the MLEs' annual accounts was conducted whereas for the latter objective CFOs from MLEs were interviewed. In cases where the CFO was unavailable, interviews were carried out with the FC.

5.2.1 Summary of Findings from the Content Analysis

With regards to the changes in KFMs, the standard's effect on the financial position was more prominent for certain MLEs than others, given that the effect's extent was mainly characterised by the level of materiality of lease commitments concerning the case entity and the industry sector in which the MLE operates. The most striking ramification of the standard was indisputably the grossing up of the SOFP, consequently influencing KFMs related to financial position. Correspondingly, materially affected entities experienced substantial increases in their gearing levels. Concerning profitability metrics, EBITDA increased whereas lower ROA and ultimate profitability[11] were reported across MLEs, on account of the revised lease expense recognition.

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[11] Naturally, profitability metrics were dependent on financial year performance.

The study also discovered that the extent of disclosures on leases was analogous to the changes in KFMs as a consequence of the standard's adoption. MLEs that suffered significant grossing up of their financial position have in parallel dedicated more emphasis on the revised lease accounting as a result of IFRS 16. The contrast in the volume of the standard's impact decipherment on the FS by MLEs was evident, whereby quantitative tabulations were also provided for better user understandability. Factually, MLEs that experienced material alterations have allocated a good deal of their annual reports' MC to IFRS 16, more specifically in the opening stages such as the Chairman's Statement and Directors' Report, to avoid any misinterpretations of the annual results. Another emergent finding was the fine-tuning of lease disclosures in the second set of FS prepared in accordance with IFRS 16, once the standard's compliance chasing stage was over.

5.2.2 Summary of Findings from Interviews with Preparers

With respect to the third research objective, a common sentiment expressed by preparers was how the standard brought about a radical change in the way the FS are now regarded. However, given that each MLE had its own state of affairs in terms of lease arrangements, emergent findings from the interviews varied accordingly.

MLEs whose lease arrangements were objectively a lease under the IFRS 16 lease definition, no major challenges were experienced in determining whether the arrangement is in scope. Similarly, in cases where the rate was implicit within the lease contract, preparers asserted that the discounting process of future lease payments was straightforward, whereas in converse cases where no rate was implicit within the lease arrangement, preparers highlighted the standard's subjectivity and high judgemental requirement to do so. Another case-specific finding is that currently, the most significant ongoing challenge is complying with IFRS 16 going forward, in terms of lease modifications. Such a finding was highlighted by an MLE which frequently encounters lease modifications. A further

key finding disclosed by two CFOs was the unprecedented drop in distributable reserves, emanating from the front-loaded lease expense in the earlier years of a lease, *ceteris paribus*.

5.3 Recommendations

By accomplishing the research objectives of this dissertation, the discussion in Chapter 4 has generated recommendations targeted at preparers and stakeholders for augmenting the current situation, which are presented hereunder.

(i) Implementation of New Emergent Technologies – Data Analytics

In light of the significant impact of IFRS 16 on the FS and in terms of preparatory work such as the numerous processing of lease arrangements and ongoing lease modifications, preparers are recommended to consider implementing data analytics to capitalise on the transition to IFRS 16, as suggested by PwC (2019). Data analytics can provide valuable insights and efficiencies in the process of identifying, collecting, and processing lease data, especially given the substantial amount of lease data in the study's discovered cases. Moreover, data analytics assists preparers in identifying areas where further optimisation can be achieved, such as identifying favourable opportunities for lease renegotiations, inefficiencies in existing lease agreements, and optimising lease terms given that they are now capitalised onto the SOFP.

(ii) The Importance of Accounting Knowledge amongst Non-Accountants

Preparers expressed the difficulty in explaining the change in lease accounting brought about by IFRS 16 to internal and external stakeholders, to the extent that in certain cases, internal accounts were prepared in accordance with the antecedent standard, IAS 17. It is crucially important for both internal and external stakeholders to possess a basic knowledge of accounting statements and terms.

