FUNDAÇÃO GETULIO VARGAS
ESCOLA DE ADMINISTRAÇÃO DE EMPRESAS DE SÃO PAULO

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THE EXPECTED IMPACT OF IFRS 16 ON RETAIL COMPANIES

SÃO PAULO
2019

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Trabalho Aplicado apresentada à Escola de Administração de Empresas de São Paulo da Fundação Getulio Vargas, como requisito para obtenção do título de Mestre em Gestão para a Competitividade.

Campo do Conhecimento: Finanças e Controladoria

Orientador: Prof. Dr. Ricardo Lopes Cardoso

SÃO PAULO

2019

Borges, Samuel Luiz Dias.
The expected impact of IFRS 16 on retail companies / Samuel Luiz Dias Borges. - 2019.
44 f.

Orientador: Ricardo Lopes Cardoso.
Dissertação (mestrado profissional MPGC) – Fundação Getulio Vargas, Escola de Administração de Empresas de São Paulo.

1. Contabilidade - Normas. 2. Balanço (Contabilidade). 3. Arrendamento mercantil. 4. Auditoria. 5. Comércio varejista. I. Cardoso, Ricardo Lopes. II. Dissertação (mestrado profissional MPGC) – Escola de Administração de Empresas de São Paulo. III. Fundação Getulio Vargas. IV. Título.

CDU 657

Ficha Catalográfica elaborada por: Isabele Oliveira dos Santos Garcia CRB SP 010191/O
Biblioteca Karl A. Boedecker da Fundação Getulio Vargas – SP

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Data de Aprovação:
10/05/2019.

Banca Examinadora:

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À minha querida esposa Paula Borges, que com compreensão suportou-me nessa jornada; ao meu amado filho Gabriel Borges, minha fonte de inspiração e força; aos meus pais Luiz Antônio Borges e Cátia Borges e ao meu irmão Ezequiel Borges por estarem comigo em todos os momentos.

ABSTRACT

Starting in 2019, Brazilian companies will have to recognize in the balance sheet not only the financial leases, but also the operating leases. This requirement arises from the entry into force of IFRS 16. Therefore, this research seeks to identify the effects of the adoption of IFRS 16 on the performance indicators of tenant entities in the year 2018 to predict their behavior for the year 2019 when the standard will take effect. Even though several studies have been written in order to understand the effect of this norm on the main financial indicators, this work brings an updated view on 2018 financial statements. According to this standard, a lease is a contract that gives the lessee the right to use the asset for a certain period. However, recognition of the right of use and its underlying responsibility in the balance sheet will to change the reading and interpretation of ratios and the way in which we evaluate the performance of the companies. For this purpose, a sample of 40 publicly retail traded companies with the publication of the financial statements on the Brazilian stock exchange B3 and others Europeans stocks exchange were studied. The values corresponding to the operating leases were identified as well the treatment given by audit firms in the financial statement of the companies identifying as a key audit matters or not. A comparison was made between the indicator indebtedness versus EBITDA and on the indicator debt versus equity looking for changes before and after the norm into force. The result of the research identified an amount of 58 billions of dollars related to operating lease contracts not included in the balance sheets of the companies analyzed and it was verified that there will be a significant change in the indicators indebtedness of the lessees. In addition, there will be a significant increase of EBITDA of the companies once that all leasing expenses will be booked as an amortization, that is, after the EBITDA.

Keywords: IFRS 16, lease, EBITDA, financial statements, audit firms, retail, key audit matters.

RESUMO

A partir de 2019, as empresas brasileiras terão de reconhecer em seus balanços não apenas os arrendamentos financeiros, mas também os arrendamentos operacionais. Essa exigência decorre da entrada em vigor da IFRS 16. Portanto, essa pesquisa busca identificar os efeitos da adoção da IFRS 16 nos indicadores de desempenho das entidades arrendatárias no ano de 2018 para prever seu comportamento para o ano de 2019 quando a norma passará a viger. Embora vários estudos tenham sido escritos para entender o efeito dessa norma nos principais indicadores financeiros, este trabalho traz uma visão atualizada das demonstrações financeiras 2018. De acordo, com esta norma, uma locação é um contrato que confere ao locatário o direito de utilizar o ativo durante um determinado período. No entanto, o reconhecimento do direito de uso e sua contabilização subjacente no balanço patrimonial irão alterar a leitura, interpretação dos índices e a maneira pela qual avaliamos o desempenho das empresas. Para tanto, foi estudada uma amostra de 40 empresas com capital aberto do ramo varejista e com publicação das demonstrações financeiras na bolsa brasileira, B3 e de outras bolsas europeias. Os valores correspondentes aos arrendamentos operacionais foram identificados, bem como o tratamento dado pelas firmas de auditoria nas demonstrações financeiras das empresas identificando se como principal assunto de auditoria ou não. Foram comparados os indicadores de endividamento líquido versus EBITDA e o indicador dívida líquida versus o patrimônio líquido buscando mudanças nos números antes e após a entrada em vigor da norma. O resultado da pesquisa identificou um montante de 58 bilhões de dólares referentes a contrato de arrendamento operacional não adicionados aos balanços das empresas analisadas e verificou-se que haverá uma mudança significativa nos indicadores de endividamento dos arrendatários. Além disso, haverá um incremento do EBITDA das empresas, uma vez que todas as despesas do arrendamento serão contabilizadas como uma amortização, ou seja, após o EBITDA.

Palavras-chaves: IFRS 16, arrendamentos, EBITDA, demonstrações financeiras, firmas de auditoria, varejo, principais assuntos de auditoria.

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ACRONYM LIST

BACEN – Banco Central do Brasil

BMF & BOVESPA – Bolsa Mercadoria e Futuros

CFC – Conselho Federal de Contabilidade

CMN – Conselho Monetário Nacional

CPC – Comitê de Pronunciamentos Contábeis

CVM – Comissão de Valores Mobiliários

EBIT - Earning Before Interest, Taxes

EBITDA – Earning Before Interest, Taxes, Depreciation and Amortization

FASB – Financial Accounting Standards Board

IAS – International Accounting Standards

IASB – International Accounting Standards Board

IFRIC – International Financial Reporting Interpretations Committee

IFRS – International Financial Reporting Standard

IOF – Imposto sobre Operações Financeiras

KAM – Key Audit Matters

SIC – International Accounting Standards

SUSEP – Superintendência de Seguros Privados

SUMMARY

1. INTRODUCTION

The process of mandatory adhering of IFRS by the European Union can be considered as an outline for harmonization and the convergence process. In 2005, all listed companies in the European Union stock markets were required to prepare their consolidated financial statements in accordance with IFRS. However, the individual statements of the listed companies were not subject to such a requirement, so that the European Union had two distinct regulatory regimes instead (LARSON; STREET, 2006).

In Brazil, accountancy is noticed by the linkage to legislation and regulation via government agencies. Its connection to legislation is mainly related to taxation. Among the main accounting agencies in Brazil are the Brazilian Securities and Exchange Commission (CVM), Brazil Central Bank (BACEN), the Accounting Pronouncements Committee (CPC) and the Private Insurance Superintendence (SUSEP). They have contributed to the process of Brazilian standards convergence to the IFRS. In view of the Brazilian securities' s concern to make convergence feasible, it is evident some norms publication related to this topic. According to 457 CVM Instruction, July 13th, 2007, it is understood that publicly-held companies must prepare and present, from late 2010, their consolidated financial statements in accordance with IFRS. This instruction issued by Brazilian Securities and Exchange Commission (CVM) represents the ultimate goal of Brazilian accounting standards being in conformity with international standards and points to the importance and necessity of such convergence. In contrast 469 CVM Instruction, dated May 2nd, 2008, refers to the application of Lei No. 11.638, which amends and introduces new provisions on Lei 6.404 / 76 and also deals with certain accounting procedures. Other CVM standards related to the subject are 464 CVM Instructions, Jan 29th, 2008; nº 550, Oct 17th, 2008; and no. 475, Dec 17th, 2008.

The International Accounting Standards articulated by IASB are being implemented in Brazil by CPC and other eligible institutions. With the recent amendment to the standard dealing with leasing, IFRS 16 has replaced IAS 17 and broken the news that all such operations will be recognized in the lessee's balance sheet, with a liability for future payments and an intangible asset for the right of use. In addition, the accounting of leases change will generate operational and financial expenses, and, as a result, the change in classification form of leasing expenses may increase EBITDA, as well as the operating cash flow (ERNST & YOUNG, 2016).

According to Torres and Olmedo (2017), the aim of IFRS 16 is to cut down the need of adjustments in agreements and leasing contracts by investors and analysts, also to improve the comparability of information and finally to build suitable conditions in order to produce clear financial information about leasing agreement for all market participants.

For SACARIN (2017), one of the objectives of IASB is to make, in order to take useful decisions, current and potential investors are provided with high quality, transparent and comparable information, through the financial statements.

