Abstract:
The International Accounting Standards Board unveiled IFRS 16 - Leases in January 2016, replacing IAS 17 - Leases for reporting periods commencing on or after 1st January 2019. The updated regulations introduce dissimilar accounting models for lessees and lessors. Although the significance of distinguishing between finance leases and operating leases has diminished for lessees, it still holds relevance for lessors. The influence of IFRS 16 on a company is contingent on the quantity of existing operating lease agreements and differs across various industries. The effect of the implementation of this standard in the hotel industry, as one of the industries with the highest amounts of leased assets, is the primary emphasis of this paper. Throughout the extensive literature review, the main challenges and consequences of this standard’s implementation will be analyzed.

Keywords:
financial reporting, IFRS, IAS, leases, lessee.

1. INTRODUCTION

In an era where accounting standards are continuously evolving to enhance financial transparency and comparability, the introduction of IFRS 16 has brought significant changes to lease accounting practices across industries. For the hotel sector, renowned for its intricate network of lease agreements that span properties, furnishings, and equipment, the adoption of IFRS 16 represents a pivotal juncture where the pursuit of hospitality excellence intersects with the precision of accurate financial reporting. This review paper delves into the multifaceted realm where hospitality operations meet financial statements, with a focus on how the implementation of IFRS 16 has resonated within the hotel industry. This is where the purpose of this paper lies, as the proper implementation of financial reporting standards poses numerous challenges and obstacles. Therefore, the contribution of this paper is reflected in assisting financial reporting practitioners and highlighting the importance of the appropriate implementation of IFRS 16. The paper is structured as follows: The following section provides an overview of IFRS 16 and the changes in leasing practices it brought. That will be followed by the main challenges and considerations of its implementation, as well as managerial and financial implications. Before conclusions are drawn, a review of the literature in this field will be presented. Finally, the paper will provide conclusions and offer recommendations for potential future research directions.
1.1. IFRS 16 OVERVIEW

International Financial Reporting Standard (IFRS) 16 - Leases replaced the previous International Accounting Standard (IAS) 17 - Leases and became effective for annual reporting periods beginning on or after January 1st, 2019. Its mandatory application in the Republic of Serbia starts from January 1st, 2021, meaning that financial statements prepared for 2021 and later reporting periods must be in accordance with said standard. IFRS 16 establishes guidelines for the recognition, measurement, presentation, and disclosure of transactions related to leasing (IFRS, 2023). The primary distinction between the updated IFRS 16 and the previously used IAS 17 revolves around how operational lease agreements are recorded in the financial records of the lessee (the entity that leased the object of the agreement). Notably, lease costs are no longer recognized on a linear basis, i.e., spreading the lease expenses evenly over the lease term. Upon the adoption of this standard in the financial records, the lessee acknowledges both the right-of-use asset and the lease liability. Specifically, calculating the present value of the lease liability necessitates determining an appropriate discount rate. The implementation of IFRS 16 results in several significant changes: an increase in the lessee’s fixed assets and lease liabilities on the balance sheet; a reduction in lease expenses; an increase in depreciation expenses; and a rise in interest expenses on the income statement. Furthermore, the new accounting approach has implications on the cash flow statement as well. The implications of IFRS 16 extend beyond the financial reporting process, resonating throughout various industries. The hotel industry, known for its dynamic lease agreements covering not only physical space but also a wide range of services and amenities, is uniquely positioned for a thorough assessment of the impact of IFRS 16 (IFRS, 2023).