Internally, employees of high seniority such as division or country managers must be knowledgeable and competent in interpreting, to avoid additional internal workload in translating internal accounts. Externally, users such as investors, creditors, and regulatory bodies must be relatively proficient in accounting concepts to make informed decisions and assessments about the financial position, performance, and other matters related to the company. Thus, entities should prioritise educating their workforce in the matter of accounting concepts, via CPE enrolment or internal seminars. Ultimately, this leads to more informed decision-making by users, increased transparency amongst relevant parties, and improved relationships with stakeholders.

5.4 Areas for Further Research

(i) Replicating the study after a period of five years

As a result of new regulatory requirements within the financial services industry sector, bank financing is on the decline, thus changing the landscape for asset financing. This development is in turn increasing the prevalence of leasing as a source of financing, potentially raising gearing levels of MLEs to new peaks. Thus, an area for further research could be replicating the study in five years, taking on an analogous methodological approach.

(ii) *Investigating the implications of IFRS 16 on non-listed entities*

Given that this study only explored the IFRS 16 implications on local equity-listed entities, analysing the effects on non-listed entities that are members of the Chamber of SMEs would be another area for further research. However, the study would have to be carried out by adopting a quantitative stance to specifically determine the sampling population.

(iii) The relevance of lease disclosures for credit institution analysts

Considering that to date, commercial banks are still the main source of financing in the local scenario, it is being suggested that a separate study would be carried out to identify and analyse the take on by bank managers of such disclosures emanating from IFRS 16 in their credit assessment and financing processes. Such a research topic was tackled by Borg (2016), whereby findings suggested that lease information contained in the FS at the time were insufficient for bankers. Therefore, conducting a similar study now would encapsulate the new standard's developments into the insights of bankers as lenders.

5.5 Concluding Remarks

This dissertation reviewed the impact of IFRS 16 in the local scenario, by specifically looking at MLEs, given they are bound by full IFRS. It is a contribution towards the existing body of literature concerning how IFRS impacts small states such as Malta. Given that markets are non-existent, applying IFRS 16 also has had its impact; in particular, establishing the IBR for existing leases. Indeed, this proved to be a matter wherein professional judgement had to be applied, as evidenced by the interview data gathered.

As leasing continues to increase in importance as a source of financing in light of the ongoing change in the financial landscape, preparers have to be aware of the possible repercussions that IFRS 16 provisions could have on distributable reserves, as was discovered by this study.

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Appendices

Appendix A: Examined MLEs

Table A.1: The 26 examined equity-listed entities (MSE Price List 2023)

Listed Entity	***Industry Sector***	***Financial Year End***
Malta International Airport p.l.c.	Tourism	31 December 20x1
International Hotel Investments p.l.c.	Tourism	31 December 20x1
BMIT Technologies p.l.c.	Technology	31 December 20x1
RS2 Software p.l.c.	Technology	31 December 20x1
Harvest Technology p.l.c.	Technology	31 December 20x1
PG p.l.c.	Retail	30 April 20x2
MIDI p.l.c.	Commercial Property	31 December 20x1
MaltaPost p.l.c.	Postal Services	30 September 20x2
MedservRegis p.l.c.	Oil & Gas	31 December 20x1
Grand Harbour Marina p.l.c.	Maritime	31 December 20x1
Simonds Farsons Cisk p.l.c.	Food & Beverage	31 January 20x2
Bank of Valletta p.l.c.	Financial Services	31 December 20x1
Lombard Bank Malta p.l.c.	Financial Services	31 December 20x1
HSBC Bank Malta p.l.c.	Financial Services	31 December 20x1
Mapfre Middlesea p.l.c.	Financial Services	31 December 20x1
FIMBank p.l.c.	Financial Services	31 December 20x1
LifeStar Holding p.l.c.	Financial Services	31 December 20x1
GO p.l.c.	Communication Services	31 December 20x1
Plaza Centres p.l.c.	Commercial Property	31 December 20x1
Tigne Mall p.l.c.	Commercial Property	31 December 20x1
Malita Investments p.l.c.	Commercial Property	31 December 20x1
Trident Estates p.l.c.	Commercial Property	31 January 20x2
Santumas Shareholdings p.l.c.	Commercial Property	30 April 20x2
Malta Properties Company p.l.c.	Commercial Property	31 December 20x1
Main Street Complex p.l.c.	Commercial Property	31 December 20x1
Loqus Holdings p.l.c.	Commercial Property	30 June 20x2