Leasing is an important funding source for many companies, IASB estimated that, in 2014, 85% of the lease commitments of companies applying IFRS and USGAAP, 3,3 trillion dollars, were not disclosed in their balance sheets (IASB, 2016). An explanation for this would be that both the currently applicable IAS 17,and the similar US standard, allow the classification of the lease contracts in finance lease (whose associated assets and liabilities are disclosed by the lessee in the statement of financial position), and operating lease (for which the lessee discloses information only in the notes).

1.1. Problem

Stated in IASB (2013), the application of IFRS must result in high quality, clear and suitable financial statements to support investors, stock market participants around the world and other users of financial statement in decisions taking.

So far, CPC has issued 48 technical pronouncements that encourage companies to disclose their accountancy information and their specific conductions over some items, leading to the harmony between Brazilian and international standards. One of the pronounces was about CPC 06 (R1) – Leasing Operations, agreed in 2010, which must be required by the companies that sustain asset leasing for a determined period (CPC, 2017). Six years after CPC 06 (R1) last review, in 2016, a new IFRS 16 international standard was released presenting some changes regarding accounting and disclosure in leasing operations. This New Standards suggests that companies bring most leases to the balance sheet, both financial and operational, recognizing new assets and liabilities, even being or not the risks and controls of goods. (IFRS BRAZIL, 2016).

In Lima, Carmo e Martins (2014) words, nothing is constant, there is always some change, and Brazil has been going through this new reality adaptation, heading to the completion of mandatory statements demanded by International Accounting but intermediated by CPC technical pronouncements about proceed acceptance.

1.2. Question of the research

Based on this context shown, the research problem that motivates this study is:

What is the impact of IFRS 16 on financial statements of retail companies in general?

Further explained, this study tends to:

- Verify whether the audit companies have taken the changes of the new standards as a key audit matter in their 2018 auditing financial statements reports;
- Test the relevance of impacts over the assets of companies;
- Examine the impact on net indebtedness in relation to shareholders' equity;
- Analyze the impact on net indebtedness in relation to EBITDA;
- Verify the total amount to be integrated to the assets of the companies after the validity of the standard;
- Examine if the companies that did not disclose the financial impact related to this new norm presented losses in its 2018 financial statements.

1.3. Justification

This study is justified by the importance of analysis on Companies' reaction to the change in assistance and accounting classification form of the commercial lease. Its results can highlight the side effects of the search for better accounting representation and correction of mistakes in financial statements of companies, as it is demanded national and internationally. This paper, also, may contribute to the lack of empirical studies in Brazilian market on the capitalization impact of financial leasing by lessors.

1.4. Structure of the Applied Paper

The applied study has been divided into five sections, counting the introduction, which describes the problem conceptualization, the question of the research, general and specific objectives, justification and, last, its structure.

Chapter 2 is about the literature and Standards review, focusing on its history report, accountancy, transition rules, publishing and key audit matters.

In section 3 the research methodology, collection and data analysis are highlighted.

Chapter 4, the results of all researches and performed evaluation are presented.

This paper conclusion and its limitations are mentioned on chapter 5, where the research references are also informed.

2. LITERATURE REVIEW

2.1. LEASING CONTRACT

2.1.1. Economic Essence of Leasing

Leasing, an English word that describes a contractual arrangement between two parts lessee (user) and lessor (owner) for use an asset. In other words, it is a short or long-term financial operation in which the user rents the land or goods let out or rented out by the owner.

Gitman (2002) explains for having the rights to use the goods or land, it is needed a contracted signed by both parts detailing the amount to be paid by the lessee while using it. Formalizing a contract was accomplished for centuries and was pointed out to the financial future and the guarantee of principles between entities (Souza et al., 2013). Later on, the agreements were developed, turning into a Technical Pronouncement CPC 06 (R1) – business operation of goods or land rental obeying the Resolution CFC nº 1.055/05 standards, whose aim is to orient the parts (lessee and lessor) on what determines the policies and information of leasing (CPC, 2012). This Pronouncement has made accounting policies valid and has spread accurate news to the parts evolved in leasing negotiations, i.e., the lessor agrees to give the rights for the lessee to use his/her goods or land in payment(s) exchange for determined period. Ribeiro, Reis and Pinheiro (2014), say that leasing is a form of credit operation that provides benefits as well as obligations for the lessee in pursuit of operational and fiscal advantages in complementing their activities. Based on International Accounting Standards (IAS 17) of International Accounting Standards Board (IASB), the Pronouncement- CPC 06 (R1) links the Brazilian accounting Standards to the International Standards, being mandatory to all updates entities in what regards to CVM nº 554/08 and, the Resolution CFC nº 1.141/08, to all accountants (IUDÍCIBUS et al., 2013).

Leasing is a form of credit-based capitalization in which it is possible to rent the means of production instead of acquiring them, releasing the company capital for other applications. Indeed, the initial propose of leasing in Brazil was associated to the economic activity of the lessee, as determined in CMN 980/1984 Resolution (revoked by CMN 2.309/96 Resolution):

> Art. 14. Leasing entities, in their operations with individuals, must observe the following conditions:
> Only goods which are served in economic activities can be leased, and must be restrict to:
> I – agriculture, agroindustry and other rural activities;
> II – proprietorship;
> III – Professional and self-employed workers (BRAZIL, 1984).

This restriction was assigned in Standards to avoid using the financial leasing the same as a loan, scattering it in market trade of tangible goods. However, for the current rules, it does not matter whether the lessee is a natural person or a legal entity, i.e., the leasing operation has acquired new objectives and purposes. In this regard, the resolution CMN 2.309/96 prefaces:

> Art. 11. Movable Assets, whether domestic or Foreigner, may be leased, and immovable property acquired by the leasing entity for the lessee's own use, as specified hereinafter.
> Art. 12. It is allowed to carry out leasing operations with a natural person (individuals) and legal entity (companies) as lessee. (BRAZIL, 1996).

2.1.2. Previous IAS 17

It is a business operation between the supplier of a property or goods and the user, so called, lessor and lessee, respectively. This operation is registered in a contract that does not specify any purchasing negotiation and/or interest. The lessor can be responsible for the maintenance and technical assistance, even if the service performed is charged. (FORTUNA, 2002). Unlikely the Finance Commercial Leasing, or just Leasing, this operation does not need an Institution intermediating the use of goods.

The contract made in this operation cannot exceed 75% of the value of the property and the lessee has the option to terminate it at any date, upon prior notice established in the agreement (FORTUNA, 2002).

In the operating leasing operation, there is no future commitment on the part of the lessee, will only make use of the good for the operations purposes, following the specific clauses in the contract. At the end of the contract, the goods or property is returned to its owner or the parts may renew the deal for a further period. This operation is characterized as a lease contract, the expenses being recorded in the company result and still being possible to interrupt the contract when it no longer needs the use of the property. By Miranda and Miranda (2008), leasing contracts were and still are one of the ways found to acquire assets usually designated to production. For the authors, part of the interest in the operation is due to the non-incidence of IOF, which is charged in other forms of financing.

According to Rech et. al. (2008, p. 1):

> In Brazil, the reflection of this alternative use is in the constant growth of leasing contracts, turning into one of the most dynamic modalities within credit operations. Its development makes an important contribution both to the viability of investments in the productive sector and also to the fulfillment of the demand for credit to finance large projects or assets, like aircrafts in civil aviation.

The financial leasing, as it has the predominant characteristic of the financing made by the lessor, is also known as commercial bank lease. This is a financial transaction in which one banking company acquires goods for another's use, called lessee. The financial leasing operation enables the company to assume new assets and transfer to the lessee all risks related to the use of the leased asset, such as depreciation and maintenance.

The assets value is an acquisition value, expressed as a percentage, which must be included in the contracts for the lessee to have the option to purchase the goods at the end of the contract (AGUSTINI, 1999).

Filgueiras (2010) points out that the basic difference between a finance lease and a rental is the option given to the lessee of purchasing the assets for a low material value in comparison to the market value. Thus, the consideration of a leasing represents an amortization of the payment for the goods, which does not occur in traditional rental.
According to Filgueiras (2010), the financial leasing may be similar to the medium- or-long-term financing, but it has clauses for contract renewal, purchasing or replacement of assets for a more modern one.

Souza and Famá (1997, p. 66) bring the idea that leasing is a way to "create and expand the development of the market," since it is an operation intended to replace investment in fixed assets. In this way, the leasing company could take advantage of the resources that would be invested in fixed assets, using them as working capital. Franzen et. al. (2009) states that business with high external funding costs reduce their investment costs through leased assets, and that the decision to buy versus rent is also influenced by the type of assets. Fixed assets for general use (houses, airplanes, trucks, electronics and computers) are easily transferable and this results in high availability in the leasing market. Because of few alternative uses, the economy of specialized assets suggests financing for conventional debts.

