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IFRS 16 Leases and its Effects on Management
Compensation Systems in the Norwegian Retail Industry

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Abstract

The background for this master thesis is the upcoming leasing standard issued by International Accounting Standards Board, IFRS 16 *Leases*. The standard will require lessees to recognize substantially all lease arrangements on the balance sheet. The current standard has been criticized for its binary classification, allowing lessees to keep certain leased assets off-balance sheet. IFRS 16 will have an effective date of 1 January 2019, and is deemed to have great impact on leasing-intensive industries.

We examine how IFRS 16 will impact key ratios for companies applying IFRS, and consequently whether this will have any possible effects on bonus compensation contracts for Norwegian retail companies. After we present the relevant literature regarding *lease accounting* and *management incentives and bonus contracts*, we conduct a case study to analyze IFRS 16's impact on the financial statements of two of the largest retail companies in Norway. The results are used to analyze the effect on identified elements in bonus contracts obtained from literature and sit-downs with executives of the case companies. This analysis includes a historical and a forward-looking approach. Succeeding interviews with auditors enlighten the topics from a professional perspective.

When capitalizing operating leases, we find evidence suggesting a significant rise in operational measures included in bonus contracts (EBITDA, EBIT, NOPAT), while included financial measures (ROIC, ROCE, EVA) are likely to decline notably. However, IFRS 16 appears to have a diminishing effect on growth in ROIC/EVA when comparing different growth scenarios in a forward-looking approach. Interviewed experts claim that making bonus contracts more robust can lead to circumvention of any possible impact from future changes in accounting policies. To ease the transition, the experts state that acquisition of new IT-systems and possession of sufficient technical knowledge will be critical for estimating an accurate present value of all future lease payments.

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Introduction

1.1 Background

Publicly available information derived from the company's financial statements is deemed to be the most valuable component in an investor's decision making. It is therefore crucial that all available information is reported with reliability and accuracy. To ensure that companies follow the same set of rules and regulations, the European Union (EU) adopted the International Financial Reporting Standards (IFRS) in 2005, applying for all publicly listed companies within EU and the European Economic Area (EEA).

IFRS is published and updated regularly by International Accounting Standards Board (IASB) with the primary purpose to fortify the harmonization of financial accounting and reporting standards as a response to the globalization of capital markets (Andersen et al, 2001). The preparation of IFRS has been, and continues to be, a dynamic process ever since its establishment in the 1970s - a time where the use of leasing as a source of financing had started to take roots in certain capital-intensive industries (Gritta, Lippman, and Chow, 1994). Any specific regulations concerning lease accounting were absent at that time. All agreements made between lessees and lessors were recognized as operating leases. This implied that the lessor retained legal ownership of the assets, whereas the lessee was entitled to the asset's right of use for an agreed period of time at a given rent. In lack of appropriate guidelines, lease financing was utilized to fund or refinance firms' operations outside of the balance sheet, known as off-balance sheet (OBS) financing.

1.1.1 Issuance and criticism of IAS 17

To discourage entities from OBS financing and to 'ensure that financial statements give a complete, relevant, and accurate picture of transactions and

events' (i.e. substance over form), the current lease accounting standard (IAS 17) was introduced in the early 1980s with effect from 1984. IAS 17 follows a binary categorization of lease contracts. Each lease agreement shall be defined as either operating or finance lease. This is determined in accordance with a set of criteria to ensure that the lease agreement's relevant asset is initially capitalized by the party that bears the substantial share of the risk and holds the right for return (Kamath, Kerkar and Viswanath, 1990). If the lease agreement meets the requirements that transfer the risk and rewards to the lessee, the lease shall be classified as finance lease. Otherwise, the agreement shall be classified as an operating lease, and is thus recognized as an operating expense in the income statement.

IAS 17 has for long been criticized for failing to meet its original purpose: to standardize financial performance of international entities and to be able to compare them on a like-to-like basis. The criticism is particularly aimed at the sovereignty to determine the classification of a company's own leases. Kopf and Harr (2013) argues that the current lack of transparency regarding off-balance sheet items can incentives tailoring of lease contracts, which does not present the economic realities of the agreement. The opportunity to choose has led to a vast proportion of all leases being classified as operational, and consequentially not reflected in the lessee's balance sheet. Besides the fact that the users of financial statements may seem misled, the binary categorization of lease contracts reduces the comparability of financial statements across companies. The relevance of accounting ratios becomes problematic when operating leases are not capitalized, and most certainly unfair for non-leasing firms (Fahnestock and King, 2001).

1.1.2 A new standard

For over a decade, IASB and Financial Accounting Standards Board (FASB) have jointly worked towards a new and improved standard for lease accounting with

intent to enhance transparency and creating a more comprehensible picture of an entity's leasing activities. After a series of exposure drafts and subsequent revisions, IFRS 16 *Leases* was approved for issuance by IASB in the beginning of 2016 with an effective date of 1 January 2019 (IFRS, 2016). IFRS 16 introduces a single lessee accounting model, which eliminates the twofold classification as per the guidelines of IAS 17. Accordingly, all leases shall be treated as finance leases and hence be recognized in lessee's balance sheet. Exceptions apply only for short-term leases under 12 month and low-value assets (EY, 2016).

1.2 Delimitation

With the new standard for lease accounting in the pipeline, a wide variety of industries will most likely be facing noticeable changes to their accounting figures, as all current and future operating leases are to be recognized as right-of-use assets and liabilities in the company's balance sheet. According to an EY report from 2016, companies in certain industries have commonalities in their business models that will make them prone to impact by IFRS 16. The characteristics are often recurrent and relates largely to rental of premises, offices, machines and other equipment necessary for execution of core business processes. The EY report finds Oil & Gas, Construction & Engineering, and Retail & Consumer Products as some of the most exposed sectors. The latter is deemed to be the most affected and with high level of effort to comply the upcoming changes. Of these reasons, we will call attention to the retail industry, more specifically the Norwegian retail market, in this research thesis.

1.3 Motivation for thesis subject

When we considered possible master thesis subjects, it was important for us to find a subject we had a common interest in. During our years at BI we both have developed a fascination with accounting as an academic field and when deciding

our Major, Business Law, Tax and Accounting was the natural choice. Our graduate courses in the field have contributed to this interest and have given us greater understanding and different ways of employing our knowledge.

Writing a master thesis can be done with widely different approaches and methods. Analyzing a newly accepted IFRS standard that has yet to be implemented requires systematic effort, usage of prepossessed knowledge and the ability to find solutions to emerging problems and questions. Past experiences from academic projects and work has made us appreciate complex problems that need cleverness and an analytical way of thinking to be solved.

The chosen thesis subject coincides well with our interests and preferred style of working, and we find the timing for this particular topic to be rather good. It seems that previous research on the topic has remained still for some time, as acceptance of the new standard have been pending. Further on, we have found an exciting extension to previous work that has not yet been explored to the fullest.

1.3.1 A thesis conducted on the German retail market

Mina Stanic (2016) did a study of IFRS 16 and its effect on management bonus systems in the German retail industry as a part of her master's degree at Copenhagen Business School. Her thesis was built on a case study of REWE Group - the second largest retailer in Germany, supported with collected theory, as well as interviews conducted with experts from the Big Four. Her study of REWE Group's financial statements show that capitalizing operating leases contribute to both positive and negative effects on the most commonly used measures in bonus systems - measures obtained from a study of Peterson & Plenborg (2007). Stanic highlights a variety of potential issues that may arise in the wake of the re-negotiation of bonus agreements, including principal-agent problems, manipulation of results and information, and investor reactions. The

methodological chapter in Stanic's thesis has been an inspirational source when planning our research project.

1.4 Problem definition

Our thesis aims to elucidate the scope of the newly approved IFRS 16 *Leases* and how it will impact earnings and financial figures, hereunder key ratios, for companies applying IFRS. The new standard for leasing will not only affect the company's financial measures, but additionally have implications for defined contractual agreements depending on particular targets derived from the company's financial statements. Our scope is extended to include the effect to which the changes in accounting for leases will have on bonus compensation contracts for companies in the Norwegian retail industry. Our approach will include the effects on various forms of commitments that trigger remuneration for executive management and middle management, and subsequent issues that may arise as a result of the arrival of IFRS 16.

Accordingly, the research question of this thesis is:

“How will the transition to IFRS 16 affect key financial ratios, and consequently the bonus compensation system in the Norwegian retail industry?”

To give a comprehensive answer to the research question, we have derived it into several sub-questions:

- Which theoretical and practical accounting consequences will IFRS 16 entail?
- How are bonus remuneration contracts structured in the Norwegian retail industry, and what are the most important performance metrics?
- How will IFRS 16 impact the related financial key performance measures?

- What are the possible economic consequences of the accounting changes and consequently potential alteration in bonus contracts?

2 Methodology

This chapter describes the methodology applied in our thesis. Our choices regarding the methods used and the structures followed for answering the research question, with accompanying sub-questions, are well founded and follow the framework of “the research onion” (Saunders et al, 2012). The research onion is an analogy for the procedural steps in a research project and we apply this framework to illustrate coherence in the methodology. The onion consists of several layers in a fixed order, and choices made in the previous layer will often influence decisions in the next.

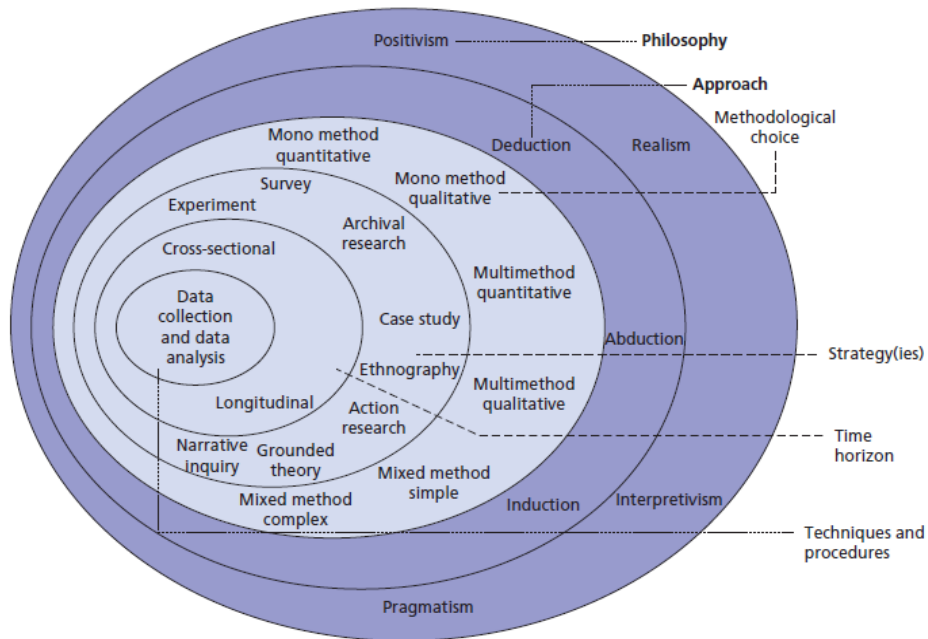


Figure 1: The research 'onion' (Saunders et al., 2012, p. 128)

2.1 Philosophy

Research philosophy is the outer layer, but unlike a real onion, the peel is not thrown away. It can be described as “... the assumptions about the way in which you view the world” and will influence which strategy and methods we choose (Saunders et al., 2012). The formulation of our research question is twofold, and due to this reason, the research procedures will differ, meaning that more than one philosophic stance can be adopted. Combining more than one is a position itself: *Pragmatism*. Pragmatism is a practical oriented stance and gives flexibility when deciding research strategy. *Positivism* is a philosophy where only observable reality can yield reliable data. It focuses on causality and its aim is to create law-like generalizations. *Interpretivism*, on the other hand, is socially constructed, and states that reality has to be given subjective interpretation (Saunders et al., 2012). The analysis of how IFRS 16 will change accounting measures and subsequently affect bonus contracts, both from a historical and forward-looking perspective, is within the philosophy of positivism. Interpretivism needs to be adopted when assessing the possible economic consequences for the parties concerned by the new standard.