The following entities were listed on the MSE within the past 3 years, therefore were excluded from the study's population:

Table A.2: The 6 MLEs excluded from the study (MSE Price List 2023)

Listed Entity	***Industry Sector***	***Listing Date***
M&Z p.l.c	Retail	March 2022
APS Bank p.l.c	Financial Services	July 2022
LifeStar Insurance p.l.c	Financial Services	June 2021
AX Real Estate p.l.c	Commercial Property	February 2022
Hili Properties p.l.c	Commercial Property	December 2021
VBL p.l.c	Commercial Property	October 2021

Appendix B: Computation of KFMs

Table B.1: Computation of the KFMs for subsection 4.2

Metric:	Measurement:	Computation:
Debt-to-Asset (%)	Gearing (Solvency)	$\frac{\text{Total Liabilities}}{\text{Total Assets}}$
Debt-to-Equity (%)	Gearing (Solvency)	$\frac{\text{Total Liabilities}}{\text{Total Equity}}$
Equity Ratio (%)	Gearing (Solvency)	$\frac{\text{Total Equity}}{\text{Total Assets}}$
Interest Coverage Ratio	Gearing (Solvency)	$\frac{\text{EBITDA}}{\text{Interest Expense}}$
Current Ratio	Liquidity	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$
Return on Assets (%)	Profitability	$\frac{\text{Net Profit}}{\text{Total Assets}}$
EBIT Ratio (%)	Profitability	$\frac{\text{EBIT}^{12}}{\text{Revenue}}$
EBITDA (€)	Profitability	EBITDA was worked out by reversing depreciation and amortisation costs from EBIT.

[12] EBIT was interpreted as the Operating Profit across all MLEs

Appendix C: Classification of Current and Non-Current Assets and Liabilities

The table below illustrates the classification of assets and liabilities for the computation of the current ratio for insurance entities. For the classification of current and non-current assets and liabilities of credit institutions, the contractual maturity ladder provided in the FS was utilised.

Table C.1: Classification of current assets and current liabilities of insurance entities

Current Assets	***Current Liabilities***
Reinsurers' Share of Technical Provisions	Short-term Outstanding Claims
Deferred Acquisition Costs	Short-term Provisions for Unearned Premiums
Insurance and Other Receivables	Insurance and Other Payables
Income Tax Receivable	Income Tax Payable
Cash and Cash Equivalents	

Appendix D: Tabulation for the Analysis of Lease Disclosures

Table D.1: Tabular Analysis of Lease Disclosures across MLEs

	References in the Management Commentary	Key Estimates and Judgements	Expected Results in Prior Year	Significant Accounting Policies	The Deciphering of the Impact	Lease Notes to the Financial Statements
Malta International Airport p.l.c.	X	X - in determining whether in scope or not	X	X	X	X
Trident Estates p.l.c.	X	-	X	X	X	X
BMIT Technologies p.l.c.	X	-	X	X	X	X
MesdervRegis p.l.c.	-	X	-	X	X	X
GO p.l.c.	X	-	X	X	X	X
PG p.l.c.	X	-	X	X	X	X
Grand Harbour Marina p.l.c.	X	X – in determining the IBR	X	X	X	X
RS2 Software p.l.c.	X	-	X	X	X	X
Harvest Technology p.l.c.	-	-	*‘Still in the process of quantifying the impact’*	X	-	X
MaltaPost p.l.c.	-	X - in determining the lease term	Yes, but just the ROU asset and LL recognition	X	X	X