Under accounting views, Martins et. al. (2008), in a study before the CPC 06 release, pronounces that leasing illustrated a good off-balance-sheet financing opportunity, that is, the company could have or obtain a financing and not needing to register the payments of it, reducing its liabilities and also its indebtedness index, making easier, for the company, when holding new credit lines and new loans. Abreu e Sauaia (2011), in an analysis that did not include the normative change either, said that one of the advantages of leasing operation was the enhancement of indicators used in balance sheets (return on fixed assets and indebtedness). Franzen et. al. (2009) states that the benefits off-balance operations and commercial leasing were vital for the activity. Pereira e Marques (2009) also come out with the idea that the commercial leasing is an efficient way to keep debts off the balance sheet, what justifies the decision of having a leasing contract rather than a term purchase contract.

At the same line of thought, Hendriksen and Van Breda (1999) explain that the lease, when supported in a correct way, allow lessees to make loans without having to evidence them in the balance sheet. This decision has a direct impact on the indebtedness of leasing companies, in relation to own capital and total assets, and may interfere with the decisions of investors, financial institutions, suppliers and other external users of the companies' accounting statements.

For both, according to Fortuna (2002) at the end of the agreement, the lessee has three options.

i. Renew the contract for an agreed value.
ii. Acquire the property or goods as stablished in the contract, for the same value or updated to the market value.
iii. Give the assets back.

Having no economic support for acquisition of the operational leasing.

2.1.3. New IFRS 16

For IFRS 16 transition, companies may chose:

- Apply the new definition of lease on all their contracts, or,
- Apply a practical profile, maintaining its previous assessment of which existing contracts are, or contain, leases.

A company that chooses to use the practical profile must:

- Apply IFRS 16 to previous leases identified in regarding to IAS 17 and IFRIC 4 – Complementary Aspects of Operations and Leasing Operations;

Do not apply IFRS 16 to previous contracts identified as not-containing leases accordance with IAS 17 and IFRIC 4:

- Apply the lease definition of IFRS 16 to assess whether contracts concluded after the date of application of the new standards are, or contain, leases.

IFRS 16 requires the disclosure of certain items in explanatory notes. In relation to the balance sheet must be disclose any:

- Additions to assets with rights of use;

  At the end of the year, the accounting register book of the right to use assets by the rank of underlying assets and (if not presented separately) on a corresponding individual line in the balance sheet;
- Lease liabilities and, if the lease liabilities are not presented separately, in a corresponding individual line in the balance sheet;
- Analysis of leases liabilities expiration.

For profit and loss statement and comprehensive income:

- The depreciation expense of the assets with right of use by the underlying asset rank;
- Interest expenses on leases liability;
- Short-term leases expenses for which the exemption from recognition is applied (leases up to a month expiration may be excluded);
- Expenses relating to leases of low value items for which exemption from recognition is applied;
- Expenses of variable lease payments not included in lease liabilities;
- Sub-lease revenue from assets with right of use;
- Gains or losses resulting from sales and leaseback transactions.

About cash flow statements:

- Total Outflows from Cash Flows to Leases.

  Other:

- Amount of short-term lease commitments if the current short-term lease expense is not representative for the following year.

With the new accounting method, changes will be made to the balance sheet and profit and loss statement.

In the balance sheet, the impact will be on non-current or long-term assets and current and non-current liabilities. In the assets, the changes were only in the values introduction, being in the leasing account, which previously recognized only the monthly remaining values and in the current accounting will be released the total value of the goods. Consequently, the monthly depreciation amounts will increase, since it was formerly released monthly on the accumulated value of the remaining value, while in this new standard it will be calculated on the total value of the property, plant and equipment.

In liabilities, current and noncurrent accounts receive the amount of the asset as well as financing and charges for monthly appropriation; each group covers the proportionality referring to its term, being it short or long.

In the yearly profit and loss statement, changes occur in financial expenses and in amounts referring to monthly depreciation. In the old accounting, the value of the consideration (rent expense) was released monthly in the financial expenses group, now this group will be used for monthly appropriation of the finance charges of the financial lease

Depreciation continues to be recognized in operating expenses on a monthly basis, however with the new form of accounting the value will increase due to the calculation being on the total value of the property, plant and equipment.

Lessee Accounting	IFRS 16	IAS 17
Balance Sheet	Use rights of equivalent assets and liabilities.	Operating Lease: neither asset nor liability is recognized
		Financial Lease: property assets and lease liabilities.
Results Statements	Particular Approach: - Assets rights of use: depreciation; and - Lease Liabilities: effective interest method rates. Note: variable rental payments are not included in the lease liabilities.	Operating Leases: lease payments on straight-lines bases.
		Financial Leasing: depreciation and lease liabilities by the effective interest method rates.
Cash Flows Statement	Cash Flow from financing activities: a fraction of lease payment that represents the main part.	Financial Leasing: similar to IFRS 16.
	Operating Cash Flow from or arising from financing activities.	Operating Leases: operating cash flow.

Table 1 – Comparison between IFRS 16 versus IAS 17
Source: The author

IFRS 16 introduces a single model for the accounting of leases in the balance sheet for lessees. A lessee recognizes a right of use asset that represents his or her right to use the leased asset and a lease liability that represents his or her obligation to make lease payments. Exemptions are available for short-term leases and low value items. The lessor's accounting remains similar to the current standards, that is, lessors continue to classify the negotiation either financial or operating leases.

IFRS 16 replaces the actual lease Standards, including IAS 17 Leasing Operations and IFRIC 4, SIC 15 and SIC 27 Complementary Aspects of Leasing Operations.

Souza et al, (2013) cite that the concepts related to commercial leasing have been challenged since 2009 when a draft was shown and nominated: Leases – Preliminary Views, in which the main point of leasing contract, either financial or operational, must be recognized as assets and liabilities of the lessee. This new concept contrasts with the current ones, in which only the assets derived from financial leasing are recognized. In the face of such thinking, it is possible to understand that the commercial leasing is periodically revised, always following the fast necessity for more clear and precise information that directly affects the accounting and disclosure of leasing contracts.

In January 2016, IASB issued the IFRS 16 – Leases, concluding their long-term goal of bringing the leases to the balance sheet of lessees. All companies that lease large assets for use in their business may see an increase in reported assets and liabilities. This will affect a wide variety of industries, from airlines leasing aircraft to retailers leasing stores. The higher the lease portfolio, the greater the impact on key financial metrics (KPMG, 2016).

According to IASB (2016) in order to reach this objective, a lessee shall recognize assets and liabilities arising from a lease agreement regardless of whether it is a financial or operating lease. Therefore, as from IFRS 16, the double accounting model was abandoned, which separated the accounting of the lease into financial and operating leases. In this sense, there is only a single model settled, similar to the one presented in the provisions of IAS 17 regarding to financial leasing, that is, both financial leases and operating leases will be recorded in equity accounts (Assets and Liabilities).

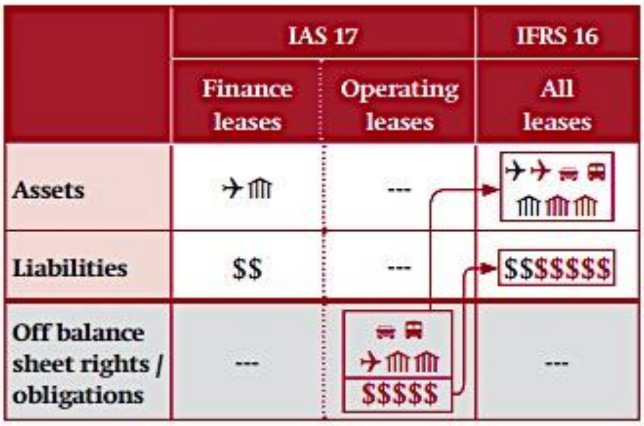

Figure 1 – Comparison of future handling between the Standards
Source: IASB, 2016.

As in Figure 1, it is possible to verify the future transactions once considered off-balance will be accounted after IFRS 16, i.e. from January 2019 operating leases will also be recorded as assets and liabilities.

Clarifying better the new way of accounting for commercial leases, another table by IASB (2016) shall be presented below:

	IAS 17		IFRS 16
	Finance leases	Operating leases	All leases
Revenue	x	x	x
Operating costs *(excluding depreciation and amortisation)*	---	*Single expense*	---
EBITDA			⇧⇧
Depreciation *and* amortisation	*Depreciation*	---	*Depreciation*
Operating profit			⇧
Finance costs	*Interest*	---	*Interest*
Profit before tax			⇔

Figure 2 – Comparison of accounting between standards
Source: IASB, 2016.

At this table it is seen that leasing expenses will now be accounted as depreciation and as financial expenses, which will definitely change the financial indices of the companies that hold leasing.

