Department of Business and Management

Master Degree in Management

Chair: Financial Reporting and Performance Measurements

IFRS 16: the impact of lease accounting on the GEDI Group Performance

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Table of Contents

LIST OF FIGURES

LIST OF TABLES

INTRODUCTION

The introduction of the new International Financial Accounting Standard 16 has impacted in a significant way the accounting of leases for listed companies. The difference between Operating and Financial leases is not present anymore, as it was under IAS 17, and this contributed to the recognition of new assets and liabilities that were kept off-balance sheet with the previous accounting standard. The aim of this thesis is to explore the impact of the new standard IFRS 16 on financial statements and on the key financial ratios computed by investors and analysts when evaluating a company's performance.

The first chapter is a theoretical analysis on the evolution of lease accounting and the normative process developed until the introduction of IFRS 16 on January 1st, 2019. The IASB and the FASB started a joint project as a result of the main concerns regarding the accounting of leases under IAS 17 and, after the publications of several documents, the two boards released the final standard that implies the recognition of a right of use asset and a related lease liability. The main goal of IFRS 16 is to overcome the limitations of the accounting method implied by IAS 17, therefore, to allow comparability among companies' statements in order to reach a faithful comparison and to improve the quality of financial reporting. Two main exceptions are allowed by the standard in order to avoid the capitalization model: the short-term and the low-value exception. In order to facilitate the transition from IAS 17 to IFRS 16, two approaches are allowed: the full-retrospective approach and the modified retrospective approach, with the possibility of using the interest rate implicit in the lease or the incremental borrowing rate in the process.

The second chapter focuses on the reasons for the adoption of IFRS 16, its implications on financial statements and financial ratios and the main advantages that it brings compared to IAS 17. Even though the introduction of the new standard will bring some costs to companies, especially regarding its implementation, especially, costs related to the acquisition of new systems and the training of employees, the benefits will outweigh these costs according to the *Effect Analysis* conducted by the IASB. The Balance Sheet is the financial statement that will be impacted more, since both an asset and a liability will be recognized under IFRS 16, that were not present under IAS 17, as a consequence particularly balance-sheet based financial ratios will differ compared to before. The changes that IFRS 16 will bring will result in an increase of comparability of financial statements and an improvement in the quality of information presented. Previously, the majority of leases, were classified as operating ones and therefore, were kept off-balance sheet, making harder the comparability between companies that classified leases in different ways.

The third Chapter is an experimental analysis on the effects of the accounting changes on leasing on an Italian listed company. GEDI is an Italian publishing group active in different sectors of communication: press, radio, advertising and digital. In order to analyse how the new standard impacted the financial statements and the overall evaluation of the company, firstly a comparative analysis of financial statements for the years 2018 and 2019 was conducted, with a focus on the items that were introduced in 2019 because of the new standards, and those items that changed the most, then a performance analysis was developed, both the profitability analysis and the liquidity analysis showed interesting differences as a result of IFRS 16, finally the fundamental analysis was computed to explore the effect on valuation models by investors and analysts. As a result of an interview with the CFO of the GEDI Group, the main difficulties and benefits derived from the application of the new standards were described.

CHAPTER 1

1. Lease contracts

A lease contract is an economic transaction that entails two parties, the lessee and the lessor. The lessor is the entity that owns the asset and, in exchange of a compensation gives the lessee the right to use it for a limited period of time.[1] In legal terms, a lease contract is between an entity and a non-bank financial contract that operates in the leasing business, however according to financial accounting standards the scope of the definition of leasing is broadened to all those contracts that entails a right to use the asset such as rental agreements and hire charges.[2]

Leasing has been a valid alternative to purchasing and to financing for decades and has became widely diffused in the last years, since almost any kind of equipment can be leased instead of purchased. This kind of financing is the principal source of foreign financing in America (Taylor, 2011), followed by bank loans and commercial mortgages. Lease contracts are popular in every kind of business and are especially useful when companies do not have enough financial liquidity to buy the assets.[3] In 2015, the annual volume of leasing amount to more than $1 trillion (White Clark Group, 2017).

A leasing decision compared to an acquisition one is made if the former can give an advantage both to the lessor and the lessee. A lessor can be any person or entity that owns an equipment, such as corporations, small businesses or individual persons. Likewise, any person or entity that needs an equipment can be a lessee, even though certain skills and expertise may be required in order to be able to use the equipment leased. Usually lessors are grouped in these main categories: individuals, independent leasing companies, lease brokers, captive leasing companies and banks.

The type of lease can vary depending on its nature, the two main classification regards financial and operating leasing. A financial lease implies a long-term lease contract, in which the total payment is almost equal to the acquisition cost, the decision is made by the financial unit of the company and all the risks and rewards of the ownership are relocated to the lessee.[4] By process of elimination, all the leases that are not financial are operating. Financial leases can be further sub-divided into net finance lease, leveraged lease or non-leveraged lease.

Before the decision of whether lease an equipment or buying it is made, an evaluation of pros and cons needs to be prepared. Depending on the circumstances and on the different situations, advantages of a lease contracts can outweigh those of purchasing or vice-versa.

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[1] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16.
[2] Sacarin, M. (2017). IFRS 16 "Leases" - consequences on the financial statements and financial indicators.
[3] Liviu-Alexandru, T. (2018). The Advantages that IFRS 16 Brings to the Economic Environment.
[4] Mirza, A. A., & Holt, G. J. (2011). Chapter 11 Leases (IAS 17).

Leasing can be convenient for those equipment that may become obsolete before the end of their useful life. By leasing it, the company will not have concerns regarding the likely loss of value. Leasing an equipment required only for a certain period of time can be suitable instead of buying it. Other advantages can be found in the preservation of capital for other uses, in obtaining specific services that the company is not able to perform, in tax benefits and in respecting budget limitations.

However, by deciding to lease an equipment the lessee may lose certain gains derived from the appreciation of the equipment. The control over the equipment may be limited and when the term expires the lessee can have troubles in finding an alternative. [5]

In sum, leasing is a critical component of all kinds of firms, ranging from public, private, smaller, bigger and not-for-profit organizations. To lease an asset can be a valid alternative than buying it and an efficient way of having access to it without carrying risks derived by the ownership of the asset. Asset leasing is widely spread nowadays, and for this reason it is crucial to understand the implications and the effects derived from its classification. [6]

An important component of lease contracts is the lease term that is “the non-cancellable period of a lease” including the options to extend and to terminate the lease if the lessee is reasonably certain to exercise or not the option. The options depend on the estimations made by the company at the signing of the contract. The options of extensions and termination can be in favour of the lessee, in favour of the lessor or in favour of both. The difference stands on who has the right to terminate the lease. The choice should be made when estimating the lease term unless the option is in favour of both the lessor and the lessee.

A purchase option can be contained within the lease contract and the same criteria of reasonably certain applies also to this option. The concept of “reasonably certain” is subjective and requires judgement, however, it should be understood as having a higher probability of happen. The penalty that may be included in case of termination of lease must be included in the cash flows of the lease.

When estimating the probability of extension and termination, there are a number of aspects to be taken into account:

- The terms and conditions of the extension/termination options in relation to the market rates
- The possible improvements of the lease that can lead to economic benefits and therefore be an incentive to exercise the extension or purchase option.
- Termination costs of the lease, for instance, negotiation costs, termination penalties, relocation costs.
- The dependence of the lessee’s operation on the underlying asset

[5] Contino, R. (1996). Handbook of Equipment Leasing : A Deal Maker’s Guide.
[6] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.

- The conditions attached to the exercise of the option

Estimating the extension or termination options is a difficult challenge for companies since judgment and discretion are required. [7]

2. Regulatory Evolution and background: from IAS 17 to IFRS 16

On September 1982 the International Accounting Standard (IAS) 17, that ruled the accounting of leasing was introduced.[8] IAS 17 was then issued in 1994 by the IASC, International Accounting Standards Committee, then replaced by the IASB in 2001. The IASB is the International Accounting Standard Board, the international body that set and governs accounting standards in Europe. The aim of the IASB is to harmonize different accounting models to increase compatibility and comparability of financial statements. For this reason, all listed companies in the European Union are obliged to follow International Financial Reporting Standards (IFRS) issued by the IASB since January 1, 2005,[9] according to the Regulation of the European Parliament and Council of 19 July 2002 (EC) No 1606/2002. The IASB main purpose is to make investors and decision-makers able to take the best conclusions after being able to analyze and compare in the most transparent way possible all the available information. [10]

Since 2010, the IASB is working together with the FASB (Financial Accounting Standard Board) to issue a new standard that is going to replace IAS 17. The process was completed January 13rd, 2016, indeed the new standard is called IFRS 16 and it is mandatory for all listed companies since January 1st, 2019.

Even before the decision by the IASB and the FASB of working together on a common project, the accounting of leases was a crucial topic very debated. As a matter of fact, in 1996 the G4 proposed a document that recalls the new standard issued 10 years later and in 2005 the SEC interrogated the implications of lease accounting. These evaluations and analyses demonstrated that the majority (almost 63%) of listed companies prefer to report operating leases instead of financial ones, and therefore, underestimating assets and liabilities based on subjective judgements. [11]

[7] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.
[8] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases
[9] Branswijck, D., Longueville, S., & Everaert, P. (2011). The Financial Impact of the proposed amendements to IAS 17: evidence from Belgium and the Netherlands.
[10] Sacarin, M. (2017). IFRS 16 "Leases" - consequences on the financial statements and financial indicators.
[11] Giner, B., & Pardo, F. (2018). The Value Relevance of Operating Lease Liabilities: Economic Effects of IFRS 16.

3. Normative Process of IFRS 16

The normative process aimed at developing a new accounting standard for leases persisted ten years, in the course of which several documents, analyses and evaluations were made. In 1996, the G4 + 1 together with the IASC and the FASB issued a document suggesting reconsidering the capitalisation of operating leases, that was possible only for financial leases under the IAS 17. The process continued nine years later, in 2005 when the SEC (Securities and Exchange Commission) suggested to revise the standard. The main reason why the SEC made this recommendation was because of the main scandals associated with off-balance sheet leases that hit US economy in the 2000s such as the Enron case.[12] Following this suggestion, the IASB and the FASB started working together and meet in March and April 2006 while their project was approved in July 2006.

The first draft standard was published four years later, in 2010 and then revised in 2013. The draft was given a critical hearing by prepares of financial statements that were against possible changes in accounting models and send letters in response to the Exposure Draft questioning its benefits and costs.

The press accused some important Spanish companies such as Santander, BBVA, Inditex, Telefonica, Iberia, Repsol, NH Hoteles and El Corte Ingles of lobbying for the keeping of IAS 17 against the new standard. They believed that the changes would imply negative effects for them such as a decline in investments, an increase in costs and debts and a decay in ratings. Media accused even the Ministry of Economy of Spain of supporting these companies, together with the European Commission. [13]

The normative process implied the publication of three documents: one DP and two Exposure Drafts. Following the due process, before publishing these documents, the IASB submitted them to public scrutiny. After the evaluations, an analysis of expected effects was conducted in 2016, the document showed that listed companies that follows IFRS or US GAAP standards have a large amount of off-balance sheet debt especially those operating in the air, retail, travel or leisure industries.

The DP published in 2009, the one that eliminates the distinction between financial and operating leases, received 302 comment letters, the majority of which came from preparers. The following Exposure Draft issued in 2010 was the most questioned one, with 786 comment letters, the majority of which came again from preparers. The Board took into consideration these comments and issued a second draft in May 2013 with major differences compared to the first one. The draft was commented by 641 letters once again mainly from preparers. [14]

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[12] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.
[13] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.
[14] Giner, B., & Pardo, F. (2018). The Value Relevance of Operating Lease Liabilities: Economic Effects of IFRS 16.

In summary, the main publications by the IASB during the process of implementation of the new standard IFRS 16, were the following: the Discussion Paper of 2009, the Exposure Draft of 2010, and the Revised Exposure Draft of 2013. The publications were driven by the thousands comment letters received that lead to a substantial number of meetings with all the interested parties, investors, analysts, preparers, regulators, standard-setters, accounting firms and others, and several round tables.[15]

The first adoption of IFRS 16 is on January 1st, 2019, however companies can begin to develop their financial statements according to this standard before, as long as they apply also IFRS 15 *Revenue from Contracts with Customers.* [16]

4. IAS 17

The main characteristic of International Accounting Standard (IAS) 17, entails the distinction between operating and financial leases by the lessor, the owner of the asset and the lessee, the holder of the right to use the lessor's asset.

4.1. Operating lease

The operating lease is characterized by the failure of demonstrating that a financial lease exists. Indeed, all the leases that do not enter into the definition of financial ones, are considered to be operating leases. The operating lease is a pure rental agreement. According to IAS 17, when a lease is considered an operating one, there is no need to raise an asset and a liability in the balance sheet, since the risks and rewards are not transferred to the lessee but instead are kept by the lessor. For what concerns the income statements instead, an expense for the lessee and an income for the lessor are recognized, both as a lease rental expense and a lease rental income.[17] Indeed, companies benefit from the accounting of operating leases, since they can exclude lease assets and liabilities from the balance sheet, and prefer to classify leases as operating instead of financial ones.[18] In 2016, 85% of leases of listed companies in the world, that totalled to €3 trillion worth, were classified as operating leases and indeed were not present in the balance sheet (Hoogervorst, 2016).

Operating leases are also disclosed in the notes of annual financial statements that showed the lessee's future cash flow commitments respectively 12 months after the financial year-end, and between 1 and

[15] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*
[16] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.
[17] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases
[18] Branswijck, D., Longueville, S., & Everaert, P. (2011). The Financial Impact of the proposed amendements to IAS 17: evidence from Belgium and the Netherlands.

5 years from the year-end. The disclosure was meant to notify possible cash flows implications and to forecast future operating commitments and was not linked to assets and liabilities in the balance sheet. The note showed the effect of capitalization of an operating lease by applying methods of present value or a factor technique by multiplying rent expense by a fixed multiplier, however, these methods are very difficult to apply and can lead to errors.

An upgrading of IAS 17 concerning operating leases was release in 2005, lease income and expenses in the income statement had to be recognised on a straight-line basis. The main effect of this update is that financial statements started to show an average of lease income and expense.

4.2.Financial lease

The definition of a financial lease is based on the risks and rewards of the ownership of the asset that in this case are wholly transferred from the lessor to the lessee. Other factors to take into consideration when defining a financial lease are: the transfer of ownership to the lessee at the end of the lease, the degree of specialism of the asset, the length of the lease in comparison to the life of the asset, the present value of the contracted lease payments that is the fair value of the asset, the useful economic life of the asset that is held by the lessee, the losses incurred by the lessee at termination of the agreement, the gains and losses of fair value that are on the lessee and the possibility that the lessee has of renting the asset at a lower market rate at the expiration of the term.[19]

Contrary to operating leases, IAS 17 required financial leases to recognize both an asset and a liability in the balance sheet. Therefore, the different accounting methods stand on the substance of the transaction and not on its legal form. The finance lease is considered an "in substance" purchase from the side of the lessee and a sale from the side of the lessor. Companies prefer not to classify leases as financials since this classification implies the recognition of an asset and a liability in the balance sheet that would have been kept off in case the lease was classified as an operating one. Nevertheless, there is a benefit associated with the classification of a lease as a financial one. The capitalization of the asset can give rise to a tax benefit due to the expense, the interest and the depreciation associated with it.[20]

[19] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.
[20] Branswijck, D., Longueville, S., & Everaert, P. (2011). The Financial Impact of the proposed amendements to IAS 17: evidence from Belgium and the Netherlands.

4.3.Critics with IAS 17

The distinction between operating and financial leases implies a certain level of subjectivity from the lessee side, since different lessees may use different indicators and reach different decisions that will have a significant impact on the balance sheet. The lessee that after an individual analysis, choses to classify its lease as an operating one would have no impact on the Balance Sheet, and on its Income Statement would appear only a rental expense representing the average expense and not the actual operating cash flow. From the other hand, the lessee that recognizes a financial lease will have an asset and a related liability on its balance sheet as well as the depreciation of the asset and the interest expense on the loan on its Income Statement. [21] Operating and financial leases that are accounted in different ways are not economically different, therefore, as a bright-line test demonstrates different lessees can treat the same lease differently based on their needs and interests.[22] The International Accounting Standard 17 hence, let managers the possibility to structure their leases as to exclude them from their balance sheet and take advantage of the lower liabilities that will result.[23]

The comparability of financial statements published according to IAS 17 is limited since in the Balance Sheet is not possible to have a whole depiction of the situation of assets and liabilities, indeed it does not represent the reality. As a matter of fact, investors rely on the other financial statements, the Income Statement and the Cash Flow Statement, but this does not allow them to take the best decisions. [24]

The fact that certain leases are recognized in the balance sheet while others, operating leases, are off balance sheet leads to a lack of comparability of financial statements and financial ratios as well as a representation that is not faithful. For example, two companies may need and use the same asset, but the first company will lease it, while the second company decides to purchase the asset through a loan, comparing financial statements and ratios will be very complicated and would not respect the reality of facts.

Many authors such as *Duke at al. (2009)*[25] critic the fact that numerous companies take advantage of operating leases in order to keep assets and liabilities off balance sheet, and as a result capital leases fell. An estimation carried by *Beattie et al. (2000)* suggested that operating leases are thirteen times larger than financial ones. [26] The benefits of operating leases derived from the fact that those result in better profitability ratios and lower debt ratios. However, investors consider operating leases as

[21] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases
[22] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.
[23] Branswijck, D., Longueville, S., & Everaert, P. (2011). The Financial Impact of the proposed amendements to IAS 17: evidence from Belgium and the Netherlands.
[24] Sacarin, M. (2017). IFRS 16 "Leases" - consequences on the financial statements and financial indicators.
[25] Duke, J., Hsieh, S., & Su, Y. (2009). Operating and synthetic leases: Exploiting financial benefits in the post-Enron era.
[26] Beattie, V., Goodacre, A., & Thomson, S. (2000). Operating leases and the assesment of lease-debt substitutability.

liabilities with the same risk on valuation models, debt ratings and bond yields as financial leases. [27] The reasons why they do so may be justified by the facts that perceptions by the market may differ due to the position of information or by errors when calculating the off-balance liabilities. Therefore, we can conclude that investors do not undervalue the liabilities derived from operating leases when assessing bond yields. [28]

Despite the benefits associated with classifying leases as operating ones, financial leases may lead to tax benefits due to the larger amount of expenses and interest tax depreciation, while the expense recognized by the operating lease will be just that of the lease payment expense.

Nevertheless, by classifying a lease as a financial one, financial ratios especially debt covenants may be negatively affected especially for large firms with more financial constraints.

Firms that prefer to classify leases as operating ones, and indeed have more off-balance sheet debt, prefer to use covenants and income statement ratios instead of balance sheet ratios, compared to firms with low levels of off-balance sheet debts.

Before IAS 17, firms used in almost an equal amount both operating and financial leases, while after the issuance of the standard they prefer to recognize leases as operating ones in order to take the advantages derived from their classification. This benefit is enjoyed especially from firms with information asymmetry or poor accounting quality.

Investors and analysts need information present in the financial statements in order to take the best decisions, under IAS 17, the material present in the statements is not sufficient since it does not depict the reality of the assets and liabilities of a company. For this reason, and for comparing statements among companies, investors and analysts need to incur in additional costs in order to adjust the information present in the financial statements with the ones on the note that refer to operating leases left out from the statement of financial position. This adjustment procedure may lead to errors and to the overestimation of debts, since liabilities in the notes are not discounted as opposed to liabilities of financial leases that are discounted in the balance sheet.

5. IFRS 16

5.1. Introduction and goal

The introduction of the International Financial Reporting Standard (IFRS) 16 brings a radical change in the way leases are accounted and in the disclosure of annual financial statements, the distinction between operating and financial leases no longer exists and all leases are recognized and measured as

[27] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.
[28] Giner, B., & Pardo, F. (2018). The Value Relevance of Operating Lease Liabilities: Economic Effects of IFRS 16.

financial ones. Hence, just one method for accounting is now possible instead of the two used under IAS 17.

The main goal of IFRS 16 is to overcome the limitations of the accounted method implied by IAS 17, therefore, to allow comparability among companies' statements in order to reach a faithful comparison and to improve the quality of financial reporting. The new accounting model will have implications on financial statements and as a consequence on financial ratios, that are crucial indicators of a company's performance and are taken into consideration when making strategic decision, to inform stakeholders and when considering possible investments. [29] Existing and possible investors will make decisions based on information that are more transparent, comparable and of high quality compared to before, thus, accomplishing a more complete analysis of the performance of companies. This is possible due to the improvement of the disclosure of those assets and liabilities that before were not recognized. [30]

The IASB and the FASB expects users to present their financial statements in a more transparent, understandable, and faithful way compared to before, by increasing their efficiency, their alignment with the FASB Concept Statement no.8 and their clarity to the recognition of leases.[31]

The expected impact of the new standard IFRS 16 will be different depending on the kind of companies and their estimations. Nevertheless, companies' aim will be that of minimizing the impact of the new standard on the leverage level. The effects will be larger for those companies that have higher operating lease intensity as in the case of airlines, retails and hotels sectors. [32]

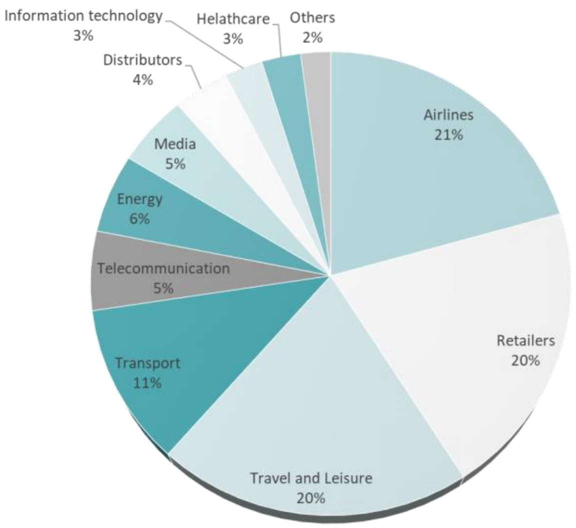

Figure 1 - Future Payments for off balance sheet leases/total assets per industry sector

[29] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases
[30] Sacarin, M. (2017). IFRS 16 "Leases" - consequences on the financial statements and financial indicators.
[31] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.
[32] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.

Some studied analyzed the impact of the new accounting standard on stock exchange, however the results suggest that investor used to recognize and value both debts and liabilities in the footnotes of financial statements also under IAS 17.[33]

The effects of the new standard will be only on the part of the lessees, while from the lessors' point of view, no changes will be present compared to IAS 17, since the classification and recognition of lease arrangements will not change for them. [34]

5.2.Capitalisation model

The capitalisation model, i.e. the way leases are accounted imply the recognition of a Right of Use (ROU) and a matching Lease Liability in the balance sheet. This new model will drastically change the effects on financial ratios and on financial statements, compared to the accounting model used under IAS 17. [35]

Financial statements, and therefore financial ratios that derive from it, are a fundamental source of information for investors in order to make the best decisions. Different accounting systems across countries make this task harder for investors that need to compare statements developed according to different rules and standards. To accomplish this duty, investors incur in additional costs, for this reason there is a common need for the harmonization of different accounting standards especially for users from different countries. International Financial Reporting Standards IFRS, that is a single set of accounting standard, has the aim of increasing the comparability among financial statements of public traded companies. Researches show that the implementation of IFRS reduces the gap in information between informed and uninformed investors, and more and more countries are adopting these standards.[36]

5.2.1. Right of use

The Right of Use (ROU) asset recognized in the balance sheet is the economic resource to be capitalized. Initially the asset is recognized as the same amount of the corresponding liability plus other costs such as the lessee's initial direct costs, prepayments made to the lessor, estimated costs of restoration, removal and dismantling and less the incentives given by the lessor. Afterwards, the

[33] Giner, B., & Pardo, F. (2018). The Value Relevance of Operating Lease Liabilities: Economic Effects of IFRS 16.
[34] Sacarin, M. (2017). IFRS 16 "Leases" - consequences on the financial statements and financial indicators.
[35] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases
[36] Bohusova, H. (2015). Is Capitalization of Operating Lease way to increase of comparability of Financial Statements prepared in accordance with IFRS and US GAAP?

asset is amortized and impaired under IAS 16 and IAS 36. For following measurements of the asset, the revaluation/fair value model can be applied as implied under IAS 16 and IAS 40. The new standard points out that if a lessee uses the fair value method to an investment property, then the lessee in question, should use the same method to the ROU asset that is considered an investment property. The same should happen with a lessee that uses the revaluation model for property, plant or equipment under IAS 16. [37]

5.2.2. Lease Liability

The Lease Liability recognized in the balance sheet and associated to the corresponding Right of Use asset, represents the obligation to transfer an economic resource and is calculated as the present value of future lease payments discounted at the rate applicable to the contract by using the effective interest rate method. [38] The interest is calculated by determining the discount rate at lease commencement, and by reducing the liability as payments are made.