Tigne Mall p.l.c.	X	-	*'Still in the process of quantifying the impact'*	X	X	X
Simonds Farsons Cisk p.l.c.	X	X	X	X	X	X
MIDI p.l.c.	-	-	*'Still in the process of quantifying the impact'*	X	X	X
Malita Investments p.l.c.	-	-	Yes, but just the ROU asset and LL recognition	X	X	X
Loqus Holdings p.l.c.	X	-	X	X	X	X
International Hotel Investments p.l.c.	-	X - in determining the lease term	X	X	X	X
Lombard Bank Malta p.l.c.	-	-	*'Still in the process of quantifying the impact'*	X	-	X
Plaza Centres p.l.c.	-	-	Yes, but just the ROU asset and LL recognition	X	-	X
FIMBank p.l.c.	X	-	Yes, but just the ROU asset and LL recognition	X	X	X
HSBC Bank Malta p.l.c.	-	-	*'Still in the process of quantifying the impact'*	X	-	X

Bank of Valletta p.l.c.	-	X - in determining the lease term	X	X	X	X
Mapfre Middlesea p.l.c.	-	-	X - declared that its impact is immaterial	X	X	X
LifeStar Holding p.l.c.	-	-	X - declared that its impact is immaterial	X	X	X
Santumas Shareholdings p.l.c.	-	-	X - declared that its impact is immaterial	X	-	-
Malta Properties Company p.l.c.	-	-	X - declared that its impact is immaterial	X - only from a lessor POV	-	-
Main Street Complex p.l.c.	-	-	X - declared that its impact is immaterial	X - only from a lessor POV	-	-

Appendix E – CFOs Interview Guide

1. It is common for listed entities to experience accounting standard transitions.
    a. If so, briefly discuss in what aspects have past transitions affected the entity.

2. What were your *expectations* prior to the IFRS 16 transition?
    a. How have you *approached and addressed* the identified expectations, as the responsible person for the finance function?
    b. Were you *concerned with any uncertainties* arising from the standard?
    c. Has the entity reached out for professional, lease accounting advice?

3. How did the finance function *make use of the 3-year transition period* (2016-2019), prior to the standard's effective date?

4. In comparison with other entities, your disclosures entailed extensive/limited explanations. Why did you feel the need to do this?
    a. What was the *rationality* behind the preparation of the voluntary disclosures pertaining to 'IFRS 16 *Leases*' in the annual report immediately preceding the transition year?

5. Certain companies had issued hybrid bonds as a direct mitigation towards the effect of IFRS 16 adoption. Has the entity taken any similar initiatives in this regard?
    a. If so, could you kindly elaborate and explain the rationale behind such measure?
    b. If not, what was the reason for not taking any direct initiatives?

6. Have you *encountered any challenges* throughout the transition to IFRS 16?
    a. Are you still experiencing any of these challenges?

7. PwC (2019) argued that reporting entities must look beyond compliance and start to reap the benefits from IFRS 16, through the availability of more precise information on lease arrangements. Do you agree with this statement?
    a. If so, in what way was it beneficial?
    b. If not, could you kindly elaborate on this aspect?

8. The IASB expected companies with material off-balance sheet leases to incur costs on adoption of IFRS 16. What specific *implementation/adoption costs* has the entity incurred in this regard?

9. Were there any *changes in the lease portfolio* throughout the past couple of years, as a result of implementing IFRS 16?

10. Was there a *link* between management commentary (incl. APMs) on performance and the changes in financial metrics?

11. Have you experienced any *unintended consequences* through applying IFRS 16?
    a. In what other aspects was the entity affected by the standard, and to what extent?

12. As adopters of IFRS 16, do you believe that IFRS 16 has tackled and addressed the shortcomings of IAS 17?
    a. Do you believe that there is the need for any amendments to the standard?