According to IASB (2016), the purpose of this amendment is to have a more reliable accounting statement of the entity not differentiating the information from the information of those who buy the asset from the one that controls the asset, obtaining the same benefits from it, but not having to buy them.

Hence, IFRS 16 introduces a unique accounting model, which requires the lessee to account for assets and liabilities for all leases with a longer term than 12 months, unless the asset is of low value. In this way, the lessee is obliged to recognize a right of use asset that represents the use right of the leased asset and a lease liability that embodies the obligation to make the lease payments.

Whereas that the lessee recognizes the equity depreciation of use right and the interest on the lease liability. It is important to note that IRFS 16 requires the lessee to separate the total amount of cash paid into principal (presented in financing activities) and interest (presented in operating or financing activities), in the cash flow.

According to IASB (2016), the previous model was heavily criticized for not congregating the user's needs of the financial statements, as it did not provide a fair representation of leasing operations, specially, the fact that leases of operating lease operations recognize assets and liabilities arising from these operations.

This new approach aims at a more accurate representation of the financial position and greater transparency on information on financial leverage and on capital invested by the lessee (IASB, 2016).

IFRS 16 estimates in its item number 53 that the lessee discloses: (a) the depreciation of the right to use assets by the rank of the underlying asset; (b) interest expense on the lease liabilities; (c) expenses on short-term leases, excluding the expenses with a one month or less lease term; (d) expenses related to the leasing of low assets; (e) expenses related to variable lease payments not included in the measurement of lease liabilities; (f) revenues from sublease of use rights of goods; (g) total cash outflow for rentals; (h) additions to the right to use goods; (i) gains or losses arising from sale and leaseback transactions; and (j) the right to use assets at the end of the reporting period by underlying asset rank (IASB, 2016).

In addition to the required information, a lessee shall disclose additional qualitative and quantitative information about its leasing activities which are needed to reach the objective of assessing the effect on the financial position, financial performance and flows from leasing activities. Such additional information may include, but not limited, the vital information that support the users of financial statements to evaluate: (a) rental lease activities; (b) flows to which the lessee is potentially bared and that are not reflected in the measurement of lease liabilities. This includes the results exposed: (i) variable lease payments; (ii) extended options and final options; (iii) residual value; (iv) leases that have not yet begun but which the lessee is engaged on; (c) restrictions or agreements required by leases; (d) sale and re-rental transactions (IASB, 2016).

Therefore, in view of the justifications made by IASB (2016) regarding changes in the accounting of operating leases, as set forth in IFRS 16, it can be observed that the recognition of a right and an obligation in the company statements, qualified as lessees, would impact the equity structure and especially the indicators of liquidity, indebtedness and financial leverage.

Before the new standards to be released, in January 2019, companies will need to collect significant data on their leases and perform calculations and estimations to be reported already in the 2018 financial statements (KPMG, 2016). For a contract to be qualified as a lease only if it is verified positively in the following tests:

What is an identified asset?

An agreement only contains a lease if it relates to an identified asset. An asset may be clearly specified in a contract or implicitly specified at the time the asset is made available for use by the lessee. (KPMG, 2016).

The company is supposed to assess whether the lessor's replacement rights are of a substantive nature at the start of the contract. (KPMG, 2016).

Are Economic Benefits generated?

The company obtains all economic benefits from the use of the identified asset throughout the period of use, as well as the management of its use. (KPMG, 2016)

The company may choose not to adopt the lessee's accounting model if the contracts last 12 months or less or if the value of the goods is equal to or less than five thousand dollars. (KPMG, 2016)

Registered by Casanova et al., (2016), to follow the new standards and adapt to the CPC propositions, companies need to amend the accounting statements what will probably affect the economic and financial diagnoses of the companies. Therefore, at first, companies must collect data on their leases and perform new calculations and estimations before the requirement and application of IFRS 16, a process that will have an expense but which will be a great challenge for many companies. The main changes, according to the new IFRS 16, to be faced by the lessee and lessor are to deal with:

> A single or unique model, with no lease classification test and all the leases recognized or registered in the balance sheet, since the lessor will have to deal with two accounting models, to carry out a lease classification test based on the classification criteria and criteria models of IAS 17, for financial leases with acknowledgment of net investment in compounding and receivables, residual assets and model based on IAS 17 criteria, for operating leases. (IFRS, 2016).

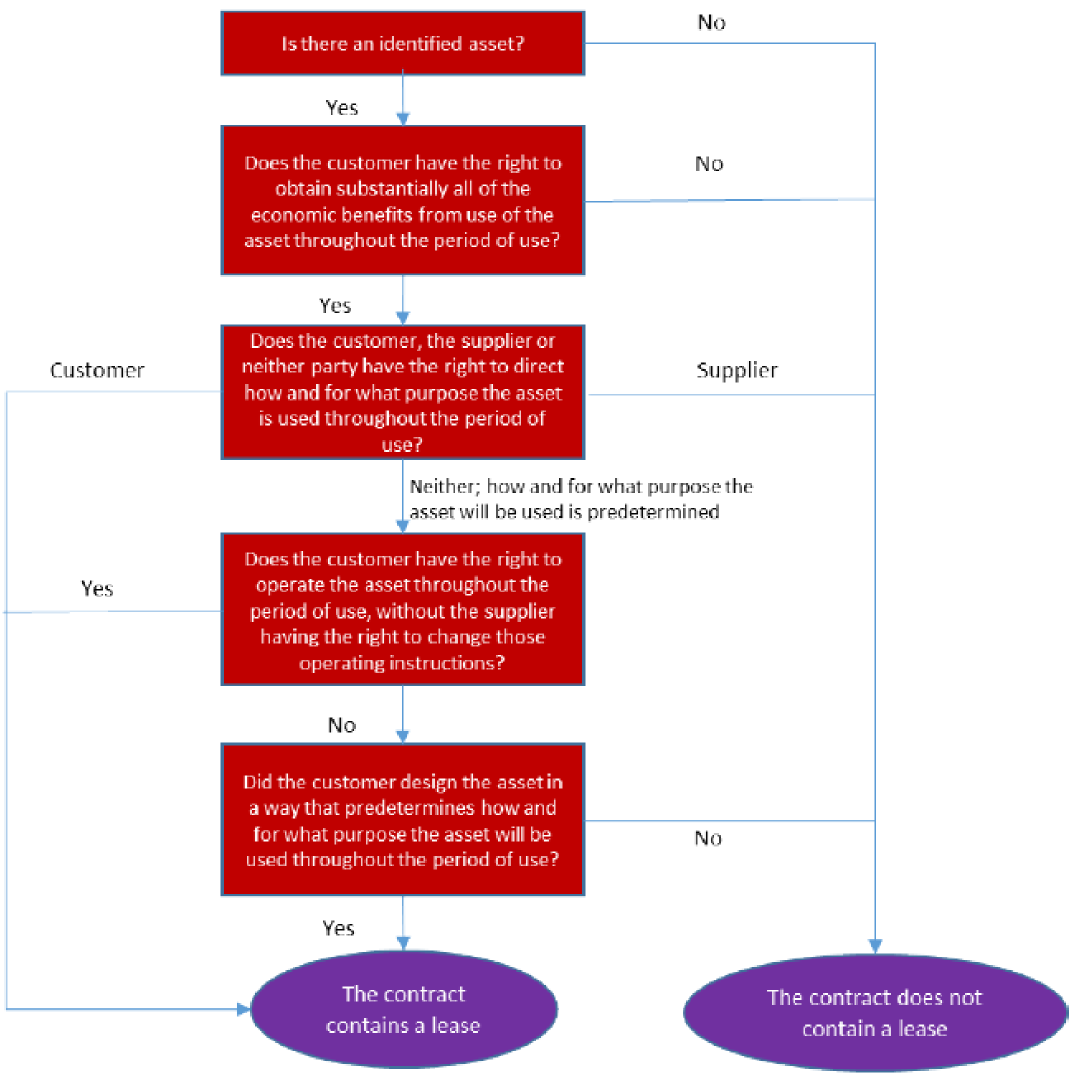

Figure 3 – Identification flow of the leasing contract
Source: IASB, 2016.

2.2. Prior Studies

Analyzing the literature, it was verified that many studies were carried out regarding to leases and that all of these studies registered a relevant impact on the financial statements.

Beattie *et.al.* (1998), inquired the impacts of non-accounting of operating leases on 232 UK companies that were sued for fraud in the UK stock market. As a result of the study, it was found that unregistered assets are 6% of total assets and non-recorded long-term liabilities are 39% of liabilities reported, on average. In addition, researchers found a noteworthy change in profit margin, asset turnover, asset return, and debt versus equity.

Beattie et. al. (1998) examined the negative effect of the non-accounting of leases in the lessee's and lessor's financial statements in terms of liquidity, financial structure, profitability and asset turnover rates. The results obtained showed negative effects significant on the indexes, which may take to misleading conclusions by the users of the accounting information.