It can happen that during the lease liability's life there is the need to remeasure the liability, in order to do so the right of use should be recognized against the difference between the old and the new liability. There are three cases that ask for a remeasurement of the lease liability: the first case is when there is a change in the lease term or in the evaluation of an option to purchase the asset, in this situation a revised discount rate is used to discount the new estimated cash flows. The second case is when there is a change in future lease payments, that can come from a variation in the index or rate used to estimate the payments. The third case happens when there is a change in the amounts to pay under a residual value guarantee. In both the second and the third case the remeasurement of the liability is estimated by discounting the new estimated cash flows using the initial discount rate.

In the case in which the estimation of an option to extend or to terminate change, the entity needs to calculate a new liability with a new discount rate to discount the new cash flow and recognize the difference between the new and old liability against the asset.[39]

5.3.Reasons for the adoption of IFRS 16

The IASB and the FASB decided to start a joint project on leases as an answer to the main alarms that several bodies reported on the lack of transparency of information of financial statements between companies. One of this worry came from the SEC, the US Security and Exchange Commission that

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[37] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.
[38] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases
[39] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.

after an analysis, found out that in the financial statements of US companies were present almost 1.25$ trillion of off-balance sheet leases.

One of the reasons why the SEC suggested the IASB and the FASB to develop this project, was the number of scandals that affected the US economy at the beginning of the 2000s, especially the Enron scandal that broke out in 2002 because of the high number of off-balance sheet leases.[40]

Other whys and wherefores leading to the issuance of IFRS 16 were the substantial number of complaints of unsatisfaction regarding the recognition, measurement, presentation and disclosure of lease assets.[41]

5.4. Lessor Accounting

Overall, the effects on the lessor's accounting when implementing IFRS 16 are not relevant, since few changes will occur for them. The lessor is required to disclose additional information for users of financial statements and will benefit from the advantages of the new accounting model, indeed better information will be provided, especially concerning the lessor's exposure to risks, even though additional costs may be present. The IASB binds lessors to disclose three main requirements: the components of their lease income, since the lease is part of the revenue-generating activities of lessors, this requirement will not create additional costs for them. The second requirement deals with the disclosure of the risk management associated with the lease that is beneficial to users in the assessment of the risk, and it requires judgment from the lessor's side in order to decide which and how to disclose information. The third requirement is the disclosure of the separation between operating leases and those owned and held by the lessor for other purposes. This information is useful for users of financial statements as the asset may be associated with different risks depending on the use of the lessee or the ownership of the lessor, and as it generates rental income. Also, for this requirement no additional costs will be incurred by the lessor.[42]

5.5. Non-lease components

When a lessor signs a contract with the lessee, the agreement includes the lease component and it may as well include a non-lease component and a third class of items unrelated to the transfer of the asset from the lessor to the lessee. Non-lease components are typically services or supplies associated to the lease such as the maintenance for a car or the cleaning service for the lease of a building. Paragraph 12 of IFRS 16 states that entities should divide lease components from non-lease components, and

[40] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.
[41] Veverkova, A. (2019). IFRS 16 and its impact on Aviation Industry.
[42] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*

therefore, account for them separately and in different ways. The capitalisation model is used for lease components: the recognition of a right of use asset with a corresponding lease liability in the balance sheet. For what concerns non-lease components, the accounting method depends on the nature of the component, services are recognized as expenses using the straight-line basis.

In order to be able to separate lease components from non-lease components, IFRS suggests to use the aggregate stand-alone price of the leases and of the non-leases, even when the breakdown is not disclosed. Regarding the third class of items, such as fees or administrative costs, IFRS indicates that these components should not be separated, as in the case of non-lease components, instead are part of the total consideration. In this third class of items are included also those payments that are considered a reimbursement from the lessee to the lessor, given that they are variable payments.[43]

5.5.1. Practical expedient

Under IAS 17, entities would not separate lease components from non lease components and would account for them in the same way. With the implementation of IFRS 16, companies are required to make an additional operational effort in order to separate each component. However, paragraph 15 of IFRS 16 allows for a practical expedient in order to reduce this effort. An entity could group assets of similar nature and use, called underlying assets, and not separate non-lease components, but as an alternative account for each lease separately, as a single component. The drawback of this expedient is the increase in assets and liabilities and in lease payments. Therefore, if the aim of a company is to minimize the capitalisation of leases, it should use the practical expedient for underlying assets that cannot separate. The practical expedient will result in a cost benefit and a reduction of complexity without causing damages to the comparability of financial statements between companies. However, its use is convenient only when the service components are small, otherwise it will result in an increase of liabilities.

5.6.Exceptions

The two exceptions that give the right to the lessee to avoid the capitalization of the asset as a Right of Use and a lease liability, are the short-term exception and the low value exception. [44]As capitalizing less leases results in less operational costs, companies try to use alternative ways of accounting such as the exceptions described below. These exceptions are voluntary, meaning that a company can decide whether or not to benefit from them. When the entity decides to apply the exceptions, the capitalisation

[43] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.
[44] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases

model is no longer used and there is the recognition of an expense on a straight-line basis as under IAS 17 for operating leases.

The reason why the IASB allows for these exceptions is related to the costs of applying the standard requirements to large volumes of small items.[45]

5.6.1. Short term exception

Short-term leases are those leases that have a length of 12 months or less, in this case the costs of applying the capitalisation model would exceed the benefits. The exception can be used for a class of underlying assets and it is not applicable when the lease contract contains a purchase option. Generally, all companies that are in the conditions of applying this exception would benefit from it, since the result would be that of reducing operational costs and the impact on leverage ratios.

5.6.2. Low value exception

The low-value exception gives lessees the right to not recognised a ROU asset and a related lease liability on their balance sheet only for those leases of low value when new. The choice should be made on a lease-to-lease basis and the assessment on each separate lease component.[46] This exception implies a subjective judgment as no specific definition of low value is provided by IFRS 16. However, the audit company KPMG suggests a threshold of 5000$ in order to consider an asset of low value, but this amount may be different depending on the country, the currency and other circumstances. The IASB offers some examples of assets that may be considered as of low value, such as tablets, laptops, telephones or small furniture, but it is still up to each company and its discretion to assess whether an asset is of low value or not. The assessment should not be different among companies, even the smallest one or large multinationals should consider leases in the same way.

The purpose of the exception is to include those low value assets that are leased in high volumes, hence, not recognizing the liabilities that may be substantial in case of large amounts. This exception could incentivize companies to lease low value assets instead of buying them in order to attain off balance sheet accounting as used to happen with operating leases under IAS 17. [47]

As in the case of the exception for short-term leases, also this exception is expected to be widely used since the result would be a reduction of costs. However, there are some cases that may lead

[45] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*
[46] Morales-Diaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.
[47] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases

companies to not voluntary benefit from these exceptions. Some companies may use IFRS financial statements even if they are subsidiaries of a parent company that is under US GAAP, since under ASC Topic 842 the low-value exception does not exist, in order to reduce the difference between the two set of standards, also subsidiaries companies would not use the exception.

When a company decides to apply the capitalisation model instead of the exception, it will reduce operational expenses (that are recognized under the exceptions) in relation to total asset. If the performance of a company is based on the relation between expenses and investments, then applying the capitalisation model can be a way of improving this ratio. However, also liabilities would increase in the balance sheet.

Other companies may prefer to have an increase in assets and liabilities, rather than an off-balance sheet treatment in order to avoid the complexity and the costs associated with having two different accounting systems. [48]

5.6.3. Intangible assets

The lease of intangible assets is another voluntary exception allowed under IFRS 16. The difference between this exception and those concerning low-value assets and short-term assets stands on the accounting model. For the previous one the capitalisation model would be replaced by a straight - line recognition of operating expenses, while this exception is applied to all the standard requirements. Indeed, IFRS 16 can not be applied for those assets that meet the definition of intangible assets under IAS 38, items such as video recordings, patents or software.

The reasons behind this exception are not conceptual, but the IASB explains the need for a deeper analysis on intangible assets before including its accounting under IFRS 16. Also in this case, companies are expected to take advantage of this exception in the majority of cases.

5.7.Transition options

IFRS 16 suggests two different approaches in order to facilitate the first adoption of the new standard: the full retrospective approach and the modified retrospective approach.

5.7.1. Full retrospective approach

The full retrospective approach implied the restatement of financial statements previous to the application of IFRS 16, therefore those of 31 December 2018, since the new standard is mandatory from January 1st, 2019. Hence, a company should present comparative financial statements and

[48] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.

opening balance sheet of 2018 and applying the new standard as of 2019. This approach implies the recalculations of all lease entries. With the restatement of financial statements, both year 2018 and 2019 would be calculated as under IFRS 16. This methodology would be even more complicated when there has been changes in cash flow caused by changes in the Consumer Price Index or in the estimations, since the company needs to estimate the initial discount rate for each lease.

The main effects of this approach are negative since there will be a negative equity impact and net of taxes. The negative impact on equity is given from the fact that lease liabilities will be higher than lease assets, since even if they start with the same amount at commencement date, then the asset is depreciated on a linear basis and the liability is amortised on an incremental basis. Conversely, if the asset was higher than the liability at commencement date, the impact on equity could not be negative. [49]

The main advantage of the full retrospective approach is that the restatement of comparative data allows greater comparability of impacts with previous periods. However, the main disadvantages regard the operational complexity linked to the acquisition and availability of the required information needed in order to determine the impacts. Another negative aspect is that chargers and timing is long in order to determine the impacts and this is because there is the necessity to acquire historical information of contracts and discount rates from the starting period of the contract.

5.7.2. Modified retrospective approach

From the other hand, the modified retrospective approach, does not require companies to restate their financial statements previous to January 1st 2019. Therefore, companies will start to apply the new standard in 2019 by discounting future lease cash flows by using the current discount rate.

The lease asset can be accounted with an amount equal to the lease liability that is previously adjusted for prepaid or accrued lease payments, or the lease asset can be accounted using a current discounting rate and depreciating the asset from the beginning of the lease. As in the full retrospective approach, also in this case the impact on equity will be negative on the opening balance sheet.

Before deciding which method to use, companies can compare the full retrospective approach with the two way for accounting lease asset in the modified retrospective approach, to see which methodology gives them the best results. The three factors to consider when choosing the best approach are: the net equity effect, the amount of lease assets and the amount of lease liabilities.

[49] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.

In the modified retrospective approach in which the right of use equals the lease liability with the retrospective recalculation on specific contracts, the main advantage is the possibility to choose lease by lease how to calculate the impacts in the transition phase, reducing the expensiveness of the retroactive calculation only at some leases. The main disadvantage concerns the fact that the restatement of comparable data is not required, indeed there is less comparability with previous periods.

Regarding the modified retrospective approach where the right of use equals the future lease liability, the main advantage is that the timeline is less intrusive, since there are specific facilitations allowed by IFRS 16 in the way the calculation is made at the date of transition.

5.8. Discount rate

The discount rate is needed in order to calculate the initial value of the asset and the liability of the lease, indeed, to discount future lease payments. IFRS 16 recommends companies to use the interest rate implicit in the lease, however the gathering of information needed to determine this rate can be difficult since historical data are crucial, and in alternative companies can use the incremental borrowing rate.

As the discount rate increases, the initial value of both the lease asset and the lease liability would decrease while the interest expense would increase, the depreciation charge would decrease, resulting in a more decreasing total expense structure over the lease life. Conversely, as the discount rate decreases, the initial value of the right of use asset and of the lease liability would increase, the interest expense would decrease while the depreciation charge would increase, resulting in a less decreasing total expense structure over the lease life.

The assumption of the discount rate requires judgment by companies, and it will have a vital impact on the assessment of leased assets and liabilities.[50]

5.8.1. Interest rate implicit in the lease (IRIIL)

The interest rate implicit in the lease is "the rate of interest that causes the present value of the lease payments and the unguaranteed residual value to equal the sum of the fair value of the underlying asset and any initial direct costs of the lessor". (IFRS 16 Appendix A). Since the fair value of the underlying asset, the residual value and the direct costs for the lessor are difficult to determine, the calculation of the interest rate implicit in the lease can be a tough challenge. [51]

[50] Deloitte. (2018). *A guide to the incremental borrowing rate. Assessing the impact of IFRS 16 "Leases".*

[51] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.

5.8.2. *Incremental borrowing rate (IBR)*

The incremental borrowing rate is a valid alternative when the calculation of the interest rate implicit in the lease is not possible. IFRS 16 defines this rate as " the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment". Therefore, the calculation is based on an assumed loan for the purchase of the asset with similar aspects as the lease asset. The calculation of the IBR is mandatory for companies that choose to use the modified retrospective approach.

In order to determine the incremental borrowing rate, IFRS 16 suggests to account for the following aspects: moment in time, the maturity of the lease, the economic environment in which the transaction occurs, the credit quality of the lessee and the nature and quality of the collateral.

The determination of the moment in time is crucial, since interest rates fluctuate according to the variation of the supply and the demand, the monetary policy of central banks and the credit spread of the issuer and other factors. Therefore, companies should calculate new interest rate for each new lease, this computation becomes harder for large companies that sign lease contracts on a daily basis, thus need to calculate discount curves more frequently.

Another important factor that needs to be considered in order to determine the incremental borrowing rate is the maturity of the lease, that indicates the lease's term. Commonly, as leases have long terms, they have also higher interest rates due to the higher risk derived by the longer period considered. To calculate the IBR we need to estimate the discount rate curve that takes into account the series of rates during the term of the lease. There are two ways in which the discount rate curve can be expressed: the zero-coupon interest rate, and the yield curve. Using the zero-coupon rate, the current value is calculated by discounting each future lease payment at its zero-coupon interest rate. On the other hand, using the yield curve, the maturity of the lease is used to discount future cash flows. It is easier to use the yield curve, since with the zero-coupon interest rate we will obtain a series of rates that will help us to determine which is the IBR.

The economic environment in which the transaction occurs is the currency of the country in which the company signs the lease contract, and it affects the risk-free market interest rate that in turn affects the determination of the IBR.

The credit risk is positively correlated to the return and to the credit spread. In order to determine the credit spread of a lessee, companies use public ratings or quoted bonds issued by the lessee, however, this information are not always available. In such circumstances, the company can rely on financials or comparable companies. In the case of a subsidiary company it is better not to use the credit quality of its parent unless there is a guarantee for the payments of the lease by the parent company or when the parent's debt interest rate is used by the subsidiary for the calculation of the IBR. KPMG suggests that the subsidiary company could, in specific cases, use the parent's IBR as a starting point and adjust it to determine its own IBR. The conditions when this is possible may be when the funding of the group is managed by the parent company or when the subsidiary does not have a treasury function.

Lastly, the nature and quality of the collateral refers to the guarantee of the lease. If the guarantee is high, the risk will be lower and therefore also the interest rate will be lower. The collateral is positively influenced by the residual value of the asset at the time of recovery in relation to the amount of the unpaid installment. Bonds have usually lower collaterals since they are unsecured compared to lease operations.

Summing up, the first step in order to determine the incremental borrowing rate is to determine the discount rate curve that can be derived from the bond yields, the rates on recently issued loans, property yields or ratings on the company. [52]

A simplified approach developed by Deloitte, to calculate the IBR takes into account three main components: the reference rate, the financing spread adjustment and the lease specific adjustment.

The first step is to determine the reference rate, that is in turn affected by three factors: the currency, the economic environment, and the term. The currency needs to be accounted for when the lease has cash flows with different currencies, and also different risk-free rates. In these cases, leases are expressed in the exchange of the cash outflows, so to avoid risks of different currencies, while the risk-free rate is the one that grants to the lessee the funding for the assets in the foreign currency. The economic environment has to be part of the analysis when there are unusual or distressed circumstances, such as when currencies differ, when there is a currency union or in hyperinflationary economies, in these cases it is better not to consider the risk free rate as a preliminary point to calculate the IBR. The lease term should be matched with the duration of the risk-free rate that depends on the duration of the government bond or the yield curve, the matching should be done with a weighted average of the lease term.

The second step, according to Deloitte, is to determine the financing spread adjustment. Factors to take into consideration when determining the spread adjustment are: the term, the level of indebtedness, the lessee entity and the economic environment. Different types of companies will use different types of debt financing. Large public interest entities have multiple data points, indeed use multiple types of debt financing such as bonds, loan notes and bank facilities. Public interest

[52] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.

entities or private companies that have a single data point usually use a bank facility as a mean of financing, while private companies with no data points available do not use debt financing. When "all-in-rate" are used, a combination of reference rate, lessee credit spread and group credit spread, the separation of the reference rate and the financing spread adjustment is required. When companies have zero debt, they should account for historical and future debt facilities, while for companies that have few individual data points indicative prices can be used. The credit spread is positively correlated to the debt duration, when both of them are low, it means that a shorter duration of the lease is associated with credit spread on bank loans. As the credit spread and the debt duration increases companies need to make estimations, while with a longer duration, credit spread matches the lease term.

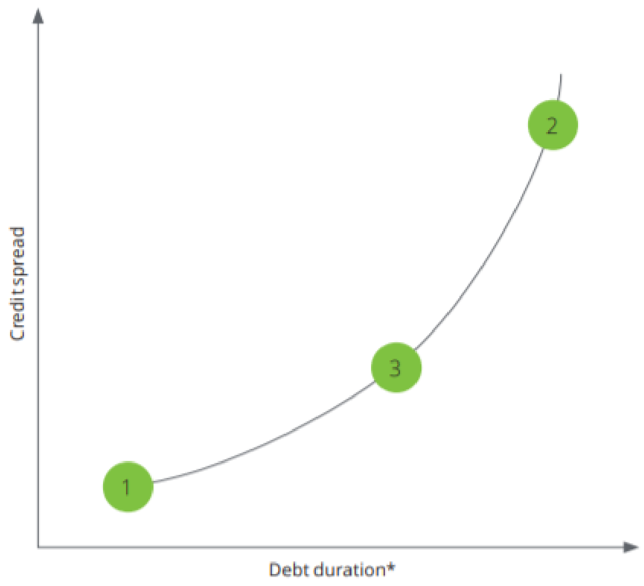

Figure 2 - Debt Duration and Credit Spread

The leverage, that represents the level of indebtedness of a company, is calculated by dividing the EBITDA to the net debt. The lender is expected to take into account this ratio as to determine the IBR. The types of financing used will affect the leverage ratio: to determine which credit spread consider, revolving credit facility can be used. When term loans and bonds are part of the financing structure, the lessor may conduct a deeper analysis on the possibility of raise additional funds.

The third step is to determine the lease specific adjustment, in order to do so, the main factor to consider is the asset type. An asset may vary based on its value. Even if all assets have a secured borrowing position, its benefits may be higher for certain types. If there is a low-value asset with a short duration, then the lessor will not benefit much from the security, on the other hand, if the asset is of high value and the duration is long, the benefits will be substantial. As a starting point, under certain circumstances, companies can take into consideration the property yields to determine the discount rate. Property yields are used to value property assets, taking into account the risks of location, quality of property, specification, future rental and capital growth prospects, tenant covenant strength and local supply/demand dynamics in both the tenant and investor markets.

The date of the entering of the lease may differ from the date of the arrangement of the debt financing, in these cases timing adjustments are needed for the determination of the reference rate and the financing spread adjustment. For the reference rate, daily rate yields are usually available for publicly listed government bonds. For financing spread instead, the frequency of credit spreads depends on the rate of activity of the traded debt.

The adjustments discussed early may not be required based on the implementation approach that the company decide to follow. The retrospective approach requires the determination of the discount rate at the date of the lease inception; indeed, it is more complex since companies need to determine different discount rates for leases that start at different times. The modified retrospective approach, instead, requires the incremental borrowing rate to be calculated at the initial application date of the lease, hence, taking into account the remaining term.

According to Deloitte, the discount rate assumption must be disclosed in the financial statements, specifically, as the importance of the lease liability will increase, the place of disclosure has to change. As the lease is not significant, the disclosure may be done in the notes to the accounts, as the importance increases respectively, in the accounting policies, in the section of significant assumption and estimation uncertainty, in the audit committee report or in the audit opinion. [53]

5.9. Individual leases

Cash payments recognized as expenses in the income statement will be the same under IFRS 16 and IAS 17 for individual leases. Nevertheless, total expense under IAS 17 is the same amount every year, since it is computed on a straight-line basis without considering variable lease terms. From the other hand, under IFRS 16, expenses will not be the same every year since they are calculated based on the timing of payments, the interest charged on the lease, and the length of the lease contract. As result, for the first half of the lease term, the straight-line method used under IAS 17 will give rise to a lower interest and depreciation compared to IFRS 16. The situation is reversed for the second half of the lease term, since the sum of interest and depreciation will be lower because is reduced as the lease liability is reduced.

[53] Deloitte. (2018). *A guide to the incremental borrowing rate. Assessing the impact of IFRS 16 "Leases".*

5.10. Group Leases

Group leases contracts are a collection of leases arrangements that depend on the term value of the leases. If the number of leases is even and there are no variable terms, then there is no difference in the accounting in the income statement under IAS 17 and IFRS 16, since the straight-line expense equals the sum of interest and depreciation. Conversely, when the group lease has variable terms, the effect on the income statement is different. Under IFRS lease expenses will be higher due to higher lease assets in the first part of the lease term while depreciating it later. [54]

[54] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.

CHAPTER 2

1. Costs vs. Benefits (Effect Analysis)

"Effects Analysis, IFRS 16 *Leases*" is an official document published by the IASB as a response to the large amount of comments letter received after the publication of the draft. The Effect Analysis (ED) is an evaluation of all the costs and benefits that companies will incur after the adoption of the new standard IFRS 16, as well as their implications on financial ratios and financial statements. The release of effect analysis is a mandatory step that the IASB publishes before the issuance of a new standard as a mean to collect all the concerns of interested parties, such as preparers, lenders, analysts, academics and auditors in this case. The document is useful for the IASB in order to analyze positive and negative aspects of the standard from different points of views and to include them in the effective issuance of the standard.

The overall goal of the IASB is the improvement of capital allocation, therefore this objective is considered when evaluating the benefits of the new standard as well as the comparative advantage of preparers of financial statements compared to the costs that users would otherwise incur in developing estimations. The effects analysed in this document are mainly qualitative, since a quantitative analysis before the first application of the standard was considered difficult to conduct.[55]

Roughly one over seven respondents of the comment letters doubted about the benefits and the costs of the implementation of the IFRS 16, their main concern regarded the fact that the implementation costs would exceed the benefits.

1.1. Implementation Costs

The transition from IAS 17 to IFRS 16 implies substantial costs for companies that in order to apply the new standard need to have a fully understanding of each lease contract. Therefore, they need to carefully analyse them to determine the right of use asset and the related lease liability. This activity requires time and resources and an added cost for companies.

Others implementation costs include the acquisition of new systems needed for the transition, the acquisition and the gathering of information, cost of quantification, assessment, evaluations and measurements and the training of employees.[56]

Three main categories of costs can be identified when applying IFRS 16 for the first time: costs of new systems and processes that need to be created in order to apply the new standard, the cost of the discount

[55] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*
[56] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases

rate that needs to be calculated and also applied to those assets and liabilities that were considered off-balance under IAS 17 and the costs for the training of the staff that has to learn how to capitalize leases and how to revise payments and contracts.[57]

All the costs discuss in the earlier paragraph will depend on three main factors: the size of the lease portfolio, the terms and conditions of the lease and the systems already used by the company for accounting under IAS 17. Once companies have incurred the initial costs of adapting their systems for the implementation of the IFRS 16, all the other costs will just be slightly higher compared to IAS 17.

The costs associated with the systems changes will be higher for those companies that have less sophisticated systems compared to those that have more sophisticated systems. Under IAS 17, companies are required to disclose some information in the notes of financial statements and in order to do this they need to possess an inventory of leases. The same inventory will be useful also for the first application of IFRS 16, while for further applications companies may incur in costs associated with the process of identifying a lease. IFRS 16 requires companies to separate lease components from non-lease components (in particular services), this process can imply additional costs, however, the standard lets companies free to decide whether separate amounts paid of the lease and service and capitalizing those related to the lease or do not separate them and account for both as a lease. Most of the information needed under IAS 17 for the disclosure in the notes are also required under IFRS 16, however, for the new standard, information may be required on a more frequent basis. For what concerns the information required under both standards such as the inventory of leases, the terms and conditions of each lease and the lease term and payments for each lease, no additional costs will be incurred by companies when transitioning from IAS 17 to IFRS 16. Although, the costs associated with the determination of the discount rate and the initial direct costs will be higher when implementing IFRS 16, mainly because these costs before were incurred only for financial leases while now will be incurred for all leases. Regarding the revised contractual payments, when inflation-linked payments are contained in the lease, additional costs will be incurred under IFRS 16, these additional costs derived from the re-measurement of the lease asset and liability. There will also be a reduction of costs associated with the classification of leases between financial and operating that is not needed anymore under IFRS 16.

[57] Liviu-Alexandru, T. (2018). The Advantages that IFRS 16 Brings to the Economic Environment.

Table 1 - Information needed under IAS 17 and IFRS 16

Information needed	under IFRS 16	under IAS 17	Costs under IFRS 16
Inventory of Leases	**YES**	**YES**	↔
Terms and conditions of each Lease	**YES**	**YES**	↔
Lease term and Lease payments for each Lease	**YES**	**YES**	↔
Discount rate	**YES**	**YES - Financial Leases** **NO- Operating Leases**	↑
Initial Direct Costs	**YES**	**YES - Financial Leases** **NO- Operating Leases**	↑
Revised contractual payments when a Lease contains inflation-linked payments	**YES**	**YES**	↑
Classification of Leases	**NO**	**YES**	↓

For companies that used to have a significant number of financial leases, the costs associated with the education and retraining of employees will be moderate, compared to those companies that had mostly operating leases.