2.2 Approach

The following layer concerns the research approach. In this thesis, a combination of deductive and inductive approach is applied. A central characteristic of deduction is to search and explain causal relationships between concepts and variables (Saunders et al., 2012). We have examined potential causal effects the implementation of IFRS 16 has on bonus compensation systems, making a deductive approach necessary. Further, IFRS 16 has been analyzed, and together with existing literature and research, we did a case study consisting of two of Norway’s largest retailers: NorgesGruppen and Reitangruppen. In the case study, we assessed how the new standard affects performance measures for three

historical years. The obtained results in this case study are further supplemented with a forward-looking analysis of three forecasted years, in addition to interviews of experts on IFRS 16 from two of “the Big Four” audit firms. Their answers enrich our own results, and add further insight when assessing the potential economic consequences of the new standard, i.e. how parties concerned will act in the aftermath of the standard approval.

A central part of our work has been to analyze how bonus systems are composed in the retail industry and finding the components which trigger payouts. Detailed understanding of the subject is a prerequisite for the extension we have applied, compared to previous research on impacts of the new standard. How the necessary information and knowledge about the applicable bonus contracts for the case companies was gathered is explained in the research strategy paragraph. It is within this part of the research process we have applied the inductive approach. From the aforementioned interviews, a set of potential economic consequences has been identified. How a company approaches the changes in lease accounting, and consequentially how it might impact bonus contracts, are both examples of questions answered in this section of the thesis.

2.3 Methodological choice

Methodological choice, i.e. the decision of choosing a quantitative, qualitative or multiple methods research design, is the third layer. Analyzing the effects IFRS 16 entail on financial measures is done purely quantitative by reformulating the publicly available accounting numbers of the case companies. The additional, forward-looking analysis of how applicable performance measures develop under two different economic scenarios fall within the quantitative approach as well. Quantitative research goes well with the deductive approach and is suitable when studying relationships between variables. Regarding philosophy, our methodological choice is often related to positivism, although highly appropriate

with pragmatism as well. A part of this study falls within the philosophy of interpretivism, and an additional, qualitative method can therefore be wise to apply. Expert opinions on the upcoming accounting changes and potential economic consequences were acquired through interviews, which required qualitative assessment. This makes a simple mixed method applicable.

The research design reflects the purpose of the research; the way the research question is put into words. We have examined *how* IFRS 16 will influence bonus remuneration contracts and to what extent this brings consequences from a behavioral perspective for the affected parties. Previous literature and research on capitalization of OBS lease contracts is extensive, but the particular scope and extension we have applied is substantially less explored. This makes an exploratory design well suited. When previous findings of a topic are limited, it may be challenging to outline a clear path regarding the research process and which expectations to have. With the exploratory design comes a certain risk that the obtained results are unrewarding in terms of revealing new knowledge on the topic. Nonetheless, a large advantage with the mentioned design is its flexibility and adaptability to change (Saunders et al., 2012). If we, somewhere during our research process, had detected an additional scope worthy of being studied, the exploratory design makes it perfectly acceptable to deviate from the original scope. Similarly, it applies if the findings on bonus remuneration contracts had revealed that the coming changes are already accounted for in every conceivable way.

2.4 Strategy

The succeeding layer looks at different alternatives for the research strategy. Saunders et al. defines a strategy as a plan of action to achieve a goal. In other words, the strategy is the plan of the specific choices that we made in order to answer the research question and the related sub-questions. In order to properly

answer how IFRS 16 might affect the bonus compensation system for retail companies in Norway, the way in which these particular bonus contracts are constructed had to be learned first – a task proven to be demanding. As a starting point for gaining this knowledge, general literature on management incentives and bonus contracts was studied. Further on, this general literature was filtered down to industry specific level for the retail market. A necessity, and challenge, for this thesis has been to obtain this very information for the Norwegian retail industry. A feature of the Norwegian retail industry for food and groceries is that it consists of a small number of groups that part the market between them. None of the groups are publicly traded, and the private ownership combined with the strong competition makes the companies keep their cards close to their chests. Numerous phone calls and e-mails to acquaintances associated with either NorgesGruppen, Reitangruppen or COOP Norge were made before sit-downs with respectively the recently resigned CFO of NorgesGruppen and the CFO of REMA 1000, Reitangruppen's retail department was achieved. In these sit-downs, we obtained the decisive performance measures in their bonus contracts, as well as other relevant information regarding their leasing policy. None of the obtained information is regarded as classified.

The case study strategy serves as a tool to explore the research topic within its real-life context (Saunders et al., 2012). In this thesis, we have made use of two of the market leading retail groups, NorgesGruppen and Reitangruppen, as context. COOP Norge was intended to be included in the case study, but as a result of its lack of operating leasing activity, in addition to their cooperative ownership structure, we chose to exclude the company. NorgesGruppen and Reitangruppen are different regarding organizational structure, so assessing IFRS 16's effect on both of their financial reported statements enrich generalizability. The results from the case study were further used to analyze IFRS 16's effect on the identified elements of bonus contracts obtained from literature and the sit-downs – both in a historical and a forward-looking scenario.

Succeeding the case study and the following analysis, a more qualitative approach was made: interviews were conducted and function as a supplement to the quantitative analysis, enlightening the topic from a professional perspective. The persons interviewed are state authorized public accountants and experts in IFRS 16, as well as IFRS in general. In addition to validate the findings in the quantitative assessment, they challenged our perspective on IFRS 16's impact on performance measures and gave further insight regarding consequences the new standard entails. The semi-structure interview format allowed for in-depth answers from the respondents and for us to ask follow-up questions if new perspectives emerged.

2.5 Time horizon, techniques and procedures

Second to the core of the onion is the research project's time horizon. Due to time constraint, this thesis is a cross-sectional study, as we investigate "*a particular phenomenon at a particular time*" (Saunders et al., 2012, p. 190). The core of the research onion addresses the collection and analysis of data. Our empirical analysis is based on financial accounting data for the target companies, NorgesGruppen and Reitangruppen. Annual reports are deemed to be first-hand information and are therefore considered as primary data. Furthermore, the full text standards IAS 17 and IFRS 16 are considered being primary data. This also applies for all information received in sit-downs and interviews. Our secondary data consists of academic books, journals and other publications such as the audit firm's reports on IFRS 16.

3 International Financial Reporting Standards

Accounting standard setting is a form of regulation that is ultimately under the control of a country's government or legislature, whereas the responsibility for standard setting in accounting is typically delegated to a specific agency (i.e. the securities commissions). In turn, the primary responsibility for devising a working regulation for public accounting practice is delegated to a semi-autonomous regulator, such as IASB and FASB (Scott, 2015, p. 487). The aim is to combine financial reporting and efficient contracting roles of accounting information in a balanced standard that equates the marginal social benefits of information to the marginal social costs (Scott, 2015, p. 487-488).

3.1 History

The IASB was established in 2001 - originated from an earlier body, which operated under the name of International Accounting Standards Committee (IASC) in the period between 1973 and 2000. IASB/IASC was founded to reduce differences in accounting standards across borders, and as an attempt to develop standards adaptable for international use. The introduction of IAS/IFRS is one of the most significant regulatory changes in accounting history (Daske et al., 2008). It has enhanced the quality and comparability of financial reporting, as well as ensured more transparency and better access to corporate information for stakeholders. IASC released a series of numerically ordered standards under the name of International Accounting Standards (IAS). The committee released its first standard, IAS 1, in the establishment years – the current official guidelines for the presentation of financial statements under IFRS. The series was completed with IAS 41 in December 2000. After the establishment of IASB the following year, the founders agreed to continue the legacy of IAS, with the proviso that future publications will be released under the name of IFRS. New principles contradicting with existing IAS standards will thus be disregarded in favor of the

latest issue under IFRS. The IASB standards were rapidly adopted by the likes of the European Union, in addition to Australia, Mexico and Russia. Other prominent countries, such as United States, China, Japan and India, are considering, or are in process of, adoption (Scott, 2015, p. 30)

3.2 The Structure and Governance of IFRS Foundation and IASB

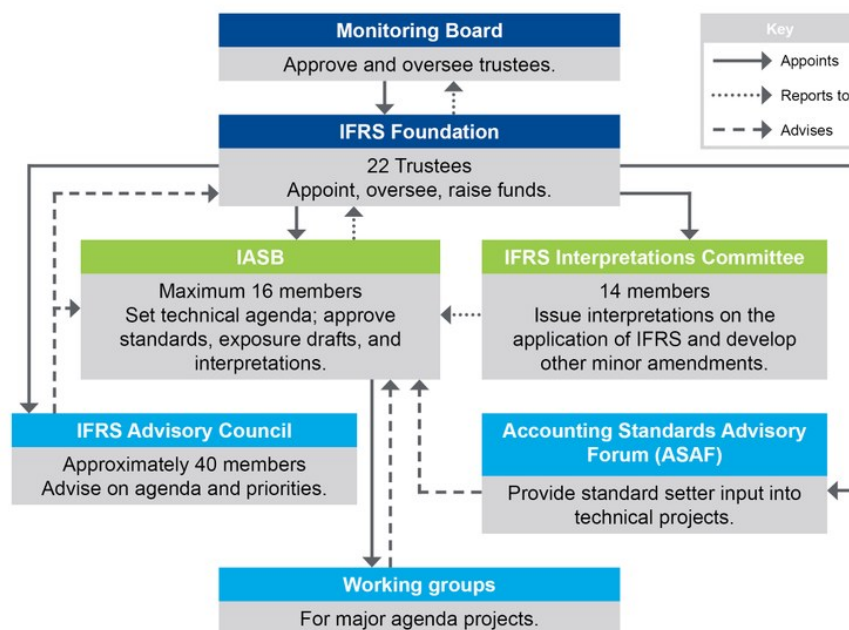


Figure 2: The structure of the IFRS Foundation and the IASB (IASPlus, 2017)

The **IASB** is part of a three-tier structure and governed by an independent organ named the IFRS foundation. The foundation is a non-profit corporation under the general corporation law of the state of Delaware, United States of America. The IASB functions as the executive body for the development and publication of new accounting standards, with IFRS Interpretation Committee (IFRS IC) serving as a judicial entity responsible for reviewing and ruling on conflicting understandings of the standards, as well as other technical support (Porter, 2014).

The **IFRS Foundation Trustees** represents the second governance tier whose primary mission are recruiting and appointing the members of IASB, the IFRS IC, as well members of the IFRS Advisory Council (IFRS AC) (Porter, 2014). Moreover, they are responsible for approving budgets and determine the basis of the funding of IASB. The third and final tier, the **Monitoring Board**, was entrenched in January 2009 to ensure public accountability of the IFRS Foundation by forming a link between the Trustees and the public authorities.

As shown in figure 2, IASB receives consultation commissioned by the trustees of the IFRS Foundation. There are two advisory entities – IFRS AC and ASAF, both composed of representative from all user groups, including national standard-setters, audit firms and accounting producers. The intent is to use a fragmented assortment of interested parties to stay abreast of current trends and to receive feedback on initiated projects. ASAF - a rather new addition to the organizational structure, comprises of national accounting standard-setters and regional bodies whose purpose is to secure a more streamlined and effective dialogue between IASB and the global accounting standard-setting community (IFRS, 2016).

3.3 The Standard-setting Process

The process of developing standards under IFRS is reckoned as highly transparent, considering that all stages involve public consultation. Moreover, all meeting and board papers are easily accessible for the general public. The process itself has become more elaborate over time and is presently classified into four main steps as portrayed below:

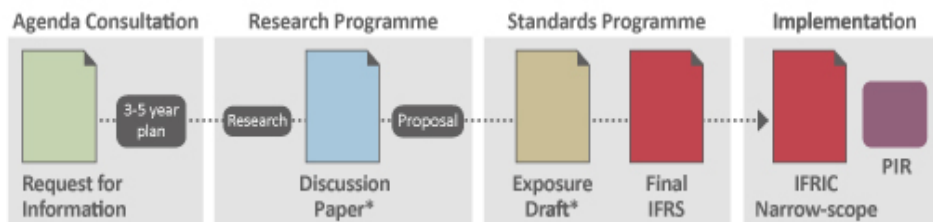


Figure 3: The standard-setting process (IFRS, 2017)

3.3.1 Agenda Consultation

The primary objective of IASB is to provide financial information about reporting companies to users of financial statements. In order to give investors, lenders and other creditors access to high quality information, the IASB has to continuously seek improvement and to develop existing and potential new standards to accommodate changes in the business environment. Every five years, the board consults the public on its technical work. Comments and requests from ASAF and IFRS IC, including other standard-setters and interested parties, are reviewed and optionally included in the work plan. The staff of IASB are also asked to identify, review and raise issues that warrant the attention of the board. All potential projects are presented to the IASB, and further discussed and voted for during the public IASB meetings. Certain projects may require additional research prior to a final decision. Cooperative standard-setters are typically responsible for this sort of extensive research before the case yet again is presented for the board. As part of the process of setting the agenda, the IASB decides whether to carry out the project on their own, or as part of a joint project with other standard-setters.