Bennett e Bradbury (2003) studied the impact of accounting for leases on the financial statements of 38 companies listed on New Zealand Stock Market. According to the study, the proportion of unregistered assets in relation to unregistered liabilities was calculated as 81% on the assumption that the life cycle of the leased assets is 10 years, the interest rate is 10% and half of the assets were consumed. Given this hypothesis, the conclusion was that there would be a 22.9% increase in liabilities and 10.6% raise, on average, in the total liability / assets index. Therefore, an 8.7% decline in the return on assets share and a 14.2% decrease in return on equity.

Goodacre (2003) views of accountancy impact for retailers leasing in England. As a conclusion, the author identified that the unrecorded operating lease liabilities are 3.3 times more than the liabilities presented in the balance sheet. Whereas operating lease assets are 28% of total assets. In addition, the author identified an increase in operating profit of 23% about, but a reduction of approximately 7% net profit.

Branswijck et.al. (2011) stated in their study that the most important change published in 2010 by IASB and FASB was the elimination of distinction between financial and operating leases. In the study, they examined the possible impacts of the related changes on companies operating in Belgium and the Netherlands. As a result, they found that the liability / equity increases while the return on assets decreases.

Singh (2012) observed the financial rates of companies, operating in transformation and retail area between 2006 and 2008, in order to examine the impacts of IFRS 16 on the financial statements. As a result, it was identified that (1) both sectors may be affected by these changes at significant levels, (2) the retail sector may be the most affected, and (3) the magnitude of the companies is an important issue in identifying the impact.

Ericson and Skarphagen (2015), examined how the accounting of operating leases would affect the debt and profitability indexes of 55 companies in Stockholm, Sweden. As a result of the study they showed a significant effect on liabilities/ equity capital, equity / assets and profit margin, return on shareholders' equity and return on assets.

Arrozio, Gonzales and Silva (2016) studied the effects of accounting for operating leases at wholesale and retail companies, qualified as lessees at BMF & BOVESPA, now B3. The results obtained through the Liquidity, Indebtedness and Leverage indicators, calculated based on the financial statements published in 2015 and the attuned statements according to the explanatory notes, have a significant impact on the equity structure of these companies. Moreover, the study presented indebtedness raise, financial leverage and liquidity drop, observed by the recognition of new assets and liabilities

Sacarin (2017) also studied the impact of IFRS 16 application and noticed relevant changes over financial statements, liquidity and structure rates.

2.3. Key audit matters

The main reasons for communicating the Key audit matters in the independent auditor's reports come particularly from investors interested in:

- More information about auditing;
- Relevant and useful information for decisions taken;
- Areas that are more complex or meanfull judgment.

Key audit matters are subjects that, according to the professional judgment of the auditor, were more significant in auditing the financial statements of the current period. The Key audit matters are selected from the subjects communicated to those in charge of governance.

Audit standards have come a long way since they were drafted and published; however, there is still no full consensus as to whether the adoption and implementation of these globally consistent standards have been successful (SORMUNEN et al., 2013).

Backof, Bowlin and Goodson (2014) understand that the changes proposed in the audit report affect the users' decision making and the ability of the audit to defend their work.

At Asare's and Wright's (2012) research, the investors can have difficult understandings about KAMs because of the use of technical conceptions and vocabulary.

Bédard, Gonthier-Besacier and Schatt (2016) have not found any relevant effect of the key audit matters (KAMs) in uncommon market returns and uncommon trade negotiations. Issues informed to the responsible for managing – Relevant issues for auditor's attention to have - KAMs: important issues for current auditor to have.

Always to consider:

- high risk area of significant distortions or significant risks,
- relevant auditor review areas related to areas that have involved considerable management judgment, including estimates of high uncertainty
- significant dealing or events

Every KAMs report must contain:

- The reason of its importance for auditing
- How the subject was conducted in auditing
- Disclosure references.

2.3.1. When not to disclose a KAM

According to NBC TA 701, a topic should not be disclosed as a major audit subject when:

a) A law or regulation forbids the public disclosure of the matter (for example, matters that are or appear to be related to money laundering);

b) Exceptionally in rare cases where the auditor concludes that the matter must not be reported because the negative consequences of such disclosure could, within a reasonable perspective, overcome the benefits of communication to the public interest;

c) When the auditor concludes that there are no Key Audit Matters. The decision not to communicate the matter is complex and involves significant judgment of the auditor. In result, the auditor may find it appropriate to obtain legal opinion.

d) Adverse Opinion: In the KAM topic report, the auditor must inform that "Except for the subject matter described in the" Adverse Opinion Basis "section, there are no other major audit issues to be reported in it;

e) Abstention of opinion: when the auditor abstains from expressing an opinion on the financial statements, his or her report are not expected to include the section "Key audit matters"

f) If the auditor determines, depending on the facts and circumstances relevant to the entity and the audit, that there are no matters to be reported as "Key audit matters" or that the only major audit matters reported are those related to item 15 (Operational continuity), it should include a statement to that effect in a separate section of its report, under "Key audit matters" (see A57 to A59).

g) Key audit Matters (communication)

h) Except for the subject described in the Basis for Restricted Opinion (adverse or material uncertainty regarding operational continuity), there are no other Key audit matters to be reported in this.

3. METHODOLOGY

3.1. Participants and data collection

The range of studies is composed of companies listed in B3, among which were selected retail companies, in general, for being clearly stores leases, and other companies in the pharmaceutical, fashion, supermarkets, laboratories and fuel distributors areas that have reported the impacts arising from IFRS 16 in their 2018 financial statements, summing up 23 Brazilian companies. Moreover, a further 17 European companies were selected in order to verify the treatment of the standards, under the point of view of reporting, in different countries, forming an intentional non-probabilistic sample. All Europeans companies selected has been released the impact of the new norm in their financial statement in 2018 and are known as retail companies.

This study observed the financial reports filed on each company investor relations websites. Based on this search, it was identified that 9 of these did not disclose estimates on the quantitative impact of the standard on assets, liabilities and EBITDA, therefore, they had an explanatory note or, in some cases, an audit subject point reporting as very relevant the impact of IFRS 16 application. The companies that did not disclose financial estimates regarding the impact of IFRS 16 on the 2018 report were:

	Company	Net Revenue ('000 US$)	Current Auditor	Auditor´s name	Country
1	Carrefour	$ 66,196	KPMG	-	France
2	J Sainsburry PLC	$ 37,484	EY	-	UK
3	H&M Hennes & Maruitz AB	$ 24,385	EY	Ása Lundvall	Sweden
4	Saraiva Livraria	$ 51	Grant Thornton	-	Brazil
5	Arezzo	$ 420	PWC	Maurício Colombari	Brazil
6	Otto (GmbH & CO KG)	$ 15,787	KPMG	Prof. Dr. Zieger	Germany
7	Marks & Spencer Group	$ 14,194	Deloitte	-	UK
8	Grupo Grazziotin	$ 119	DRS Auditores	-	Brazil
9	Hermes Pardini S.A	$ 78	PWC	Guilherme Campos	Brazil

Table 2 – Companies with no financial estimates
Source: The author

It is remarkable that the companies listed above, Marks & Spencer Group and H & M Hennes & Maruitz AB treated the new standard as a major audit subject. Below, there is the companies' composition by country:

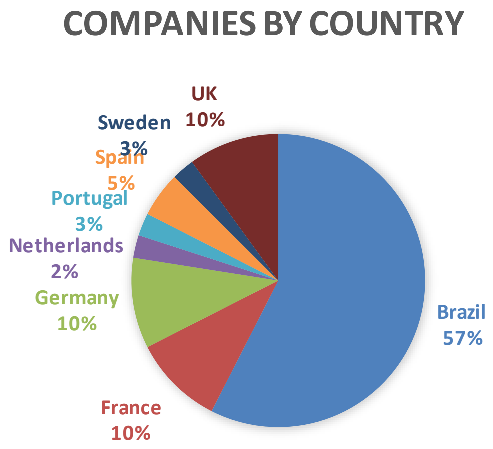

Figure 4 – Companies by country
Source: The author

For samples, countries that adopted IFRS as the accounting standard were selected. Hence, the study was focused on countries in the European continent and Brazil.

The sample underlined its studies on companies that have, in their essence, physical points to perform their sales, since they tend to have lease contracts of their sales points, which is focus of this paper.