13. Are there any other post-implementation matters that you would like to disclose

Appendix F – Financial Metric Results for all MLEs

Entity: ***MedservRegis p.l.c.***

MedservRegis p.l.c						
	2016	**2017**	**2018**	**2019**	**2020**	**2021**
Gearing						
Total Liabilities/Total Assets	78%	82%	88%	91%	96%	58%
Total Liabilities/Total Equity	360%	445%	739%	998%	2737%	140%
Equity Ratio	22%	18%	12%	9%	4%	42%
Interest Coverage	1.90	1.00	1.36	2.23	1.10	2.22
Liquidity						
Current Ratio	3.18	2.14	1.36	1.45	1.73	2.36
Profitability						
Return on Assets	2%	-5%	-6%	-2%	-7%	-5%
EBIT Ratio	0%	-14%	-10%	4%	-17%	-25%
EBITDA (€)	5,401,429	4,434,014	7,318,591	12,718,683	5,565,272	5,304,677

Entity: ***Malta International Airport p.l.c.***

Malta International Airport p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	34%	46%	47%	46%
Total Liabilities/Total Equity	51%	84%	88%	84%
Equity Ratio	66%	54%	53%	54%
Interest Coverage	365.51	30.37	2.68	12.03
Liquidity				
Current Ratio	0.86	1.14	0.88	1.06
Profitability				
Return on Assets	18%	14%	-2%	3%
EBIT Ratio	51%	55%	-12%	28%
EBITDA (€)	54,430,426	63,156,812	5,608,141	24,078,681

Entity: ***Grand Harbour Marina p.l.c.***

Grand Harbour Marina p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	85%	88%	91%	92%
Total Liabilities/Total Equity	576%	707%	977%	1128%
Equity Ratio	15%	12%	9%	8%
Interest Coverage	3.10	2.49	2.48	2.35
Liquidity				
Current Ratio	3.34	1.70	1.67	2.89
Profitability				
Return on Assets	2%	1%	-1%	-3%
EBIT Ratio	29%	31%	41%	35%
EBITDA (€)	2,200,000	2,730,000	2,780,000	2,560,000

Entity: *GO p.l.c.*

GO p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	53%	62%	65%	70%
Total Liabilities/Total Equity	113%	161%	183%	235%
Equity Ratio	47%	38%	35%	30%
Interest Coverage	39.46	21.80	18.55	12.19
Liquidity				
Current Ratio	0.70	0.63	0.96	0.98
Profitability				
Return on Assets	8%	4%	4%	3%
EBIT Ratio	19%	15%	12%	12%
EBITDA (€)	69,486,000	73,192,000	72,129,000	73,212,000

Entity: *BMIT Technologies p.l.c.*

BMIT Technologies p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	49%	51%	54%	58%
Total Liabilities/Total Equity	98%	104%	119%	137%
Equity Ratio	51%	49%	46%	42%
Interest Coverage	-	72.99	34.79	40.06
Liquidity				
Current Ratio	0.53	1.19	1.10	0.97
Profitability				
Return on Assets	33%	19%	19%	20%
EBIT Ratio	33%	33%	33%	33%
EBITDA (€)	9,300,000	10,000,000	10,508,000	10,655,000

Entity: ***Trident Estates p.l.c.***

Trident Estates p.l.c.				
	2018-19	**2019-20**	**2020-21**	**2021-22**
Gearing				
Total Liabilities/Total Assets	12%	18%	23%	37%
Total Liabilities/Total Equity	13%	22%	30%	59%
Equity Ratio	88%	82%	77%	63%
Interest Coverage	-	3.11	2.49	2.27
Liquidity				
Current Ratio	1.85	4.93	0.33	0.31
Profitability				
Return on Assets	2%	0%	1%	0%
EBIT Ratio	27%	42%	32%	29%
EBITDA (€000)	298	570	456	413