3.3.2 Research Program

The next stage falls within the preparation of the discussion paper. Although the paper is not a mandatory step in the due process, the IASB commonly presents such publications on important topics. In exceptional circumstances, they always disclose reasons for why the step is disregarded. A discussion paper is typically an

iterative process in which the IASB staff write a paper that presents the problem with a possible solution. After tentative decisions and repeated feedback from the board, a ‘preliminary views’ paper is presented with discussions of alternative approaches, including the direction of the Board’s preferences. An invitation to comment on current work is also sent out to other standard-setters and interested parties. The comment period usually lasts for about 120 days, with the possibility of extended time for extensive projects (Walton, 2010). Selected commentators may have the opportunity to elaborate on their comments through round-table meetings, field trips and public hearings (IFRS Foundation, 2013).

3.3.3 Standards Program

Once all responses have been analyzed and further summarized in an outline published on the IASB’s website, the Board prepares an overview of the main attendant issues. A preliminary exposure draft is made by the research staff and circulated privately to Board members as a ‘pre-ballot draft’. Questions and issues regarding the draft are then raised, and selected parties, such as IFRS IC and IFRS AC, are invited for a ‘fatal flaw’ review. Once all aspects of the draft are scrutinized by professionals, IASB will conduct a ballot, and the exposure draft is published and opened for public comments for a period of 120 days.

The staff and the Board follow roughly the same procedure as for the discussion paper after the exposure draft is published. The only exception is that the Board is not looking for alternative approaches, but rather comments on fatal shortcomings in the draft. If it transpires that the draft contains major deficiencies, or substantial issues have emerged during the comment period, the Board has to decide whether to publish a revised proposal for another round of comments. However, IASB is obliged to *not* include any requirements that has not been exposed to comments. Hence, if the Board decides to change something substantial, they will be forced to re-expose the proposal. When all necessary actions have been implemented, the

Board does a final ballot where the simple majority rule decides if the standard is to be issued. (IFRS Foundation, 2013, and Walton, 2010)

3.3.4 Implementation

An issuance of a new standard is always supplied with an ‘effective date’, which is a minimum of one year after the date of issue. The conscious postponement gives IASB time for the standard to be translated from English into other languages. The postponement also allows for different national laws to incorporate the new practice into their code of law. As regards to the companies concerned, the IASB will allow an early adoption if appropriate (Walton, 2010). After an IFRS standard is issued, the IASB and the staff arrange regular meetings with interested parties, including other standard-setters, to ensure that the practical implementation and potential consequences from the issuance is fully acknowledged (IFRS Foundation, 2017).

4 Accounting for leases

4.1 Previous research

Leasing as a financing method has been an extensive research topic ever since the first regulatory standard for leases, IAS 17, was introduced in the 1980s. As previously mentioned, IAS 17 has in practical terms made way for companies to easily manage their balance sheet. By adjusting the lease contracts with intention of avoiding the criteria for finance leases, companies were able to achieve more preferable financial ratios. In 2012, Cornaggia, Franzen and Simin conducted a study to prove whether firms use operating lease activity to manage their balance sheet. By using time-series plot and regression analysis, the first of their two main hypotheses were that operating lease activities are explained by theoretical determinants (such as financial constraints, company size, marginal tax rate and asset value). The second was that unexplained operating lease activities are

positively associated with incentives to keep debt off the balance sheet. Their evidence suggests that operating lease activities are greatest among firms that initially are not deemed to have a high propensity to lease assets. This implies that firms choosing OBS lease financing are the ones without the traditional economic benefits of leasing. Although, the results also indicate that operating lease activities allow firms to circumvent debt covenants and that these lease activities are positively related to the existence of such covenants limiting further borrowing. Koh and Jang (2009) supports this in a study of the determinants of using operating leases in the hotel industry when it comes to companies with high leverage, which is not necessarily financially distressed. However, a Dutch study from Erasmus University Rotterdam contradicts this. The study included 38 listed companies in financial distress and 62 healthy companies in the period from 2000 to 2004, and concluded that financially distressed companies are more likely to use operating leases as a financing method than healthy companies (Lückerath-Rovers, 2009).

Off-balance sheet financing and how it affects a company's covenants has been a long-debated topic within the accounting literature. It is obvious that OBS financing provides a plentiful environment for investigating how changes in financial key figures could impact any other forms of agreements involving operating leases being capitalized. Imhoff, Lipe and Wright (1993) published a research paper on whether decisions made by shareholders and executive compensation committees were influenced by footnote disclosures concerning long-term non-cancellable operating leases. They found evidence suggesting that market participants using financial statements to assess the risk of a firm's shares do appear to capitalize OBS operating leases. On the contrary, there was no evidence supporting the hypothesis that executive compensation committees adjust reported amounts to account for footnote disclosures regarding operating leases when establishing the CEO cash compensation.

The findings of Imhoff et al. from 1993 regarding market participants contradicts their previous study on the adverse effects of capitalization of leases on key financial ratios (1991). The 1991 study used seven different pairs of high- and low-leasing firms in seven industries; the evidence demonstrates that operating leases can have a significant impact when comparing key financial statement ratios. For instance, the results indicate that when the leases are being capitalized, the average decrease in ROA for high lessees is 34 percent and 10 percent for low lessees.

A number of other researchers, such as Beattie et al. (1998), Kilpatrick and Wilburn (2006), and Bennett and Bradbury (2003), have documented the same effect of lease capitalization on financial ratios by partly adopting the method developed by Imhoff et al. (1991). Beattie et al. (1998) applied a modified procedure to capitalize the operating leases of 300 listed UK companies. The results showed a significant impact (on 1 percent level) on the companies' profit margin, return on assets, asset turnover, and three different measures of gearing.

Kilpatrick and Wilburn (2006) replicated the work of Imhoff et al. (1991) using data from 2004 for the same nine firms, and compared it with the original data from 1987. The results showed that the capitalization impact on financial ratios had increased since 1987; the average capitalized debt from operating leases increased with 1.9 billion (average increase of 267%); and 50% of the observed companies would have more than twice as much unreported lease liabilities than total reported liabilities if the leases were capitalized. Duke, Hsieh and Su (2009) also adopted the Imhoff et al. (1991) method and opted to divide their sample into positive and negative income groups. This was to examine the impact of lease capitalization on net income in the post-Enron era. Their results showed that the top quartile positive subgroup experienced 18% increase in income, while the top quartile negative subgroup yielded an income decline of 11%.

4.2 IAS 17

4.2.1 Scope and determining whether an arrangement contains a lease

IAS 17 defines a lease as “... *an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time*” (IAS 17.4). The basic is that the standard covers all lease agreements, with certain exceptions (e.g. nonrenewable natural resources, intangible assets such as licenses for entertainment, copyrights and patents) (IAS 17.2).

An arrangement might not be a lease per legal definition, but can still give right of use to an asset in return of one (or a series of) payment(s). International Financial Reporting Interpretation Committee (IFRIC) issued IFRIC 4 as an interpretation of IAS 17. It addresses how to determine whether or not an agreement is, or contains, a lease as included in the definition in IAS 17. The interpretation highlights two aspects: the first is regarding the arrangement’s dependency of a particular asset; the second assessment is whether the paying party freely can operate/access the asset while obtaining the substantial part of the asset’s output (IFRIC 4.6-4.9). The assessments of IFRIC 4 ought to be done at the initiation of the agreement. Any reassessments must only be done if the contractual terms regarding lease term, dependency of the asset *or* the physical characteristics of the asset changes significantly (IFRIC 4.10).

4.2.2 Classification of leases

A lease is classified to be either financial or operating. This is conditional on the allocation of risks and rewards connected to the asset to either lessor or lessee. If the arrangement essentially transfers all risks and rewards incidental to ownership, it is classified as a finance lease, and otherwise as an operating lease. In this process, the principle of substance over form applies (IAS 17.8). Whether a lease

is financial or operating must be decided at the inception of the arrangement. Modifications to the deal, other than basic renewals, that changes how the lease is classified under the decisive criteria, makes the revised deal replace the old (IAS 17.12-13).

4.2.3 Accounting by lessee

Lessees must, at the initiation of a lease term, acknowledge finance leases as assets and liabilities in their financial statements at the lower amount of fair value or the present value of minimum lease payments. For the calculation of the present value, applied discount rate should be the implicit interest rate in the lease agreement. If this is impractical, the lessee's incremental borrowing rate is used. Any relevant indirect costs the lessee is burdened with are added to the asset (IAS 17.20). As for the substance of lease arrangements, the legal title to the asset is not transferred, but the economic reality of a finance lease is regarded to be similar as ownership. For this reason, finance leases must be included in an entity's financial statements, as an omission will fail to reflect their true financial resources and obligations, and consequently distort financial ratios. (IAS 17.21-22).

The lease payments are allocated between finance charges and reduction of the liability. The finance charges are in turn allocated such that a constant periodic interest rate on the remaining balance of the liability is produced (IAS 17.25). As a result of a finance lease, depreciation and finance costs increase for the lessee. Depreciation for leased assets should be accounted for in the same manner as for owned assets, and shall be in accordance with the rules for depreciation of property, plant and equipment and intangible assets. If there is lack of reasonable certainty that ownership of the asset will be transferred at the end of the leasing term, the period until full depreciation is the shorter of the lease term or as long the asset is functional (IAS 17.27).

The policy for operating leases is that the lease payments are to be recognized as expenses over a straight-line basis throughout the lease period. If this is not practical, different measures are allowed if they are more representative for the time pattern for use of the asset (IAS 17.33).

4.3 IFRS 16 Leases

As of 1 January 2019, all companies applying IFRS must have implemented IFRS 16 *Leases*. An earlier application is permitted for companies that have already adopted IFRS 15 *Revenue from Contracts with Customers*. This chapter will provide a brief summary of IFRS 16, with emphasis on elements of importance to this thesis. Additionally, the most influential changes from the old to the new requirements will be enlightened.

4.3.1 Scope

All leases shall follow the rules and guidelines of IFRS 16 *Leases*. Specific exceptions are made for special cases such as leases to use/search for non-renewable natural resources, leases for biological assets, and service concession arrangements according to IFRIC 12 *Service Concession Arrangements* (IFRS 16.1-4). It is optional for lessee to recognize and measure short-term leases and leases for low-value assets according to the requirements of IFRS 16. A short-term lease is defined to be a lease without a purchase option, with a lease term of 12 months or less. A lease qualifies as low value if, for instance, the asset is beneficial on its own, or in combination with other assets already in the lessee's possession. If the lessee chooses not to apply the standard, the lease payments should be accounted as an expense on a straight-lined basis over the lease term, or in a way that better reflects the use of the asset (IFRS 16.5-6).

4.3.2 Identifying a lease

If an arrangement transfers an identified asset's right-of-use to another party for a period of time in return for compensation, the arrangement is to be recognized as a lease. The right-of-use is transferred if the lessee has the right to direct the use of the asset and at the same time the right to obtain the resulting economic benefits (IFRS 16.9-10).

To identify whether an arrangement is, or contains, a lease, these criteria needs to be fulfilled (IFRS 16 B13-30):

- The asset of question needs to be identified in the contract, either explicitly or implicitly. Rights to use the identified asset is not transferred if the supplier (lessor) has the right to substitute the asset during the contract period;
- The customer (lessee) has the right to the economic benefits resulting from use of the asset during the contract period;
- The customer has decision-making rights for how, and for what purpose, the asset is used during the time it is available;
- If mentioned decision-making rights are preset, the customer can freely operate the asset (or assign to others), without the supplier having the right to alter the operating instructions; and
- The asset is designed by the customer so that how and for what purpose the asset is used, is set in advance.

4.3.3 Lease term

The lease term is defined to be the period the parties cannot terminate the agreement if the consequence is a penalty greater than an insignificant amount. Furthermore, the term includes periods in which exercising an extension option is expected, and periods where exercising a termination option is improbable. In the assessment of these likelihoods, all circumstances that might give incentives to

either extend or terminate a lease have to be taken into consideration (IFRS 16.18-21).