1.2. HOTEL LEASE ACCOUNTING PRACTICES

The hotel industry, characterized by its diverse array of lease agreements, navigates a complex landscape of contractual arrangements that go beyond mere occupancy of physical space (Schlup, 2004). Hotel lease agreements encompass not only properties but also an intricate web of services, amenities, furnishings, and equipment. These multifaceted arrangements have been traditionally structured in ways that align with the industry’s unique operational requirements. However, the introduction of IFRS 16 prompts a reevaluation of these practices and necessitates an understanding of how they intersect with the principles set forth in the standard (EY, 2016). Hotel lease agreements encompass a variety of arrangements, each tailored to cater to different aspects of the guest experience. Property leases form the cornerstone of these arrangements, with hotels leasing space to accommodate guests. Additionally, equipment leases are prevalent, covering furnishings, fixtures, and specialized equipment used in hotel operations. Moreover, service agreements, which involve the provision of various services in conjunction with the lease of space, contribute to the intricate tapestry of hotel lease accounting practices. Unlike industries where lease agreements often center solely on the use of space, hotel leases encompass a range of services that contribute to the overall guest experience. From concierge services and housekeeping to access to amenities such as pools and fitness centers, hotel lease agreements incorporate a blend of hospitality elements. As such, the recognition of lease components and the allocation of payments to various aspects of the agreement can present unique challenges. Furthermore, the often-long-term nature of hotel lease agreements introduces considerations related to contract modifications and evolving service offerings.

1.2.1. Pre-IFRS 16 Accounting Practices and Transition and Implementation Challenges

Before the advent of IFRS 16, hotel lease accounting practices typically adhered to the guidance outlined in IAS 17 (IFRS, 2023). Many hotels classified lease agreements as operating leases, resulting in off-balance sheet treatment. While this approach allowed for operational flexibility, it also limited the visibility of lease obligations in financial statements (Liviu-Alexandru, 2018). The dynamic nature of hotel leases, involving both physical space and services, often led to complex assessments of whether leases met the criteria for capitalization. To satisfy the recognition criteria under IFRS 16, a lease agreement needs to meet these conditions (Rihter & Conic, 2022):

- The asset must be clearly specified;
- The lessee must derive most of the economic advantages from utilizing the leased asset; and
- The lessee must possess the authority to dictate how the asset is utilized.

The transition to IFRS 16 has prompted hotels to reassess their lease accounting practices (Zamora-Ramírez & Morales-Díaz, 2018). The complexities introduced by the standard’s new recognition criteria have necessitated a comprehensive review of existing lease agreements. This involves identifying lease components, determining lease term and payments, and applying the appropriate discount rates. The diverse nature of hotel leases, often involving intricate service offerings, amplifies the intricacy of these assessments. Hotels must balance the precision of lease accounting with the fluidity of their operational models. The advantages generated by IFRS 16 include (Liviu-Alexandru, 2018):

- The quality of financial statements for companies that include off-balance sheet leasing contracts
will see an enhancement. This will lead to an improvement in the comparability of financial statements between reporting periods as well as business entities among themselves.

- By accurately reflecting assets and liabilities on the balance sheet, the company’s transparency is heightened. Consequently, investors and stakeholders can assess the company’s financial position and performance more effectively in a qualitative manner. This stems from the comprehensive representation of assets under the tenant’s control and utilization for their operations.

- The enhancement in comparability results from the recognition of assets and liabilities for all leases, a uniform assessment approach, and the recognition of only acquired rights and obligations arising from the lease.

1.3. CHALLENGES AND CONSIDERATIONS

The implementation of IFRS 16 within the hotel industry is not devoid of challenges. Namely, they arise from the distinctive nature of hotel lease agreements, and the intricate blend of services, and physical space they encompass. As hotels strive to balance the art of hospitality with the precision of financial reporting, several challenges emerge, warranting careful consideration (Stancheva-Todorova & Velinova-Sokolova, 2019). The upcoming figure will illustrate the challenges and considerations of IFRS 16.

One of the foremost challenges in implementing IFRS 16 lies in the collection of lease-related data (Magli et al., 2018). Hotels must gather a comprehensive inventory of lease agreements, encompassing both property leases and equipment leases. The diverse array of services embedded within these agreements necessitates meticulous identification of lease components. The inclusion of various service elements, often intertwined with lease payments, demands a granular understanding of contractual terms and an ability to distinguish between lease and non-lease components.