Implementation costs will be incurred not only by companies, but also by other stakeholders such as investors and analysts, regulators and tax authorities.

There are some concessions that are allowed to companies for the first implementation of IFRS 16. For instance, companies are not required to restate comparative information, and they can choose whether measure off balance sheet assets as IFRS 16 requires, or based on the related liability, and therefore reducing the costs. [58]

1.2.Critics to IFRS 16

A number of preparers and analysts criticized the fact that all leases under IFRS 16 need to be recognized in the balance sheet, they claimed that there should be a distinction between loans and other kinds of leases that can be easily withdrawn from the contract without incurring in additional payments as opposed to loans where the recession is contingent to a payment.[59] However, the more skeptical remains the firms that are afraid that these changes will affect their performance analyses.

[58] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*

[59] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.

Companies doubt the economic consequences that can have because of the effect of the standard on financial ratios used as debt covenants. The negative impacts will be especially damaging for those entities that have a more constrained finance and indeed use more operating leases. However, this view is also criticized, as opponents may argue that covenants based on balance sheet items are not so common by firms that use off-balance sheet leases since they would benefit more from income statement-based ratios.

Other reasons for critics can be found in the fact that IFRS 16 will have an impact on the economic value of some leases and indeed make more complicated their understanding, jeopardizing the reliability and quality of information. [60]

There have been several lobbies by preparers of financial statements against the introduction of the new accounting standard IFRS 16, mainly due to the negative economic consequences that they claimed the capitalization of all leases will bring to companies.[61]

One of the main benefits of the application of IFRS 16 is to increase comparability among companies and their financial statements, however, some differences persist and are mainly due to the different jurisdictions across countries. Accounting procedures are also influenced by different governance models and their legal classification, for this reason some authors ask for a harmonization also in this direction.[62]

The application of IFRS 16 involves additional costs for companies that not always will compensate the benefits generated, costs are associated especially to the complexity of the new accounting method.[63]

1.3.IASB response to the main concerns

The predominant IASB response to all the concerns and critics to IFRS 16 by interested parties was that the commitments to pay the lease will not change but the only transformation stands on the accounting method. Indeed, the financial position is still the same, but the way information is presented is more transparent and allows for greater comparability among financial statements. For what concerns the assessment of credit risk, the implications of the new standard may negatively affect lessees, but

[60] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.
[61] Branswijck, D., Longueville, S., & Everaert, P. (2011). The Financial Impact of the proposed amendements to IAS 17: evidence from Belgium and the Netherlands
[62] Giner, B., & Pardo, F. (2018). The Value Relevance of Operating Lease Liabilities: Economic Effects of IFRS 16.
[63] Sacarin, M. (2017). IFRS 16 "Leases" - consequences on the financial statements and financial indicators.

the IASB underlines the fact that many credit rating agencies as well as more sophisticated analysts already took into account off balance sheet liabilities under IAS 17. [64]

The IASB also kept on stressing the outweigh of benefits over the costs and the improvement of the quality of information associated with the implementation of the new standard. [65]

As an answer to the complexity of the application of IFRS 16 and the costs related to it, the IASB allows for some exceptions that gives the lessees the right to decide whether to disclose specific cases on the Balance Sheet.

2. Implications on Balance Sheet

The Statement of Financial Position will drastically change after the implementation of IFRS 16, especially for those companies that have a high number of operating leases, because it will result in an increase of assets and liabilities. As a consequence of the increase of assets and liabilities, the equity may increase or decrease. The impact on the equity will depend on numerous other aspects such as the length of the lease arrangement, the time limits of the payments, the effective interest rate, the amortisation of the asset and the financial leverage. However, the IASB does not expect there will be significant changes for most companies concerning the equity.[66] In general, the equity is expected to decrease because the amount of lease assets will be reduced more quickly compared to the amount of the lease liability, so even though at the beginning and at the end of the lease the amounts will be the same, during the lease term the asset depreciation is on a straight line basis, while the lease is reduced by the amounts of the payments and increase by the interest.[67]

The asset leased by the lessor usually decreases faster than the amount of the leases assets, both for individual and portfolio leases.[68]

3. Implications on Income Statement

Under IFRS 16, companies will have an increase in their operating profit due to the increase in finance cost derived by the implicit interest on the payment. However, the increase in the operating profit will be proportional to the amount of off-balance sheet leases reported under IAS 17. [69]

[64] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases

[65] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.

[66] Sacarin, M. (2017). IFRS 16 "Leases" - consequences on the financial statements and financial indicators.

[67] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*

[68] Veverkova, A. (2019). IFRS 16 and its impact on Aviation Industry.

[69] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.

The expenses recognized on the Income Statement will be the same under IFRS 16 and IAS 17 for the total period of the lease, however for every reporting period there will be some differences. Under IFRS 16 operating expenses and interest expenses are recognized together with the amortization of the asset. The value of these expenses will be different for each period contingent to several factors such as the length of the contract, the amortisation of the asset and the implicit interest rate. The separation of depreciation on assets and interest on liabilities will improve the quality of information that investors and analysts use.[70]

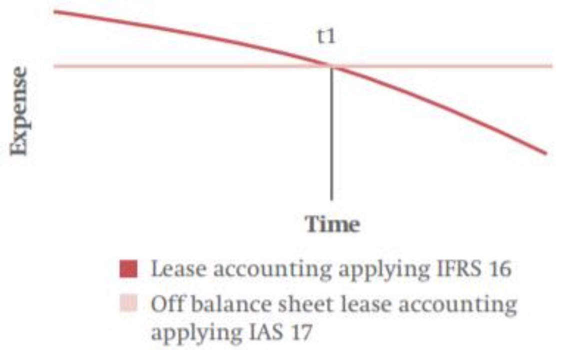

Figure 3 - Expenses related to Leases

At the beginning of the lease term, expenses under IFRS 16, indeed the sum of interest and depreciation, are greater compared to straight-line expenses under IAS 17, however at the end of the lease the situation is the opposite. At the point t1 in *figure 3* the two amounts will be equal, this will happen after the mid-point of the lease term.

Therefore, both EBIT and EBITDA will greatly increase due to the place where expenses are reported and because of depreciation costs.[71]

Table 2 - Implications on Income Statement

	IAS 17		IFRS 16
	Finance Leases	Operating Leases	All Leases
Revenue	x	x	x
Operating Costs		*Single Expense*	↑
EBITDA			↑
Depreciation and Amortisation	*Depreciation*		*Depreciation*
Operating Profit			
Finance Costs	*Interest*		*Interest*
Profit Before Taxes			↔

[70] Sacarin, M. (2017). IFRS 16 "Leases" - consequences on the financial statements and financial indicators.
[71] Veverkova, A. (2019). IFRS 16 and its impact on Aviation Industry.

4. Implications on Cash Flow Statement

The principal repayment of the lease is considered as a financing activity under IFRS 16, therefore it will increase the cash flow from financing activities and reduce the cash flow from operating activities, because under IAS 17 the off-balance sheet leases were considered as operating costs, hence, part of the cash flow from operating activities.

The total net cash flows will not change under IFRS 16 compared to IAS 17; however, the cash flows generated by operating and financing activities will change. The cash flow generated by operating activities will increase because the paid amount recognized as interest is considered part of operating activities. By the same amount cash flows generated by financing activities will decrease because of the inclusion of the fraction of the paid amount representing principal repayment.[72]

Table 3- Implications on Financial Statements

Balance Sheet	Income Statement	Cash Flow Statement
Assets ↑	Operating Profit ↑	Cash Flow from Financing Activities ↑
Liabilities ↑	Finance Cost ↑	Cash Flow from Operating Activities ↓

5. Implications on Financial Statement Notes

IAS 17 requires companies to disclose leases by classes and the sum of cash outflow on the notes of the financial statements. This standard also gives criteria for the disclosure of maturity analysis of the liabilities, such as the time bands of less than one year, between one and five years or more than five years. Instead, for lease contracts with complex characteristics, it does not provide criteria for their reporting.

Differently, IFRS 16 requires entities to disclose the components of lease expenses in the notes. For what concerns the maturity analysis of lease liabilities, the IFRS 7 *Financial Instrument Disclosure* requirement is applied, therefore judgment is a prerequisite for the choice of disclosing time bands. According to the IASB, this disclosure will provide more information compared to the criteria applied by the IAS 17. Another disclosure required by IFRS 16 implies the information of material specific

[72] Sacarin, M. (2017). IFRS 16 "Leases" - consequences on the financial statements and financial indicators.

details for those lease contracts that have complex characteristics. For the reporting of this contracts, the standard makes available some objectives that give entities more information. [73]

6. Implications on Financial Ratios

Financial ratios are a key indicator of a company's performance, its future and its wealth, and are used by stakeholders and by the company itself to make important decisions, to inform investors, to assess the overall effectiveness of the company and to evaluate the financial position of an entity. For these reasons, the implications that the new accounting standard has on financial ratios is of crucial interest for many parties and need to be carefully assess in order to have a fully understanding of the situation. Some of the ratios will improve compared to before while others will worsen.

The main impact that the recognition of assets and liabilities has in the balance sheet, is that of decreasing the net income while increasing debt ratios, EBITDA (Earnings Before Interest, Tax and Depreciation) and interest expense. These changes can affect many stakeholders such as lenders and employees, if their contract implies incentives based on such ratios.

The effects of the new IFRS 16 on key financial ratios will influence also investors decisions, share prices and therefore, the behavior and choices of managers especially concerning financings and earnings. The following ratios are strongly affected by the new model of capitalization of both operating and financial leases. Effects may vary depending on the different industries; however, the main implications can be summarized in the following paragraphs.

6.1. Leverage

The Leverage ratio is an indicator of the solvency of a company and it is calculated by dividing the liabilities to equity. With the implementation of IFRS 16, additional liabilities (present value of future lease payments) will be recognized in the balance sheet, leading to an increase of the leverage ratio since equity will stay the same, due to the fact that both assets and liabilities will increase.

6.2. Asset Turnover

The Asset Turnover is an indicator of the profitability of a company and it is calculated by dividing the sales to the assets. Since the assets will increase with the new standard, while the sales will not be impacted, the asset turnover will decrease compared to the application of IAS 17.

[73] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.

6.3.ROA

Return on Assets ratio is an indicator of the profitability of a company, and it is calculated by dividing the net income by the average of total assets. Under IFRS 16 new assets are recognized as the right of use, therefore, ROA will decrease.[74] The material decrease in ROA is independent of the level of usage of the lease.[75]

6.4.Interest Expense

The Interest Expense measures the interest of a financial liability, since the lease liability would increase total liabilities, also the interest expense will increase. The liability is calculated with the amortised cost basis, by taking into consideration the time value of money.

6.5.Depreciation Expense

The depreciation expense measures the consumption of the useful life of the asset over time, since a Right of Use asset will be recognized under IFRS 16, a related depreciation expense will be accounted for, hence increasing total depreciation expenses. The Right of Use asset is depreciated as a property asset, as it is used.

6.6.Rental Expense

The rental expense is the expense recognized when the lessee receives the right to use the leased asset in exchange of a payment to the lessor. Under IFRS 16 this expense is no longer recognized, meanwhile an interest expense on the lease liability and a depreciation expense on the asset are recognized.

6.7.EBITDA and Profit Margin

Earnings Before Interest, Tax, Depreciation and Amortization are an indicator of the profitability of a company. Considering that EBITDA is calculated by detracting expenses from sales, under IFRS 16 this ratio will increase because of the decreasing of rental expenses compared to IAS 17. [76] Operational expenses are substituted by depreciation and interest expenses that will increase the earnings.[77] Under IFRS 16 interest and depreciation are reported separately on the income statement and interest is

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[74] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.
[75] Branswijck, D., Longueville, S., & Everaert, P. (2011). The Financial Impact of the proposed amendements to IAS 17: evidence from Belgium and the Netherlands
[76] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases
[77] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.

presented as a finance cost, while under IAS 17, operating leases are operating expenses in the income statement. [78]

6.8.EBIT

EBIT is usually used by analysts as an indicator of the profitability of a company independent from its financial and ownership structure. Earnings Before Interest and Taxes will increase under IFRS 16 compared to IAS 17 because the latter will include the operating lease cost and the interest as operating expenses in the income statement. Indeed, amortisation expense are lower than operating expenses and this will increase EBIT. [79]

6.9.EBITDAR

The EBITDAR is another indicator of the profitability of a company and it measures the Earnings Before Interest, Tax, Depreciation, Amortization and Rent. There is no change in this indicator compared to IAS 17 because even if the EBITDA will increase, the effect is balanced by the rent that will decrease.

Table 4 - Implications on Financial Ratios

SOLVENCY RATIOS	PROFITABILITY RATIOS	EXPENSES
Leverage	Asset Turnover	Interest Expense
	ROA	Depreciation Expense
	EBITDA	Rental Expense
	EBIT	
	EBITDAR	

7. Implications on Net Financial Position

Under IFRS 16, a right to use asset and a corresponding lease liability will appear on the balance sheet, therefore increasing the number of activities present in the statement of financial position and increasing financial liabilities. This will have an impact on the Net Financial Position, since the overall financial indebtedness will grow. [80]

[78] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.
[79] Sacarin, M. (2017). IFRS 16 "Leases" - consequences on the financial statements and financial indicators.
[80] Deloitte. (2017). *L'evoluzione del bilancio. Riflettori puntati sui leasing.*

8. Implications on Taxes

The effects on taxes derived by the change from IAS 17 to IFRS 16 is expected to be substantial and is derived from the way the amount of tax is recognised by a company. For this reason, the IASB assumes that different jurisdictions will modify tax laws accordingly, since the implications will depend on country-specific tax rates and laws.[81]

9. Implications on Covenants

Terms and conditions of future debt covenants may be impacted by the transition from IAS 17 to IFRS 16, however, the changes will be the results of an improve and more transparent decision-making. Otherwise, the economic position and the commitment to pay cash will not change.[82]

10. Credit Risk Assessment

Credit risk is the risk incurred by creditors when lending money to someone, creditors do not know if they will be paid back but decide anyway to take this risk in exchange of a possible reward given by the interest associated to the loan. Debt-holders expect to pay their debts by using future cash flows possibly generated but that they cannot guaranteed. Together with the time value, that's why creditors charge high interests on loans.

Usually, the higher credit risk is associated with a higher return and therefore a higher interest rate.[83]

Lenders' job is to assess their credit risk in order to decide which interest charge the debt-holders. Interest expense by debt-holders represent the interest income received by the lenders and the aim of creditors is to maximizing it. The calculation of the interest is based on the judgment of the lender on the debt-holder's ability to repay the loan in the future, if the lender believes that he will be repaid than the risk is low and the interest as well is low, otherwise there will be an higher risk and an higher interest. However, lenders rely on credit rating agencies that analyze specific customers and give an assessment on their trustworthiness, when this information are not available, creditors rely on financial statements and financial ratios. It is straightforward that analysing statements and ratios under IAS 17 could have led to misleading conclusions. For example, when assessing the interest on an operating lease based on the leverage ratio, the lenders can reach two completely different conclusions depending on the fact that the company comply with the IAS 17 or IFRS 16. Under IAS 17 no lease liabilities and no interest expense would appear in the balance sheet and in the income statement hence, considering

[81] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.
[82] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*
[83] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.

this company safer and with a lower credit risk. In reality, the two companies will incur in the same amount of lease payments.

Therefore, the mandatory capitalisation of operating leases under IFRS 16 will have a strong impact on the assessment of credit risk by lenders, and lessees are worried that this will result in a reduction of new loans and an increase of interest rate, especially after the first application of the new standard.[84]

11. Effects on the leasing market

Companies' decisions whether to lease or buy assets may be affected by the implementation of IFRS 16. The increase in comparability may push entities to buy instead of leasing but the new accounting model will have no effect on the overall demand for assets. However, the benefits derived from leasing an asset will remain also after the change in the accounting standard. Some important benefits derived from the choice of leasing are: the financing of the asset without guarantees, the fixed regular lease payment, the renewal of the asset, the independent financing from bank loans, the right to use the asset without the ownership, the services associated with the asset, the different tax treatment, the sharing of risks and profits with the lessor and the operational flexibility. Usually the terms and conditions of a lease are negotiated based on the business need and not on the accounting method, however, some companies may decide to re-examine the lease term and the payments. Smaller companies consider leasing as a fundamental source of financing and they will keep use leases also after the implementation of IFRS 16, the price is not expected to increase, and the benefits related to the transparency of information will be enjoyed also from smaller firms.

12. Advantages of IFRS 16

The conclusion of the IASB in its document "*Effect Analysis*" is that the overall benefits of the implementation of IFRS 16 outweighs the costs of implementing it. The main advantages that the new standard brings to companies are two: the increase in the comparability of financial statements between entities and the improvement in the quality of information disclosed in the statements.[85]

12.1. Comparability

The analysis of Financial Statements and Financial Ratios can be made in order to compare past, present and future information, to compare different companies in the same industry or to compare

[84] Milton, S., & Genevieve, N. (2019). The expected impact of the implementation of International Financial Reporting Standard (IFRS) 16 - Leases

[85] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*

companies in the market as a whole. When comparing statements of the same company, the accounting system used does not represent a problem, while if the comparison is made between companies that come from different countries and use different accounting methods, difficulties are more likely to rise. The use of IFRS 16 solves this problem, since under IAS 17 the same transaction on leases was accounted in different ways, while now comparison between different financial statements is possible thanks to the harmonization of the accounting of leases in the balance sheet. [86]

The comparability will increase especially between companies that lease the assets and those that borrow to buy the assets. By improving the comparability of financial statements, investors will need to make less adjustments in the balance sheet and income statement.

The improvement of the comparability between financial statements is the result of the recognition and measurement of assets and liabilities for all leases in the same way, and the recognition of solely the rights and liabilities obtained and incurred. The comparability improves also because under IFRS 16, when leases and borrowings to buy an asset are similar economic transactions, will be reported in a similar way, indeed making it possible to compare the two transactions, this comparison is very useful for investors and analysts. However, there are some differences: for the lease, the only rights recognized are those of using the asset and to lease/sublease it, while for the borrowing to buy, the rights recognized are also those to sell and pledge the item and the legal title to the asset. The IASB wanted to underline the difference between control the right to use the asset and control the asset, even though the two transactions are economically similar, are not the same.

Table 5 - Lease and Purchase the asset

	Lease	Purchase
Right to use the asset	x	x
Right to sell and pledge the asset		x
Right lo Lease/Sublease the asset	x	x
Legal Title to the asset		x

Another improvement in the comparability of statements is given by the better information provided when a company changes its financial flexibility by extending or reducing the length of the lease. The changes in the lease portfolio will be directly reflected in the balance sheet, and as a consequence in the income statement and cash flow statements. Changes in the lease portfolio can derived from the sale of the asset owned and the leasing back of others. Under IAS 17, sales and leasebacks would modify assets and liabilities in the balance sheet, while under IFRS 16, a right to use and a financial commitment to make payments are recognized for both assets. This change will decrease the number

[86] Bohusova, H. (2015). Is Capitalization of Operating Lease way to increase of comparability of Financial Statements prepared in accordance with IFRS and US GAAP?

of sales and leasebacks, since the incentive of modifying assets and liabilities will not be present anymore.

The measurement of leases under IFRS 16 is simplified for what regards the variability in the payments. The lease liability does not include variable payments, but it makes an exception for those payments that the company is reasonably certain to make. For instance, considering two leases, one with fixed payments and another with variable payments, the two will be reported in a different way. The IASB justified this different methodology by underlining the difference in the contractual commitments. The same happens with optional payments, let's consider a lease of five-year with an option to extend for three years, and an eight-year lease. By reporting the two leases in a different way, the IASB wants to emphasize the different financial flexibility of the contracts. [87]

12.2. Quality of Information

The European Commission asked the EFRAG (European Financial Reporting Advisory Group), to review the new standard IFRS 16. The EFRAG is an international body aimed at protecting European interests especially in the contest of accounting standards. An independent society appointed by the EFRAG developed an *"Ex ante impact assessment of IFRS 16"*. In this document the company estimated that total debts of listed companies under IFRS 16 will increase of 576 € billions, the analysis included only European companies. The sectors that will have a higher impact are airlines, retail and travel and leisure, according to the EFRAG. In conclusion, the overall opinion was positive and the European Financial Reporting Advisory Group stated: "*IFRS 16 meets the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, leads to prudent accounting, and that is not contrary to the true and fair view principle […]".*[88]

By improving the quality of information, investors and companies are expected to improve their decision-making, and therefore allocate in a more efficient way their capital, credit and investments.

The improvement of the quality of information is benefited both from investors and analysts and companies, since a more faithful representation is depicted in the balance sheet and therefore there will be greater transparency in the leverage ratios and in the capital employed. Under IAS 17 some useful information were disclosed in the notes to the financial statements, however these disclosures are not enough to provide investors and analysts with the information they need in order to make the best decisions. Some of them used to make adjustments and estimate the amount of assets and liabilities

[87] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*
[88] Deloitte. (2017). *L'evoluzione del bilancio. Riflettori puntati sui leasing.*

kept off the balance sheet. Otherwise, those analysts that do not consider the disclosures in the notes, are not properly informed and therefore will not make the best decisions given a lack in the information held by them. The adjustments are difficult to perform and consequently are made only by expert users of financial statements, as stated by the Capital Market Advisory Committee, a body that belongs to the IASB: *"…while a disclosure-only solution might be acceptable to expert users of financial statements, it would not be helpful to the majority of investors who require financial statements to provide them with a clear information from the outset."* Under IAS 17 investors made adjustments both for the balance sheet and the income statement. In the balance sheet the main estimations made are those of the asset and liabilities of operating leases, however some investors estimate also the present value of future lease payments. In the Income Statement investors adjust the operating profit to assess in a better way the performance of the company.

In 2015, the credit rating agency Moody published a methodology for making estimations of off-balance sheet leases, the adjustments suggested are both in the balance sheet and in the income statement, and the outcome are very similar to the effects of applying IFRS 16. The approach used by analysts for estimations in the balance sheet was that of capitalising operating leases by using a different multiple depending on the industry. Moody instead suggest to use the minimum obligation that arises from the off balance sheet lease commitments and the industry multiple of annual rent or the present value of the company's minimum lease commitments. For the adjustments in the Income Statement, analysts used to make estimates by classifying one-third of off-balance sheet lease expenses as interest expense and two-thirds as depreciation. The credit rating agency suggests to keep classifying leases as interest expenses and depreciation, but the proportions will depend on the multiplication of off balance sheet lease debt adjustment to an interest rate with the remaining portion of the expenses associated to the off balance sheet leases associated to the depreciation.

Besides investors and analysts, also companies will benefit from the improvement in the quality of information. Companies will present more precise information and therefore there will be more level playing field between different companies. Under IAS 17, companies that considered leases as an important source of financing, disclosed some "non-GAAP" information in order to provide investors, analysts and users with more accurate information. Companies used to make these adjustments by capitalizing off balance sheet commitments, by allocating lease expenses into interest and depreciation, or by allocating cash flows for operating leases into interests and principal repayments. They did so in order to calculate leverage ratios adjusting to debt and earnings.[89]

[89] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*

13. Main differences between IFRS 16 and FASB on Leases

The main difference between IFRS 16 by the IASB and Topic 842 Model by the FASB on Leases, stands on the number of possible accounting models that can be used. The IASB allows only for one model that requires the capitalisation of all leases, while the FASB allows for two different accounting models depending on the classification of the lease as an operating or financial lease. Under US GAAP, financial leases are capitalized as all leases under IFRS 16, while operating leases on a linear basis. Exceptions of low value assets apply only under IFRS 16 and are not present for Topic 842.[90]

The SFAS 13 is the equivalent standard to the IAS 17, the antecedents of IFRS 16 and Topic 842. Since the definition of financial lease remains for the US GAAP, that calls it capital lease, we must go back to the previous standard to analyze the differences between the two definitions. A capital lease under US GAAP has to meet certain conditions that are not present under IAS 17. At the beginning of the term, the present value of the lease must be equal or exceed the 90% of the fair value of the underlying asset, there has to be the transfer of ownership from the lessor to the lessee at the end of the term, in the contract there must be a bargain purchase price, and the lease must equal or exceed the 75% of the estimated economic life of the asset.[91]

However, the two boards have work together for years on this joint project, thereby reaching very similar decisions on the main aspects of the standard such as the presentation of the assets and liabilities and the definition of leases.

With respect to the implication on the balance sheet, there are three main differences between IFRS 16 and the FASB. The first divergence regards the exception of low-value assets that is allowed by the IASB but not by the FASB, however the impact of low value is minimal therefore the difference in the liabilities will not be relevant. The second difference regards the depreciation of leased assets. In the case of the FASB, the process is slower in the first years and then faster while under IFRS, the depreciation is on a straight-line basis. As a result, companies following the FASB will have more profit and therefore equity, in the first years. However, in the long run this difference will be reduced. The third difference regards the disclosure of former off-balance sheet items, under IFRS companies are required to disclose only those items considered relevant to users of financial statements, while under FASB, companies must disclose those items in a line item.