4.3.4 Lessee

From the commencement date (the day an underlying asset is made available), the lessee must recognize a right-of-use asset and a lease liability. At this date, the asset should be measured at cost. Lessee's initial recognition of the lease liability shall be at the present value of all future lease payments. Applied discount rate is the interest implicit in the lease, and if this is not obtainable, lessee's incremental borrowing rate is to be applied (IFRS 16.22-27).

Subsequent measurement of right-of-use assets is primarily done with a cost model. The asset is measured at cost, with any accumulated depreciations and impairment losses deducted. Further on, the cost is adjusted for any reassessments of the liability or modifications of the lease. The alternative measurement models are the fair value model for investment properties in IAS 40 and the revaluation model for assets classified as property, plant and equipment in IAS 16 (IFRS 16.29-35).

In the subsequent measurement of the liability, the carrying amount is reduced by the lease payments, and increased to reflect the interest on the lease liability. If any modification of the agreement or adjustments to the lease payments is done, the carrying amount must be remeasured to reflect these changes (IFRS 16.36). If modifications of the lease agreement are necessary, the liability is remeasured by adjusting the carrying amount of the asset to reflect the modified arrangement (IFRS 16.44-46).

The lessee shall *separate* the right-of-use assets from other assets, and lease liabilities from other liabilities, on either the balance sheet or in the notes. If not

separated, the right-of-use assets shall be included in the same line item as they would if they were owned, and disclosed in which line item they are included. Similar treatment applies for the lease liabilities. In the presentation of comprehensive income, interest expense on the liability is a finance cost and presented separately of the depreciation cost of the asset. In the cash flow statement, cash payments for the major part of the liability is classified within financing activities, whereas the interest portion goes under interest paid. Payments for short-term and low-value leases, as well as for variable payments excluded from measurement of the liability, shall be classified within operating activities (IFRS 16.47-50).

Information regarding lease agreements, in which the entity is a lessee, shall be disclosed either in the notes or separately in the financial statements. The following shall be disclosed: Depreciation charges; interest expenses; expenses connected with short-term and/or low-value leases as well as variable lease payments excluded from measurement of the liability; sublease income; total cash outflow for leases; additions to right-of-use assets; gains or losses from sale/leaseback transactions; the right-of-use asset's carrying amount at the reporting period's end (IFRS 16.51-53).

4.3.5 Changes IFRS 16 entail

As a measure for enhancing transparency in entities' financial reporting and to increase comparability of entities with different financing methods, a number of changes have been made from the current lease accounting standard, IAS 17. IFRS 16 is a more extensive standard, and will supersede the following standards and accompanying interpretations (IFRS 16 IN3):

- IAS 17 *Leases*
- IFRIC 4 *Determining whether an Arrangement Contains a Lease*

- SIC-15 *Operating Leases - Incentives*
- SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*

The wording of the *definition of a lease* may seem similar in the two standards. However, IFRS 16 gives more thorough and detailed instructions and guidelines to the assessment whether a contract is, or contains, a lease. Key in this assessment is to what extent the customer has obtained the right to control an identified asset for a specified period of time. It is anticipated that the greater number of leases in accordance with IAS 17 will still be identified as leases by the definition in the new standard. As leases and services are often combined in arrangements, the exception will be for some service contracts recognized as leases in IAS 17. IFRS 16 applies only for leases, and therefore requires non-lease elements to be separated from service elements in such arrangements (IFRSF, 2016).

Accounting for lessees undergoes substantial changes with the new standard. A finance lease by the current requirements is a lease that is economically equal to buying the asset, and hence needs recognition on the balance sheet. This binary classification is eliminated in IFRS 16, and all leases within the guidelines of the new standard will have to be capitalized. The way this is accounted for remains more or less the same, with only a few notable changes. The most influential change is how *residual value guarantees provided to lessor* is treated. While IAS 17 requires the maximum amount guaranteed to be recognized, IFRS 16 only recognizes the amount expected to be payable. All leases that are not financial are under IAS 17 classified as operating leases and kept off-balance sheet.

The most significant changes

All leased assets and liabilities - with the exception of short-term leases (12 months or less) and low-value leases (PCs, office furniture etc.) - shall be

recognized in the balance sheet, initially measured at the amount of the present value of all predetermined future lease payments, like table 2 shows. Further on, depreciation on the leased assets and interest on the accompanying liabilities shall be recognized in the income statement over the lease term, as illustrated in table 1. In the cash flow statement, the lessee must separate the principal portion from the interest portion in total lease payments made. As a measure to increase transparency, the requirement for additional disclosed information is also enhanced by the new standard.

| | IAS 17 | | IFRS 16 |
|---|----------------|-----------------------|--------------|
| | Finance leases | Operating leases | All leases |
| Revenue | x | x | x |
| Operating costs <i>(excluding depreciation and amortization)</i> | --- | Single expense | |
| EBITDA | | | ↑↑ |
| Depreciation and amortization | Depreciation | | Depreciation |
| Operating profit | | | ↑ |
| Finance costs | Interest | --- | Interest |
| Profit before tax | | | ↔ |

Table 1 Changes in the Income statement (IASB, 2016)

| | IAS 17 | | IFRS 16 |
|---|----------------|------------------|------------|
| | Finance leases | Operating leases | All leases |
| Assets | Assets | | Assets |
| Liabilities | Cash | | Cash |
| Off balance sheet rights / obligations | | Assets & Cash | |

Table 2 Changes in the Balance sheet (IASB 2016)

5 Management Incentives and Bonus Contracts

The compensation and remuneration of executive officers and middle management have been a widely discussed topic within academia, as well as among practitioners throughout the business world. In fact, incentive compensation has been one of the most actively studied topics in economics, accounting and management research in the past two decades (Gibbs, 2012). Especially during – and in the wake of – the financial crisis in 2008-2009, the attention was drawn towards managers who benefited from volume-based compensation plans on high-risk mortgages in the American housing market. Bonus incentives shall be designed in the sense that it encourages the managers to act in accordance with the company's best interests. The housing bubble that burst in the United States about 10 years ago caused a prolonged period of global recession. It is therefore reasonable to argue that poorly designed incentive schemes for any management level of an organization could have fatal consequences for a domestic economy, or even the global economy. An example can be if the way of designing such incentive systems constitute the industry standard in a sector that has great influence on the rest of the economy, such as the financial sector.

5.1 The purpose of management incentives

A great deal of modern agency theory is founded on the principle that today's leaders are acting on the basis of an egocentric view, with the company's compensation policy as the only motivational factor to act in the best interest of the company. Proper incentives for the management, and other employees, have historically been an important part of the effectiveness of management control systems. Merchant and Van der Stede (2012) identify three types of management control benefits: *Informational, motivational and attraction and retention*.

The *Informational* benefit calls the employee's attention towards, or provides a reminder of, the critical profit-bearing areas of the organization. Areas such as customer service, cost, quality and growth are often the most highlighted areas of a company's operations, and therefore frequently used in an employee's annual bonus plan. The main objective is to implicitly inform the employees of which focus areas that must be emphasized the most, and thus highly determined by the situation. Say for instance that Statoil recently had a major oil spill from one of their platforms. Such oil spills are costly due to lawsuits and federal sanctions, in addition to major cleanups at their own expense. To prevent such incidents to occur in the future, Statoil could temporarily adjust the bonus contracts to be solely based on how the employees work towards improvement of safety, and towards enhancing the procedures for risk management. These initiatives may lead to permanent amendment in the company practice, but more importantly, in the employee's mindsets.

The second benefit - *motivation* - is an effort-inducing purpose simply constructed to steer the employees in the direction of working hard and to do their best. Even diligent employees need stimuli, and the hope for a reward is a powerful incentive to give a spur or zeal in the employees for better performance.

The last control benefit is *attraction and retention* of personnel. Attracting and retaining highly skilled and talented employees are both costly and time-consuming. Performance-dependent rewards are often an important part of the employee's total payroll. A field study carried out by Banker et al. (2000) suggests that performance-based incentive systems act as an effective screening device to sort potential new employees by capabilities, which will consequently attract and retain more productive employees. Competitive industries with limited access to skilled workers will, as part of their recruitment strategy, be able to offer a compensation package that is comparable, or even superior, to those offered by their peers in order to stay competitive and to hold on to necessary capabilities.

5.2 Incentive System Design

To fulfill the purpose of having an incentive program in the most appropriate and effective manner, the company needs to structure a system that acknowledges judgement and the understanding of individual differences. Michael Gibbs, Ph. D, from the University of Chicago Booth School of Business has prepared an article on how to design incentive plans based on new insight from modern academic research. According to Gibbs, it is important to break down the design into two components – *effectiveness of the evaluation* and *the relationship between the evaluation and reward*. Even though both components could seem particularly obvious, it is surprisingly many incentive plans that violates these conditions.

First and foremost, the effectiveness of the evaluation should be studied. The evaluation shall reflect *each* employee's effort, actions and decisions with reasonable strength and accuracy (Gibbs, 2012). Incentive plans that are designed to reward larger groups or divisions will not endorse individual effort, and will therefore fail to evoke the original intent: increased joint performance within the organization. Furthermore, there is evidence suggesting that result-based plans, rather than plans based on behavioral assessments, are more easily evaluated, more accurate and gets the best effect (Kramar and Syed, 2012).

Secondly, there must be a reasonably strong relationship between evaluation and reward that is, in fact, valued by the employee. To promise a reward to a highly motivated person, that initially does not see the value in the reward, is a bit like offering salt water to someone who is thirsty. As mentioned above, group rewards will not always reflect performance on an individual level, nor justify every effort in achieving the company's objectives. Such schemes will always accommodate "free riders", which can result in dissatisfaction and reduced performance. The size of the compensation package is, naturally, also a key factor when designing

incentive plans. Pay-for-performance often implies that a significant proportion of the total salary is variable, which inevitably results in the employee bearing the risk. For the employee to incur such a risk, the expected compensation must be higher than what it would be when offered a fixed salary (Merchant and Van der Stede, 2012).

5.2.1 Two Principles of Performance Evaluation

The very basis that determines how well an incentive plan is designed, is how performance is *evaluated*. Needless to say, the reward tied into the performance evaluation is a natural part of the incentive plan, but the evaluation is, however, a much more complex issue. Without an adequate evaluation structure, the reward will have virtually no causal effect on performance.

According to Gibbs, there are two key criteria to an ideal performance evaluation. First, the employee should be evaluated entirely on measures within his or her control, and thus shut out noise the employee cannot influence directly or indirectly. This is per se an accepted tenet within the field of managerial accounting, and goes by the terminology of *controllability*. Demski (2013) argues that controllability alone is not sufficiently explanatory in the context of performance evaluation. He believes it should also be based on the concept of conditionality. Say, for instance, that a manager is evaluated on the company's relative performance compared to its peers. An index computation based on the performance of their main competitors is by no means controllable by the manager. However, it may be informative (thus conditionally controllable) and therefore useful when evaluating the company's relative performance.

Secondly, an ideally constructed incentive system is built to motivate the employee to use information and knowledge on behalf of the firm. An analyst possesses skills and understanding of an advanced spreadsheet on profit and loss

for a given market, the same way as a CEO has knowledge and overview of the organization's capabilities and composition. The point is that the analyst's supervisor and the CEO's chairman of the board (with the rest of the board) have hired someone with the capabilities to fulfill tasks they are not able to perform on their own. Because there exists a knowledge gap between the employee and the employer, there is a limit to how much direct guidance the employer can give the employee on how to perform their job. To fill this knowledge gap with control, and to make sure their supervisors are able to give guidance beyond their limitation, there must be given specific goals and motivation to guide their behavior in direction of the company's interests.

5.2.2 Incentive Formula

An incentive formula shall, in an understandable manner, express the employee's bonus plan by translating performance into incentive pay. It is up to the employer to decide the approach to evaluation. The most common and preferred approach is the explicit use of numerical measures – the rewards are assigned objectively. In such a manner, the employee will know where she stands at any given point in time, and there is often little room for arguments, as this is usually outside of the supervisor's discretion (Gibbs, 2012).