Entity: *RS2 Software p.l.c.*

RS2 Software p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	38%	56%	81%	47%
Total Liabilities/Total Equity	62%	126%	439%	87%
Equity Ratio	62%	44%	19%	53%
Interest Coverage	108.75	-1.38	-3.24	43.80
Liquidity				
Current Ratio	1.56	0.91	0.59	1.58
Profitability				
Return on Assets	12%	-10%	-16%	7%
EBIT Ratio	26%	-9%	-13%	17%
EBITDA (€)	7,846,000	-210,000	-1,464,000	8,760,000

Entity: *Tigne Mall p.l.c.*

Tigne Mall p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	43%	44%	41%	38%
Total Liabilities/Total Equity	75%	77%	71%	61%
Equity Ratio	57%	56%	59%	38%
Interest Coverage	9.14	7.61	6.41	10.40
Liquidity				
Current Ratio	0.57	0.60	0.76	0.92
Profitability				
Return on Assets	3%	3%	2%	3%
EBIT Ratio	63%	63%	53%	63%
EBITDA (€)	5,800,000	6,200,000	4,800,000	6,100,000

Entity: *Bank of Valletta p.l.c.*

Bank of Valletta p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	92%	91%	92%	92%
Total Liabilities/Total Equity	1122%	1061%	1099%	1175%
Equity Ratio	8%	9%	8%	8%
Interest Coverage	2.42	2.90	1.81	3.62
Liquidity				
Current Ratio	0.49	0.50	0.47	0.50
Profitability				
Return on Assets	0%	1%	0%	0%
EBIT Ratio	42%	49%	22%	43%
EBITDA (€000)	138,854	156,790	78,484	139,300

Entity: *Lombard Bank Malta p.l.c.*

Lombard Bank Malta p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	88%	88%	88%	88%
Total Liabilities/Total Equity	720%	722%	745%	706%
Equity Ratio	12%	12%	12%	12%
Interest Coverage	3.71	4.10	3.10	3.49
Liquidity				
Current Ratio	0.67	0.72	1.32	1.31
Profitability				
Return on Assets	1%	1%	1%	1%
EBIT Ratio	29%	32%	26%	27%
EBITDA (€000)	21,035	22,953	18,665	21,526

Entity: *HSBC Bank Malta p.l.c.*

HSBC Bank Malta p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	92.7%	92.8%	92.9%	93.2%
Total Liabilities/Total Equity	1276%	1283%	1307%	1365%
Equity Ratio	7.3%	7.2%	7.1%	6.8%
Interest Coverage	4.30	4.50	3.21	5.33
Liquidity				
Current Ratio	0.35	0.28	0.36	0.45
Profitability				
Return on Assets	0.5%	0.3%	0.1%	0.2%
EBIT Ratio	35%	28%	13%	26%
EBITDA (€000)	56,968	47,100	24,741	42,385

Entity: *Mapfre Middlesea p.l.c.*

Mapfre Middlesea p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	92.6%	93.8%	93.3%	92.2%
Total Liabilities/Total Equity	1251%	1503%	1382%	1176%
Equity Ratio	7.4%	6.2%	6.7%	7.8%
Interest Coverage	324.78	179.43	151.51	204.25
Liquidity				
Current Ratio	1.32	1.24	1.50	1.17
Profitability				
Return on Assets	0.6%	0.6%	0.5%	0.5%
EBIT Ratio	94.4%	91.9%	91.8%	84.5%
EBITDA (€000)	21,760	24,044	26,211	23,897

Entity: ***International Hotel Investments p.l.c.***

International Hotel Investments p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	46%	47%	50%	51%
Total Liabilities/Total Equity	84%	88%	100%	102%
Equity Ratio	54%	53%	50%	49%
Interest Coverage	2.29	3.65	-0.37	0.62
Liquidity				
Current Ratio	1.08	1.13	0.92	1.52
Profitability				
Return on Assets	0.5%	0.3%	-4.9%	-1.8%
EBIT Ratio	15%	13%	-54%	-12%
EBITDA (€000)	67,504	69,790	-13,240	15,932