The Income Statement of a company using IFRS will differ from the one of a company using FASB. This alteration is given by the operating profit that is larger for entities under IFRS because of higher finance cost that includes the implicit interest on the payment, while under FASB it will part of the

[90] Morales-Dìaz, J., & Zamora-Ramirez, C. (2018). IFRS 16 (leases) implementation: Impact of entities' decisions on financial statements.
[91] Branswijck, D., Longueville, S., & Everaert, P. (2011). The Financial Impact of the proposed amendements to IAS 17: evidence from Belgium and the Netherlands

operating cost. The factors that influence this difference are the previous value of off-balance sheet leases, the period of the lease contract and the discount rate.

The Cash Flow Statement does not present an economic difference between a company under IASB and another under FASB. Although, cash flow from financing activities will be higher under IFRS because of the repayments of finance lease obligations and the correlated interest, while the opposite happens for cash flow from operating activities that under the FASB includes also previous off-balance sheet leases.

For what concerns the Financial Statements Notes Disclosure, no material difference between FASB and IASB will be present. The main differences can be found in the disclosures of off-balance sheet transactions, qualitative information and specific disclosures. From one hand, the IASB requires companies to define lease objectives in order to decide which information is relevant to disclose. From the other hand, the FASB requires companies to disclose off-balance sheet transactions, lease terms, requirements for the extension of the lease arrangement and termination clauses.

Main differences between the two boards can be found in the financial ratios. There are three ratios that differ more when applying IASB or FASB: the debt to EBITDA, the interest cover and the return on capital employed.

The debt to EBITDA ratio is a measure of financial leverage and is calculated by summing up the borrowings of a company and the lease liabilities. Since EBITDA under IFRS is higher because of the exclusion of off-balance sheet items that are instead present under FASB, the debt to EBITDA ratio is higher under FASB.

The interest cover ratio is another indicator of the financial leverage of a company, and it is calculated by dividing EBIT by the interest expenses. Considering that under FASB interest payments are classified as an operating expense, EBITDA will be higher compared to interest and therefore, the interest cover will be higher compared to the interest cover under IFRS that considers interest payments as finance costs.

The third ratio that will show differences under FASB and IASB is the return on capital employed that is a measure of the performance of a company. This ratio is calculated by dividing the EBIT to the capital employed. Operating profit increases under IFRS, for this reason the ratio will be higher under this standard compared to the FASB that does not present an increase in the operating profit.

The overall cost of applying IFRS or US GAAP will be generally similar since the same data are needed for both accounting methods. For some companies it may be cheaper to move to the FASB than to the IASB because changes in the Income Statement and Cash Flow Statements are less relevant under the FASB. From the other hand, some companies believe that costs will be lower under IFRS because no classification of leases is needed, the measurement of lease assets is similar to other assets, and there is the low-value exception. [92]

In conclusions, these differences are not very relevant but instead the two bodies have reached similar conclusions on the way leases should be accounted for, reducing the divergence between the Financial Accounting Standard Board and the International Accounting Standard Board even more.

		IFRS 16	US GAAP (FASB model) Former ON balance sheet leases	US GAAP (FASB model) Former OFF balance sheet leases
Balance sheet				
Recognition	All leases on balance sheet	✓	✓	✓
	Exemption for short-term leases	✓	✓	✓
	Exemption for leases of low-value assets	✓	---	---
Measurement	Lease liabilities on a discounted basis	✓[59]	✓[59]	✓[59]
	Initial lease asset = lease liability	✓	✓	✓
	Depreciation of lease assets	Typically straight-line	Typically straight-line	Typically increasing[60]
Presentation	Lease liabilities	IAS 1[61]	Separate presentation (from former off balance sheet leases)	Separate presentation (from former on balance sheet leases)
	Lease assets	PPE *or* own line item[62]		
Income statement				
Operating costs		Depreciation	Depreciation	Single expense
Finance costs		Interest	Interest	---
Cash flow statement				
Operating activities		Interest[63]	Interest	Interest and principal
Financing activities		Principal	Principal	---

Figure 4 - Differences between IFRS 16 and US GAAP

14. Comparison between IFRS 16 and IAS 17

The definition of Leases provided by IFRS 16 slightly changes compared to the definition under IAS 17, however the application of it changes deeply. Under IFRS 16, a lease is a right of use of the asset for a period of time and it excludes some services contracts that were considered leases before.[93] This definition is linked with IFRS 15 *Revenue from Contracts with Customers* that introduced a new way of recognizing revenues based on the fact that the entity should recognize those so as that the transfer of goods and services to the customers is expressed in an amount that reflects the consideration the entity expects to receive. Moreover, this definition reflects the economics of the lease in its accounting model. Under IAS 17, when a lessor gives the lessee the right to use an asset for a period of time in exchange of payments, the focus of the definition stands on the risks and rewards carried by the lessee and both lease and non-lease components are off-balance sheet.

Contracts considered lease contracts under IAS 17 will keep being considered lease contracts also under IFRS 16, however the concept of control changes. With the new standard, the right of control of

[92] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*
[93] Osei, E. (2017). The Financial Accouting Standards Board (FASB), and the International Accouting Standards Board (IASB) sings similar tune: comparing the accouting treatment of new IFRS 16 with the IAS 17, and the new FASB model on leases.

the use of the asset is a fundamental prerequisite for the lease definition. Another difference in this regard, is related to the service contracts that are excluded under IFRS 16.

From the side of the lessor, the changes will be minimal, the separation of finance and operating leases will still be present, but more information will be disclosed related to the risks the lessor incurs when leasing an asset. The main reason why little will change from the lessor's perspective is that the costs of modifying also this accounting method would outweigh the benefits related to it according to investors and analysts. [94]

Regarding the classification of leases, under IFRS 16 those contracts considered leases are all recognized in the same way, with few exceptions, therefore the distinction between operating and financial leases does not exist anymore. Under IAS 17, at the inception date a distinction is made between operating and financial leases.

Both the initial and the subsequent measurement of the lease, from the lessee's side, differ under IFRS 16 and IAS 17. The initial measurement under IAS 17 implied the recognition of an asset and an obligation that can be the present value of the minimum lease payments or the fair value of the asset. The subsequent measurement implies the amortisation of the asset and an allocation of the payments between a finance charge and a reduction of the obligation. As a discount rate, a company can use the interest rate implicit in the lease, or the incremental borrowing rate. Under IFRS 16 all leases are accounted for in a way similar to finance leases under IAS 17. In the balance there will be two new items: the right of use asset and the lease liability. The liability is measured as the present value of the lease payments that are discounted using the interest rate implicit in the lease or the incremental rate of borrowing. The asset is depreciated over the term and it can be accounted following IAS 16 *Property, Plant and Equipment* or under the cost model, and then impaired under IAS 36 *Impairment of Assets.* Summing up, the right of use asset is given by the difference between the lease liability and the initial amount of the lease, plus the initial direct costs, the cost of removal or restore, the payments made previously less the lease incentives received. The lease liability is given by the sum of the fixed payments, the variable payments, the residual value guarantee, the purchase options and termination costs less the payments made previously.

The difference in accounting will be reflected on the financial statement of the lessees. In the balance sheet the implications are an increase of the assets and liabilities that will affect the equity, the higher the off-balance sheet leases of a company under IAS 17, the higher the effect of changing the accounting method. In the Income Statement there will be an increase in the EBITDA, in the operating profit and in the finance costs. Under IAS 17 the leases expense is considered part of the operating expenses. Under IFRS 16 the cash flow statement will present an increase in cash flow from operating

[94] IASB. (2016). *Effect Analysis, IFRS 16 Leases.*

activities and a decrease in cash flow from financial activities, but the total amount will remain unchanged. [95]

15. IFRS 16 and Covid-19

On April 2020, the IFRS published an Exposure Draft called *"Covid-19-Related Rent Concessions"* in which it proposes an amendment to IFRS 16. The publication of the draft is the result of the increase of rent concession derived from the world pandemic of Covid-19. Examples of rent concessions are rent holidays or reductions and are common for leases of retail property. Lessees may find difficult to account for covid-19 related rent concession, since a large volume of leases is expected due to the sanitary emergency. IFRS' aim is to soothe lessees during this difficult period while at the same time, keeping providing high quality and transparent information to users of financial statements. The outcome of the amendment will be a practical expedient that gives the right to lessees to avoid the assessment of covid-19 related rent concession as lease modifications, and therefore to avoid accounting them as so and simplify their operations. The amendment, if approved, will have no effect for lessors that will keep account for leases and rent concession in the same way as before.

The two most important paragraphs of the draft are the paragraph 46A and 46B that regards the practical expedient and the paragraph C1A and C20A that regards the effective date and transition of the amendment. The practical expedient consists of the choice by the lessee to not account for covid-19-related rent concession as lease modifications, and therefore modifying its way of accounting it. Some requisites need to be met in order to benefit from this practical expedient: the consideration before and after the lease payments change has to be the same or less, the payment reduction occurs only for leases expiring in 2020, and the other terms and conditions do not change. Two conditions need to be met concerning the application of the amendment: the change in the accounting can be enjoyed only for reporting periods after 1 June 2020 or before this date but coinciding with the date of issuance of the amendment, the amendment can be applied retroactively through an adjustment.

A lessee that decides to benefit from this practical expedient must disclose it. The lease modification is defined in the IFRS 16, and it deals with a change in the scope of the lease from its terms and conditions. The lease modification can imply a change of the lease payments, when this happens, the lessee has to remeasure the lease liability and redetermine the discount rate. There are three main reasons why the amendment will affect only the lessee: the first reason is that lessors are not subject to IFRS 16 and therefore to a new accounting model, the second reason regards operating leases, lessors do not have to remeasure amounts when there is a lease modification if the lease is operating, and the majority of covid-19-related rent concessions are classified as operating leases. For what concerns

[95] Bunea-Bontas, C. A. (2017). Lease Accounting under IFRS 16 and IAS 17 - A comparative approach.

financial leases, the lessor has to follow IFRS 9 *Financial Instruments* that provides already important information to financial statements' users. The IASB is aware of the risks that this amendment may create if largely applied, consequently its use is limited to those concessions that can be proven being a result of the world pandemic and the decision to benefit from it is on a voluntary basis, however, when a lessee takes this decision, all lease contracts with similar characteristics are subject to the practical expedient.

There are three main kinds of change that can result in a modification of the accounting process: one change can result from a forgiveness or waiver; therefore, a variable lease payment can be recorded and a corresponding adjustment to the lease liability. Another type of change can derive from the reductions in payments in a particular period and increase in those payments in another period, hence the change is in the timing of payments. It can happen that covid-19-related rent concessions change both the timing of the payment and can result from a waiver.

When applying the practical expedient, a lessee has to recognise the lease liability as the present value of future lease payments, hence granting a faithful representation of its obligations and providing useful information to interest parties. A critic to the amendment can derive from the lack of comparability that may result from its application, since there may be differences between financial statements of lessees that decide to apply the amendment and those that decide not to apply it. However, to overcome this limitation the IASB suggests to make an impairment of the right to use asset, and to disclose the application of the practical expedient.

The Covid-19 world pandemic resulted in numerous challenges for lessees, henceforth, the IASB wanted in some ways to lighten their job by simplifying the way of accounting Covid-19-related rent concessions, and considering the urgent need, by make it possible to apply the practical expedient for annual reporting periods starting from 1st June 2020. [96]

[96] IASB. (2020). *Covid-19-Related Rent Concessions Proposed Amendment to IFRS 16.*

CHAPTER 3

1. GEDI Gruppo Editoriale: firm, main events, performance

GEDI is an Italian publishing group active in different sectors of communication: press, radio, advertising and digital. For what concerns the press, the company publishes daily newspapers: La Repubblica, La Stampa, Il Secolo XIX and other thirteen local daily newspapers with all their supplements, a weekly newspaper, L'Espresso and some periodical newspapers: National Geographic, la Scienza, Mind, Limes, MicroMega and National Geographic Traveler Italia. The three radios owned by the company are Radio Deejay, Radio Capital and m2o, while the digital section is aimed at providing a digital presence for all the brands of the group, especially for La Repubblica, with La Repubblica.it, La Repubblica + and Rep:, and La Stampa with La Stampa.it and La Stampa tuttodigitale.

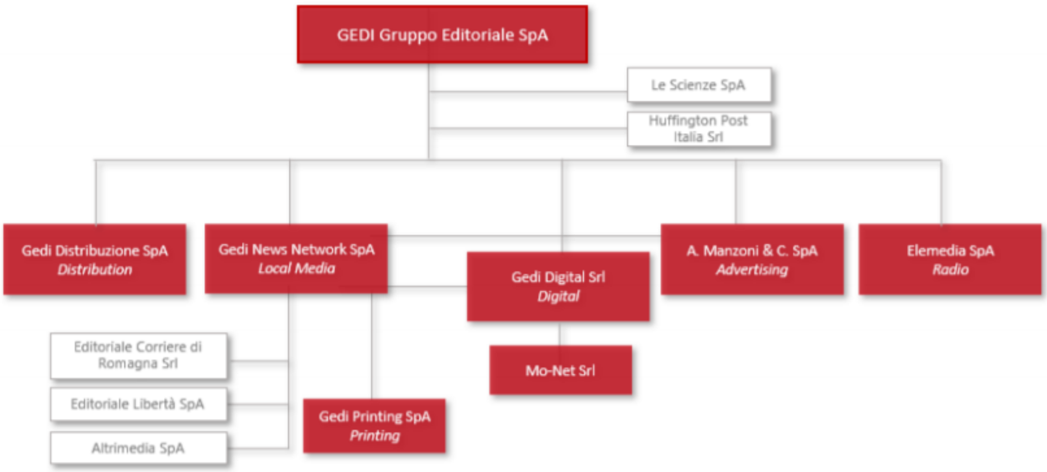


Figure 5 - GEDI Gruppo Editoriale

Finally, the advertisement sector is operated by A. Manzoni & C. with an exclusive dealership by means of the GEDI group. As by the end of 2019, GEDI accounted 603,5 million of euros in revenues and an EBITDA of 59.3 million of euros. The group counts 2221 employees, with headquarter in Rome, the current president is John Elkann, the CEO is Maurizio Scanavino and the main shareholder is the Cir Group spa. GEDI's mission is to offer information, culture, opinions and entertainment in accordance with the principles of independence, freedom and respect. Central for the group is the role of the citizen-reader and also the creation of value for all its stakeholders by offering high-quality products taking into consideration social and environmental sustainability.

In 1955 N.E.R. was founded, the publishing company of L'Espresso, with Adriano Olivetti as the main shareholder. 1976 is the year of birth of La Repubblica with Eugenio Scalfari as director, the newspaper was born as a joint venture between L'Espresso and Arnoldo Mondadori Editore. During the following years L'Espresso acquires some local newspapers and half of Manzoni, the advertisement company. In 1984, L'Espresso is listed in the Stock Exchange, and some years later it acquires half of Radio Deejay. In 1991, the Espresso Group is founded with CIR as the main shareholder and La Repubblica is listed in the Stock Exchange. During the following years other acquisitions characterize the group such as Radio Capital and m20, and the multimedia development starts to take place. In 2016, Espresso Group and ITEDI, publishing company of La Stampa and Il Secolo XIX decided to merge the two companies and create GEDI group.

Some of the main corporate actions of the last years are the merger of Itedi and local entities to create the Gedi News Network, the transfer of the printing facility to Gedi Printing, and the concentration of all the digital activities of the group in Gedi Digital.

Since GEDI operates in different sectors, we can consider three main markets: advertising industry, newspapers industry and radio industry. In 2018 the advertising market was quite stable and the media used showed a positive improvement except for the press, since its advertisement has achieved a decline both with daily and periodic newspapers.

The newspaper industry has suffered a deterioration both for sales in newspaper kiosk as well as for subscriptions, all kinds of newspapers sales are in decline: dailies, weeklies, monthly, national and local newspaper, as well as advertisements on them and investments on advertisements. It is a declining industry with an average growth between 2014 and 2019 of -2.7%. A good news come from the radio industry, even if the number of audience is in slight decrease, advertisement investments are improving and this industry is the best performing one.

There are two main trends that characterize the publishing world: even if there is an increasing growning of digital channels, the main portion of revenues for publishing companies is still given by the paper press. Nevertheless, the business model is evolving, circulation revenues, those revenues that derive from publications, are the main source of revenues, overcoming advertisement ones. This trend is pushing journalists to focus on quality, in order to engage the reader through a customized offer. Publishing companies are focusing on memberships, since it is the solution to digital advancement, however this is not sufficient to cover for the loss due to the press, the final solution is to diversify as much as possible sources of revenues, even focusing on finding new ones. [97]

[97] GEDI spa. (2018). *"Report on corporate governance and the ownership structure pursuant to article 123-bis of Consolidated Law on Finance 2018*

In order to analyse the advertisement, newspaper and radio industry, a Porter's 5 forces analysis can be developed.

Since only the radio industry is growing while the others are declining, the threat of new entrants is not very relevant. There are high barriers to entry, due to the high initial investment required to enter in the industry and the cost advantage derived from the economy of scale used in both the newspaper and radio market. There is also a high product differentiation, since the industry is based on the quality of radio programs, and newspapers and buyers are willing to be loyal to the firm they are most inclined to. Also, legal and regulatory barriers are high due to the need of licenses to operate, however the access to channel of distribution is low due to the ease through which the product can arrive to the shelves.

The availability of substitutes is increasing due to the advancement of digital platforms where to read news and listen to music, as well as news on tv and tv shows. Buyers are very inclined and willing to substitute due to the huge offer that they can receive also for free. In conclusion, the threat of substitutes is high and must be tackled from the firms in the industry. There is a significant number of suppliers that have low power since they offer to the firms standardize products, so the companies in the industry do not face high switching costs when choosing one supplier over another.

Firms in the industry offer highly differentiated products and the quality of them is crucial for buyer's loyalty, there are a lot of buyers and few firms, indeed a relative low buyers' bargaining power can be considered.

There are eight main publishing groups in Italy, all of them with a turnover of over 80 million euros. Indeed, the market share is pretty concentrated in the hands of these major groups, however they offer differentiated products, and buyers are willing to switch from one competitor to another based on their loyalty, the quality of the product and the inclination they have towards the product. There are high barriers to exit, due to the fixed costs involved in the production and the loss of reputation attached to the exit from the industry.

Bearing in mind these factors, the rivalry between competitors can be considered moderate. The seven main competitors of GEDI gruppo editoriale are: Gruppo Mondadori, that even if it is the main Italian publishing group, it does not publish newspapers but only books, RCS Mediagroup, Gruppo Il Sole 24ore, Gruppo Monrif, Gruppo Caltagirone Editore, and Gruppo Class Edition. The GEDI Group is the third one in terms of revenues, preceded by Gruppo Mondadori and RCS MediaGroup, and followed by Gruppo Il Sole24ore and Gruppo Monrif.

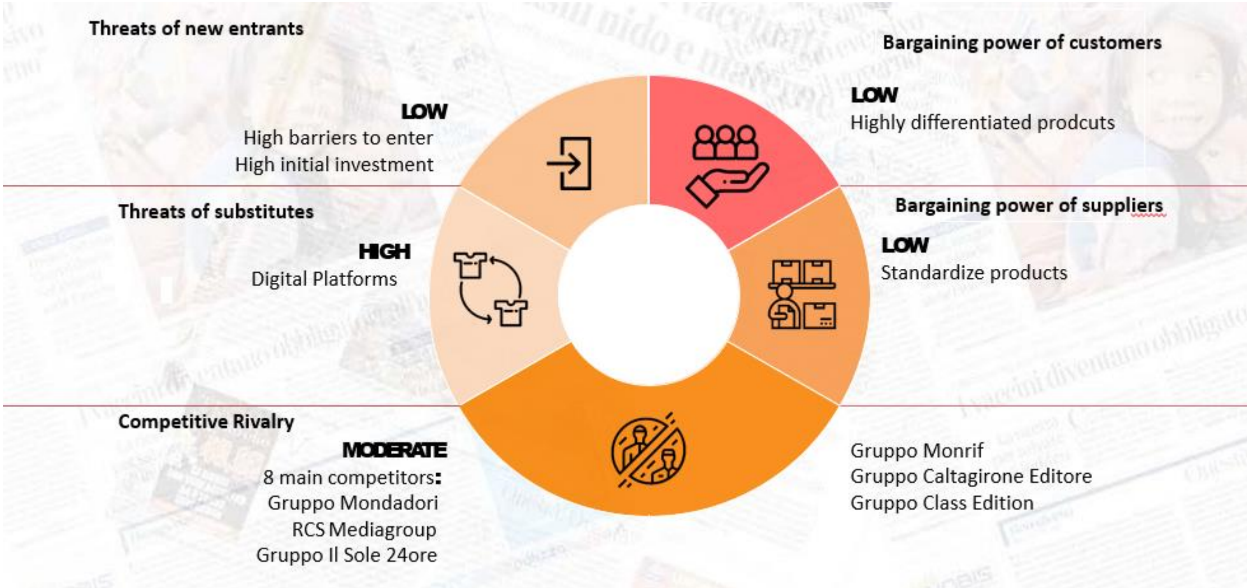


Figure 6 - Porter's Five Forces Analysis

GEDI's group has defined a strategy towards high growth but without ignoring the strengthening and development of traditional activities. The company has set four main objectives with which achieve a differentiation advantage: focusing on new challenges offered by the market, without underestimate traditional activities. Aiming at developing brands and digital performance. Regarding the advertisement industry, the group aims at emphasizing this market. Even if the sector is facing a crisis, the company aims at saving its profits by cutting costs and reorganizing the company. [98]

GEDI is a leader in all the industries it operates, for what concerns the press, it is number one of the national and local circuit, of online news and video and in local advertising, for the radio industry, it is the leader of advertising collection while the number three of audience, it is the first multimedia sales organization for diversification on advertising and the fourth player in Italy of advertising after TV groups and Google. Financial results of 2018 shows an increment of revenues, from 615.8 to 648.7, the most profitable business unit is the GEDI News Network one, with an increment of 24,6% from 2017 to 2018, while the national press shows a loss of 8,2% with respect to the previous year.

One of the main strengths of the GEDI group, is its portfolio of strong brands, as well as the quality of the products offered that contributed to the solidification of the brands. There are a lot of opportunities that the group can pursue in order to keep and improve its leadership: the focus on most profitable local areas for the development of local newspapers, a business transformation towards the digital and it can exploit also the opportunities of a growing radio business.

One of the main weaknesses of the group is the national press that for the year 2018 underperformed the market, the company decided also to close some printing facilities and to reduce external collaboration. One of the major threats comes from the fact that Italy is one of the most undervalued

[98] GEDI spa. (2018). *Annual Report at December 31, 2018.*

country in Europe for what concern the radio market, that instead represents an opportunity for the group.

The GEDI group has a differentiation advantage since it is able to offer to its customers a unique product that they value and towards they are loyal. The source of this advantage stands on the quality of the products offered.[99]

2. Analysis of Consolidated Financial Statements 31.12.2018 and 31.12.2019

The Consolidated Financial Statements of the GEDI Group are prepared according to the International Financial Reporting Standards IFRS issued by the International Accounting Standard Board IASB. The statements are prepared on a going concern basis and following the principle of accounting at historical costs assets and liabilities while at fair value derivative instruments and some particular types of assets and liabilities. By comparing financial statements of 2018 and those of 2019, we can notice that the classification, form, order and nature of items is the same, with two exceptions: all the items impacted by the introduction of IFRS 16, and by IFRS 5 for the Persidera S.p.A. investment. The financial statements taken into consideration are consolidated, meaning that include the statements of the Parent company, its subsidiaries and its associated.