Another way to design an incentive contract is to leave the formula and contract details wholly or partially implicit, thus giving it a subjective judgement. Contract terms can be left implicit for several reasons. For instance, by keeping the contract flexible, the employee's motivation and effort can be kept stable under changing conditions that are outside of the employee's control. Say, for example, that there is a minor government regulation that will affect how companies within a specific industry operate. Even a small amendment could have significant impact on the company's results, and consequently on how the manager's performance is evaluated. Subjective bonus plan can encourage the manager not to give up in the

face of nearly unachievable performance targets, but instead constantly work for improved results (Merchant and Van der Stede, 2012). Subjectivity can also reduce the employee's propensity for manipulating the company's performance measures in favor of personal gain.

According to Gibbs (2012), there are plenty of potential problems when using subjective evaluation. A robust subjective evaluation will require continuous monitoring by the supervisor, which could be both time-consuming and expensive. Favoritism and bias are both common issues, and the relation between the employee and employer must be built on trust that the evaluation given is fair. Extensive research suggests that the optimal incentive plan is mainly based on the most suitable numeric performance measures, in which subjective evaluation can be used to address possible weaknesses and shortcomings arising (Gibbs, 2012).

5.2.3 Characteristics of numeric performance measures

Together with Merchant, Van Der Stede and Vargus, Gibbs wrote a paper in 2004 on performance evaluation, where they studied an important component of incentive systems: *the properties of performance measures*. By examining data on incentive contracts for auto dealership managers, they arrived at three key properties that have the most significant effects on the design of the incentive system: risk, distortion, and manipulability. It appears that the firms choose the most suitable measures along these three dimensions, which we will use the following paragraphs to elaborate on.

Distortion

To be able to explain the characteristics of distortion in conjunction with incentive systems, it can be necessary to define a performance measure that is considered to be undistorted, such as *the total value of the firm*. An incentive contract based on how well the CEO is able to increase the value of the company will never be

distorted; the effects of the CEO's actions on the performance measure will *always* correlate with the effect on the firm value. Because this parameter expresses zero distortion and is easily observable, firm value is a frequently used performance measure in incentive contracts among publicly traded companies (Baker, 2002). In other words, the level of distortion is reflected in the extent to which the effect of the employee's actions on performance measure does *not* correspond to the effect on firm value (Gibbs et al., 2004).

Consider a simplified example in which a general manager's incentive plan is to motivate her sales staff to achieve, by all means, the highest possible sales figures. The higher the sales figures, the higher the manager's total compensation. The sales staff will be encouraged to focus on sales, ignoring costs, and thereby distorting away from caring about the company's best interests: increasing the firm value by increasing profits. There are few performance measures that do not include traces of distortion. Even if the company directs the incentive plan towards yearly profit, the manager will probably still distort her actions towards avoiding potential prospective investments in favor of short-term gain. The issue is *not* whether it is possible to include the ideal non-distorting performance measure, but to what extent it is possible to find a combination of selected measures that minimize the total distortion.

Risk

Risk and distortion tend to be negatively correlated in performance measures. Consequently, it often occurs a trade-off between distortion and risk when designing incentive contracts (Baker, 2002). Risk related to pay-for-performance can be divided into controllable and uncontrollable risk. The latter is referred to as noise, which should be avoided. E.g. an attempt to reward individuals based on group performance allows for uncontrollable events, such as other individuals' performance, to affect the outcome. In conjunction with distortion, stock-based incentives provide an optimal illustration of the negative relationship between

uncontrollable risk and distortion in performance measures. Since the stock price is widely understood as an accurate measure of a company's value, it will not distort incentives. However, there are countless factors affecting the company's stock price that is beyond any manager's, or even the CEO's, control, making it a relatively poor performance measure in certain cases.

Needless to say, the controllable risk is naturally part of the risk that the employee is able to control to a certain extent. To illustrate, consider an asset manager that manages investments on behalf of a company. Her job is to generate the highest possible return on the capital at her disposal. Suppose the manager is exposed in the housing market in Oslo with 70% of her portfolio. As a result of falling oil prices, the housing market experienced a major correction, which negatively affected the asset manager's investments. You could say the event was outside of the manager's control - she has by no means the ability to influence the oil price. However, she could have diversified her portfolio or done other precautionary actions that could have minimized the loss the company suffered.

As illustrated, risk will, in some cases, have consequences for both the principal and the agent. Risk that is uncontrollable should be filtered out of the evaluation, while risk that is controllable should be included in order to motivate the employee to effectively manage risk on behalf of the company (Gibbs, 2012).

Manipulability

We have previously mentioned how a stock-based performance measure is undistorted, and said to be well suited for creating long-term value for the company's owners. Although the measure appears to be optimal for use in bonus contracts, it could also facilitate accounting manipulation, by using informational advantages, which do not improve the company value (Gibbs, 2012). Manipulability is the flip side of controllable risk – it creates incentives to hide actions and information from the principal, which can be exploited for the agent's

own short-term gain. The management of a listed company may apply different techniques of earnings management to meet financial expectations, and to keep the company's stock price up.

6 Case study - The Norwegian Retail Industry

6.1 Introduction

In order to illustrate the effects of IFRS 16 from a lessee perspective, we conducted a case study including two of the most important players in the Norwegian retail industry: NorgesGruppen and Reitangruppen. Retail is amongst the industries, which are expected to experience the greatest conversion from the current standard, and thus justifies our choice. This is supported in a report published by EY (2016), stating the retail industry to be the most affected industry worldwide. An effects analysis carried out by IFRSF in 2016 clearly states the upcoming standard to have a conspicuously high level of impact on retailers – only beaten by the airline industry. The table below is derived from the same analysis, and indicates that just over one-fifth of the retail industry's total assets are accounted for as '*present value of future payments for off balance sheet leases*' – an amount that will be capitalized as a result of the new standard.

| Industry sector | No. Of companies | Total assets (in millions of US\$) | PV of future payments - off-balance sheet leases (in millions of US\$) | PV of future payments (in % of total assets) | Reported on BS, IAS 17 (in millions of US\$) | If all leases on BS, IFRS 16 (in millions of US\$) | Percentage growth in capitalized debt |
|--------------------|------------------|------------------------------------|--|--|--|--|---------------------------------------|
| Airlines | 50 | 526 763 | 119 384 | 23 % | 114 818 | 234 202 | 204 % |
| Retailers | 204 | 2 019 958 | 431 473 | 21 % | 378 698 | 810 171 | 214 % |
| Travel and leisure | 69 | 403 524 | 83 491 | 21 % | 135 423 | 218 914 | 162 % |
| Transport | 51 | 585 964 | 68 175 | 12 % | 124 107 | 192 282 | 155 % |
| Telecom. | 56 | 2 847 063 | 172 644 | 6 % | 808 574 | 981 218 | 121 % |
| Energy | 99 | 5 192 938 | 287 858 | 6 % | 1 017 236 | 1 305 094 | 128 % |

| | | | | | | | |
|------------------------|--------------|-------------------|------------------|--------------|------------------|------------------|--------------|
| Media | 48 | 1 020 317 | 55 764 | 5 % | 340 330 | 396 094 | 116 % |
| Distributors | 26 | 581 503 | 25 092 | 4 % | 174 509 | 199 601 | 114 % |
| Information technology | 58 | 1 911 316 | 56 806 | 3 % | 280 487 | 337 293 | 120 % |
| Healthcare | 55 | 1 894 933 | 54 365 | 3 % | 437 284 | 491 649 | 112 % |
| Others | 306 | 13 959 223 | 306 735 | 2 % | 2 629 476 | 2 936 211 | 112 % |
| Total | 1 022 | 30 943 502 | 1 661 787 | 5,4 % | 6 440 942 | 8 102 729 | 126 % |

Table 3 Effects analysis of IFRS 16 (IASB, 2016)

Similarly, if all leases were to be capitalized on the balance sheet, the world's retail industry would have an increase in *'long-term financial liabilities'* of more than twice the amount that is already accounted for.

According to IFRSF, the airline industry is listed at the very top of the most affected industries. However, we find retail companies more interesting as case objects for several reasons. Firstly, the airline industry has been covered at a broader level within the field of research regarding capitalization of operating leases, compared to the retail industry. Secondly, the retail industry is simply bigger and the area of impact is therefore broader. Lastly, the Norwegian retailers are known for being closed, family-owned companies, making possible discoveries within the companies' bonus contracts more interesting. We have chosen to exclude Coop Norge SA from our case study, partly because of the company's ownership structure, but mostly due to its lack of operating leases as a way of financing their stores and other non-current assets (Coop Norge SA Annual report, 2016).

The purpose of this case study will be to chart how the case objects' financial key figures will be affected by the upcoming lease standard. The results will be measured against financial performance indicators handed out in interviews with top and middle management in the companies studied, as well as link the findings to relevant theory within management incentives.

6.2 About Reitangruppen AS

Reitangruppen AS has legal status as a non-public limited company wholly owned by Odd Reitan and his two sons, Ole Robert Reitan and Magnus Reitan. Odd Reitan functions as CEO and Chairman of the Board of the mother company, as well as Chairman of the Board for all other areas of business. Ole Robert Reitan and Magnus Reitan act as Executive Vice President in different positions in the group, in addition to their seat in the Board of Directors.

Reitangruppen AS is one of the largest companies in Norway with a turnover of about NOK 1.3 billion and over 38.000 employees all over the Nordic and the Baltic Region. The group is an important player within wholesale and retail franchise, and consists entirely of five different business areas: REMA 1000, Reitan Convenience, Uno-X Gruppen, Reitan Eiendom, and Reitan Kapital. Reitangruppen has approximately 3,836 stores in Norway, Sweden, Finland, Estonia, Latvia and Lithuania. All areas of business in Reitangruppen is operated and run independently, with the mother company headquartered at Lade in Trondheim.

6.3 About NorgesGruppen ASA

NorgesGruppen ASA has legal status as a public limited company, despite being a privately held company whose stocks are not traded at Oslo Stock Exchange. The reason is that the company has bonds and certificate loans listed at the stock exchange, and are hence obliged to issue semi-annual financial statements in accordance with IFRS. NorgesGruppen is to a great extent a family-owned and -controlled company. The Johansson family owns through Joh. Johansson AS 74.4% of the company, in addition to 'grocery nestor' Knut Hartvig Johansson's role as chairman of the board. Even though the family holds the majority of the shares, they have proclaimed, in a rear interview, the importance of taking the

remaining shareholders' opinions into account, and thus not wanting a Johansson as CEO of NorgesGruppen (Valvik, M., 2016).

NorgesGruppen ASA is one of Norway's largest companies and is the current market leader (42.3% in 2016) in its core business – the retail and wholesale market within daily consumer goods. In addition to serving the retail-store sector, both nationally and internationally, the company also operates within services and institutional catering. The group has 1,850 grocery stores spread all over the country, in which 60% are independent retailers (NorgesGruppen, 2017). NorgesGruppen is also one of the largest real estate players in Norway, aiming to develop and manage the group's real estate portfolio to continuously ensure that the store chains have the best possible locations.

6.4 Competition

The companies operate in an industry characterized by strong price competition and low gross margins. A particular focus on efficient processes in the value chain is critical to maintain a positive bottom line. Although, the food chain giants themselves say that they are low-margin businesses, it does not, however, mean that their owners' do not get an ample return on their invested capital. Exceptionally stable operating margins, combined with high volume, and almost no tied-up capital, have resulted in an average return on equity of 16.3% the last ten years. Without the need to constantly invest in R&D and other growth-creating investments, NorgesGruppen's owners have additionally been able to yield an annual dividend of NOK 4.1 billion over the period.

NorgesGruppen and Reitangruppen's particular relevance for this case study comes from their leading positions in the Norwegian retail sector, and the sector's characteristics regarding leasing as a financing method. Although the companies are significant real estate players, they also follow the industry norm by leasing a

fair share of their store locations. NorgesGruppen's lease agreements are in essence all operating leases and will be presented in detail in this chapter's paragraph *Operating leases* (NorgesGruppen Annual Report, 2015).

In the following sections, we have chosen to call attention to only one of the case objects, NorgesGruppen ASA, in order to allow for a more in-depth analysis of the group's financial data. Our data processing of the two companies' financial figures shows a striking resemblance, and therefore underpins our choice to focus solely on one of the companies. Financial analysis of Reitangruppen, hereunder reformulation of basic data, capitalization of leases and comparison of relevant ratios, can be found in Appendix A. Accordingly, a presentation of NorgesGruppen's basic accounting data will be given, as well as an analytical view of the group's accounting figures. Thereafter, there will be shed light on the company's use of operating leases, which will be capitalized with the intent to analyze the effects of IFRS 16 on their financial statements.