Entity: ***Malita Investments p.l.c.***

Malita Investments p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	33%	32%	34%	42%
Total Liabilities/Total Equity	48%	47%	51%	73%
Equity Ratio	67%	68%	66%	58%
Interest Coverage	10.63	25.25	4.93	5.15
Liquidity				
Current Ratio	0.11	0.10	0.07	1.59
Profitability				
Return on Assets	6.1%	15.8%	3.8%	-8.2%
EBIT Ratio	189%	528%	96%	98%
EBITDA (€)	15,167,433	42,597,552	8,132,975	8,118,165

Entity: ***PG p.l.c.***

PG p.l.c.				
	2018-19	**2019-20**	**2020-21**	**2021-22**
Gearing				
Total Liabilities/Total Assets	55%	58%	53%	50%
Total Liabilities/Total Equity	123%	137%	111%	99%
Equity Ratio	45%	42%	47%	50%
Interest Coverage	22.52	11.19	14.49	17.08
Liquidity				
Current Ratio	0.51	0.51	0.68	0.92
Profitability				
Return on Assets	10.4%	9.4%	10.2%	10.9%
EBIT Ratio	12%	13%	13%	12%
EBITDA (€000)	14,230	17,813	19,023	20,997

Entity: *Simonds Farsons Cisk p.l.c.*

Simonds Farsons Cisk p.l.c.				
	2018-19	**2019-20**	**2020-21**	**2021-22**
Gearing				
Total Liabilities/Total Assets	37%	38%	36%	36%
Total Liabilities/Total Equity	58%	62%	56%	56%
Equity Ratio	63%	62%	64%	64%
Interest Coverage	18.74	16.57	12.00	17.70
Liquidity				
Current Ratio	1.63	1.57	1.89	1.45
Profitability				
Return on Assets	9%	6%	2%	6%
EBIT Ratio	15%	13%	8%	15%
EBITDA (€)	23,222,000	22,700,000	14,950,000	22,697,000

Entity: *Plaza Centres p.l.c.*

Plaza Centres p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	39%	36%	31%	31%
Total Liabilities/Total Equity	64%	55%	46%	44%
Equity Ratio	61%	64%	69%	69%
Interest Coverage	5.57	6.25	3.92	4.69
Liquidity				
Current Ratio	0.50	7.69	4.63	2.73
Profitability				
Return on Assets	2%	3%	1%	1%
EBIT Ratio	62%	64%	45%	44%
EBITDA (€)	2,584,905	2,864,323	1,931,369	1,632,068

Entity: Santumas Shareholdings p.l.c.

Santumas Shareholdings p.l.c.				
	2018-19	**2019-20**	**2020-21**	**2021-22**
Gearing				
Total Liabilities/Total Assets	5%	6%	6%	7%
Total Liabilities/Total Equity	6%	6%	7%	7%
Equity Ratio	95%	94%	94%	93%
Interest Coverage[13]	-	-	-	-
Liquidity				
Current Ratio	2.59	2.38	2.41	1.58
Profitability				
Return on Assets	5%	-7%	1%	-3%
EBIT Ratio	65%	-65%	32%	-133%
EBITDA (€)	531,595	333,393	71,182	172,916

[13] Santumas Shareholdings p.l.c. did not report any interest expenses/finance costs.

Entity: *MaltaPost p.l.c.*

MaltaPost p.l.c.				
	2018-19	**2019-20**	**2020-21**	**2021-22**
Gearing				
Total Liabilities/Total Assets	38%	42%	45%	45%
Total Liabilities/Total Equity	60%	71%	81%	82%
Equity Ratio	62%	58%	55%	55%
Interest Coverage	-	70.00	79.33	57.45
Liquidity				
Current Ratio	1.51	1.37	1.16	1.08
Profitability				
Return on Assets	5%	4%	3%	1%
EBIT Ratio	8%	8%	7%	3%
EBITDA (€000)	3,805	4,340	4,284	2,815