Table 6 - Balance Sheet

ASSETS (€ thousand)	**31 December 2018**	**31 December 2019**	**Δ 2018 vs 2019** value	%
Intangible assets with an indefinite useful life	556.656	425.242	(131.414)	-24%
Other intangible assets	10.052	10.327	275	3%
Intangible assets	566.708	435.569	(131.139)	-23%
Right-of-use assets		53.717	53.717	
Property, plant and equipment	80.164	73.158	(7.006)	-9%
Equity-accounted investments	109.371	17.891	(91.480)	-84%
Other equity investments	10.244	9.244	(1.000)	-10%
Non-current receivables			-	
Other assets	1.159	925	(234)	-20%
Deferred tax assets	39.228	38.809	(419)	-1%
NON-CURRENT ASSETS	**806.874**	**629.313**	**(177.561)**	**-22%**
Inventories	14.902	15.919	1.017	7%
Trade receivables	187.207	173.042	(14.165)	-8%
Other financial assets	814	3.107	2.293	282%
Tax assets	6.617	4.640	(1.977)	-30%
Other assets	22.218	13.093	(9.125)	-41%
Cash and cash equivalents	77.279	51.418	(25.861)	-33%
CURRENT ASSETS	**309.037**	**261.219**	**(47.818)**	**-15%**
TOTAL ASSETS	**1.115.911**	**890.532**	**(225.379)**	**-20%**

[99] GEDI spa. (2019). *Annual Report at December 31, 2019.*

LIABILITIES (€ thousand)	**31 December 2018**	**31 December 2019**	**Δ 2018 vs 2019** value	%
Share capital	76.304	76.304	-	0%
Reserves	227.302	228.316	1.014	0%
Retained earnings (losses)	251.371	217.738	(33.633)	-13%
Loss for the year	(32.153)	(128.986)	(96.833)	301%
Equity attributable to the owners of the parent	**522.824**	**393.372**	**(129.452)**	**-25%**
Non-controlling interests	580	517	(63)	-11%
EQUITY	**523.404**	**393.889**	**(129.515)**	**-25%**
Loans and borrowings	3.507	1.746	(1.761)	-50%
Lease Liabilities		41.723	41.723	
Provisions for risks and charges	24.529	8.830	(15.699)	-64%
Employee termination indemnity and other retirement benefits	54.814	52.137	(2.677)	-5%
Deferred tax liabilities	114.905	89.977	(24.928)	-22%
NON-CURRENT LIABILITIES	**197.755**	**194.413**	**(3.342)**	**-2%**
Financial debt			-	
Loans and borrowings	177.766	96.836	(80.930)	-46%
Lease Liabilities		13.578	13.578	
Provisions for risks and charges	34.758	32.208	(2.550)	-7%
Trade Payables	111.154	88.263	(22.891)	-21%
Tax Liabilities	11.598	16.649	5.051	44%
Other Payables	59.476	54.696	(4.780)	-8%
CURRENT LIABILITIES	**394.752**	**302.230**	**(92.522)**	**-23%**
TOTAL LIABILITIES	**592.507**	**496.643**	**(95.864)**	**-16%**
TOTAL LIABILITIES AND EQUITY	**1.115.911**	**890.532**	**(225.379)**	**-20%**

Looking at the Balance Sheet of GEDI Group of 2018 and 2019, we can notice that intangible assets decreased by 23% from 2018 to 2019, derived especially from the decrease in intangible assets with an indefinite useful life, in particular the highest decreases were in publications and trademarks, goodwill and TV frequencies, due to the impairment losses. We expected balance sheet of companies pre and post implementation of IFRS 16 to be drastically different, however, total assets and total liabilities decreases respectively by 20% and 16% from 2018 to 2019, as a consequence the equity decreases by 25%, from 523.404 thousand euros in 2018, to 393.889 in 2019.

Table 7 - Statement of Changes in Equity

(€ thousand)	Share capital	Share Premium	Treasury shares	Fair value reserve	IFRS Reserve	Res. Stock Option	Equity Reserves	Retained earnings	Profit (loss) for the period	**Own share equity**	Third party share equity	**Total share equity**
Position at 31 December 2017	76.304	71.999	(34.579)	-	52.904	11.952	134.002	367.808	(123.336)	**557.054**	502	**557.556**
Movements in net profit	-	-	-	-	-	-	-	(123.336)	123.336	-	-	-
Dividends	-	-	-	-	-	-	-	-	-	-	(17)	(17)
Capital increases, capital contributed by shareholders	-	-	-	-	-	-	-	-	-	-	-	-
Valuation of stock options	-	-	-	-	-	780	-	-	-	780	-	780
Own share transactions	-	-	110	-	-	-	-	(228)	-	(118)	-	(118)
Transfer between reserves	-	-	-	-	41	-	(8.904)	8.863	-	-	-	-
Effect of adopting IFRS9	-	-	-	-	(1.003)	-	-	-	-	(1.003)	-	(1.003)
Other changes	-	-	-	-	-	-	-	(2.500)	-	(2.500)	-	(2.500)
Changes in statement of comprehensive income:												
Actuarial profit (loss) on personnel provisions	-	-	-	-	-	-	-	764	-	764	-	764
Net profit (loss) for the period	-	-	-	-	-	-	-	-	(32.153)	(32.153)	95	(32.058)
Position at 31 December 2018	**76.304**	**71.999**	**(34.469)**	**-**	**51.942**	**12.732**	**125.098**	**251.371**	**(32.153)**	**522.824**	**580**	**523.404**
Allocation of loss	-	-	-	-	-	-	-	(32.153)	32.153	-	-	-
Dividends	-	-	-	-	-	-	-	-	-	-	(64)	(64)
Capital increases, capital injections	-	-	-	-	-	-	-	-	-	-	-	-
Stock options	-	-	-	-	-	1052	-	-	-	1.052	-	1.052
Treasury shares	-	-	5.287	-	-	-	-	(5.305)	-	(18)	-	(18)
Transfers	-	-	-	-	(670)	-	(4.655)	5.325	-	-	-	-
Other changes	-	-	-	-	-	-	-	(182)	-	(182)	-	(182)
Changes in statement of comprehensive income:												
Actuarial gain (loss) on employee benefits	-	-	-	-	-	-	-	(1.318)	-	(1.318)	-	(1.318)
Loss for the year	-	-	-	-	-	-	-	-	(128.986)	(128.986)	1	(128.985)
Position at 31 December 2019	**76.304**	**71.999**	**(29.182)**	**-**	**51.272**	**13.784**	**120.443**	**217.738**	**(128.986)**	**393.372**	**517**	**393.889**

Δ 2018 vs 2019												
valore	0	0	5.287	0	(670)	1.052	(4.655)	(33.633)	(96.833)	**(129.452)**	(63)	**(129.515)**
%	0%	0%	-15%		-1%	8%	-4%	-13%	301%	-25%	-11%	-25%

Table 8 - Highlights Balance Sheet

(€ million)	31 December 2018	31 December 2019	Δ 2018 vs 2019 valore	Δ 2018 vs 2019 %
Net invested capital	626,6	437,9	(189)	-30%
Equity (inc. non-controlling interests)	523,4	393,9	(130)	-25%
Attributable to the owners of the parent	522,8	393,4	(129)	-25%
Non-controlling interests	0,6	0,5	(0)	-17%
Net Financial debt before IFRS 16	(103,2)	(44,1)	59	-57%
Lease liabilities and right-of-use IFRS 16	n.a.	(55,3)		
Net Financial debt after IFRS 16	n.a.	(99,4)		
Employees	2.359	2.221	(138)	-6%

The implementation of IFRS 16 leads to an increase in the Net Financial debt that without the new standard, in 2019 would have been of 44,1 million euros compared to the actual debt of 99.4 million euros derived from the increase in lease liabilities.

The main difference in the Balance Sheet of 2018 and 2019 is the recognition of a right of use asset and lease liabilities, that are not present in 2018. In this case, the asset equals the present value of minimum lease payments of the lessee, the advance payments and the direct costs incurred. These payments are going to be amortised. The lease liability from the other hand includes the lessee's minimum lease payment and the accrued expenses not settled yet. However, as already noted, the main consequence in the balance sheet is the increase of the Group net financial debt for 55.3 million euros that is the amount of lease liabilities recognized. There are no consequences on the covenants.

Depreciation expenses increase by 119.619 thousand euros from 2018 to 2019, since new right of use assets are recognized, the related depreciation expense will increase total depreciation expenses. In 2019 no Rental Expense is recognized, instead that amount is now accounted under Depreciation Expense.

Table 9 - Income Statement

(€ thousand)	Year 2018	Year 2019	Δ 2018 vs 2019 valore	Δ 2018 vs 2019 %
Revenues	648.736	603.508	(45.228)	-7%
Change in inventories	128	(30)	(158)	-123%
Other operating income	15.545	8.295	(7.250)	-47%
Purchases	(59.820)	(56.108)	3.712	-6%
Services	(308.321)	(269.374)	38.947	-13%
Other operating costs	(13.344)	(14.852)	(1.508)	11%
Personnel costs	(249.855)	(237.256)	12.599	-5%
Depreciation, amortisation and impairment losses	(44.153)	(163.772)	(119.619)	271%
Operating Profit (loss)	**(11.084)**	**(129.589)**	**(118.505)**	**1069%**
Net financial income (expense)	(11.636)	(7.829)	3.807	-33%
Net gains (losses) on equity-accounted investments	648	440	(208)	-32%
Profit (loss) before taxes	**(22.072)**	**(136.978)**	**(114.906)**	**521%**
Income taxes	1.092	24.460	23.368	2140%
Loss from continuing operations	**(20.980)**	**(112.518)**	**(91.538)**	**436%**
Profit (loss) from discontinued operations	(11.078)	(16.467)	(5.389)	49%
Loss for the year	**(32.058)**	**(128.985)**	**(96.927)**	**302%**
Non-controlling interest	(95)	(1)	94	-99%
LOSS ATTRIBUTABLE TO THE OWNERS OF THE PARENT	**(32.153)**	**(128.986)**	**(96.833)**	**301%**
Loss per share, basic	(0,066)	(0,263)	(0)	298%
Loss per share, diluted	(0,059)	(0,257)	(0)	336%

Table 10 - Statement of Comprehensive Income

(€ thousand)	Year 2018	Year 2019	Δ 2018 vs 2019	
			valore	%
LOSS	**(32.058)**	**(128.985)**	**(96.927)**	**302%**
Other comprehensive income (expenses):			-	
Actuarial gain (loss)	1.005	(1.737)	(2.742)	-273%
Fair value gains (losses) on available-for-sale financial assets	-	-	-	
Related tax	(241)	419	660	-274%
Other comprehensive income (expenses), net of tax	**764**	**(1.318)**	**(2.082)**	**-273%**
TOTAL COMPREHENSIVE INCOME/EXPENSE	**(31.294)**	**(130.303)**	**(99.009)**	**316%**
Total comprehensive income/(expense) attributable to:			-	
Owners of the Parent	(31.389)	(130.304)	(98.915)	315%
Non-controlling interests	95	1	(94)	-99%

We expected operating profit to be higher in 2019 compared to 2018, however, the operating loss of the company increases substantially. This increase depends especially from the increase in operating costs such as purchases, services, personnel and other operating costs, and from the increase in depreciation, amortisation and impairment losses that includes also operating expense and interest expenses under IFRS 16. Indeed, total expenses increases under IFRS 16 and this led to an overall increase of the loss for the year that from – 32.058 in 2018 becomes – 128.986 in 2019.

Table 11 - Highlights Income Statement

(€ million)	Year 2018	Year 2019	Δ 2018 vs 2019	
			valore	%
Revenue, of which:	648,8	603,5	(45)	-7%
circulation	284,6	269,7	(15)	-5%
advertising	318,0	293,7	(24)	-8%
add-on products and sundries	46,2	40,1	(6)	-13%
Adjusted gross operating profit	51,7	59,3	8	15%
Gross operating profit	33,1	34,2	1	3%
Adjusted operating profit	**33,1**	**27,5**	**(6)**	**-17%**
Operating loss	(11,1)	(129,6)	(119)	1068%
Profit (loss) before taxes	(22,1)	(137,0)	(115)	520%
Loss from continuing operations	(21,0)	(112,5)	(92)	436%
Profit (loss) from discontinued operations	(11,1)	(16,5)	(5)	49%
Adjusted operating profit	**16,7**	**12,2**	**(5)**	**-27%**
Loss for the year	(32,2)	(129,0)	(97)	301%

The decrease in Revenues between 2018 and 2019 contributed to the increase in the loss for the year of the company that is mainly operating. The Gross operating profit of 2019 doesn't include lease payments, while it does include amortisation of right of use asset and the financial expense on the liability recorded. Indeed, the gross profit of 2019 is higher by 1.1 million euros compared to the one in 2018, this increase is derived from the different nature, qualification and classification of lease payments. However, the loss for the year increases substantially.

Table 12 - IFRS 16 Effects

	2018	2019 (without IFRS 16)	2019 (With IFRS 16)	
Adjusted Gross Operating Profit	51,7	44,7	59,3	⬆
Adjusted Profit	16,7	13,5	12,2	⬇
Net Financial Debt	103,2	44,1	59,1	⬆

The adjusted gross operating profit increases by 13% from 2018 to 2019, from 51.7 million euros to 59.3 million euros. Without the introduction of the new standard IFRS 16, the amount for 2019 would have been 44.7 million euros. Also, the adjusted profit and the net financial debt would have been different without the IFRS 16. Both the adjusted gross operating profit and the net financial debt increases with IFRS 16 compared to without, respectively they go from 44.7 million euros to 59.3 million euros, and from 44.1 million euros to 59.1 million euros. From the other hand, the adjusted profit decreases, from 13.5 million euros to 12.2 million euros.

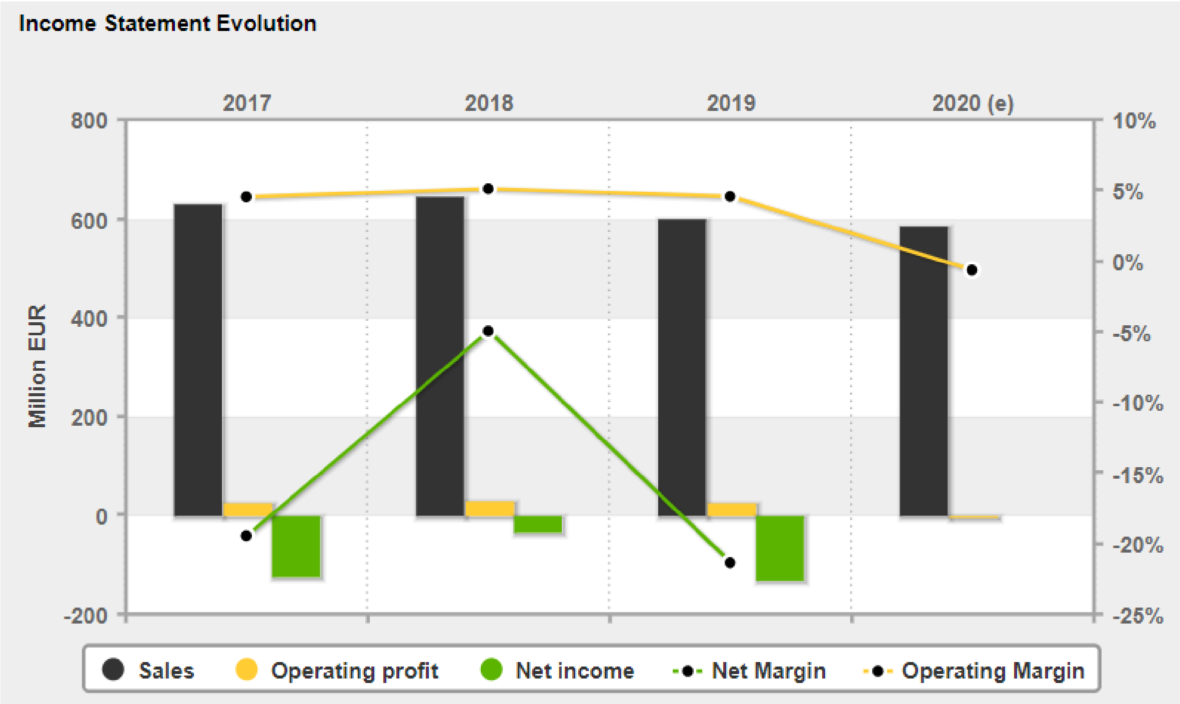


Figure 7 - Income Statement Evolution

Table 13 - Cash Flow Statement

(€ thousand)	Year 2018	Year 2019	Δ 2018 vs 2019 valore	Δ 2018 vs 2019 %
OPERATING ACTIVITIES				
Net profit (loss) for the period, including minority interests	(32.058)	(128.985)	(96.927)	302%
Adjustments:			-	
Depreciation, amortisation and write-downs	44.153	163.772	119.619	271%
-Actuarial valuation stock option plans	780	1.052	272	35%
-Net change in employee benefits	(4.383)	(2.677)	1.706	-39%
-Net change in provisions for risks and charges	2.679	(18.249)	(20.928)	-781%
-Gains on disposal of non-current assets	(3.268)	(140)	3.128	-96%
-Gains on disposal of equity investments and securities	(68)	(100)	(32)	47%
-Fair value gains on financial assets	871	-	(871)	-100%
-Adjustments to the value of financial assets			-	
-Adjustments for equity-accounted investments	3.005	4.392	1.387	46%
-Loss (profit) from discountinued operations	11.078	16.467	5.389	49%
Dividends (received)			-	
Self-financing	**22.789**	**35.532**	**12.743**	**56%**
Changes in working capital and other flows	**(1.285)**	**(20.971)**	**(19.686)**	**1532%**
CASH FLOW FROM OPERATING ACTIVITIES	**21.504**	**14.561**	**(6.943)**	**-32%**
of which:			-	
Interest received (paid)	(3.120)	(3.140)	(20)	1%
Income taxes received (paid)	(1.657)	(2.275)	(618)	37%
INVESTING ACTIVITIES			-	
Outlay for purchase of non-current assets	(16.410)	(11.303)	5.107	-31%
Outlay for purchase of equity investments	(5)	-	5	-100%
Proceeds from sales	4.537	1.332	(3.205)	-71%
(Purchase) sale of securities, available-for-sale assets			-	
Dividends (received)			-	
Proceeds from the sale of assets	7.000	71.054	64.054	915%
CASH FLOW FROM (USED IN) INVESTING ACTIVITIES	**(4.878)**	**61.083**	**65.961**	**-1352%**
FINANCING ACTIVITIES			-	
(Repurchase) sale of treasury shares	110	(18)	(128)	-116%
Increase (decrease) in bond loans	-	(99.700)	(99.700)	
Lease payments	-	(14.208)	(14.208)	
Increase (decrease) in loans and borrowings	(3.533)	13.864	17.397	-492%
Other changes	519	(1.564)	(2.083)	-401%
CASH FLOW USED IN FINANCING ACTIVITIES	**(2.904)**	**(101.626)**	**(98.722)**	**3400%**
Increase (decrease) in cash and cash equivalents	**13.722**	**(25.982)**	**(39.704)**	**-289%**
CASH AND CASH EQUIVALENTS AT BEGINNING OF THE PERIOD	**63.467**	**77.189**	**13.722**	**22%**
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	**77.189**	**51.207**	**(25.982)**	**-34%**

Lease payments are considered a financing activity under IFRS 16, therefore we can notice that in 2018 this item was not present in GEDI's Cash Flow Statement, while in 2019 it amounts to – 14.208 thousand euros, therefore decreasing total cash flow used in financing activities from – 2.904 thousand euros, to – 101.626 thousand euros. This decrease in cash flow used is given also by the changes in bond loans, and loans and borrowings. From the other hand, operating activities are expected to be reduced in 2019, since off-balance sheet leases are not present under operating costs anymore. From 2018 to 2019 the cash flow from operating activities decreases by 32%, from 21.504 thousand euros, to 14.561 thousand euros. However, the two effects in operating activities and financing activities offset themselves, and the total net cash flow is not impacted. In this case the cash at the end of the year decreases in 2019 by 25.982 thousand euros, but this does not depend from the effect of IFRS 16, but especially from the increase in cash flow used in investing activities (the proceeds from the sale of assets decrease and the decrease in cash flow used in financing activities due to the decrease in bond loans.)

3. Process of first application of IFRS 16

As of 1 January 2019, the GEDI Group started applying the new standard IFRS 16, before this transition date, the group conducted a preliminary assessment of the expected impact, the assessment process involved several steps, among which, the mapping and analyses of lease contracts. The Group found out that property leases are those that mainly impact the company, and therefore it conducted and in-depth analysis of each contract in order to determine if they may include an extension option. To make this analysis, the aspects took into consideration were: the planned use of the property, for instance, industrial, publishing, administrative or other and the capacity of present and future space. The GEDI Group benefited from the short-term exception, not applying the standard for leases of less than 12 months, and the low-value exception for leases of items valued less or equal 5.000€. Another in depth analysis was conducted regarding Housing contracts in Italy, the company has equipment housed for broadcasting radio signals, and it analysed if the equipment is present in a space that can give the Group a right to acquire economic benefits such as the reception and process of satellite signals, and the broadcast in the area. Only those items associated with economic benefits enter under the scope of IFRS 16.

The Group followed the guidelines of the IASB in order to first apply the new standard IFRS 16. At the commencement date, a right of use asset and a related lease liability were recognised. The asset was measured at cost and accounted with an adjustment related to the payments and the indirect costs incurred and estimated for the future. While the liability was accounted at the present value of the payments and discounted using the interest rate implicit in the lease or the incremental borrowing rate. After the commencement date, the asset is depreciated using a straight-line method over the term, and the liability is amortised by the effective interest method. In the Balance Sheet, the right of use assets appears under non-current assets, while the lease liability under financial liabilities. In the Income Statement the interest expense is a financial expense separated from the depreciation.

In order to facilitate the first adoption of the new standard, the Group decided to use the modified retrospective approach, not restating comparative information of 2018, and measuring right-of-use assets as an amount equal to the lease liability.

Table 14 - Effect of first-time application IFRS 16

(€ million)	1 January 2019
Right-of-use assets: "Property"	61,958
Right-of-use assets: "Vehicles, electronic machines and other assets"	3,538
Lease liabilities for right-of-use	65,496
Lease liabilities for undiscounted right-of-use	71,969

As showed in *table 14*, the effects of first-time application of IFRS 16 were substantial. The right-of-use asset is divided into property and vehicles, electronic machines and other assets, with those of property being the most considerable, and the amount equals the lease liabilities for right of use. This approach can be used only for the first application in order to facilitate the transition process.

Right-of-use assets can be divided into property, being the most substantial amount, and vehicles, electronic machined and other assets, as showed in the table below.

Table 15- Right of use assets

	2018	**2019**	valore	%
Property	27.322	21.657	-5.665	-21%
Vehicles, electronic machines and other assets	1.280	1.005	-275	-21%
TOTAL RIGHTS-OF-USE	**28.602**	**22.662**	**-5.940**	**-21%**

The discount rate ranged from 2% to 3.77% depending on the expiration of contracts. In the table above, the data related to 2018 are referred to the first application of IFRS 16. By comparing the two years, we can notice that there has been a decrease in both property and vehicles, electronic machines and other assets.

Table 16 - Property, Plant and Equipment

	2018	**2019**	valore	%
Industrial and civil buildings	167	117	-50	-30%
Leashold improvements	4.051	3.224	-827	-20%
Plant and machinery	1.617	1.608	-9	-1%
Furniture, fixtures and vehicles	2.084	1.567	-517	-25%
Assets under consutruction	47	-	-47	-100%
Other assets	-	3	3	
TOTAL PROPERTY, PLANT AND EQUIPMENT	**7.966**	**6.519**	**-1.447**	**-18%**

Property, plant and equipment can be breakdown into six main components: industrial and civil buildings, leasehold improvements, plant and machinery, furniture, fixtures and vehicles, assets under construction and other assets. From 2018 to 2019, we can observe a decrease in all the components with the exception of other assets that from 0€ increases to 3.000€. In both the years 2018 and 2019, the most relevant investments were made for leasehold improvements, those developments that a lessee can made in order to enhance the lessor's assets.

Table 17- Leasehold improvements

	2018
Opening balance	
Original cost	30.216
Accumulated amortisation and write-downs	-25.424
Opening balance	**4.792**
ADJUSTMENTS TO ORIGINAL COST	
Increases	328
Decreases	-
ADJUSTMENTS TO PROVISIONS	
Increases	-1.069
Decreases	-
Closing balance	
Original cost	30.544
Accumulated amortisation and write-downs	-26.493
Closing balance	**4.051**

	2019	valore	%
Opening balance			
Historical cost	30.544	328	1%
Accumulated amortisation and impairment losses	-26.493	-1.069	4%
Opening balance	**4.051**	**-741**	**-15%**
ADJUSTMENTS TO HISTORICAL COST			
Increases	112	-216	-66%
Decreases	-	0	
ADJUSTMENTS TO ACCUMULATED DEPRECIATION			
Increases	-936	133	-12%
Decreases	-	0	
Closing balance			
Historical cost	30.656	112	0%
Accumulated amortisation and impairment losses	-27.428	-935	4%
Closing balance	**3.228**	**-823**	**-20%**

In 2018, the main investments were made for the restructuring of the office located in Rome, while in 2019, the 112.000€ of increases relates to the maintenance of offices.

Table 18 - Non-current loans and borrowings

Non-current financial debt	**31/12/2017**	**31/12/2018**
Bonds	87.907	-
Bank Loans	-	-
Other financial debt	-	-
TOTAL NON-CURRENT FINANCIAL DEBT	**87.907**	**-**

Non-current loans and borrowings	**31/12/2019**
Bonds	-
Bank Loans	-
Lease Liabilities	17.163
TOTAL NON-CURRENT LOANS AND BORROWINGS	**17.163**

Table 19 - Current Financial Debt

	31/12/2017	**31/12/2018**
Bonds	5.795	98.884
Bank Loans	-	7
Financial payables to Group companies	60.028	86.358
TOTAL CURRENT FINANCIAL DEBT	**65.823**	**185.249**

	31/12/2019	valore	%
Bonds	-		
Bank Overdrafts	19.507	19.500	278571%
Loand and borrowing - Group Companies	80.703	-5.655	-7%
Lease Liabilities	6.053		
TOTAL CURRENT FINANCIAL DEBT	**106.263**	**- 78.986**	**-43%**

Table 20 - Financial Liabilities

	Bank loans	Total financial liabilities	Bond issue	Other financial debt
Balance at 31/12/2017	**93.702**	**-**	**-**	**93.702**
Cash flows	-	-	-	-
Other changes				
Change in the fair value and amortised cost	5.331	-	-	5.331
Balance at 31/12/2018	**99.033**	**-**	**-**	**99.033**

	Bonds	Loans and borrowings with banks and Group companies	Lease Liabilities	Total financial liabilities
Balance at 31/12/2018	**98.884**	**86.365**	**-**	**185.249**
Cash flows	(99.700)	13.845	(6.179)	(92.034)
Other changes				
Initial recognition of lease liabilities	-		28.602	28.602
Change in the fair value and amortised cost	816	-	793	1.609
Balance at 31/12/2019	**-**	**100.210**	**23.216**	**123.426**

A reclassification of financial liabilities was made in 2019 due to the changes introduced by IFRS 16. At the end of the year, lease liabilities amounted to 23.216 thousand euros, that with respect to the first recognition of lease liabilities at the beginning of the year, decreased by 5.386 thousand euros. 6.179 thousand euros decrease in the cash flows represents the lease payments and the financial expenses.