The information, hereinafter, was collected by seeking the audited financial statements in 2018 on their investor's websites related. The data analyzed was:

- Net revenue
- Asset and liabilities
- Cash
- Debt and Equity
- EBITDA
- Audit firm
- Auditor name
- Segment
- Country

4. RESULTS

From the financial statements, at the end of 2018, more precisely Dec, 31st, the data was conducted as follows: Initially, the financial position of these companies was identified through the amounts of revenue, assets, liabilities and income statements. The intention of this research was to deepen in analyzes that could have significant effects as a result of the new amendment of IFRS 16 application. The data collected is listed in Table 3.

in USD thousand

	Company	Net Revenue	Total Asset	Cash and Equiv	Liability	Debt	Equity	EBITDA	Current Auditor	Auditor´s name	Segment	Country
1	Tesco PLC	$ 75,382	$ 62,726	$ 7,209	$ 48,104	$ 12,054	$ 14,622	$ 4,107	Deloitte	Panos kakoullis	Retail	UK
2	Ahold Delhaize	$ 74,173	$ 38,134	$ 4,099	$ 21,183	$ 7,044	$ 16,951	$ 4,974	PWC	D. van Ameijden	Eletronics	Netherlands
3	Carrefour	$ 66,196	$ 41,580	$ 3,745	$ 24,542	$ 7,208	$ 9,830	$ -	KPMG		Supermarket	France
4	Auchan Holding	$ 44,421	$ 31,300	$ 2,979	$ 14,918	$ 6,411	$ 9,971	$ 1,741	KPMG	Hervé Chopin	Retail	France
5	LVMH Moet Hennessy Louis Vuitton	$ 40,787	$ 64,716	$ 87	$ 25,520	$ 9,581	$ 29,614	$ 354	EY	Patrick Vincent-Genod	Retail	France
6	J Sainsburry PLC	$ 37,484	$ 30,476	$ 2,678	$ 20,210	$ 3,103	$ 10,266	$ 1,645	EY		Supermarket	UK
7	Edeka Group	$ 33,487	$ 7,987	$ 269	$ 5,997	$ 226	$ 1,990	$ 575	BDO		Supermarket	Germany
8	Casino Guichard-Perrachon	$ 31,882	$ 32,872	$ 3,249	$ 14,703	$ 7,700	$ 10,469	$ 1,624	EY	Yvon Salaun	Retail	France
9	Inditex S.A	$ 28,966	$ 25,117	$ 7,949	$ 8,329	$ 20	$ 16,788	$ 6,199	Deloitte		Fashion Retail	Spain
10	BR Distribuidora	$ 26,921	$ 6,529	$ 787	$ 4,034	$ 1,435	$ 2,495	$ 763	KPMG	Bruno Bressan Marcondes	Fuels	Brazil
11	Ultrapar S.A	$ 24,973	$ 7,857	$ 1,750	$ 5,332	$ 3,917	$ 2,524	$ 747	KPMG	Wagner Bottino	Fuels	Brazil
12	H&M Hennes & Maruitz AB	$ 24,385	$ 13,044	$ 1,273	$ 6,615	$ 2,172	$ 6,429	$ 2,916	EY	Ása Lundvall	Fashion Retail	Sweden
13	Mercadona S.A	$ 21,363	$ 9,143	$ 3,291	$ 3,611	$ -	$ 5,532	$ 766	PWC		Supermarket	Spain
14	Otto (GmbH & CO KG)	$ 15,787	$ 11,117	$ 632	$ 9,246	$ 3,695	$ 1,870	$ 688	KPMG	Prof. Dr. Zieger	Retail	Germany
15	Kingfisher PLC	$ 15,167	$ 14,676	$ 326	$ 5,105	$ 250	$ 9,571	$ 1,218	Deloitte		Retail	UK
16	Jeronimo Martins	$ 14,865	$ 5,516	$ 298	$ 3,317	$ 540	$ 1,659	$ 823	EY		Supermarket	Portugal
17	Marks & Spencer Group	$ 14,194	$ 10,596	$ 311	$ 6,450	$ 2,521	$ 4,146	$ 978	Deloitte		Retail	UK
18	Pão de Açucar	$ 13,599	$ 13,614	$ 1,125	$ 10,023	$ 1,423	$ 3,591	$ 844	EY	Antônio Humberto B. dos Santos	Retail	Brazil
19	Aldi Group	$ 11,807	$ 5,272	$ 159	$ 2,198	$ 505	$ 3,074	$ 457	KPMG		Retail	Germany
20	Via Varejo	$ 7,415	$ 5,424	$ 956	$ 4,774	$ 1,133	$ 650	$ 178	Deloitte	Eduardo Franco Tenório	Retail	Brazil
21	Lojas Americanas	$ 4,548	$ 4,554	$ 949	$ 966	$ 2,322	$ 1,266	$ 718	KPMG	Carla Bellangero	Retail	Brazil
22	Magazine Luiza	$ 4,293	$ 2,266	$ 260	$ 1,673	$ 117	$ 593	$ 327	KPMG	Marcelle Mayume Komukai	Retail	Brazil
23	Raia Drogasil	$ 4,076	$ 1,894	$ 62	$ 983	$ 217	$ 911	$ 313	PWC	Renato Barbosa Postal	Pharma	Brazil
24	Cosan S.A	$ 2,836	$ 7,416	$ 695	$ 4,602	$ 2,565	$ 2,814	$ 643	KPMG	Rogério Hernandez Garcia	Fuels	Brazil
25	Lojas Renner	$ 2,320	$ 2,272	$ 357	$ 1,254	$ 496	$ 1,019	$ 479	KPMG	Cristiano Jardim Seguecio	Fashion Retail	Brazil
26	Localiza Rent a Car S.A	$ 2,174	$ 3,604	$ 629	$ 2,807	$ 1,970	$ 797	$ 438	Deloitte	Daniel de Carvalho Primo	Car Rent	Brazil
27	Hypera S.A	$ 1,025	$ 2,719	$ 424	$ 590	$ 145	$ 2,130	$ 362	PWC	Valdir Renato Coscodai	Pharma	Brazil
28	Cia Locação das Américas	$ 803	$ 2,253	$ 506	$ 1,592	$ 1,003	$ 661	$ 231	KPMG		Car Rent	Brazil
29	Fleury S.A	$ 734	$ 1,007	$ 208	$ 557	$ 324	$ 451	$ 190	KPMG	Marcos A. Boscolo	Medical	Brazil
30	Marisa Lojas S.A	$ 711	$ 727	$ 118	$ 222	$ 258	$ 247	$ -	KPMG	Marcelle Mayume Komukai	Fashion Retail	Brazil
31	Movida Participações S.A	$ 699	$ 1,338	$ 209	$ 910	$ 584	$ 427	$ 133	KPMG		Car Rent	Brazil
32	Burger King	$ 604	$ 643	$ 43	$ 128	$ 72	$ 441	$ 74	EY	Marcos Alexandre S. Pupo	Fastfood	Brazil
33	CVC Brasil Operadora S.A	$ 466	$ 1,589	$ 89	$ 1,302	$ 364	$ 287	$ 181	KPMG	Moacyr Humberto Piacenti	Travel	Brazil
34	Arezzo	$ 420	$ 269	$ 61	$ 86	$ 29	$ 183	$ 64	PWC	Maurício Colombari	Fashion Retail	Brazil
35	Lojas Hering	$ 396	$ 356	$ 83	$ 99	$ -	$ 339	$ 67	KPMG	Marcelo Lima Tonini	Fashion Retail	Brazil
36	Restoque S.A	$ 320	$ 953	$ 63	$ 294	$ 87	$ 572	$ 97	KPMG	Wagner Bottino	Retail	Brazil
37	Grupo Grazziotin	$ 119	$ 204	$ 3	$ 76	$ -	$ 128	$ 15	DRS Auditores		Retail	Brazil
38	Metro Ag	$ 101	$ 1,299	$ 145	$ 168	$ 104	$ 1,131	$ 12	KPMG	Lurweg	Retail	Germany
39	Hermes Pardini S.A	$ 78	$ 309	$ 33	$ 92	$ 61	$ 156	$ -	PWC	Guilherme Campos	Medical	Brazil
40	Saraiva Livraria	$ 51	$ 223	$ 24	$ 141	$ 44	$ 38	$ (29)	Grant Thornton		Bookstore	Brazil

Table 3 – List of the analyzed companies
Source: The author

The so known Big Four represent 92,5% of the analyzed companies, having KPMG as the most used firm for auditing in 2018 financial statements.

For application transition to the standard, the explanatory notes or the key audit matters of the companies were analyzed, where it was possible to identify the future obligations with operating leases, their values being specified as short-term and long-term obligations, since it was identified that the companies have contracts valid no longer than 1 year, from 1 to 5 years and further than 5 years.

The companies analyzed also intend to assume the modified retrospective approach in order to apply IFRS 16, therefore, the information has not been updated and has still been reported under IAS 17 and IFRC 4 standards.