Entity: *MIDI p.l.c.*

MIDI p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	56%	56%	55%	55%
Total Liabilities/Total Equity	126%	126%	124%	120%
Equity Ratio	44%	44%	45%	45%
Interest Coverage	7.77	4.83	-0.41	0.85
Liquidity				
Current Ratio	2.70	3.01	2.93	2.79
Profitability				
Return on Assets	5%	4%	-1%	1%
EBIT Ratio	35%	42%	-43%	20%
EBITDA (€)	19,084,909	12,073,848	-961,310	2,110,226

Entity: ***Malta Properties Company p.l.c.***

Malta Properties Company p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	37%	37%	41%	39%
Total Liabilities/Total Equity	60%	58%	70%	64%
Equity Ratio	63%	63%	59%	61%
Interest Coverage	3.62	4.23	3.90	3.02
Liquidity				
Current Ratio	2.39	2.31	0.87	2.81
Profitability				
Return on Assets	13%	3%	3%	3%
EBIT Ratio	69%	62%	62%	57%
EBITDA (€)	2,287,539	2,136,099	2,145,910	2,090,707

Entity: *Main Street Complex p.l.c.*

Main Street Complex p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	13%	13%	12%	12%
Total Liabilities/Total Equity	14%	15%	14%	14%
Equity Ratio	87%	87%	88%	88%
Interest Coverage	12.79	524.47	268.40	534.59
Liquidity				
Current Ratio	0.80	1.13	1.45	2.19
Profitability				
Return on Assets	2%	3%	1%	2%
EBIT Ratio	65%	63%	44%	53%
EBITDA (€)	584,136	619,398	327,447	444,780

Entity: *FIMBank p.l.c.*

FIMBank p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	85%	85%	87%	87%
Total Liabilities/Total Equity	571%	571%	687%	698%
Equity Ratio	15%	15%	13%	13%
Interest Coverage	1.60	1.58	-1.39	1.16
Liquidity				
Current Ratio	0.95	0.97	0.97	0.95
Profitability				
Return on Assets	1%	0%	-3%	0%
EBIT Ratio	48%	37%	-33%	27%
EBITDA (€)	39,921,346	28,735,918	-18,816,129	14,645,320

Entity: *LifeStar Holding p.l.c.*

LifeStar Holding p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	87%	87%	89%	85%
Total Liabilities/Total Equity	646%	686%	802%	584%
Equity Ratio	13%	13%	11%	15%
Interest Coverage	3.97	5.11	-0.29	4.85
Liquidity				
Current Ratio	0.05	0.06	0.04	0.00
Profitability				
Return on Assets	0%	1%	0%	0%
EBIT Ratio	36%	73%	-19%	44%
EBITDA (€)	1,964,192	3,054,525	-145,967	2,678,332

Entity: *Harvest Technology p.l.c.*

Harvest Technology p.l.c.				
	2018	**2019**	**2020**	**2021**
Gearing				
Total Liabilities/Total Assets	53%	51%	41%	41%
Total Liabilities/Total Equity	113%	103%	71%	69%
Equity Ratio	47%	49%	59%	59%
Interest Coverage	26.30	25.90	37.36	75.48
Liquidity				
Current Ratio	1.16	1.25	1.42	1.49
Profitability				
Return on Assets	3%	10%	15%	12%
EBIT Ratio	6%	20%	24%	25%
EBITDA (€)	1,355,370	3,914,680	5,415,645	4,748,659

Entity: *Loqus Holdings p.l.c.*

Loqus Holdings p.l.c.				
	2018-19	**2019-20**	**2020-21**	**2021-22**
Gearing				
Total Liabilities/Total Assets	70%	77%	69%	57%
Total Liabilities/Total Equity	234%	336%	222%	135%
Equity Ratio	30%	23%	31%	43%
Interest Coverage	5.62	4.10	9.71	22.81
Liquidity				
Current Ratio	0.38	0.45	0.62	1.00
Profitability				
Return on Assets	3%	-1%	11%	12%
EBIT Ratio	11%	3%	18%	15%
EBITDA (€)	1,174,395	1,123,106	2,544,089	2,736,463