6.4.1 Basic data

NorgesGruppen's financial statements are derived from the group's annual reports, published on their official website. Since the annual report for 2016 is yet to be published by Reitangruppen, this case study includes an analysis of the accounting periods starting from 2013 to 2015.

According to the group's annual report, the company was able to achieve an acceptable top line growth throughout the relevant period, with an average growth of 7.1%. This was mainly driven by acquisition of previous ICA-stores, as well as increased sales revenues from ASKO through its wholesale distribution. The operating profit (EBIT) is reported to have increased by NOK 535 million, from NOK 2,636 million to NOK 3,170 million in 2013 and 2015, respectively. Net income is reported to be 1,793, 1,930 and 2,361 (million NOK) during the same

period (3 year CAGR of 9.6%). The group is considered to be solid with an equity ratio of 42.2% in 2015 and an overall downward trend in interest-bearing debt. Their total assets are valued to 30,914 and 35,104 (million NOK) in 2013 and 2015, respectively. See Appendix A: 10.1.1 – 10.1.3 for further details.

6.4.2 Reformulation of Financial Statements

Income Statement

The reformulated income statement is provided to distinguish between operating and financing activities. Such interventions reveal the company's underlying ability to generate value from its operating activities, and it is a necessary action in order to calculate the group's financial ratios (Penman, 2013). All tax-related items are computed with a marginal tax rate from its respective fiscal year.

| All numbers in MNOK | Basic data | | | Reformulated data | | | Change in % after reformulation (in comparable years) | | |
|----------------------|------------|------------|------------|-------------------|-------|-------|---|------------|------------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| EBITDA | 5 017 | 4 623 | 4 261 | 4 083 | 4 357 | 3 899 | -19 % | -6 % | -8 % |
| EBIT | 3 170 | 2 945 | 2 636 | 2 236 | 2 679 | 2 274 | -29 % | -9 % | -14 % |
| Profit of the period | 2 361 | 1 930 | 1 793 | 2 361 | 1 930 | 1 793 | 0 % | 0 % | 0 % |
| NOPAT | <i>N/A</i> | <i>N/A</i> | <i>N/A</i> | 1 802 | 1 976 | 1 698 | <i>N/A</i> | <i>N/A</i> | <i>N/A</i> |

Table 4 Reformulated Income statement, NorgesGruppen ASA

Investors often consider EBIT as the primary source of value creation, while lenders contemplate it as the main source for servicing debt. Operating profit shows a firm's profit from its core business regardless of how it has been financed (Peterson & Plenborg, 2012). When preparing a reformulated income statement, the primary operation should be to identify and separate activities not considered to be part of the group's operating activities. *'Income from investments in affiliates'* has consequently been deducted from EBIT (Appendix A: 10.1.4). The income derives in this case from BAMA Gruppen AS – a company in which the

group holds a stake of approximately 45%. Consequently, BAMA Gruppen AS is not regarded as a subsidiary and thus not part of the group's core business. The same must apply to income related to discontinuing operations, which in this case are four shopping malls sold in 2015. We have considered this a one-time event, which also is the company's own assessment, and thus deducted NOK 646 million from the operating profit in the relevant year. The consequences of our adjustments reveal a reduction in EBIT of 935, 912 and 1,008 (million NOK) from 2015 to 2013, respectively.

The next step will be to disclose the net operating profit after tax (NOPAT) - a performance measure frequently used to calculate return on invested capital (ROIC) and economic value added (EVA). NOPAT is generally used as an analytical based measure, and is therefore normally not disclosed in annual reports. Revenues related to non-recurring and non-operating items, as presented in the preceding paragraph, are excluded from NOPAT. Since NOPAT is an after-tax measure, it is calculated by deducting tax on EBIT. The reported tax is positively affected by net financial expenses, and it is therefore necessary to re-add the tax shield. This is calculated by multiplying net financial items with the marginal tax rate (Peterson & Plenborg, 2012). See Appendix A: 10.1.4 for additional details.

Balance sheet

A typical balance sheet normally classifies assets and liabilities as either current or non-current to get an overview of the company's liquidity. The reformulated balance sheet is, however, prepared to distinguish between operating and financial activities. The purpose is to chart the assets and liabilities that generate operating income, and likewise for assets and liabilities that produce financial income and incur financial expenses (Penman, 2013). All balance sheet items are classified and allocated to three possible formats: 'Total assets' (TA-Format), 'Capital employed' (CE-format) and 'Net operating assets' (NOA-Format). Another

purpose is to ensure consistency with the calculated elements from the reformulated income statement when key financial ratios are to be calculated.

To ensure consistency for non-current assets, 'Investments in associates' are deducted from operations and accordingly included as *financing activities*. The same will apply to 'Investments in shares' and 'Other financial assets'. In terms of current assets, we have classified 'bank deposit and cash' as excess cash and thus labeled them financial assets. The reason being that the cash position has remained relatively stable across the observed period, and is thus *not* considered as part of the group's day-to-day operations (Peterson & Plenborg, 2012). Without further information in the notes, 'Other financial assets' are assumed to not be part of operations, and therefore classified as financial assets.

Next up is to undergo the same procedure for the group's reported liabilities. All debt is classified as either 'interest-bearing debt' or 'operating liabilities'. For non-current liabilities, 'long-term debt', 'other financial liabilities' and 'pensions' are all debt in which interest is paid according to the information given by the company. As regards to deferred tax liabilities, it is related to operationally driven earnings and is hence classified as operational. For current debt, only 'other financial liabilities' are assumed to be interest-bearing and thus classified as financial, whereas the remaining are labeled as operating. See Appendix A: 10.1.5 for full report on the reformulation.

Cash Flow Statement

According to the requirements of IAS 7 *Statement of Cash Flows*, the companies are not required to identify cash flow measures commonly used by equity analysts, such as Free Cash Flow (FCF). FCF, the net cash generated from operations, is an important measure to determine a firm's ability to pay off its debt and return cash to shareholders. Operating cash flows are often confused with

financing cash flow, and therefore leads to misclassifications in the reported cash flow statements (Penman, 2013).

Yet again, we have made a few adjustments to ensure consistency. As in the aforementioned reformulations, all items related to ‘investment in associates’ are deducted from operations and included in investing activities. ‘Loss/gain on sale of operating assets and financial assets’ is likewise identified as investments. The overall changes result in a FCF of 452, 265 and -415 (million NOK) over the relevant period from 2015 to 2013. See Appendix A: 10.1.6 for additional details.

6.4.3 Operating leases

In accordance with the current standard for leasing under IFRS, IAS 17, NorgesGruppen is not obliged to recognize leased assets and liabilities on the balance sheet, provided that the risks and rewards are still connected to the true owner of the asset – the lessor. They are, however, required to recognize the lease payments as expenses over a straight-line basis throughout the contractual period. In the notes of the annual report, NorgesGruppen has listed all lease payments recognized in the period. According to the recently resigned CFO of NorgesGruppen, the lease commitments extend from 1 to about 15 years, in which the majority of the agreements lie between 10 to 15 years. The table below illustrates the total lease expenses, which solely relate to retail stores and other properties under the company’s possession. Other operational leases *not* related to premises are considered to be of minor character and therefore omitted in the notes (NorgesGruppen Annual Report, 2015). The expenses are included in ‘Other operating expenses’ in the income statement and, on average, account for approximately 30% of the group’s total other operating expenses.

| All numbers in MNOK | 2015 | 2014 | 2013 |
|---|--------------|--------------|--------------|
| Lease and sublease payments recognized in the period | | | |
| Expensed minimum lease | 1 783 | 1 717 | 1 791 |
| Expensed variable lease | 94 | 88 | 78 |
| Net leasing expenses | 1 877 | 1 805 | 1 869 |
| <i>as % of other operating expenses</i> | 29 % | 30 % | 32 % |

Table 5 Lease payments recognized in the period, NorgesGruppen ASA

As for the present value of the lease payments, NorgesGruppen has listed all minimum operating lease obligations in the notes related to irrevocable operating leases. This is done by acknowledging the lower amount of fair value or the present value of the minimum lease payments. This method is compared with Moody's method for adjustment of operating leases, which is further explained in the following section. The resulting values will be further used to capitalize all operating leases to comply with the requirements in the upcoming lease standard – IFRS 16 *Leases*. See Appendix A: 10.1.7 for additional details

6.4.4 Financial Statements after capitalization of leases

We have at this point mapped out the group's yearly lease payments for the relevant period. In order to capture the overall effect of the new leasing standard, and to be able to compare the results with the non-capitalized key measures, the balance sheet will have to reflect the true value of the lease expenses. This is done by acknowledging operating leases as finance leases, using the capitalized lease method. The method is widely used by financial analysts and credit analyst to reveal the company's underlying value, and to improve assessment of credit risk and other credit-relevant ratios. The method ensures comparability between companies regardless of how they are financed, and improves transparency of the company's financial risk. The method used is retrieved from Moody's approach for adjusting financial statements related to operating leases. Moody's consider operating leases to be debt-like financing given the fact that failure to make the

contractual payments could result in adverse consequences leading to default. The method involves increasing the balance sheet with debt and non-current assets by an amount that equals the greater of:

1. The present value of minimum lease commitments (capped at 10x), or
2. A sector multiplier times the annual rent expense, as for the retail industry is set to 5.

According to Moody's, the present value of minimum lease commitments shall reflect an estimate of the actual legal liability. The sector multiplier represents the floor, while the cap is set to 10 times the group's annual rent expense. The limitations are used to enhance comparability for companies that have unrealistically short or long lease tenors. In our case, as mentioned earlier, the group has consistency in their lease tenors, mainly ranging from 10 to 15 years. Consequently, we believe the use of a sector multiplier of five may significantly understate the economic liability for the company. The present value of minimum lease commitments calculated by the group themselves provides a higher value than applying the sector multiplier. We have therefore chosen to use the company's own calculations to ensure that the capitalization is not underestimated, which is in accordance with Moody's highest value principle.

A company like NorgesGruppen, that appears to have high solvency with a debt-to-asset ratio of merely 32%, seems significantly less solid post capitalization. This is due to the fact that they allegedly have almost an average of NOK 12 billion worth of leases outside the balance sheet (Appendix A: 10.1.7). The capitalized leases will not only have a significant impact on the Group's balance sheet, but, as a result, also redistribute the past operating expenses into depreciation and financial expenses.

All the following actions are shown in the financial statements after capitalization in Appendix A: 10.1.8 – 10.1.10. The first step is to extract operating lease expenses from other operating expenses for the last three years. These are the same costs as mentioned in table 5, and are used to transform operating leases into financial leases. Furthermore, the amount is added to both assets and debt in the balance sheet. As illustrated in table 6, the increase in non-current assets/non-current liabilities is equivalent to an average of 6.4 times the operating expenses.

| All numbers in MNOK | 2015 | 2014 | 2013 |
|--|---------------|---------------|---------------|
| Operating leasing expenses | 1 877 | 1 805 | 1 869 |
| Increase in non-current assets | 13 053 | 11 578 | 11 094 |
| Increase in non-current liabilities | 13 053 | 11 578 | 11 094 |
| <i>Lease multiple</i> | <i>7,0</i> | <i>6,4</i> | <i>5,9</i> |
| Interest expenses on capitalized leases | -405 | -394 | -422 |
| <i>Interest rate</i> | <i>3,1 %</i> | <i>3,4 %</i> | <i>3,8 %</i> |
| Depreciation of capitalized leases | -1 472 | -1 411 | -1 448 |
| <i>Depreciation rate</i> | <i>11,3 %</i> | <i>12,2 %</i> | <i>13,1 %</i> |

Table 6 Capitalization of operating leases, NorgesGruppen ASA

As a result of the increase in both non-current assets and non-current liabilities, the next step will be to further adjust for subsequent depreciation and interest expenses. The depreciation of the asset is reported within ‘depreciation and impairments’, while interest expenses is reported within ‘financial expenses’ – both included in the income statement. The interest expenses were, for simplicity, calculated using the group’s average borrowing rate reported in the annual report. Among several types of debt, the interest rate is based on the payable interest on the group’s existing finance leases, which makes it suitable measure for the capitalization of operating leases. The interest rate for the relevant period is hence set to 3.10%, 3.40% and 3.80%, respectively.