Hotels are increasingly turning to software solutions to aid in the transition to IFRS 16 compliance. These solutions are designed to facilitate data management, lease identification, and the calculation of lease liabilities. However, the integration of such software into existing operational systems presents a challenge (Stancheva-Todorova & Velinova-Sokolova, 2019). Ensuring seamless data transfer, compatibility with accounting platforms, and user training necessitates a strategic approach to software implementation.

The dynamic nature of hotel operations often leads to lease modifications, as service offerings are refined and adjusted to cater to guest preferences. These modifications can introduce complexities in lease accounting, necessitating the reassessment of lease terms, payments, and components. The challenge lies in maintaining accurate and up-to-date records of these modifications while adhering to IFRS 16’s recognition criteria.

Figure 1. IFRS 16 Challenges and considerations.
Hotels engage in an array of lease types, ranging from long-term property leases to shorter-term equipment rentals. This diversity introduces considerations related to lease term determination, lease payments, and discount rate selection. Hotels must grapple with assessing the appropriate lease classification, considering the implications of IFRS 16’s finance and operating lease distinction.

For hotels with international operations, IFRS 16 implementation may involve navigating varying local regulations and accounting practices. The challenge lies in achieving consistency in lease accounting across diverse geographical locations while adhering to local reporting requirements. With the implementation of IFRS 16 in the Republic of Serbia, there has also been a change in the Regulation on the chart of accounts and the content of accounts in the chart of accounts for other legal entities (Official Gazette of RS No. 89/2020, 2023). New accounts have been provided for recording business transactions related to lease agreements, namely:

- 015 - Intangible assets taken on lease - are intangible assets with the right to use for more than one year that meet the requirements to be recognized as assets in accordance with IFRS 16;
- 025 - Real estate, plants and equipment leased with the right to use for more than one year - are recognized on the lessee's financial statements for those leases or leases that meet the conditions for recognition as assets in accordance with IFRS 16; and
- 416 - Long-term lease liabilities - are presented as obligations arising from financial leasing or leasing obligations in accordance with the accounting policy.

1.4. MANAGERIAL AND FINANCIAL IMPLICATIONS

The intersection of IFRS 16 with hotel lease accounting extends beyond financial statements, exerting influence on managerial decisions, strategic planning, and operational considerations (IFRS, 2023). The recognition of lease obligations on the balance sheet brings forth a cascade of implications that hotels must navigate while ensuring the seamless delivery of exceptional guest experiences. The upcoming figure will illustrate the Managerial and financial implications of IFRS 16.

With lease liabilities now visible on balance sheets, hotels may encounter shifts in lease negotiations. Lessors and lessees alike may approach negotiations with an altered perspective, considering the financial implications of lease commitments. This necessitates hotels to engage in more informed discussions and assess the long-term financial impact of lease agreements on their financial statements.

The transparency introduced by IFRS 16 can reshape the way hotels approach financial planning and budgeting (A&S Landscape, 2023). Lease payments that were once buried in operating expenses now command attention as explicit obligations.

![Managerial and financial implications of IFRS 16](image-url)
This can prompt hotels to adopt more meticulous forecasting methods, ensuring that lease obligations are factored into long-term financial planning and budgetary decisions.

The shift in lease accounting under IFRS 16 may prompt hotels to reevaluate their decision-making processes concerning leasing versus purchasing assets. As lease obligations are brought to the forefront, hotels may reassess whether leasing is the most financially prudent option or if ownership would yield greater benefits over the long term.

The intricate interplay between service components and lease agreements necessitates hotels to adjust their operational strategies. Aligning the delivery of services with the delineation of lease components becomes crucial to ensuring that financial reporting accurately represents the economic reality of lease agreements. This entails collaboration between finance and operational departments to ensure consistency.

As hotels factor lease obligations into their balance sheet, the allocation of capital and investment decisions may be influenced. Capital-intensive projects may require a more nuanced evaluation, considering their impact on lease liability ratios and other financial metrics. Investment strategies may evolve to balance operational enhancements with financial prudence. Finally, transparent lease reporting under IFRS 16 demands effective communication with stakeholders. Hotels must articulate the implications of lease accounting changes to investors, analysts, lenders, and other interested parties. Clarity in communication is vital to ensure that stakeholders have an accurate understanding of the hotel’s financial position and obligations.