Table 21 - Cost of Services

	2018	2018 Reclassified	2019
Printing and other work carried out by third parties	17.264	17.264	16.594
Distribution	93.591	93.591	85.424
Reproduction rights SIAE and other copyright costs	7.117	7.117	5.356
Promotions	18.343	18.343	14.627
Agent and agency fees	25.876	25.876	24.245
Editing costs	53.002	53.002	48.772
Radio and TV productions	231	231	207
Advisory	9.597	9.597	7.880
Travelling expenses	7.941	7.941	6.913
Telephone and data transmission	2.905	2.905	2.298
Maintenance and utilities	17.444	17.444	16.940
Technical equipment operation	8.885	8.885	9.227
Rentals payable	18.140		
Lease and other expense for use of third party assets		22.199	9.739
Security, cleaning and refuse disposal	3.139	3.139	3.108
Other costs for services	24.846	20.787	18.044
TOTAL SERVICE COSTS	**308.321**	**308.321**	**269.374**

For what concerns the Income Statement, in the section Costs of Services, we can notice a difference with respect to previous the application of IFRS 16. In 2019, there is a new item called: *"Lease and other expense for use of third-party assets"* that was not present in the previous years. This item includes expenses for service or maintenance components relative to individual contracts, while it does not include lease expenses for the Group's premises and vehicles and other machinery leases that have been reclassified. In 2018, the amount accounted under this name was split between the items of *"Rentals payable"* and *"Other costs for services"*.

Table 22 - Depreciation, Amortisation and Impairment Losses

	2018	2019
Amortisation	4.501	5.592
Amortisation of right-of-use assets	-	13.961
Depreciation on tangible assets	14.139	12.277
Impairment losses of intangible assets	24.247	131.931
Impairment losses of property, plant and equipment	1.266	11
TOTAL DEPRECIATION, AMORTISATION AND IMPAIRMENT LOSSES	**44.153**	**163.772**

Amortisation and Depreciation of 2019 are in line with the amounts of 2018, however the great difference in the total is justified by two events: the effects of the introduction of IFRS 16 can be seen in the recognition of new amortisation of right of use assets, 139.961 thousand euros, and the increase of impairment losses of intangible assets is given by the loss derived from publications in the impairment test.

Table 23 - Net Financial Expense

	2018	2019
Dividends	**-**	**-**
Interest received on current accounts and short-term deposits	56	47
Foreign-exchange gains	11	11
Other financial income	53	140
Financial Income	**120**	**198**
Accessory banking expenses	(1.201)	(1.198)
Interest on bonds issued	(7.799)	(2.125)
Interest on loans and financing	(790)	(1.794)
Foreign-exchange losses	(53)	(28)
Financial expense IFRS 16		(1.913)
Financial charges on application of IAS	(899)	(946)
Other financial charges	(181)	(148)
Financial expense	**(10.923)**	**(8.152)**
Capital gains on disposal of investments	68	100
Charges from cash flow hedge IFRS 9	2	25
Impairment losses and losses on investments	(871)	-
Charges from cash flow hedge IFRS 9	(32)	-
NET FINANCIAL EXPENSE	**(11.636)**	**(7.829)**

In Financial Expenses is it possible to assess the impact of IFRS 16 that in 2019 was of 1.913 thousand euros, however in this case the decrease of net financial expenses is given also from other items such as the impairment losses, the repayment of equity-link convertible bond, and the revolving credit facility undertook.

Table 24 - Net Financial Debt

	31/12/2018	31/12/2019
Loan assets - group companies	174	175
Cash and deposits	77.105	51.243
Bank overdrafts	(90)	(211)
Cash and cash equivalents	**77.189**	**51.207**
Marketable securities and other financial assets	814	3.107
Bond issue	(98.884)	-
Other bank loans and borrowings	(6.349)	(23.026)
Other loans and borrowings	(75.950)	(75.345)
Other financial liabilities, net	**(180.369)**	**(95.264)**
NET FINANCIAL POSITION	**(103.180)**	**(44.057)**
Lease liabilities - IFRS 16	**n.a.**	**(55.301)**
CLOSING NET FINANCIAL DEBT AFTER - IFRS 16	**n.a.**	**(99.358)**

The application of IFRS 16 results in the recognition of 55, 3 million euros of lease liabilities, therefore increasing the net financial position, from 44,1 million euros to 99,6 million euros. However, without the implementation of IFRS 16 the net financial position would have decreased by 59,1 million compared to 2018, mainly due to the increase in cash flow from ordinary operations and the sale of Persidera.

4. Performance Analysis

To conduct a Performance Analysis, a reformulation of the Balance Sheet and the Income Statement is required. The managerial statement of financial position and income statement allow us to compute the financial ratios, that are crucial in order to analyse and evaluate the performance of a company over the years. This analysis is not possible to perform using traditional financial statements, since the operating criteria of assets and liabilities is more useful in this case compared to the liquidity one of traditional statements. The reformulated balance sheet implies the division of assets and liabilities into operating and financial. This separation is needed in order to calculate the Net Operating Assets and the Net Financial Position of the company. The reformulated Balance Sheet gives information on the firm's strategy to run the business and on how the firm invests and conducts financing operations. The main difference derived by the introduction of IFRS 16 in the operating assets section stands in the right of use asset item that was not present in 2018, while from the side of financial liabilities, the introduction of lease liabilities will substantially increase this section. The Net Operating Assets is computed as the difference between Operating Assets and Operating Liabilities and it amounts to 466.112 thousand euros in 2019, compared to 506.969 thousand euros in 2018. This decrease is justified by the decrease in operating liabilities, the distinction between operating and financial leases does not exist anymore and therefore all lease liabilities are considered a financial item now. From the other hand, the Net Financial Position is calculated as the difference between Financial Assets and Financial Liabilities, and it totalled to -72.223 thousand euros in 2019 compared to 16.435 thousand euros in 2018. This decrease is justified by a decrease in Financial Assets derived mainly by a decrease in equity-accounted investments. However, we expected the Net Financial Position to decrease anyway due to the recognition of lease liabilities that were not part of financial liabilities before. The negative Net Financial Position implies that the company is in a position of Net Financial Obligations and therefore its financial liabilities are higher than its financial assets.

Table 25 - Reformulated Balance Sheet

(€ thousand)	31 December 2018	31 December 2019
Intangible assets with an indefinite useful life	556.656	425.242
Other intangible assets	10.052	10.327
Intangible assets	566.708	435.569
Right-of-use assets	-	53.717
Property, plant and equipment	80.164	73.158
Non-current receivables	-	-
Other assets	1.159	925
Deferred tax assets	39.228	38.809
Inventories	14.902	15.919
Trade receivables	187.207	173.042
Tax assets	6.617	4.640
Other assets	22.218	13.093
Operating Assets	**918.203**	**808.872**
Equity-accounted investments	109.371	17.891
Other equity investments	10.244	9.244
Other financial assets	814	3.107
Cash and cash equivalents	77.279	51.418
Financial Assets	**197.708**	**81.660**
TOTAL ASSETS	**1.115.911**	**890.532**

(€ thousand)	31 December 2018	31 December 2019
Share capital	76.304	76.304
Reserves	227.302	228.316
Retained earnings (losses)	251.371	217.738
Loss for the year	(32.153)	(128.986)
Equity attributable to the owners of the parent	**522.824**	**393.372**
Non-controlling interests	580	517
EQUITY	**523.404**	**393.889**
Provisions for risks and charges	24.529	8.830
Employee termination indemnity and other retirement benefits	54.814	52.137
Deferred tax liabilities	114.905	89.977
Provisions for risks and charges	34.758	32.208
Trade Payables	111.154	88.263
Tax Liabilities	11.598	16.649
Other Payables	59.476	54.696
Operating Liabilities	**411.234**	**342.760**
Loans and borrowings	3.507	1.746
Lease Liabilities	-	41.723
Loans and borrowings	177.766	96.836
Financial debt	-	-
Lease Liabilities	-	13.578
Financial Liabilities	**181.273**	**153.883**
TOTAL LIABILITIES AND EQUITY	**1.115.911**	**890.532**
NOA	506.969	466.112
NFP	16.435	(72.223)

GEDI Gruppo Editoriale calculates its Net Financial Position by subtracting financial liabilities to the sum of other financial assets and cash and cash equivalents. Therefore, not considering equity investments as financial assets. By implementing this method, the net financial position of the company at the end of 2019 is of -99.358 thousand euros compared to -103.180 of 2018.

Table 26 - Net Financial Position

Other financial assets	814	3.107
Cash and Cash equivalents	77.279	51.418
loans and borrowings	181.273	98.582
NFP	**(103.180)**	**(44.057)**
Lease Liabilities	-	55.301
NFP	**(103.180)**	**(99.358)**

Moreover, in order to complete the Performance Analysis, also the Income Statement of the company needs to be reformulated. The strategic income statement allows us to calculate the Net Operating Profit After Taxes (NOPAT). There are two possible methods in order to compute this item: the top-down and the bottom-up. By using the top down method, the NOPAT is calculated as the difference between EBIT (Earnings Before Interest Taxes) and the Tax Benefit and Tax as reported. In 2019 the NOPAT amounts to -107.191 thousand euros, while in 2018 to -13.058 thousand euros. The decrease in NOPAT is justified by the substantial decrease in EBIT and by the increase in tax as reported. In order to compute the tax benefit, the corporate tax rate of Italy, 27.90% was multiplied by the net financial expenses. The result using the bottom up method is the same, however in this case the tax benefit and the net financial expenses are subtracted to the net income.

Table 27 - Reformulated Income Statement

	Year 2018	Year 2019
TOP DOWN		
EBIT	(11.084)	(129.589)
Tax Benefit	(3.066)	(2.062)
Tax as reported	1.092	24.460
NOPAT	**(13.058)**	**(107.191)**
BOTTOM UP		
Net Income	(20.980)	(112.518)
Net Financial Expenses	10.988	7.389
Tax Benefit	(3.066)	(2.062)
NOPAT	**(13.058)**	**(107.191)**

	2018	2019
Tax benefit	3.066	2.062

4.1.Profitability Analysis

A Profitability Analysis is computed in order to evaluate a company's ability to generate profits. In order to do so, the most important profitability ratios were computed. The Return on Equity (ROE) is an indicator of the productivity of the capital invested by stockholders. From 2018 to 2019 this ratio decreased drastically, meaning that the expected return from an investment in the equity is negative. The Return on Common Equity, that is an indicator of the effectiveness of the use of resources by the company, and of its creation of wealth for common shareholders, can be calculated in two different ways: the first method implies the ratio between Total Comprehensive Income and Equity, while the second uses the financial leverage, and it is calculated as the sum of RNOA with the difference between RNOA and NBC multiplied by the FLEV. The Return on Net Operating Assets (RNOA) is negative in both years, and it is lower than the Net Borrowing Cost in 2019, and higher in 2018, therefore, the spread, the difference between RNOA and NBC is negative in 2019 while positive in 2018, when the spread is negative it means that the financial leverage is unfavourable. The Net Borrowing Cost (NBC) takes into consideration the net financial expense, cleaned up by the tax effect, the other comprehensive income and the net financial obligations. The Financial Leverage (FLEV), is the multiplier of the spread and it is an indicator of the degree to which Net Operating Assets are financed by Net Financial Obligations, therefore borrowings. In 2019 the FLEV is positive compared to the previous year, since Financial obligations increase while equity decreases.

The Leverage Ratio, that gives insight regarding the solvency of a company, is the ratio between liabilities and equity and it is 1,13 in 2018 and 1,26 in 2019, the increase in the ratio is justified by the additional liabilities recognized under IFRS 16.

The Return on Asset ratio (ROA) is the ratio between net income and total assets, the ratio amounts to -2,9% in 2018 and -14,5% in 2019. The decrease of ROA is given by the fact that new assets are recognized in 2019 such as the right of use asset.

The Return on Net Operating Assets is another indicator of the company's ability to use capital invested in an efficient way and it includes the NOPAT, therefore it can be used to compare companies in different countries and industries. The Profit Margin (PM) and the Asset Turnover (AT) are part of the RNOA. The Profit Margin, is calculated as the ratio between NOPAT and Sales, therefore indicating how profitable is each unit of sale, the amount of sales revenues that the company will be able to transform into operating income after taxes. In both years, this ratio is negative, therefore for each sale the company loses a part of the net operating profit.

The Asset Turnover is calculated as the ratio between Sales and NOA, and it indicates the ability of the company to generate revenues given a level of asset, the amount of money that the company invests in NOA in order to run the business in relation of the amount of money that the company will be able to have as revenues of sales. The ratio decreases from 2018 to 2019 due to an increase in Net Operating Assets. Assets are impacted by IFRS 16, while sales remain the same, therefore a decrease in asset turnover was expected with the implementation of IFRS 16.

ROCE increases as RNOA increases, therefore in 2019 these two ratios both decreases, this means that the company decreases equity returns when NOA is financed by debts, and the assets provide a return lower than the cost of debt. GEDI is in a situation where it has lower financial income than financial expenses in 2019, therefore it is in a Net Financial Obligation position and its ROCE is lower than RNOA.

The Return on Investments (ROI) investigates the efficient usage of capital invested in the business, and it is calculated as the ratio between EBIT and Net Operating Asset, it is negative in both years, meaning that NOA is higher than EBIT for 2018 and 2019.

Table 28 - Profitability Analysis

(€ thousand)	Year 2018	Year 2019
ROE	-6,1%	-32,7%
ROCE	-6,0%	-33,1%
RNOA	-2,3%	-13,3%
PM	-2,0%	-17,8%
ATO	112,7%	74,6%
NBC	-52,9%	9,2%
FLEV	-3,1%	18,3%
ROCE (fin leverage)	-3,9%	-17,4%
ROI	-1,9%	-16,0%
Leverage	1,13	1,26
ROA	-2,9%	-14,5%

The Account Receivables Turnover (ART) is the ratio between Sales and Average Account Receivables, and by dividing the days of the year by this ratio we can find how many days the company waits on average to collect account receivables. Therefore, GEDI expects to collect its account receivables after 111 and 108 days in 2018 and 2019 respectively.

The Inventory Turnover (IT) measures the number of days in which the company expects to sell its inventory, and it amounts to 8 in 2018 and 11 in 2019.

The Account Payable Turnover instead measures the number of days in which the company pays its creditors, and it amounts to 34 days in 2018 and 41 in 2019.

Finally, the Working Capital Cycle (WCC) can be calculated as the sum between the account receivable turnover in days and the inventory turnover in days, minus the account payable turnover in days. The WCC is useful to assess liquidity problems due to mismatches between cash inflows and outflows. The WCC of GEDI is positive in both years, therefore the company has less days to pays its creditors compared to the number of days in which it expects to collect receivables and sell its inventories.

Table 29 - Profitability Ratios

ART	3,28	3,35	ART in days	111,26	108,94
IT	45,67	32,21	IT in days	7,99	11,33
APT	10,75	8,69	APT in days	33,94	41,98
			WCC	**85,31**	**78,29**

4.2.Liquidity Analysis

A Liquidity Analysis is a complementary analysis to the profitability one, and it is conducted in order to assess the performance of a company. To perform this analysis, the Working Capital Requirement is calculated as the difference between short-term operating assets and short-term operating liabilities. The WCR is positive both in 2019 and 2018 meaning that the company has enough short-term investments to run operating activities, so long-term investments are not needed. In both years the difference between long-term operating assets and long-term operating liabilities is positive, meaning that part of long-term operating assets will be financed using short-term operating liabilities.

The Current Ratio is the ratio between current assets and current liabilities, and it represents the company's ability to pay current liabilities with short-term assets. The ratio is lower than 100% both in 2018 and 2019, meaning that the amount of assets is not sufficient to repay short-term liabilities. Indeed, GEDI uses also non-current assets to pay back its creditors. However, the current ratio increases from 2018 to 2019, due to the decrease in current liabilities.

The Quick Ratio is calculated as the ratio between the sum of cash and account receivables and current liabilities and it is an indicator of the company's ability to pay current liabilities using quick assets, namely cash and account receivables, those assets that can be converted into cash in a short period. The ratio increases from 2018 to 2019, this is a good sign for the company, meaning that quick assets are increasing compared to current liabilities, even though the sum of them is still lower than the amount of current liabilities.

Table 30 - Liquidity Analysis

	Year 2018	Year 2019
LT operating assets	687.259	602.178
LT operating liabilities	194.248	150.944
ST operating assets	230.944	206.694
ST operating liabilities	216.986	191.816
WCR	**13.958**	**14.878**
Current assets	309.037	261.219
Current liabilities	394.752	302.230
Current ratio	**78%**	**86%**
Cash	77.279	51.418
Account receivables	187.207	173.042
Current liabilities	592.507	496.643
Quick ratio	**44,64%**	**45,20%**

There is an alternative way of reformulating the Balance Sheet in order to highlight the liquidity situation of a company.

Table 31 - Reformulated BS

Cash	Short-term debt
WC Requirement	Long-term financing
Net fixed operating assets	
Invested Capital	Capital employed

77.279	177.766
13.958	526.911
493.011	
Invested Capital	Capital employed
584.248	704.677

51.418	110.414
14.878	437.358
451.234	
Invested Capital	Capital employed
517.530	547.772

The Invested Capital that is the sum of Cash, WCR and Net Fixed Operating Assets decreases from 2018 to 2019 since all the three items decrease, especially Cash. Also, the Capital Employed decreases from one year to another, since short-term debt and long-term financing both decreases.

Table 32 . Reformuated BS

WC Requirement	13.958	14.878
Net Fixed Asset	493.011	451.234
NOA	506.969	466.112
Net Financial Position Short-Term	- 99.673	- 55.889
Net Financial Position Long-Term	116.108	- 16.334
Equity	523.404	393.889
Capital Employed	539.839	321.666

Both the Net Operating Assets and the Capital Employed decrease from 2018 to 2019, since the long-term net operating assets decreases, the net financial position goes from a position of asset to a position of obligations and the Equity decreases.

5. Fundamental Analysis

The aim of the Fundamental Analysis is to recognise the real intrinsic value of a company's shares in order to improve the quality of information of investors that can take more informed and rational decisions about their investments. By computing a fundamental analysis, the value of a share is based on future payoffs, therefore the forecast of future financial statements is needed. In order to implement this analysis, the Residual Earnings Model can be applied, therefore using the Book Value of the company. The Residual Earnings Model implies the forecast of some elements: future earnings, dividends and book value. Since GEDI company did not distributed dividends for the last 6 years, we estimate that it will continue to do so, this choice is justified by the recurring loss incurred during the years. The result of the fundamental analysis is the intrinsic value of the company that is given by the sum of the book value at the beginning of the period and the present value of expected residual earnings. The present value of expected residual earnings is discounted using the required return rate that can be calculated using the Capital Asset Pricing Model (CAPM). Therefore, the formula of the CAPM to estimate the required return r is:

$$r = rf + \beta\ (rm - rf)$$

Rf is the risk-free rate and represents the rate of Italian BTP 10 years [100] and it is 2.68%, the Beta of a company is its systematic risk and it measures the volatility of a security compared to the market. The

[100] ISole24ore.com. (2020). Retrieved from https://www.ilsole24ore.com/

Beta of GEDI is 0.63[101]. However, the Beta can also be calculated by comparing the share prices of GEDI and those of the industry as a whole, the FTSE MIB for Italy. The period took into consideration was from the August the 6th 2017, to July 26th, 2020. The share price decreases substantially, from 0.722 during August 2017 to 0.46 in July 2020. The main drop in the share price happened at the beginning of 2018. Therefore, the value of the Beta is derived from the returns of GEDI's weekly stock prices and those for FTSE MIB,[102] and the result is quite different from the one taken from *Reuters.com,* the calculated Beta amounts to 0.330. The third element needed to calculate the required Return is the risk premium that is the difference between the Return on the market portfolio (Rm) and the Risk-free rate. The Risk premium is 9.02%[103], and it represents the Italian Equity Risk premium. Therefore, by applying the CAPM, the required return amounts to 8.36% (using a given Beta) or 5.65% (by applying the calculated Beta).

Table 33 - CAPM model

Beta	0,63	0,330
Risk free return	2,68%	2,68%
Risk premium	9,02%	9,02%
Book value (2019)	393.889	393.889
Shares outstanding	490.037	490.037
Required return	**8,36%**	**5,65%**
g	1%	1%

The Growth rate assumed is 1%, and it is used to estimate the growth of continuing value of RE. The 1% growth rate estimation is given by the fact that the last years were critical for the publishing sector in general, since advertising collections on print and circulation figures both dropped. The macroeconomic sector in which GEDI operates is full of uncertainties and the recent COVID pandemic contributed to the downward estimates of the GDP performance. However, for what concerns credit risk exposure, GEDI is not subject to significant risk thanks to the sectors in which it operates.

Nevertheless, the company is also focus toward a digitalization process and created a centralised Digital Division of the group in order to effectively meet this necessity. This division is continuously improving, and new platforms and products have been launched, new versions of the websites were introduced, the Group audio content was improved, and technological projects and funding developed, such as the Google's Digital News Innovation (DNI). The Group also launched the CRM system to

101 Reuters.com. (2020). Retrieved from https://www.reuters.com/
102 Investing.com. (2020). Retrieved from https://www.investing.com/
103 Damodaran.com. (2020). Retrieved from http://people.stern.nyu.edu/adamodar/New_Home_Page/home.htm

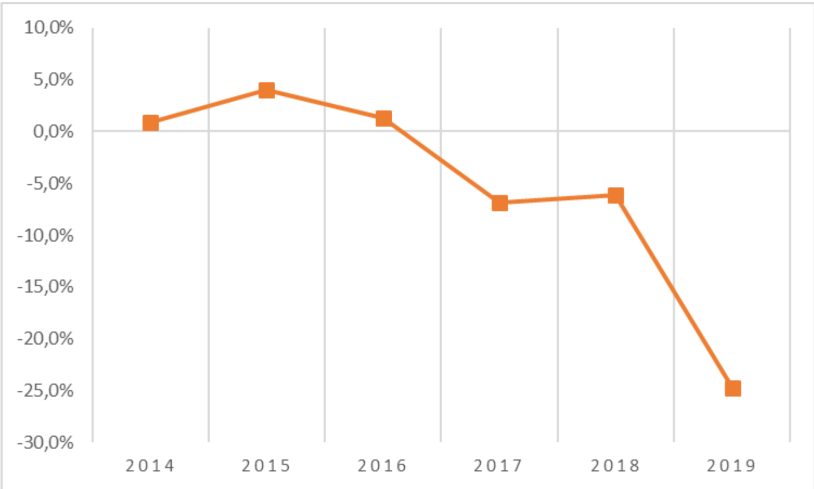
optimise user relations and maximize profits. [104] For the reasons stated above the 1% growth rate was estimated.

The first step in order to conduct a Fundamental Analysis is to look at previous years data, we can observe that the Book Value decreases over time, especially between 2018 and 2019, due to a decrease in revenues.

Table 34 - Previous years performance

	Previous years data						
	2013	2014	2015	2016	2017	2018	2019
Book value	562.217	567.433	590.423	598.360	557.556	523.404	393.889
Growth rate		0,9%	4,1%	1,3%	-6,8%	-6,1%	-24,7%
Net income/loss	3.840	8.616	17.138	10.471	-123.256	-32.058	-128.985
Other comprehensive incor	2.018	-3.743	3.817	-1.269	-515	764	-1.318
Total comprehensive incon	5.858	4.873	20.955	9.202	-123.771	-31.294	-130.303
Net sales	689.056	643.459	605.119	585.512	615.834	648.736	603.508

Table 35 - Book Value Evolution



For the estimated period (2020-2022), we expect the book value to slowly increase, since the company implemented a plan towards digitalization aimed at increasing profits by creating new sources of revenues. However, for 2020 the Book Value is still expected to be negative due to the peculiarities of the year and how it affected the Italian Economy as a whole. The Group did not distributed dividends for the past 6 years, therefore we estimated that it will continue to do so even if the book value will increase. We calculated the present value of the continuing value by using the 1% growth rate and by summing it with the present value of expected residual earning, we found a discount of -305.179 thousand euros. The intrinsic value of the company, that is the sum of the book value in 2019, the total present value of RE and the present value of the current value is 88.709 thousand euros, it is lower than the current value of the company that is 393.889, meaning that GEDI's share are overvalued and the

[104] GEDI spa. (2018). *Annual Report at December 31, 2018.*

best strategy for the company would be to sell and do not buy. Therefore, the P/B ratio is equal to 0.23 since the market value is higher than the intrinsic book value of the company.