Next up will be to calculate the annual depreciation of the capitalized asset. Since the new lease standard only ensures that operating expenses are being

redistributed, the depreciation will accordingly represent the difference between the operating lease expense from the original income statement and the recently calculated interest expenses. Consequently, the amount of depreciation for the last three years gives an average depreciation rate of approximately 12%. Since the costs are being redistributed from exclusively being operational to also include financial expenses, the net income shall thus be unchanged, compared to pre capitalization. The zero-sum game between operating lease and finance lease is obviously depending on which year of the agreement that is being discussed. Considering that the analyzed period is only three years, measures were taken to ensure that this assumption holds. For instance, to keep the depreciation rate slightly floating to maintain an unaffected bottom line.

Finally, adjustments were made to the group's cash flow statement. The transition to IFRS 16 is not intended to increase nor decrease the company's liquidity. Accordingly, there are no changes in cash and cash equivalents. However, similar to the income statement, a redistribution of costs and expenses are made. Cash flow from operating activities increases with the reduction of operating expenses, as well as from the increase in depreciation. The overall increase is redistributed in its entirety to cash flow from financing activities through increased financial costs and repayments on the capitalized lease. The annual installment is set to reflect the difference between the total increase in operating activities and the annual financial expenses.

It must be stressed that these calculations do not represent an exact transfer to IFRS 16. There are aspects of these calculations that are based on assumptions and approximate measures due to absent information in the company's lease contracts, hereunder the exact duration. Nevertheless, we feel confident that the effects of the capitalization are sufficiently accurate to predict the probable tendencies in the industry, as a consequence of the introduction of IFRS 16.

6.4.5 Results after capitalization of leases

The operations shown above have given us the context of comparison for the most relevant financial measures before and after the operating leases are capitalized. The following sections will present the main results from the capitalization of each financial statement.

Income statement

Other operating expenses:

Operating lease expenses accounted for the largest part of the group's other operating expenses with approximately 30%, on a three-year average. Capitalizing the operating leases involves deducting the operating lease expenses from the cost item. This leads to a decrease in other operating expenses of approximately 30%.

EBITDA:

EBITDA increases markedly as a result of the decrease in other operating expenses. The increase amounts to 46%, 41% and 48% for the three relevant years, respectively.

Depreciation:

Depreciation is among the largest changing cost items, with an average increase of about 84% each fiscal year.

EBIT:

NorgesGruppen's operating profit also undergoes significant changes. EBIT bears the mark of other operating expenses and depreciation pulling in different directions. Overall, the operating profit increases by 18%, 15% and 19% in the three analyzed years, respectively.

NOPAT:

NOPAT is somewhat adjusted upwards by the increased tax shield, but affected to the same extent as EBIT. It can refer to an annual average increase of about 16% over the analyzed period.

Financial expenses:

Financial expenses are subject to the highest growth of all cost items as a result of the capitalization of leases. The increase extends from 89% to 129%.

Profit of the period:

The costs are, as mentioned, redistributed from exclusively being operational, to also include financial expenses. The profit of the period stays unchanged for each analyzed year.

Table 7 summarizes and shows the numbers related to the mentioned metrics from the income statement.

| All numbers in MNOK | Before capitalization of leases | | | After capitalization of leases | | | Change in % after capitalization (in comparable years) | | |
|---|---------------------------------|--------------|--------------|--------------------------------|--------------|--------------|--|-------------|-------------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| Other operating expenses | -6 448 | -6 035 | -5 777 | -4 571 | -4 230 | -3 907 | -29 % | -30 % | -32 % |
| Depreciation and impairment of fixed assets | -1 847 | -1 678 | -1 625 | -3 319 | -3 090 | -3 073 | 80 % | 84 % | 89 % |
| Financial expenses | -314 | -441 | -380 | -719 | -834 | -801 | 129 % | 89 % | 111 % |
| EBITDA | 4 083 | 4 357 | 3 899 | 5 960 | 6 162 | 5 769 | 46 % | 41 % | 48 % |
| EBIT | 2 236 | 2 679 | 2 274 | 2 640 | 3 073 | 2 695 | 18 % | 15 % | 19 % |
| NOPAT | 1 802 | 1 976 | 1 698 | 2 098 | 2 263 | 2 002 | 16 % | 15 % | 18 % |
| PROFIT OF THE PERIOD | 2 361 | 1 930 | 1 793 | 2 361 | 1 930 | 1 793 | 0 % | 0 % | 0 % |

Table 7 Metrics from NorgesGruppen's Income statement before and after capitalization

Balance sheet

Operating non-current assets (ONCA):

The capitalization of leases has, in average, increased the value of the balance sheet with approximately 36%. This is as a consequence of an increase in the group's 'property, plant and equipment' of 62%, 58% and 60% for the previously three years, respectively.

Non-current interest-bearing debt (NCIBD):

NorgesGruppen's liabilities post capitalization amounts to nearly NOK 12 billion in average. This reflects an increase of the group's obligations with approximately 200% in 2013, 178% in 2014, and 185% in 2015.

An increase of this magnitude will certainly have enormous consequences for financial indicators affected by the metrics derived from the balance sheet. Table 8 gives a more detailed review of the repercussions resulting from the capitalization.

| All numbers in MNOK | Before capitalization of leases | | | After capitalization of leases | | | Change in % after capitalization (in comparable years) | | |
|-------------------------------------|---------------------------------|--------|--------|--------------------------------|--------|--------|--|-------|-------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| <i>Assets</i> | | | | | | | | | |
| Property, plant and equipment | 21 079 | 19 849 | 18 540 | 34 131 | 31 428 | 29 634 | 62 % | 58 % | 60 % |
| TOTAL OPERATING ASSETS | 31 476 | 30 284 | 27 873 | 44 528 | 41 863 | 38 967 | 41 % | 38 % | 40 % |
| TOTAL ASSETS | 35 104 | 33 515 | 30 914 | 48 157 | 45 093 | 42 008 | 37 % | 35 % | 36 % |
| <i>Equity and Liabilities</i> | | | | | | | | | |
| Other financial liabilities | 6 829 | 6 259 | 5 410 | 19 443 | 17 407 | 16 123 | 185 % | 178 % | 198 % |
| TOTAL EQUITY AND LIABILITIES | 35 104 | 33 515 | 30 914 | 48 157 | 45 093 | 42 008 | 37 % | 35 % | 36 % |

Table 8 Metrics from NorgesGruppen's Balance sheet before and after capitalization

Cash flow statement

EBT net of operating lease expenses:

As explained under *'Income statement'*, the operating lease expenses are deducted from EBT, which give an increase of about 63%, 69% and 78% from 2015 to 2013, respectively.

Depreciation:

The increase in annual depreciation was likewise explained under *'Income statement'* and had an average yearly growth of nearly 84%. The cash flow indicates an increase of 1.472, 1.411 and 1.448 (million NOK) the past three years, resulting in an annual increase in cash flow from operations of approximately 94%.

Financial expenses:

Financial expenses underwent a powerful increase with a growth ranging from 89% to 129%, resulting in a financial cash outflow of 405, 494 and 422 (thousand NOK) from 2015 to 2013, respectively.

Repayments on finance leases:

Repayments are usually fixed throughout the contract period. However, an exception was made to ensure that 'change in cash and cash equivalents' is kept unaffected. In the same manner as for depreciation under *'Income statement'*, the repayments are kept slightly floating over the relevant period. The overall decrease in cash flow from financing activities coincides with the increase in cash flow from operations, creating a zero-sum game.

For further information on the financial statements after capitalization, see Appendix A: 10.1.8 – 10.1.10.

7 Performance measures in bonus contracts for retail companies in Norway

7.1 Introduction

With chapter 5 ‘*Management Incentives and Bonus Contracts*’ in mind, it is certain that this topic is far from straightforward. As described in the mentioned chapter’s paragraphs about ‘*Incentive Formula*’, there are numerous ways to form such contracts, although numeric performance measures are suggested as the preferred and most sensible elements. These measures can either be of operational or financial character, and are both in great extent derived and calculated from the company’s reported financial numbers. The case study in the previous chapter illustrates how the implementation of IFRS 16 might affect the target companies’ financial reports, and consequently the financial performance measures used in bonus systems.

In general, typical executive remuneration measures are NOPAT, EBIT, EBITDA, ROIC, EVA and similar measures, both absolute and relative (Peterson and Plenborg, 2012). A recent report on incentive practices in the American retail industry, conducted by a large consulting firm, confirms that this is the usual practice in retail as well (FTI Consulting, 2017). The report states that including two performance measures in bonus systems is most common, and that 94% of retailers have one to three measures included. The predominant measures are connected to *profitability and revenue*, i.e. earnings-related numbers and *capital efficiency*, i.e. return on assets/equity/invested capital.

The retail industry in Norway consists of a few large groups in fierce competition. The constellation of the industry creates a price competing market with low margins, making volume a key driver. Accordingly, efficiency is vital and operational excellence is something every large retail group strives for.

Information regarding specific details in the target companies' management bonus policy is limited and not disclosed in their annual reports. In order to obtain the necessary information, sit-downs with representatives associated with NorgesGruppen and Reitangruppen have been conducted – respectively NorgesGruppen's recently resigned CFO (resigned the fall of 2016) and the CFO of REMA 1000, Reitangruppen's retail company. An initial finding was that due to the groups' sizes and organizational structures, their bonus systems vary depending on the applicable level of management. Being the operational focused industry retail is, the mid-managements' bonus systems are solely based on operational performance measures. The retail chain executives' main responsibility is to get their stores to generate profit and seize market shares from competitors, which in turn increases the value for the parent company. It was to a great extent confirmed by the CFO that the operational measures mentioned in this chapter, with **EBIT** as a prominent example, in some way or another, are included in REMA 1000's bonus contracts at this level. Whereas bonuses for mid-management are operations-oriented, executive management at group level highlights financial measures and *capital efficiency*. In line with the literature applied in this thesis, executives in NorgesGruppen are measured by **EBITDA** and other “defined financial key figures” – **ROCE** was confirmed to be the paramount ratio in their bonus agreements. This composition of bonus measures suggests that NorgesGruppen aims to reduce uncontrollable risk with respect to their bonus systems. As described in subchapter 5.2 *'Incentive System Design'*, the flipside of an incentive formula composition with unilateral focus on risk is that it may neglect distortion as a formula characteristic. Furthermore, this focus may leave room for executives to manipulate the books for their own short-term gain.

In calculation of the mentioned measures, the reformulated numbers of the income statement and the balance sheet have been used. Even though the measures obtained in the interviews are from two competing companies and at different

hierarchical levels, the interview objects could confirm that ratios of similar character are likely to be the industry norm. Typical measures used in bonus systems are often derived from companies reported financial statements, and capitalization according to IFRS 16 will, as proven in the case study, change specific key financial figures. With basis from the aforementioned interviews and literature presented in chapter 5, the focus will be on how capitalization of operating leases will affect the following measures in detail: *EBITDA*, *EBIT*, *NOPAT*, *ROIC*, *ROCE* and *EVA*. Due to industry competitiveness and the private ownership, the specific targets triggering payouts were not given in either meeting. None of the information obtained is regarded as classified and there was not given any restrictions concerning the publishing of the information.

7.2 Analysis of relevant measures in bonus systems

EBITDA ↑

Earnings before interest, tax, depreciation and amortization (EBITDA) is fairly self-explanatory and a popular performance measure. A well-recognized feature is that EBITDA eliminates differences in accounting policies and financing methods (Peterson and Plenborg, 2012). However, this creates an issue for EBITDA as an incentive formula characteristic, as the measure does not account for executive management's decisions regarding interest, taxes and depreciation policy. In turn, this leads to an incomplete perception of a company's true performance. The measure is calculated by the following formula:

$$EBITDA = Net\ revenue - operating\ expenses\ excl.\ depreciation\ and\ amortization$$

For both target companies in the case study, EBITDA was the measure that changed the most after capitalization. The change amounts to a 78% increase if one compares the aggregated average for the two firms. These results coincide well with the largest audit firms', as well as the IFRS Foundation's own,

predictions. The reason is that the entire lease expense is recognized as operating expenses under IAS 17, whereas the leases are considered to be financial related under IFRS 16, and hence not part of EBITDA. I.e. after capitalization, operating expenses will decrease significantly while depreciation and financial expenses increase accordingly. The exact results after capitalization can be seen in table 7. EBITDA is an important and recurrent measure when evaluating executive performance, and companies affected by IFRS 16 need to be aware of the degree of impact. Retail companies like NorgesGruppen, which explicitly measures executive performance on EBITDA, need to adjust accordingly.