2. LITERATURE REVIEW

This section starts with research with that conserve as a warning of possible ramifications of operating lease capitalization. Grossman & Grossman (2010) examined consequences of capitalizing operating leases within a dataset of 91 nonfinancial firms from the Fortune 500’s top 200 list. They investigated the impact of incorporating total operating lease payments on the current ratio and the ratio of total liabilities to total assets. The findings indicate that, in a significant portion of the companies within the sample, both the current ratio and the total liabilities to total assets ratio have deteriorated. Consequently, this implies that certain entities are in breach of debt agreements, which mandate stringent debt ratio compliance. Also, they found that the most significant percentage rises in current liabilities occurred within from different industries.

This is not the first time authors notes the connection between leases and financial ratios (Barone, Birt, & Moya, 2014). Although a subset of these scholars has directed their attention toward examining its influence on stock market prices (Ro, 1978; Bowman, 1980), the majority have concentrated on scrutinizing how capitalizing operating leases affects critical financial ratios (Ashton, 1985; Imhoff, Lipe, & Wright, 1991; Beattie, Edwards, & Goodacre, 1998; Goodacre, 2003; Durocher, 2008; Jesswein, 2009; Grossman & Grossman, 2010; Singh, 2010; Fitò et al., 2013; Nuryani et al., 2015; Magli, Nobolo, & Ogliari, 2018; Riether & Conic, 2022).

The impact of implementing IFRS 16 will vary based on the utilization of operating lease agreements across different industry sectors. Leases serve as a crucial and flexible method of financing for many entities, with listed companies that adhere to IFRS and U.S. GAAP collectively holding significant amounts of lease commitments. Prior to implementing the standard, research was undertaken to assess the potential impact of IFRS 16 adoption. Particular attention was given to its influence on the balance sheet, both pre- and post-implementation, by business entities. In order to offer insights into the anticipated effects of the implementation of IFRS 16 on the financial reports of Italian entities, (Magli et al., 2018) conducted an empirical investigation. In this research, data from the 2016 financial statements of 384 entities listed on the Italian Stock Exchange were employed to analyze operating lease commitments. The results offer insights into their impact on the performance and financial position of these entities. The study highlights notable alterations in the financial statements of lessees. To elaborate, the balance sheet will reflect an elevation in lease assets, a growth in financial liabilities, and a decrease in equity. Furthermore, the income statement will show an increase in EBITDA and a rise in finance costs. The implementation of IFRS 16 has been studied on Spanish entities, as well (Zamora-Ramírez & Morales-Díaz, 2018). Authors suggested that impact of standard is more pronounced compared to European companies, especially in sectors that are heavily affected. The balance sheet had significant changes, with both total assets and liabilities increasing, resulting in heightened leverage ratios. Additionally, there is a notable decline in the interest coverage ratio. Sectors with a larger proportion of leases belong to professional services, such as retail, hotels and restaurants, and media, had experience more pronounced effects.

Lemos et al. (2023) in their paper demonstrate that, during the initial year of IFRS 16 adoption, the average compliance level with disclosure requirements is approximately 0.66, when it comes to the sampled companies that are listed in Euronext Lisbon. As expected, the results of the multivariate analyses show a significant positive impact of auditor type on the compliance disclosure index.
Consequently, authors conclude that entities whose financial accounts are audited by one of the Big Four firms tend to exhibit a higher level of disclosure compared to those audited by other auditing firms.

Rihter & Conic (2022) have pointed out the impact of the new method on the performance of economic entities, particularly its influence on profitability and indebtedness. Rise in lease-related obligations will provide a more accurate representation of companies’ indebtedness levels. Additionally, frontloading higher costs during the early lease years will lead to decreased profitability. The primary focus has centered on how the adoption of the standard affects the balance sheet, primarily because of a notable surge in fixed assets and lease-related obligations. The most prominent effects on the balance sheet were identified within the aviation industry, retail sector, and hotel industry.