At table 4, it is introduced the impact on balance sheet and EBITDA accounts disclosed by companies.

	in USD thousand					Estimated impact on financial statements		
	Company	Current Auditor	Auditor´s name	Segment	Country	Asset & Liability	EBITDA	Treated as KAM
1	Tesco PLC	Deloitte	Panos kakoullis	Retail	UK	$ 6,794	$ 976	No
2	Ahold Delhaize	PWC	D. van Ameijden	Eletronics	Netherlands	$ 5,574	$ 218	Yes
3	Carrefour	KPMG		Supermarket	France	No estimates	No estimates	Yes
4	Auchan Holding	KPMG	Hervé Chopin	Retail	France	$ 4,364	$ 726	No
5	LVMH Moet Hennessy Louis Vuitton	EY	Patrick Vincent-Genod	Retail	France	$ 11,323	$ -	No
6	J Sainsburry PLC	EY		Supermarket	UK	No estimates	No estimates	No
7	Edeka Group	BDO		Supermarket	Germany	$ 1,312	$ 87	No
8	Casino Guichard-Perrachon	EY	Yvon Salaun	Retail	France	$ 3,484	No estimates	No
9	Inditex S.A	Deloitte		Fashion Retail	Spain	$ 5,660	No estimates	No
10	BR Distribuidora	KPMG	Bruno Bressan Marcondes	Fuels	Brazil	$ 193	$ -	No
11	Ultrapar S.A	KPMG	Wagner Bottino	Fuels	Brazil	$ 351	$ -	Yes
12	H&M Hennes & Maruitz AB	EY	Ása Lundvall	Fashion Retail	Sweden	No estimates	No estimates	Yes
13	Mercadona S.A	PWC		Supermarket	Spain	$ 3,444	$ 121	No
14	Otto (GmbH & CO KG)	KPMG	Prof. Dr. Zieger	Retail	Germany	No estimates	No estimates	No
15	Kingfisher PLC	Deloitte		Retail	UK	$ 3,200	No estimates	Yes
16	Jeronimo Martins	EY		Supermarket	Portugal	$ 2,089	$ 321	Yes
17	Marks & Spencer Group	Deloitte		Retail	UK	No estimates	No estimates	Yes
18	Pão de Açucar	EY	Antônio Humberto B. dos Santos	Retail	Brazil	$ 1,234	$ 241	No
19	Aldi Group	KPMG		Retail	Germany	$ 900	No estimates	No
20	Via Varejo	Deloitte	Eduardo Franco Tenório	Retail	Brazil	$ 1,018	$ 203	Yes
21	Lojas Americanas	KPMG	Carla Bellangero	Retail	Brazil	$ 410	$ -	No
22	Magazine Luiza	KPMG	Marcelle Mayume Komukai	Retail	Brazil	$ 694		No
23	Raia Drogasil	PWC	Renato Barbosa Postal	Pharma	Brazil	$ 934		Yes
24	Cosan S.A	KPMG	Rogério Hernandez Garcia	Fuels	Brazil	$ 1,157	$ -	No
25	Lojas Renner	KPMG	Cristiano Jardim Seguecio	Fashion Retail	Brazil	$ 512		No
26	Localiza Rent a Car S.A	Deloitte	Daniel de Carvalho Primo	Car Rent	Brazil	$ 257	$ -	No
27	Hypera S.A	PWC	Valdir Renato Coscodai	Pharma	Brazil	$ 14	$ -	No
28	Cia Locação das Américas	KPMG		Car Rent	Brazil	$ 877	No estimates	No
29	Fleury S.A	KPMG	Marcos A. Boscolo	Medical	Brazil	$ 249	$ -	No
30	Marisa Lojas S.A	KPMG	Marcelle Mayume Komukai	Fashion Retail	Brazil	$ 163	$ -	No
31	Movida Participações S.A	KPMG		Car Rent	Brazil	$ 654	No estimates	No
32	Burger King	EY	Marcos Alexandre S. Pupo	Fastfood	Brazil	$ 185		No
33	CVC Brasil Operadora S.A	KPMG	Moacyr Humberto Piacenti	Travel	Brazil	$ 19	$ -	No
34	Arezzo	PWC	Maurício Colombari	Fashion Retail	Brazil	No estimates	No estimates	No
35	Lojas Hering	KPMG	Marcelo Lima Tonini	Fashion Retail	Brazil	$ 18		No
36	Restoque S.A	KPMG	Wagner Bottino	Retail	Brazil	$ 66	$ 32	No
37	Grupo Grazziotin	DRS Auditores		Retail	Brazil	No estimates	No estimates	No
38	Metro Ag	KPMG	Lurweg	Retail	Germany	$ 697	$ 261	No
39	Hermes Pardini S.A	PWC	Guilherme Campos	Medical	Brazil	No estimates	No estimates	No
40	Saraiva Livraria	Grant Thornton		Bookstore	Brazil	No estimates	No estimates	No

Table 4 – Impact on asset & liabilities and EBITDA
Source: The author

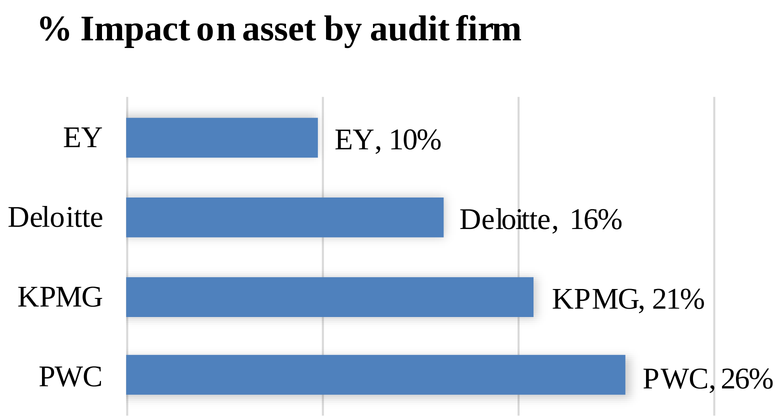

Figure 6 – Impact on asset by audit firm
Source: The author

As demonstrated above, the companies audited by PWC estimated an average impact regardless to the use rights increment, to be reported after 2019, 26%, followed by KPMG, 21%, Deloitte 16% and, finally, the lowest impact on assets at EY with 10%.

At only 22% of the 40 companies analyzed, the imminent application of IFRS 16 was treated by the auditors as the Key audit matters. However, they all disclosed explanatory lines holding information on the impact, in a descriptive way, on the balance sheet or income statement, and in a quantitative way, that is, expressed in amounts other than those mentioned in part 3.2.

Analyzing, particularly, the disclosure made by the audit firms regarding the part of Key audit matter, it is evidenced the concern that, for Deloitte, the subject was conducted considering:

(i) The design of intern controls related to the identification and classification of lease agreement;

(ii) Accountancy policies analysis established by the Management in comparison with the requirements of the IFRS 16technical pronouncement;

(iii) The documentary trial of operating lease contracts, calculation basis; and;

(iv) Specialists evolved in technical and professional accounting standards to analyze the Administration premises to calculate the effects on this new technical pronouncement application.

For PWC, the issue was conducted highlighting the information acquired by companies, such as:

(i) Understanding of the criteria adopted by the administration to define the contract periods considered, with reference to cancellation and renewals clauses;

(ii) Understanding of the criteria adopted by the administration to determine taxation discount (incremental financing rate) used to measure the lease liability;

(iii) Amendment of lease disclosures made by management in compliance with the requirements of the new accounting pronouncement, which contain the amounts determined for the purpose of the lease liability and the asset use right;

On the other hand, KPMG pointed out in its disclosures of the key audit matter, regarding the subject of IFRS 16 that:

> *Counting with the help of internal experts in corporate finance we have evaluated the assumptions used in discount rates determination and sensitivity analysis on the model adopted by the Company and its subsidiaries. We evaluate the lawsuits applied by the Company and its subsidiaries for the other assumptions used as contractual lease terms. We performed the reconciliation with the auxiliary records and performed documentary tests on the database used to support the disclosed values.*

Comparing the auditors firms from 2017 financial statement to 2018 the nine companies that treated the new norm as Key audit matter, all maintained the same auditor firm.

Another impact analyzed was about the Debt / Equity indicator that specifies the degree of the company leverage, coming to the conclusion of the lower the better.

Table 5 brings the Debt on Equity indicator before and after the expected impact of IFRS 16 application. For this indicator, debt are financial commitments with banks and equity i.e. values held by shareholders and for their analysis the best understanding is that the smaller the better once it shows a lesser exposure company with third parties.