Table 36 - Fundamental Analysis

		Forecast years		
		1	2	3
	2019	**2020**	**2021**	**2022**
EPS	-0,26	-0,03	0,03	0,02
Earnings	-128.880	-14.701	13.024	11.592
Book value	393.889,00	379.187,89	392.212,07	403.803,59
Book value growth rate		-3,73%	3,43%	2,96%
ROCE		-0,04	0,03	0,03
RE (using ROCE)		-47.640,47	-18.685,79	-21.207,61
RE		-47.640,47	-18.685,79	-21.207,61
			-60,78%	13,50%
Discount rate		1,08	1,17	1,27
PV of RE		-43.963,94	-15.913,02	-16.666,85
Total PV of RE	-76.543,81			
Continuing value				-290.925,55
PV of CV	-228.635,47			
Premium/discount	-305.179,28			
Value in 2019	88.709,72			
Premium/discount per share	-0,62			
Value in 2019 per share	0,18			
P/B ratio	0,23			

To forecast the income statement for the period 2020-2023, we used 7 different grow rates. The first considering Revenue. The years 2018 and 2019 saw a decrease of relatively almost 8%. We thus assumed that sales will keep decreasing for 2020, but after some years that will be needed to recover all the previous losses the company will start to increase its revenues especially due to the digitalization process initiated years before that will start to bring positive benefits to the company such as the introduction of new platforms.

To forecast the growth of Other operating costs, we observed these costs to be quite stable in the three years (2017-2019). Thus, we assumed them to follow this path in the forecasted period, as an average of the past years.

For what regards Personnel Cost, GEDI recognizes the importance of human resources and for this reason invests a substantial amount of money in their remunerations and incentives. The number of employees increases from 2017 to 2018, however decreasing again in 2019. Since the company is implementing a cost control plan, we expect that also the personnel costs will be impacted and therefore, this cost will slightly decrease through the years.

Lastly, we considered an increasing growth rate of depreciation. The growth rate for the Net Operating Income, follows from the growth rate assumptions of revenues and costs, the company will keep having a loss for the first two years forecasted that are needed in order to recover for the bad years of 2018 and 2019, anyways thanks to its cost control plan and the increase in revenues due to the digitalization process GEDI will achieve a profit in 2022 and 2023.

Table 37 - Forecasted Income Statement

(€ thousand)	2017	2018	2019	2020	2021	2022
Revenues	615.834	648.736	603.508	598.592	596.710	597.816
Growth Revenues		*5,343%*	*-6,972%*	*-0,81%*	*-0,31%*	*0,19%*
Change in inventories	45	128	(30)	-21	-15	-11
Growth Change in inventories		*184,444%*	*-123,438%*	-30,5%	-29,5%	-28,5%
Other operating income	10.792	15.545	8.295	8.227	8.202	8.217
Purchases	(54.256)	(59.820)	(56.108)	-54.972	-54.134	-53.579
Growth Purchases		*10,255%*	*-6,205%*	-2,0%	-1,5%	-1,0%
Services	(293.793)	(308.321)	(269.374)	-259.021	-251.655	-247.016
Growth Services		*4,945%*	*-12,632%*	-3,8%	-2,8%	-1,8%
Other operating costs	(14.496)	(13.344)	(14.852)	-14.603	-14.285	-13.903
Growth Other costs		*-7,947%*	*11,301%*	-1,7%	-2,2%	-2,7%
Personnel costs	(211.331)	(249.855)	(237.256)	-221.613	-211.433	-205.950
Growth Personnel		*18,229%*	*-5,043%*	-6,6%	-4,6%	-2,6%
Depreciation, amortisation and impairment losses	(24.570)	(44.153)	(163.772)	-131.018	-78.611	-31.444
Growth Rate		*80%*	*271%*	*-20%*	*-40%*	*-60%*
Operating Profit (loss)	**28.225**	**(11.082)**	**(129.590)**	**(74.427)**	**(5.222)**	**54.130**
Growth Operating profit		***-139,263%***	***1069,394%***	***-42,567%***	***-92,984%***	***-1136,594%***

In the Balance sheet we forecasted 4 main items: Property, plant and equipment, Inventories, Trade receivables and trade payables. For each of them, we first observed the growth rate in the years 2017, 2018 and 2019, the variations were substantial for each element. Thus, we calculated for PPE, inventory and sales the fraction of sales that these represented and for payables, the fraction of COGS. In this calculation, the revenues and COGS considered regard those forecasted in the Income Statement. Once calculated these 4 main items, we could easily understand the Net Working Capital's value in the years and successively its variation, that will further on be used in the Discounted Cash Flow calculation.

Table 38 - Forecasted Balance Sheet

(€ thousand)	2017	2018	2019	2020	2021	2022	2023
Property, plant and equipment	90.559	80.164	73.158	78.184	74.669	75.120	76.524
Growth PPE		-11%	-9%	7%	-4%	1%	2%
PPE/Sales	15%	12%	12%	13%	13%	13%	13%
Inventories	12.936	14.902	15.919	14.038	14.480	14.765	14.529
Growth Inventories		15%	7%	-12%	3%	2%	-2%
Inventories / Sales	2%	2%	3%	2%	2%	2%	2%
Trade receivables	208.277	187.207	173.042	182.272	174.995	176.255	179.089
Growth Trade Receivables		-10%	-8%	5%	-4%	1%	2%
Account Receivables / Sales	34%	29%	29%	30%	29%	29%	30%
Trade Payables	113.194	111.154	88.263	100.976	94.991	92.257	94.412
Growth Trade Payables		-2%	-21%	14%	-6%	-3%	2%
Trade Payables / COGS	-208%	-185%	-157%	-184%	-176%	-172%	-177%
Revenues	615.834	648.736	603.508	598.592	596.710	597.816	601.914
COGS	-54.301	-59.948	-56078	-54.951	-54.119	-53.568	-53.290
NWC	108.019	90.955	100.698	95.334	94.484	98.763	99.206
NWC Variation		-17.064	9.743	-5.364	-850	4.279	444

In order to develop a Discounted Cash Flow model, to determine the total value of GEDI to both equity and debt holders, we started from the forecasted EBITDA for the years 2020, 2021, and 2022. We subtracted to EBITDA the forecasted depreciation, and then subtracting taxes again, that we calculated with a 27,90% tax rate (from GEDI Annual Report 2019), we found NOPAT (Net Operating Profit After Taxes), adding again the depreciation, we calculate the Operating Cash Flow. At this point we forecasted Capex, by previously estimate Property, Plant and Equipment. Capex estimation was done using the formula = PPE current – PPE previous + depreciation. For what concerns the variation in Net Working Capital, we previously forecasted inventories, trade receivables and trade payables by using the same method of estimation used for the Capex. By subtracting capex and adding the NWC variation to the operating cash flow, we found the Free Cash Flow that the firm has available to pay all debt and equity holders. We discounted it in order to find the Discounted Free Cash Flow.

Table 39 - Discounted Cash Flow

(€ thousand)	2017	2018	2019	2020	2021	2022
EBITDA	52.795	33.071	34.182	56.590	73.389	85.575
DEPRECIATION	(24.570)	(44.153)	(163.772)	(131.018)	(78.611)	(31.444)
EBIT	**28.225**	**(11.082)**	**(129.590)**	**(74.427)**	**(5.222)**	**54.130**
Taxes		(1.974)	22.398	(20.765)	(1.457)	15.102
NOPAT		**(13.055)**	**(107.192)**	**(95.193)**	**(6.679)**	**69.233**
DEPRECIATION		(44.153)	(163.772)	(131.018)	(78.611)	(31.444)
OPERATING CASH FLOW		(57.208)	(270.964)	(226.210)	(85.289)	37.788
-CAPEX		33.758	156.766	136.044	75.095	31.895
NWC Variation		(17.064)	9.743	(5.364)	(850)	4.279
FCF		**(108.030)**	**(417.987)**	**(367.619)**	**(161.234)**	**10.172**
Discounted Period				1	2	3
Discounted Factor				0,931	0,866	0,806
DCF				**151.358**	**32.450**	**1.703**

RWacc	7,44%

Having these values for the forecasted years, we proceed with the estimation of the enterprise value and the equity value. We sum up the estimated DCF, to have a cumulated net available cash flows, we then compute the terminal value using the free cash flow, the WACC and the growth rate. We estimated a growth rate of 1%, we assume that the company will continue to grow at a constant rate into perpetuity. In order to compute the PV of the terminal value, we discounted it, and by adding the cumulated net available cash flows, to the PV of terminal value we derived the enterprise value that is equal to 295.753 €, and it represents the value of the firm, of the unlevered business, with all its debts paid. We then subtract the Net Financial Position to the Enterprise Value, to calculate the Equity Value of the firm, by dividing it to the number of outstanding shares that the company owns. We arrive to an expected Share Price of 0,46€.

Table 40 - Equity Value

Estimation of Equity Value	
Cumulated Net Available Cash Flows	185.511
Terminal Value	136.724
PV of Terminal Value	110.242
Enterprise Value	**295.753**
Net Financial Position	(72.223)
Equity Value	**223.530**
outstanding shares	490.037
Share Price	0,46
WACC	0,0744
G	

In order to perform a Valuation of the GEDI company, we compared its main competitor's data with the ones of the company we are evaluating. We took into account the main competitors, similar for what concerns the industry, the size, the business mix, and the fact that all of them are listed in the stock exchange. We compared three elements: the P/E ratio, the P/B ratio and the P/S ratio.

The Price to Earnings indicates how many times the share price absorbs the amount of earnings, indeed how many times the earnings are contained in the market value of a company. A high P/E ratio is a good sign for a company, meaning that investors expect a high growth for the firm. In 2018 GEDI has one of the lowest P/E ratio, worse is only Gruppo Caltagirone Editore, while in 2019, the ratio is in the average compared to its competitors.

The Price to Book Value ratio is an indicator of the intrinsic value of a company and it measures if a company is undervalued or overvalued by the market. The P/B ratio of GEDI is below 1 in both years, it is slightly below the average of its competitors both in 2018 and 2019.

The Price to Sales ratio is the ratio between share price and sales of a company, and it shows the value placed of each euro in the sales. GEDI, once again is in the average compared to its competitors in both years.

Table 41 - Multiple Analysis

GEDI s.p.a.		
P/E	-5,36	-1,75
P/B	0,33	0,57
P/S	0,27	0,37

Gruppo Mondadori	
-2,51	18,73
19,85	0,29
3,16	0,06

RCS Mediagroup	
7,20	7,75
1,80	1,61
0,47	0,49

Gruppo il Sole24ore	
-4,22	-33,20
0,49	4,89
0,08	0,90

Gruppo Monrif	
1,88	-5,15
1,49	1,84
0,19	0,20

Gruppo Caltagirone Editore	
-14,86	
0,02	0,03
0,05	0,08

Gruppo Class Edition	
-3,00	-3,56
0,42	0,83
0,11	0,17

6. Interview to the CFO

A deep and constructive discussion with Gabriele Acquistapace, the CFO of GEDI Group, has brought to light the process that the company has adopted in order to apply the IFRS 16.

The GEDI Group has started the study of the standard, and therefore the analysis of the repercussions both in organizational terms and for what concerns the financial statements, since the last quarter of 2017, almost one year before the mandatory first application of the standard. In order to implement the project, the Group followed 15 principal milestones, starting from December 2017 until August 2019.

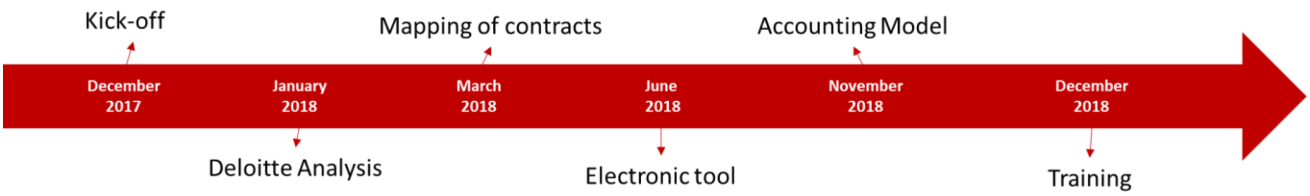


Figure 8 - First Year Milestones

In December 2017, the Finance and Administration Department of the Group organized several kick-off meetings inside the company aimed at analysing the standard and at developing the first evaluations on the consequences of the application of IFRS 16, the company decided also to appoint the consulting company Deloitte in order to develop simulations on the impacts of the adoption of the standard on the Financial Statements. In January 2018, Deloitte conducted and analysis by examining a sample of contracts mainly representative of the company for category or because of their economic value. In March 2018, the Group started a meticulous mapping and classification of all the existing contracts in order to identify the scope of IFRS 16. In June 2018, an electronic tool was developed from Deloitte in order to manage the effects on the accounting process coming from the application of the standard. In November 2018, an ad hoc accounting model was developed with the opening of accounts, the identification of accounting entries and the sharing of a unique management model for the entire Group. Finally, in December 2018, internal courses of training to all prosecutors and heads of the different areas were provided in order to raise awareness between internal managers of the effects of implementing IFRS 16.

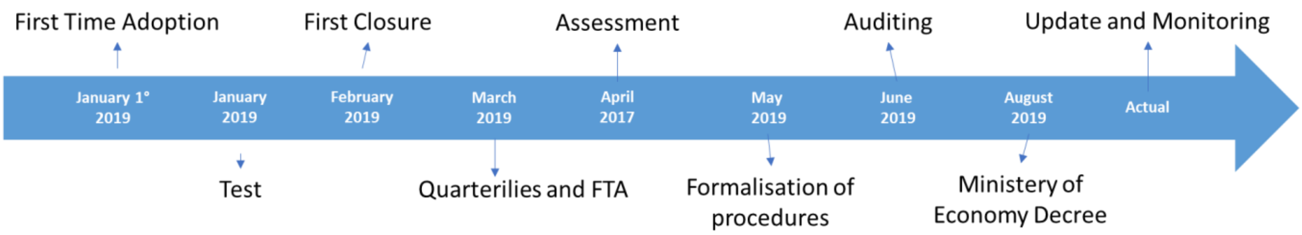


Figure 9 - Second Year Milestones

January 1st 2019 is the date of the mandatory first adoption of the standard, during the month of January, a test of the first monthly closing extra system was done, based on the data coming from the electronic tool and the analysis of fine tuning on the results. In February the same test was done, but this time it was not extra system, while in March 2019, a definitive establishment of the scope of FTA and the quarterlies was conducted with the automatic feeding of the entries from the tool to the accounting system. In April 2019, Deloitte conducted an assessment aimed at verifying the completeness of the contracts inside the scope of IFRS 16 and the accuracy of the internal results entered in the accounting system. In May 2019, a formalisation of procedures was developed in order to check every month the process of the implementation of IFRS 16. In June 2019, a broad disclosure in the notes to the financial statements was written to reveal the procedures and the impacts of the standard, and the auditing activity was conducted by KPMG for the half-year financial statement. In August 2019, an analysis of the Ministry of Economy Decree was conducted on the fiscal aspects of IFRS 16, and since then, the Group conducts an activity of constant updating of the scope, changes in the rate, new contracts, termination of current contracts and monitoring of the effects on the accounting on a monthly basis.

The Group identified more than 400 contracts inside the scope of IFRS 16, the majority of the economic value derives from the leasing of buildings for example the headquarters, secondary offices or guest houses, the other part comes from company cars and other equipment. By using the short-term and the low-vale exception, the company excluded from the scope those contracts with a term of less than 12 months, or an economic value lower than 5.000€. the Group excluded from the scope also the complex management of hospitality fees of radio antennas, since the company assessed not to have the right to enjoy the economic benefits associated to the use of the spaces that were the object of the contracts, in this case there is a right to transmit the signal rather than a lease of an asset.

The number of contracts that entered in the scope of the standard were 410 by January 1st 2019 leading to 65,5€ millions in right of use, while in the first semester of 2019, so at the date of June 30th, they amount to 434 with an associated right of use of 59,5€ million. Almost 55% of contracts are related to business cars, while almost the 95% of the value of the right of use comes from the leasing of buildings.

The accounting management of the standard has led to the absolute need to balance every step ex ante, to not lead to distortion hard to identify ex post.

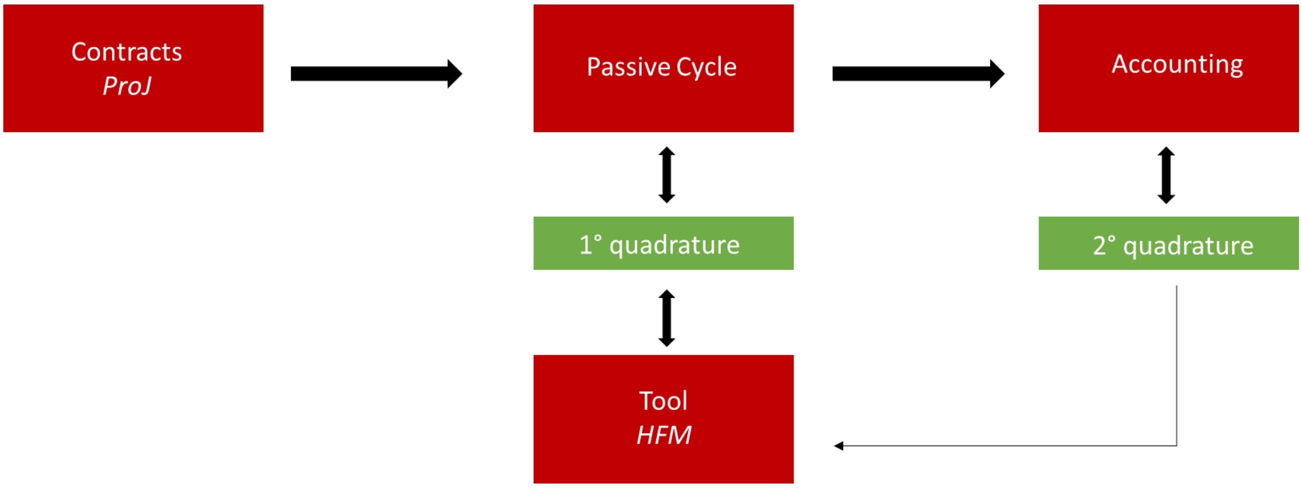


Figure 10 - The process

The first step in the process is to manage all the contracts inside the accounting system, thanks to an accounting structure developed ad hoc for IFRS 16. The tool is fed by the massive download for the first time, and then updated manually for every subsequent need. The first quadrature is the balance between the orders generated by the tool after the insertion of the contracts and the orders generated by the system of contracts. The second quadrature is the balance between the economic values generated by the tool and the economic values that are in the accounting system on every contract.

The process of balance is translated for every contract, for every company and at every monthly closure, in order to do so a prospect was developed by the Group that allows the administration to monitor the impact and if necessary to act in order to correct them. The prospect shows the category of the contract in order to trace chronologically its typology, description, condition of payment and other characteristics on every supplier and on contracts inside the scope of IFRS 16.

Once the first and second quadrature are completed, the tool automatically upload the accounting entries in the accounting system. The process takes into account two different flows: the flow of cancellation that annuls the amounts related to the contracts inside the scope, on the previous accounting entries, and a flow of uploading, that uploads the entries related to the IFRS 16 in the Income Statement, amortization and expenses, and in the Balance Sheet right of use and lease liabilities.

In the last step, there are a series of checks in order to formalise the process and to certify the results that are going to be inserted in the Financial Statements. Some examples of the activities that each CFO of the companies of the Group has to signed in order to certify the control over them are: the procedure of annulation, the assessment of the contracts inside the scope every month, closure of IVA, activation of calculation of tool, and creation of file of quadrature, verifying the balances, adjusting entries etc…

Categoria Contratto	Codice Contratto	Descrizione Contratto	Codice Fornitore	Fornitore	Icp	Freq.	Data Ini Contr	Data Fin Contr	Data Estinz Antic	Mesi Contratto	Flag Antpost	Quota Pagamento Teorico

Quota pagamento Effettivo	Delta pagamento (T - E)	Importo Ordini Proj	Importo HFM	Importo CoAn Proj	Ammortamento	Diritto d'utilizzo	Fondo Ammortamento	Passivita Correnti	Passivita Non Correnti	Passivita Finale	Interesse su pagamento teorico	Interesse su competenza	Ratei pass. finanz

Figure 11 - The Tool

6.1 Analysis pre-implementation

The GEDI Group commissioned Deloitte & Touche S.p.A. to perform a preliminary analysis aimed at giving information regarding the implementation of the new standard IFRS 16. The information provided by Deloitte gives to the firm important elements regarding the completeness and accuracy of the contracts included in the system implemented for determining the effects on the Financial Statements of the Group. The project followed different phases: assessment of the context in which the new principle will be applied, assessment of the discount rate, assessment of completeness of contracts included in the system ProJ and in the Tool to calculate the impact of IFRS 16, analysis of particular contracts aimed at the definition of the scope of application of IFRS 16, assessment of the accuracy of the calculation of the impacts of IFRS 16.

The management of the Group decided to adopt the modified retrospective approach where the right of use equals the future lease liability, however with the possibility of applying the modified retrospective approach where the right of use equals the future lease liability with the retrospective recalculation for specific contracts.

Table 42 - Impact IFRS 16 on Balance Sheet

GEDI Group	1st January 2019		
	Right of Use	*Lease Liability*	
		Current	Non-Current
GEDI Gruppo Editoriale s.p.a	28.602	5.654	22.900
GEDI News Network s.p.a.	21.700	2.682	19.010
ELEMEDIA s.p.a.	6.882	1.070	5.812
GEDI Digital s.p.a.	2.595	830	1.763
GEDI Distribuzione	65	24	40
A.MANZONI & Co s.p.a.	12.275	3.665	8.610
GEDI Printing s.p.a.	5.013	1.769	3.244
TOTAL	**77.132**	**15.694**	**61.379**

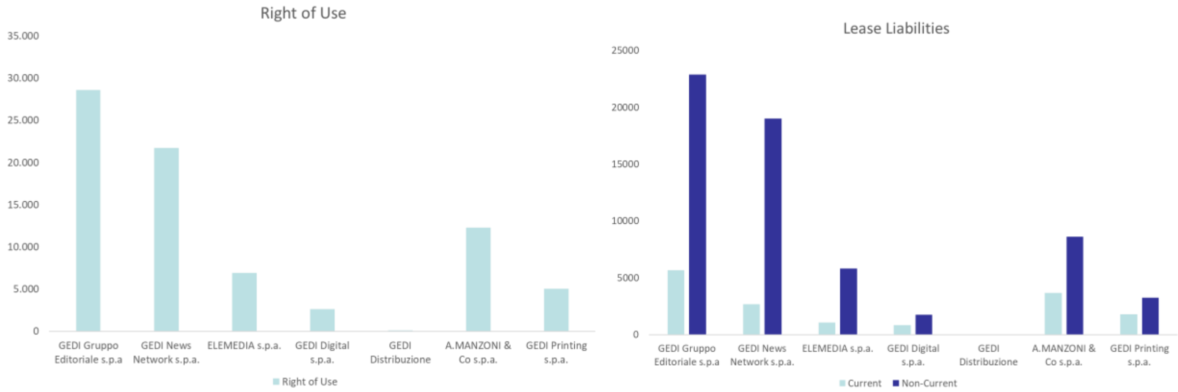


Figure 12 - ROU and Lease Liability per company

As we can see in the Table, the sum of current and non-current lease liabilities is lower than the right of use, the difference is relative to the share of advanced payments.

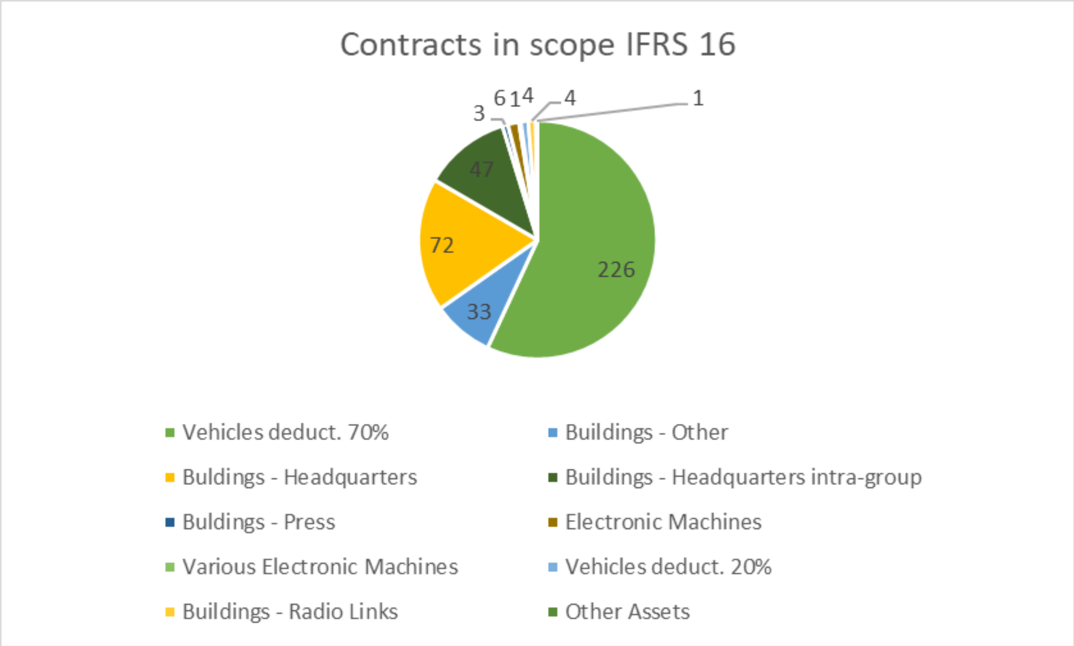


Figure 13 - Contracts in scope IFRS 16

In the Figure we can notice that the majority of contracts regards Vehicles and Headquarters Buildings.