While authors agree that the change has negative impact of leverage and current ratio, there is no agreement on whether change has positive, negative, or has no effect on market capitalization of companies (Gligoric et al., 2019). In that sense, Chung (2022) asserts that the implementation of IFRS 16 has a detrimental effect on financial health metrics. This adverse impact arises from the reclassification of operating to finance leases, consequently inflating the entity’s lease liabilities. The same authors claim that this surge in leverage ratios diminishes the attractiveness of entities engaged in operating leases by constraining their access to future financing opportunities and heightening the risk of violating obligations related to the company’s liabilities. Conversely, Honny et al. (2022) assert that the leverage ratios resulting from the adoption of IFRS 16 do not exert any influence on the entity’s value. Authors claim that the entity’s value remains unaffected in this process, as entities have already made their decision regarding reclassification. On the other hand, Agyei-Boapeah et al. (2020) affirms that the introduction of new IFRS 16 adoption enhances entity value in countries with mature financial markets. This enhancement can be ascribed to the diminishment of information asymmetry between owners and the management of the entity, along with the improved availability of external funding. The research results indicate that there is a favorable connection between the rise in lease amounts according to PSAK 73 (IFRS 16 adoption) and firm value in Indonesia throughout the pandemic COVID-19. Furthermore, the study uncovers an adverse association between lease amounts under the previous standard and entity value before the pandemic occurred (Nugroho & Gantyowati, 2023). On the contrary, Lau (2023) reports that from 2011 (right after the initial exposure draft that led to IFRS 16) to 2018 (just before IFRS 16 became effective), there was a decline in operating lease intensity. Furthermore, it observes that variations in operating lease amount during 2011 to 2018 are influenced by gearing, aligning with the debt agreement hypothesis.

To summarize, the consequences of adopting IFRS 16 can vary depending on the nature of operating lease contracts or industry, yet they consistently exhibit significant effects, as highlighted in various studies. These effects encompass (Dayag et al., 2023):

- A rise in financial liabilities, owing to the recognition of lease liabilities that equal to the present value of future payments (Sacarini, 2017; Malili, 2018; Yu, 2019);
- A decrease in return on assets (ROA) as a result of the increase of total amount of assets, as indicated by research conducted by (Tai, 2013; Wong & Joshi, 2015; Nuryani et al., 2015; Ozturk & Sercemeli, 2016; Joubert et al., 2017; Veverkova, 2019; Raoli, 2021);
- An increase in the debt-equity ratio due to the decrease in total amount of liabilities (Wong & Joshi, 2015; Nuryani et al., 2015; Ozturk & Sercemeli, 2016; Magli et al., 2018; Morales-Diaz & Zamora-Ramirez, 2018a); and
- An increase in EBITDA resulting from the increase of depreciation and interest expenses in place of lease expenses (Stancheva-Todorova & Velinova-Sokolova, 2019).

These effects are anticipated to be more pronounced in industries that heavily depend on operating leases and, consequently, in entities that extensively incorporate such leases into their operations, as noted in (Karwowski, 2018).

3. CONCLUSION

In summary, the shift to IFRS 16 in the hotel industry represents a significant transformation in lease accounting practices, with far-reaching implications. Proper implementation is paramount for accurate financial reporting and transparent communication with stakeholders. It’s worth noting that the standard IFRS 16 was issued on January 13th, 2016, and became effective on January 1st, 2019, with mandatory application in the Republic of Serbia starting from January 1st, 2021. The primary challenge for hotels is to strike a balance between their dedication to delivering exceptional guest experiences and the precision required by IFRS 16. The intricacies of hotel lease agreements, often involving service components that contribute to guest satisfaction, must be accounted for in a manner that maintains transparency and meets financial reporting obligations. Future work might revolve around determining impacts of the use of IFRS 16 on financial ratios of selected hotel businesses.
4. LITERATURE


Official Gazette of RS No. 89/2020. (2023, September 5). Regulation on the chart of accounts and the content of accounts in the chart of accounts for other legal enti-