	Company	Net Revenue	Debt/Equity Before IFRS 16	Debt/Equity After IFRS 16
1	Tesco PLC	$ 75,382	3.29	3.75
2	Ahold Delhaize	$ 74,173	1.25	1.58
3	Carrefour	$ 66,196	2.50	No estimates
4	Auchan Holding	$ 44,421	1.50	1.93
5	LVMH Moet Hennessy Louis Vuitton	$ 40,787	0.86	1.24
6	J Sainsburry PLC	$ 37,484	1.97	No estimates
7	Edeka Group	$ 33,487	3.01	3.67
8	Casino Guichard-Perrachon	$ 31,882	1.40	1.74
9	Inditex S.A	$ 28,966	0.50	0.83
10	BR Distribuidora	$ 26,921	1.62	1.69
11	Ultrapar S.A	$ 24,973	2.11	2.25
12	H&M Hennes & Maruitz AB	$ 24,385	1.03	No estimates
13	Mercadona S.A	$ 21,363	0.65	1.28
14	Otto (GmbH & CO KG)	$ 15,787	4.94	No estimates
15	Kingfisher PLC	$ 15,167	0.53	0.87
16	Jeronimo Martins	$ 14,865	2.00	3.26
17	Marks & Spencer Group	$ 14,194	1.56	No estimates
18	Pão de Açucar	$ 13,599	2.79	3.14
19	Aldi Group	$ 11,807	0.72	1.01
20	Via Varejo	$ 7,415	7.35	8.91
21	Lojas Americanas	$ 4,548	0.76	1.09
22	Magazine Luiza	$ 4,293	2.82	3.99
23	Raia Drogasil	$ 4,076	1.08	2.11
24	Cosan S.A	$ 2,836	1.64	2.05
25	Lojas Renner	$ 2,320	1.23	1.73
26	Localiza Rent a Car S.A	$ 2,174	3.52	3.84
27	Hypera S.A	$ 1,025	0.28	0.28
28	Cia Locação das Américas	$ 803	2.41	3.74
29	Fleury S.A	$ 734	1.23	1.79
30	Marisa Lojas S.A	$ 711	0.90	1.56
31	Movida Participações S.A	$ 699	2.13	3.66
32	Burger King	$ 604	0.29	0.71
33	CVC Brasil Operadora S.A	$ 466	4.53	4.60
34	Arezzo	$ 420	0.47	No estimates
35	Lojas Hering	$ 396	0.29	0.34
36	Restoque S.A	$ 320	0.59	1.01
37	Grupo Grazziotin	$ 119	0.59	No estimates
38	Metro Ag	$ 101	0.15	0.76
39	Hermes Pardini S.A	$ 78	0.28	No estimates
40	Saraiva Livraria	$ 51	3.76	No estimates

Table 5 – Impact on Debt/Equity indicator
Source: The author

In accordance with this data, it is estimated that on average the indicator will increase by 54%, that is, companies will become more leveraged or indebted to their equity and this may, somehow, alter the investors' perception of risks over these companies after the implementation of IFRS 16 in 2019.

The table below shows the impact of the standard on the Net debt on EBITDA indicator. From the sample analyzed, 29 companies or 72.5% did not estimate the impact on EBITDA.

	Company	Current Auditor	Country	Net Debt/EBITDA Before IFRS 16	Net Debt/EBITDA After IFRS 16
1	Tesco PLC	Deloitte	UK	1.18	0.95
2	Ahold Delhaize	PWC	Netherlands	0.59	0.57
3	Carrefour	KPMG	France	Not released	No estimates
4	Auchan Holding	KPMG	France	1.97	1.39
5	LVMH Moet Hennessy Louis Vuitto	EY	France	26.83	No estimates
6	J Sainsburry PLC	EY	UK	0.26	No estimates
7	Edeka Group	BDO	Germany	-0.07	-0.06
8	Casino Guichard-Perrachon	EY	France	2.74	No estimates
9	Inditex S.A	Deloitte	Spain	-1.28	No estimates
10	BR Distribuidora	KPMG	Brazil	0.85	No estimates
11	Ultrapar S.A	KPMG	Brazil	2.90	No estimates
12	H&M Hennes & Maruitz AB	EY	Sweden	0.31	No estimates
13	Mercadona S.A	PWC	Spain	-4.29	-3.71
14	Otto (GmbH & CO KG)	KPMG	Germany	4.45	No estimates
15	Kingfisher PLC	Deloitte	UK	-0.06	No estimates
16	Jeronimo Martins	EY	Portugal	0.29	0.21
17	Marks & Spencer Group	Deloitte	UK	2.26	No estimates
18	Pão de Açucar	EY	Brazil	0.35	0.27
19	Aldi Group	KPMG	Germany	0.76	No estimates
20	Via Varejo	Deloitte	Brazil	1.00	0.47
21	Lojas Americanas	KPMG	Brazil	1.91	No estimates
22	Magazine Luiza	KPMG	Brazil	-0.44	1.00
23	Raia Drogasil	PWC	Brazil	0.50	No estimates
24	Cosan S.A	KPMG	Brazil	2.91	No estimates
25	Lojas Renner	KPMG	Brazil	0.29	No estimates
26	Localiza Rent a Car S.A	Deloitte	Brazil	3.06	No estimates
27	Hypera S.A	PWC	Brazil	-0.77	No estimates
28	Cia Locação das Américas	KPMG	Brazil	2.15	No estimates
29	Fleury S.A	KPMG	Brazil	0.61	No estimates
30	Marisa Lojas S.A	KPMG	Brazil	Not released	No estimates
31	Movida Participações S.A	KPMG	Brazil	2.82	No estimates
32	Burger King	EY	Brazil	0.39	No estimates
33	CVC Brasil Operadora S.A	KPMG	Brazil	1.52	No estimates
34	Arezzo	PWC	Brazil	-0.50	No estimates
35	Lojas Hering	KPMG	Brazil	-1.23	No estimates
36	Restoque S.A	KPMG	Brazil	0.29	0.22
37	Grupo Grazziotin	DRS Auditores	Brazil	-0.19	No estimates
38	Metro Ag	KPMG	Germany	-3.26	-0.15
39	Hermes Pardini S.A	PWC	Brazil	Not released	No estimates
40	Saraiva Livraria	Grant Thornton	Brazil	-0.68	No estimates

Table 6 – Impact on Net debt/EBITDA indicator
Source: The author

For this analysis, it may be considered as debt, only any bank indebtedness accounted by the company in December 2018.

Thus, the Net debt indicator on EBITDA will have an impact an average downward impact of 58% on companies that estimated the values. This indicator must be analyzed as the lower the better, so IFRS 16 will improve the leverage perception of financial analysts since increasing EBITDA, consequently, it increases the ability to have the bank debts paid.

The study verified whether there was no correlation between the companies that did not disclose the financial impact of the new norm on their assets versus the net result in 2018.

5. CONCLUSIONS

Unlike the current IAS 17, IFRS 16 will no longer differentiate between finance and operating lease, at the lessee. More, all lease contracts will be recognized in the statement of financial position. At the lessee, this treatment will lead to changes of the information disclosed in the financial statements. In this line, the value of the assets and the liabilities disclosed in the statement of financial position will increase. In addition, the profit or loss of the period will no longer be distributed on a straight-line basis, as it is currently the case for operating leases. The expense associated to the lease contracts, consisting in the amortization of the right of use and the finance cost, will differ between the reporting periods, depending on the period of the contract, the amortization of the right to use the asset, the payment deadlines. Though the total net cash flow will not be influenced, the statement of cash flows will show a higher operating cash flow, while the net cash flow generated by financing activities will decrease by the same amount. A change of the amounts disclosed in the financial statement will implicitly result in a change of the financial indicators determined based on these. Hence, the debt ratio, total assets turnover will decrease, while the profitability indicators EBITDA and EBIT will increase.

In order to achieve the general objective of this study which was to analyze the effects of IFRS 16 applicability on the performance indicators of lessees entities in 2018, verifying if there is a significant difference compared to the form of accounting prior to evidence said standard, the study covered 40 companies that published their financial statements in 2018 on the stock exchange of their respective countries and that have operating lease agreements being characterized as lessees of the it.

According to the results collected from the search, it is observed that due to the application of IRFS 16 not yet being in application, an amount of US$ 58 billion originated by operational leasing contracts, did not carry over in the balance sheets of the companies analyzed in this research about the year 2018.

In spite of the significant impact on the assets and liabilities of the companies, the independent auditing firms have, mostly, 78%, judged not to present the changes in the financial statements of IFRS application as the key audit matters.

The results confirm that the adoption of IFRS 16 will have a significant impact on the financial indicators of the companies, changing the perception of the investors regarding the results of the indicators. The capital structure indicators related to long-term debt composition and third party participation on equity have increased, since the obligations assumed through leases are more relevant in the long term, since most of the contracts have significant values in 12-month-longer periods.

For research to come, it is recommended to evaluate the impacts of IFRS 16 application on stock prices of publicly traded companies, since the statements will be more transparent in relation to the operating lease transaction, it is understood that there will be a share price variation because of the clarity regarding the financial condition of the companies due to the registration of responsibilities that hold pertinent values.

Summing up, the importance of EBITDA to verify the cash production capacity of a company will be damaged, since a relevant expense, namely rent expenses, will not be considered in its calculation, increasing value and reducing its scale indeed.

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