In order to determine which contracts enter into the scope and which contracts are outside the scope of IFRS 16, the Group conducted an analysis and concluded that four kinds of contracts are excluded from the scope of the standard. The company took advantage of the short-term and low value exceptions and decided not to apply the standard for those leasing contracts of immaterial activities such as software for informatic licenses not of property or publishing system, as of paragraph 4 of the standard. Another kind of contracts that have been excluded from the scope are hospitality contracts of radio station, since the space on the tower/antenna does not have a value while the spaces for the equipment can be easily substituted by the counterparts.

6.2 Main difficulties in the application of IFRS 16

One of the main difficulties that the GEDI Group have found in the application of IFRS 16 was the mapping of contracts in order to determine which one enter into the scope of the standards and which can be excluded. A particular difficult task, according the to CFO of the Group Gabriele Acquistapace, was the exclusion of hospitality of radio station contracts. Three main considerations were made to determine the exclusion of this kinds of contracts, regarding the hospitality of boxes and cabins for the equipment, the hospitality of the receiving equipment on towers/pylons or on the ground, and hospitality of spaces on towers/pylons of transmission.

For the hospitality of boxes and cabins for the equipment, if the positioning inside the cabin is not delimited or identified inside the contract, the space is not clearly identified, the subject that manages the station defines autonomously the location. Therefore, this element of the contract is not classified as a lease inside the scope of IFRS 16.

For the hospitality of boxes and cabins for the equipment and the hospitality of the receiving equipment on towers/pylons or on the ground, as in the previous case, the space is not clearly identified, therefore also this element is not included in the scope.

For the hospitality of spaces on towers/pylons of transmission, are excluded from the scope all the situations in which the cell towers transmit more radio frequencies in response to a mix of frequencies located at the bottom of the tower. Also other situations, although the space is implicitly identified at the moment in which the cell tower is installed on the pylon and although the supplier does not have a right of substantial substitution, can be excluded from the application of IFRS 16, since the cost of hospitality referred to them in comparison to the total cost for single location is still irrelevant.

Another important aspect in which the company decided to put a lot of effort is the diffusion of a culture regarding IFRS 16 both for employees of the management control and for corporate attorneys. The Group organized several internal courses in Rome and Milan in order to provide employees with the tools to recognize which contracts enter into the scope of IFRS 16. After the courses, the creation of a unique office to analyse all the contracts was implemented.

A subsequent difficulty deals with the management of the standard from an electronic perspective. The software IRP did not develop a specific module, therefore the necessity to develop an ad hoc tool was urgent. In July Deloitte chose a Tool, and in September the first tests were made in order to customize the tool to the need of the Group. The Group identified two main necessities for the customization of the tool: the possibility to be audited by third parties in order to give solidity and the automation of accounting entries directly in the accounting system of the company. The tool presents also a monitoring system in order to check the balance between the accounting system and accounting entries of the company, there are around 20 checks that each month the CFO of each company has to sign.

6.3 Main benefits derived from the application

The CFO pointed out that the introduction of IFRS 16, greatly improved the presentation of Financial Statements, now it is possible to acquire useful information, to improve valuations and to compare different statements more accurately. Even though, the difficulties of first implementation were substantial, after two years from the adoption, the CFO noticed the great benefits that this standard has brought.

CONCLUSION

For many years, the accounting of leases has followed the financial and operating distinction, with the introduction of IFRS16, companies have completed revolutionized the way leases are accounted for, and this has led to substantial impacts on the Financial Statements, especially on the Statement of Financial Position and the Income Statement.

The GEDI Group is an example of how Financial Statements have changed from 2018 to 2019, when the new standard was made mandatory for listed companies. As of 1 January 2019, the GEDI Group started applying the new standard IFRS 16, before this transition date, the group conducted a preliminary assessment of the expected impact, the assessment process involved several steps, among which, the mapping and analyses of lease contracts. The Group found out that property leases are those that have a major effect in the company. In order to facilitate the first adoption of the new standard, the Group decided to use the modified retrospective approach, not restating comparative information of 2018, and measuring right-of-use assets as an amount equal to the lease liability. An analysis regarding the performance, profitability and liquidity of the company pointed out the main elements impacted by the new way of accounting leases. The greatest impact stands on the increase in the Net Financial debt and in the recognition of a right of use asset and lease liabilities in the Balance Sheet that were not present in 2018.

A deep and constructive discussion with Gabriele Acquistapace, the CFO of GEDI Group, has brought to light the process that the company has adopted in order to apply the IFRS 16. The GEDI Group has started the study of the standard, and therefore the analysis of the repercussions both in organizational terms and for what concerns the financial statements, since the last quarter of 2017, almost one year before the mandatory first application of the standard. The Group identified more than 400 contracts inside the scope of IFRS 16, the majority of the economic value derives from the leasing of buildings for example the headquarters, secondary offices or guest houses, the other part comes from company cars and other equipment. The GEDI Group commissioned Deloitte & Touche S.p.A. to perform a preliminary analysis aimed at giving information regarding the implementation of the new standard IFRS 16. The information provided by Deloitte gives to the firm important elements regarding the completeness and accuracy of the contracts included in the system implemented for determining the effects on the Financial Statements of the Group

In conclusion, the new standard IFRS 16 has greatly increase the comparability and the quality of information of financial statements of companies, by highlighting also those off-balance sheet leases that were not present before. This resulted in an increase of the Net Financial Debts of companies and in assets and liabilities. Also the main representative financial ratios have been impacted, therefore improving the quality of performance analysis that investors can develop. Even though, the complexity of application of the new standard represents the main difficulty, as evaluated by the IASB, the benefits that this principle brings to companies and investors outweighs the initial costs incurred in its implementation.

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Summary

Leasing an asset is a popular alternative to purchasing or owning it. A lease contract can be stipulated between two parties: the lessor and the lessee. The former is the owner of the asset, that decides to grant to the latter the right to use the aforementioned asset for a compensation, for a limited period of time. The main reason why companies decide to lease an asset is the lack of financial liquidity required to buy it, other advantages arising from this choice are the anticipated obsolescence of the lease and the avoidance of risks associated with the ownership. In a lease contract can be present the Lease Term that is an option to extend or terminate the lease from the side of the lessee, provided that the criteria of reasonably certainty persist. Another element of a lease contract is the purchase option that a lessee can exercise as long as the same criteria for the extension or termination options occurs.

IAS 17 is the International Accounting Standard that regulated the accounting of leases from 1994 until January 1st 2019, when IFRS 16 replaced it. Both IAS 17 and IFRS 16 are issued by the IASB, the International Accounting Standard Board that sets and governs the accounting standards in Europe. The normative process of IFRS 16 started in 2010 when the IASB and the FASB, the Financial Accounting Standard Board, starting a joint project in order to replace IAS 17. The process was completed January 13rd, 2016 and become mandatory for all listed companies since January 1st, 2019.

The normative process that led to the introduction of IFRS 16 was long and complicated and it persisted ten years. It started in 1996, when the G4+1, the IASC (the former IASB), and the FASB published a document, underlying the necessity of reconsidering the capitalization of leases. After nine years, the Security and Exchange Commission, agreed to the necessity of revision of the standard mainly because of the main scandals associated with off-balance sheet leases that hit the US economy in that period. In 2009 a Discussion Paper was published by the two boards, followed by the first draft standard in 2010 then revised in 2013. All the three documents received a significant number of comment letters from interested parties, especially from preparers of financial statements. The first adoption of IFRS 16 is on January 1st, 2019, however companies can begin to develop their financial statements according to this standard also before as long as they apply also IFRS 15 *Revenue from Contracts with Customers.*

The main characteristic of IAS 17 is the distinction between operating and financial leases. Leases are classified as financials when the risks and rewards of the ownership of the asset is wholly transferred from the lessor to the lessee. Financial leases lead to the recognition in the Balance Sheet of an asset and a liability, therefore companies tend to classify leases as operating in order to keep them off-balance sheet, they are allowed to do so since the classification choice is based on a subjectivity criteria.

From the other hand, operating leases are all the leases that do not fall into the definition of financial leases. When a lease is classified as an operating one, there is no associated asset or liability in the Balance Sheet, in the Income Statement a lease rental expense from the lessee's side and a lease rental income, from the lessor's

side are recognized, while in the notes of annual financial statements a disclosure of operating leases is present. However, companies benefit from the accounting of operating leases, since they are kept off-balance sheet.

One of the main critics associated with IAS 17 is the subjectivity associated with the classification of leases as operating or financials, since different lessees may use different indicators and reach different decisions that will have a significant impact on the balance sheet. Operating and financial leases that are accounted in different ways are not economically different, therefore, IAS 17 let managers the possibility to structure their leases as to exclude them from their balance sheet and take advantage of the lower liabilities that will result. Off-balance sheet leases strongly undermine the comparability and the faithful representation of Financial Statements, the Balance Sheets computed under IAS 17, do not represent the actual situation of assets and liabilities of companies, and since certain companies recognize certain leases while others not, it leads to a lack of comparability. For these reasons, investors rely on other financial statements, this imply an increase in their costs and in less information available in order to take the best decisions. The benefits of operating leases derived from the fact that those result in better profitability ratios and lower debt ratios, by classifying a lease as a financial one, financial ratios especially debt covenants may be negatively affected especially for large firms with more financial constraints. Therefore, when classifying leases as operating ones, companies prefer to use covenants and income statement ratios. Before IAS 17, firms used in almost an equal amount both operating and financial leases, while after the issuance of the standard they prefer to recognize leases as operating ones in order to take the advantages derived from their classification. This benefit is enjoyed especially from firms with information asymmetry or poor accounting quality.

With the introduction of IFRS 16, the distinction between operating and financial leases is no longer present, and all the leases are accounted as they were financial. The two accounting methods possible under IAS 17 are replaced by a unique method. The main goals of the new standard are the improvement of comparability and faithful representation of financial statements, therefore increasing the transparency, comparability and quality of the decision-making process of investors. The expected impact of the new standard IFRS 16 will be different depending on the kind of companies, the effects will be larger for companies having higher operating leases intensity. The effects of the new standard will be only on the part of the lessees, while from the lessors' point of view, no changes will be present compared to IAS 17.

The capitalization of leases under IFRS 16 implies the recognition of a Right of Use (ROU) asset and a related Lease Liability in the Balance Sheet. This new way of accounting leases will have an impact both on Financial Statements and Financial Ratios. The ROU represents the economic resource to be capitalized. Initially the asset is recognized as the same amount of the corresponding liability plus other costs, later, the asset is amortized and impaired. The Lease Liability is associated with the corresponding ROU and represents the obligation to transfer an economic resource and is calculated as the present value of future lease payments discounted at the rate applicable to the contract by using the effective interest rate method. It can happen that during the lease liability's life there is the need to remeasure the liability, in order to do so the right of use should be recognized against the difference between the old and the new liability.

Lease contracts include lease components as well as non-lease components such as services or supplies associated to the lease. IFRS 16 requires companies to divide lease from non-lease components and to account for them in different ways. Paragraph 15 of IFRS 16 allows for a practical expedient in order to reduce the effort of separating lease from non-lease components, companies can group assets of similar nature and use, underlying assets, and account for each lease separately, as a single component. The practical expedient will result in a cost benefit and a reduction of complexity without causing damages to the comparability of financial statements between companies.

There are two voluntary exceptions allowed by IFRS 16 that companies can take advantage from, to avoid the capitalization of leases. The Short-term exception can be used for leases that have a length of 12 months or less, since the costs of applying the capitalization model would exceed the benefits in this case. The low-value exception can be used for lease that have low value when new. The low-value criteria imply a subjective judgment that should be made on a lease-to-lease basis, the audit company KPMG suggests a threshold of 5000$. The purpose of the exception is to include those low value assets that are leased in high volumes, hence, not recognizing the liabilities that may be substantial in case of large amounts. The lease of intangible assets is another voluntary exception, however, by exploiting this exception, all the standard requirements would not be applied, not only the capitalization model as in the case of the short-term and the low-value exception.

There are two approaches that companies can use in order to shift from IAS 17 to IFRS 16: the full retrospective approach and the modified retrospective approach. The first option implies the restatement of Financial Statements as of the December 31st, 2018, in order to present comparative financial statements. This approach implies the recalculations of all lease entries. The main effects of this approach are negative since there will be a negative equity impact and net of taxes, while the main advantage is that it allows for greater comparability with previous periods. However, it is a complex process that requires a lot of information. The modified retrospective approach, instead, requires companies to start applying the new standard in 2019. This approach can be further divided into two ways of accounting leases: The lease asset can be accounted with an amount equal to the lease liability that is previously adjusted for prepaid or accrued lease payments, or the lease asset can be accounted using a current discounting rate and depreciating the asset from the beginning of the lease.

The discount rate is needed in order to calculate the initial value of the asset and the liability of the lease, indeed, to discount future lease payments. Companies can decide whether to use the Interest Rate Implicit in the Lease (IRIIL), recommended by IFRS 16, or the Incremental Borrowing Rate (IBR). The IRIIL is "the rate of interest that causes the present value of the lease payments and the unguaranteed residual value to equal the sum of the fair value of the underlying asset and any initial direct costs of the lessor". (IFRS 16 Appendix A), and its calculation is very complex. The IBR is "the rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment". The calculation of the IBR is mandatory for companies that choose to use the modified retrospective approach.

"Effects Analysis, IFRS 16 *Leases*" is an official document published by the IASB as a response to the large amount of comments letters received after the publication of the draft. The document implies an evaluation of the costs and benefits that companies will incur when adopting IFRS 16. The effects analysed in this document are mainly qualitative and the main concern of the comment letters was the fact that the implementation costs would exceed the benefits.

Implementation costs include the analysis of each lease contract in order to determine the ROU and the Lease Liability, the acquisition of new systems, the gathering of information, the training of employees and the cost of calculation of the discount rate. All these costs will depend on the size of the lease portfolio, the terms and condition of the lease and the sophistication of the systems already used by the company. Once companies have incurred the initial costs of adapting their systems for the implementation of the IFRS 16, all the other costs will just be slightly higher compared to IAS 17.

The main critics to IFRS 16 concerns the fact that all leases are recognized in the Balance Sheet, and therefore performance analyses will be affected. Other reasons for critics can be found in the fact that IFRS 16 will have an impact on the economic value of some leases and indeed make more complicated their understanding, jeopardizing the reliability and quality of information. The application of IFRS 16 involves additional costs for companies that not always will compensate the benefits generated, costs are associated especially to the complexity of the new accounting method.

The IASB responded to the critics to IFRS 16 and underlined the fact that the commitments to pay the lease are not affected, but the only change stands on the accounting method. The Board emphasized the outweigh of benefits over costs and the improvement of the quality of information associated with the implementation of the new standard.

The Balance Sheet is the Financial Statement that will have more implications with the introduction of IFRS 16. Assets and liabilities will both increase, while the impact on equity may increase or decrease, but it is expected to decrease since the amount of lease assets will be reduced more quickly compared to the amount of the lease liability.

In the Income Statement, companies will notice an increase in operating profit. Expenses are the same under the two principles, however, for every reporting period there will be some differences. The EBITDA also will increase due to the different place where expenses are reported and because of depreciation costs.

In the Cash Flow Statement, the total net cash flows will not change under IFRS 16 compared to IAS 17, however the allocation is revised, since the cash flow generated by operating activities will increase because the paid amount recognized as interest is considered part of operating activities and by the same amount cash flows generated by financing activities will decrease because of the inclusion of the fraction of the paid amount representing principal repayment.

Under IAS 17, companies disclosed leases by classes and the sum of cash outflow in the Notes to Financial Statements, while under IFRS 16, the disclosure regards the components of lease expenses.

Financial ratios are a key indicator of a company's performance, its future and its wealth, and are used by stakeholders and by the company itself to make important decisions, to inform investors, to assess the overall effectiveness of the company and to evaluate the financial position of an entity. The main impact that the recognition of assets and liabilities has in the balance sheet, is that of decreasing the net income while increasing debt ratios, EBITDA and interest expense. Solvency ratios such as Leverage will increase, since liabilities will increase. Regarding profitability ratios, the asset turnover and the ROA will decrease, due to the increase of assets, while EBIT and EBITDA will increase since rental expenses and amortization expense decrease. The EBITDAR will have no impact because the effect is balanced by the rent that will decrease. Regarding expenses, both the interest and the depreciation expense will increase, while the rental expense will decrease. The overall financial indebtedness will grow, due to the increase in liabilities.

Lenders rely on credit rating agencies that analyze specific customers and give an assessment on their trustworthiness, when this information are not available, creditors rely on financial statements and financial ratios. It is straightforward that analysing statements and ratios under IAS 17 could have led to misleading conclusions. The mandatory capitalisation of operating leases under IFRS 16 will have a strong impact on the assessment of credit risk by lenders, and lessees are worried that this will result in a reduction of new loans and an increase of interest rate, especially after the first application of the new standard.

In the "Effect Analysis" document, the IASB concluded that the benefits of the new principle are greater than the costs. The two main benefits that IFRS 16 will bring are: the increase in the comparability of Financial Statements and in the quality of information contained in the Financial Statements. The mandatory capitalisation of operating leases under IFRS 16 will have a strong impact on the assessment of credit risk by lenders, and lessees are worried that this will result in a reduction of new loans and an increase of interest rate, especially after the first application of the new standard. The comparability improves also because under IFRS 16, when leases and borrowings to buy an asset are similar economic transactions, will be reported in a similar way, indeed making it possible to compare the two transactions. The EFRAG estimated that total debts of European listed companies under IFRS 16 will increase by 576€ billions, this estimation implies that the introduction of the new standard will substantially improve the quality of information disclosed. A more faithful representation is depicted in the balance sheet and therefore there will be greater transparency in the leverage ratios and in the capital employed.

The IASB and the FASB, the Financial Accounting Standard Board, have work together for years on the joint project of developing a new standard for the accounting of leases, however some minimal differences are still present. The main one is the number of accounting models possible; the FASB allows for two different accounting models depending on the classification of the lease as an operating or financial lease. Another difference regards the low-value exception that is not present under the FASB, and the depreciation of lease assets that is slower in the first years and then faster, compared to the straight-line basis used under IFRS, and operating profit that is larger for entities under IFRS because of higher finance cost. Three are the ratios that differ more when applying IASB or FASB: the debt to EBITDA and the interest cover that are higher under the FASB, and the return on capital employed that instead is higher under IFRS. The overall cost of applying IFRS or US GAAP will be generally similar since the same data are needed for both accounting methods.

On April 2020, the IFRS published an Exposure Draft called *"Covid-19-Related Rent Concessions"* in which it proposes an amendment to IFRS 16. The publication of the draft is the result of the increase of rent concession derived from the world pandemic of Covid-19. The aim of IFRS is to soothe lessees that may encounter difficulties in accounting for Covid-19 related rent concession, but at the same time keeping providing high quality and transparent information to users of financial statements. The outcome of the amendment will be a practical expedient that gives the right to lessees to avoid the assessment of covid-19 related rent concession as lease modifications, and therefore to avoid accounting them as so and simplify their operations.

GEDI is an Italian publishing group active in different sectors of communication: press, radio, advertising and digital. For what concerns the press, the company publishes daily newspapers: La Repubblica, La Stampa, Il Secolo XIX and other thirteen local daily newspapers with all their supplements, a weekly newspaper, L'Espresso and some periodical newspapers: National Geographic, la Scienza, Mind, Limes, MicroMega and National Geographic Traveler Italia. The three radios owned by the company are Radio Deejay, Radio Capital and m2o, while the digital section is aimed at providing a digital presence for all the brands of the group, especially for La Repubblica, with La Repubblica.it, La Repubblica + and Rep:, and La Stampa with La Stampa.it and La Stampa tuttodigitale. Finally, the advertisement sector is operated by A. Manzoni & C. with an exclusive dealership by means of the GEDI group. As by the end of 2019, GEDI accounted 603,5 million of euros in revenues and an EBITDA of 59.3 million of euros. The group counts 2221 employees, with headquarter in Rome, the current president is John Elkann, the CEO is Maurizio Scanavino and the main shareholder is the Cir Group spa. GEDI's mission is to offer information, culture, opinions and entertainment in accordance with the principles of independence, freedom and respect. The Consolidated Financial Statements of the GEDI Group are prepared according to the International Financial Reporting Standards IFRS issued by the International Accounting Standard Board IASB. The statements are prepared on a going concern basis and following the principle of accounting at historical costs assets and liabilities while at fair value derivative instruments and some particular types of assets and liabilities.

By comparing the Balance Sheet of the GEDI Group of 2018 and 2019, we can notice that the implementation of IFRS 16 leads to an increase in the Net Financial debt that without the new standard, in 2019 would have been of 44,1 million euros compared to the actual debt of 99.4 million euros derived from the increase in lease liabilities. Another difference is the Right of Use Asset and the associated Lease Liability that were not present in 2018. Depreciation expenses also increase by 119.619 thousand euros from 2018 to 2019, since new right of use assets are recognized, the related depreciation expense will increase total depreciation expenses.

In the Income Statement, the main effects regard the increase in total expenses and in the gross operating profit that does not include lease payments anymore in 2019, while it does include amortisation of right of use asset and the financial expense on the liability recorded.

As of 1 January 2019, the GEDI Group started applying the new standard IFRS 16, before this transition date, the group conducted a preliminary assessment of the expected impact, the assessment process involved several steps, among which, the mapping and analyses of lease contracts. The GEDI Group benefited from the short-term exception, not applying the standard for leases of less than 12 months, and the low-value exception for leases of items valued less or equal 5.000€. In order to facilitate the first adoption of the new standard, the Group decided to use the modified retrospective approach, not restating comparative information of 2018, and measuring right-of-use assets as an amount equal to the lease liability.

A performance and a fundamental analysis are developed in order to understand the effects of IFRS 16 on companies' Financial Statements. The Net Operating Assets decrease from 2018 to 2019, from 466.112 thousand euros in 2019, compared to 506.969 thousand euros in 2018. This decrease is justified by the decrease in operating liabilities, the distinction between operating and financial leases does not exist anymore and therefore all lease liabilities are considered a financial item now. Also the Net Financial Position decreases, from 16.435 thousand euros in 2018, to -72.223 thousand euros in 2019, this decrease is justified by a decrease in Financial Assets derived mainly by a decrease in equity-accounted investments. However, we expected the Net Financial Position to decrease anyway due to the recognition of lease liabilities that were not part of financial liabilities before. In 2019 the NOPAT amounts to -107.191 thousand euros, while in 2018 to -13.058 thousand euros. The decrease in NOPAT is justified by the substantial decrease in EBIT and by the increase in tax as reported.

The ROE decreases, meaning that the expected return from an investment in the equity is negative. The Leverage Ratio increases because of the additional liabilities recognized under IFRS 16. The ROA decreases because new assets are recognized in 2019 such as the right of use asset. The Return on Net Operating Assets is negative in both years, therefore for each sale the company loses a part of the net operating profit. The Asset

Turnover decreases due to an increase in Net Operating Assets. Also the ROCE ratio decreases, and the ROI is negative in both years.

The Liquidity Analysis outlines the positive WCR in both years, meaning that the company has enough short-term investments to run operating activities, so long-term investments are not needed. The Current Ratio is lower than 100% both in 2018 and 2019, meaning that the amount of assets is not sufficient to repay short-term liabilities. While the Quick Ratio, increases, meaning that quick assets are increasing compared to current liabilities, even though the sum of them is still lower than the amount of current liabilities.

A deep and constructive discussion with Gabriele Acquistapace, the CFO of GEDI Group, has brought to light the process that the company has adopted in order to apply IFRS 16. The GEDI Group has started the study of the standard, and therefore the analysis of the repercussions both in organizational terms and for what concerns the financial statements, since the last quarter of 2017, almost one year before the mandatory first application of the standard. The Group identified more than 400 contracts inside the scope of IFRS 16, the majority of the economic value derives from the leasing of buildings, for example the headquarters, secondary offices or guest houses, the other part comes from company cars and other equipment. The GEDI Group commissioned Deloitte & Touche S.p.A. to perform a preliminary analysis aimed at giving information regarding the implementation of the new standard IFRS 16. The information provided by Deloitte gives to the firm important elements regarding the completeness and accuracy of the contracts included in the system implemented for determining the effects on the Financial Statements of the Group.

In conclusion, the new standard IFRS 16 has greatly increase the comparability and the quality of information of financial statements of companies, by highlighting also those off-balance sheet leases that were not present before. This resulted in an increase of the Net Financial Debts of companies and in the assets and liabilities. Also the main representative financial ratios have been impacted, therefore improving the quality of performance analysis that investors can develop. Even though, the complexity of application of the new standard represents the main difficulty, as evaluated by the IASB, the benefits that this principle brings to companies and investors outweighs the initial costs incurred in its implementation.