EBIT ↑

Earnings before interest and taxes (EBIT) is another valued measure, as it captures a company's ability to generate earnings from operations disregarding taxes and capital structure (Peterson and Plenborg, 2012). When using EBIT as an incentive formula characteristic, one needs to be cautious as the question of including or excluding transitory items may lead to inconsistency. Additionally, accounting manipulation by the management could occur as a threat. EBIT is calculated by the following formula:

$$EBIT = \text{Net revenue} - \text{operating expenses incl. depreciation and amortization}$$

EBIT increased significantly post capitalization. Because of the recognition of depreciation, the increase was more moderate than the quite radical increase in EBITDA. On a three-year average, the aggregated increase for the two case companies amounted to 29% (the exact numbers are found in table 7). The nature of this measure makes this performance indicator critical for mid-level management in the retail industry, and the large gap between post and pre-capitalization should raise awareness.

NOPAT ↑

Net operating profit after tax (NOPAT) is, as stated in the case study chapter, a theoretical measure focusing on a company's core operations, and hence widely used to assess operating efficiency. Even though NOPAT is a highly appreciated measure, one must bear in mind that NOPAT is based on accounting data. Hence, the use of such measures must consider potential distortions arising from the chosen accounting measures (Peterson and Peterson, 1996). The formula is as follows:

$$NOPAT = EBIT - \text{taxes on EBIT}$$

Since NOPAT is of operational character and derived from EBIT, the increase is remarkable. The positive change after capitalization is in comparable size with the change in EBIT and amounts to an aggregated three-year average of 26 %.

ROIC ↓

Return on invested capital (ROIC) is a well-regarded ratio, both for valuation purposes and as a measure to evaluate profitability. ROIC provides an impression of how efficient a company is using its money to generate returns. Since ROIC is based on NOPAT, the same pitfalls regarding incentive formula characteristics apply. The two formulas for calculating ROIC are as follows:

$$ROIC = \frac{NOPAT}{\text{Invested capital}} \times 100 \text{ or } ROIC = \text{profit margin} \times \text{asset turnover}$$

Invested capital is found by either multiplying 'net interest-bearing debt' (NIBD) and 'equity', or subtracting 'total operating liabilities' from 'total operational assets'. In the alternative formula, profit margin is found by dividing NOPAT with net revenues, and asset turnover by dividing net revenues with invested capital. The yearly calculations, both pre and post capitalization, are found in Appendix A: 10.1.11.

Due to the reallocation of attached lease expenses, the three first analyzed measures have all increased after capitalization. ROIC however, is found to decrease notably. The combined three-year average amounts to a decrease of 33%. This is despite NOPAT's rather large increase. In order to explain this, the formula needs closer examination. Invested capital increases severely for both case companies as a result of immense increases in NIBD. This, in turn, is due the recognition of future lease payments as financial liabilities on the balance sheet. The increase in invested capital for both companies, relative to the increase in NOPAT, is by far greater and leads to a decrease in ROIC.

ROCE ↓

Return on capital employed (ROCE) is a widely used profitability ratio for assessing capital efficiency. ROCE and ROIC are close to equivalents, however, there are certain differences making it suitable to assess the pair. While ROIC captures efficiency of a company's total invested capital, ROCE evaluates the efficiency of business operations, which is of great importance for the retail industry. The measure is based on EBIT, making the issue of judgment regarding transitory items a potential pitfall. ROCE, as stated in the introduction of the chapter, is the decisive ratio included in NorgesGruppen's bonus system for their senior management, making it particularly interesting for this thesis. The formula is as follows:

$$ROCE = \frac{EBIT}{Capital\ employed}$$

The explanation of the 29% increase (in average) in EBIT is explained above. For the three years analyzed, capital employed for both companies are found to have an average increase of 2/3. This is due to the same reason as invested capital is enlarged; the capitalization of future lease payments makes interest-bearing debt

increase severely. Because the increase in capital employed is more than twice the increase in EBIT, ROCE is found to decrease by 23% in average for the companies compounded. Companies including ROCE in their bonus programs, with NorgesGruppen specifically in mind, must be attentive of the momentous drop in ROCE, and adjust accordingly. An appropriate adjustment for this type of bonus contract is given in chapter 8.

EVA ↓

Economic value added (EVA), also known as *excess return*, *super profit* and *above normal return*, is a measure of “true” value creation. Reported profit is not necessarily value generating – the return on invested capital needs to exceed the company’s required rate of return on total capital to create value. In literature of performance evaluation, EVA is deemed to be an effective measure and is often suggested to be closely to ideal. Nonetheless, EVA also has its drawbacks. When assessing performance by EVA, the *horizon problem* arises, i.e. the use of single period measures instead of multiple periods. In addition, the management may have incentives to run the company with regard to short-term rather than long-term value. However, these issues are applicable for almost all performance measures derived from accounting data and EVA is ultimately highly acknowledged (Ross, Westerfield, Jaffe, Roberts, 2002). EVA is calculated by the following formula:

$$**EVA = (ROIC - WACC) \times Invested\ capital**$$

Weighted average cost of capital (WACC) is the combined rate of return expected by the owners and the debtholders, and is computed as follows:

$$WACC = \frac{NIBD}{NIBD + BVE} \times r_d \times (1 - t) + \frac{BVE}{NIBD + BVE} \times r_e$$

Reitangruppen and NorgesGruppen are unlisted, privately owned firms. This makes it infeasible for us to calculate the correct market value of equity. Thus, the reported book value of equity has been used. As for the required rate of return on NIBD (r_d), the companies' yearly average interest rates on all interest-bearing debt have been applied. To calculate the required rate of return on equity (r_e), unlevered and levered beta is needed. The applied unlevered betas are industry specific to the European retail market for grocery and food (Damodaran, 2016, 2015, 2014). The applicable unlevered betas used, are the ones for calculation of total beta, rather than for market beta, as it is appropriate for computing the cost of equity for privately held firms (Damodaran, 2016). The levered beta is obtained by multiplying the unlevered beta with the financial leverage ($1 + \text{NIBD}/\text{Equity}$). To obtain required return from shareholders (r_e), the risk-free rate for Norway, according to Norges Bank, is added to the levered beta multiplied with the market risk premium ($r_f + \beta_L \times \text{MRP}$). For the exact calculations, please see Appendix A: 10.1.11.

After capitalizing the companies' operating leases, EVA experiences a solid drop. This is despite the aforesaid fairly large increase in invested capital. WACC stays more or less stable, leaving ROIC as the explanatory measure in the EVA equation. The excess return in percentage diminishes as ROIC decreases and approaches the level of WACC. NorgesGruppen's EVA is, in a three-year average, NOK 952 million before capitalization. The average declines to NOK 593 million when operating leases are recognized on the balance sheet. For Reitangruppen, the effects of capitalization are harsher. In this case, WACC exceeds ROIC, resulting in a negative EVA. Before capitalization, Reitangruppen's average EVA is NOK 247 million, and turns negative to an average of NOK 330 million post capitalization. Yet again, the reason is the large increase of NIBD. Looking at the amount of total lease expenses recognized, Reitangruppen is at another level than NorgesGruppen, with over a billion more in total lease expenses.

7.3 A forward-looking approach

7.3.1 Purpose

Our case study has so far analyzed the group's accounts based on historical figures, and has thus made it possible to assess the effects of IFRS 16 on their financial measures from a retro-perspective. A forward-looking approach, on the other hand, will allow for an attempt to estimate the company's future prospects given different growth scenarios. The aim is to elucidate NorgesGruppen's future financial performance based on two possible scenarios:

- *Dynamic scenario:*

The purpose is to simulate a growth-seeking company with increased willingness to expand their operating business. The dynamic scenario focuses thus on a higher investment pace with increasing top-line growth. The underlying aim is to exhibit an example of a company with changes in their balance sheet, and to what extent this will affect the company's key figures after the introduction of IFRS 16.

- *Static scenario:*

The purpose is to simulate a company with more or less constant development in their balance sheet. In other words, we wish to reflect a company with stable exposure, without clear signs of growth in operations or new investments with growth potential. The analysis, as well as the comparative basis, will be in similar fashion as for the dynamic scenario.

7.3.2 Description and assumptions

This forecast is based on the comprehensive forecasting approach described in Palepu, Healy, and Peek's 'Business Analysis and Valuation' from 2013. The

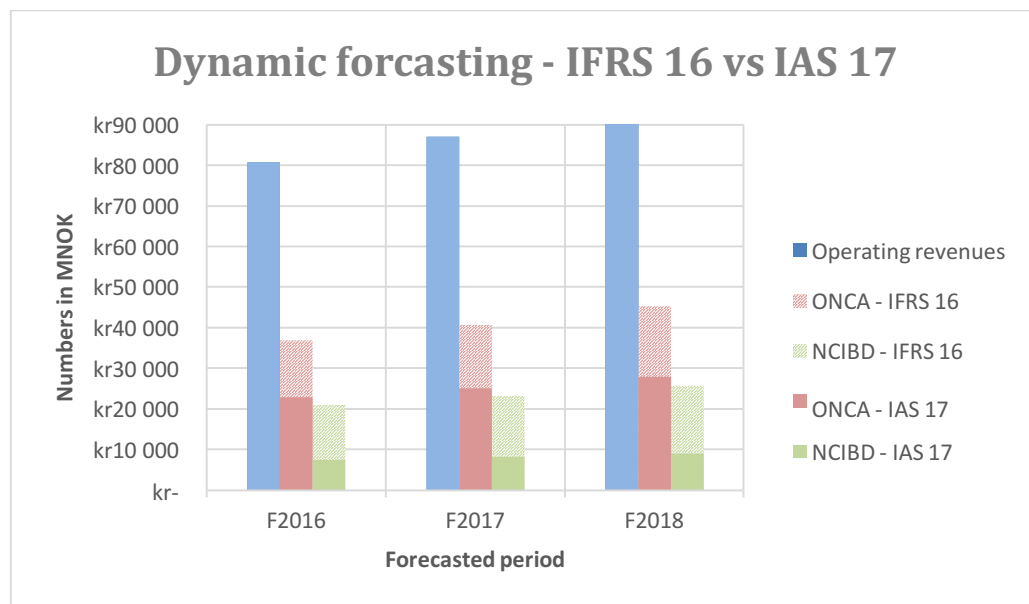
model seeks to forecast the future by linking all three statements together, through a small set of assumptions about the future of the firm. Simplicity increases the chances of avoiding internal inconsistency and unrealistic implicit assumptions. Considering that the primary purpose of this forecast is to examine developments in the balance sheet figures, the necessity of a forecasted cash flow statement is not present in our opinion. The comprehensive forecasting approach is normally used as a necessary step towards a valuation, and we believe an elaboration of a detailed forecasted cash flow statement to avoid unrealistic assumptions becomes redundant in this context.

The overall structure of the forecast is based on the same format as for the previous reformulated statements, with historical figures obtained from statements compiled both before and after capitalization of operating leases. The forecasted income statement is built upon the group's growth in revenues, in which the subsequent accounting items are set to reflect ratios relative to revenues. The points of departure are for the sake of simplicity based on prior behavior of NorgesGruppen's accounting figures, in which the two desired scenarios are derived from. The forecasted balance sheet is built upon asset turnover rates with points of departure in the balance figures from the end of 2015. Equity to majority shareholders is dependent upon the yearly dividend and the current year's net income. The payout ratio is flat to 20% and 30% over the forecasted period for the static and dynamic scenario, respectively. Non-current interest-bearing debt is forecasted to reflect the same growth pace as operating non-current assets, and it is thus assumed that long-term liabilities exclusively follow investments in fixed assets financed with leases. Other balance sheet items are kept relatively constant in relation to net revenue.

The dynamic scenario is characterized by increasing operating revenues and increasing investments in non-current assets. Hence, the latter will increase yearly depreciation in addition to yearly financial expenses as percentages of revenues.

As for the static scenario, the revenue growth is set to the Norwegian annual inflation target, while holding everything else constant. This will increase the group’s asset size with approximately the same pace as revenue growth.

7.3.3 Dynamic scenario

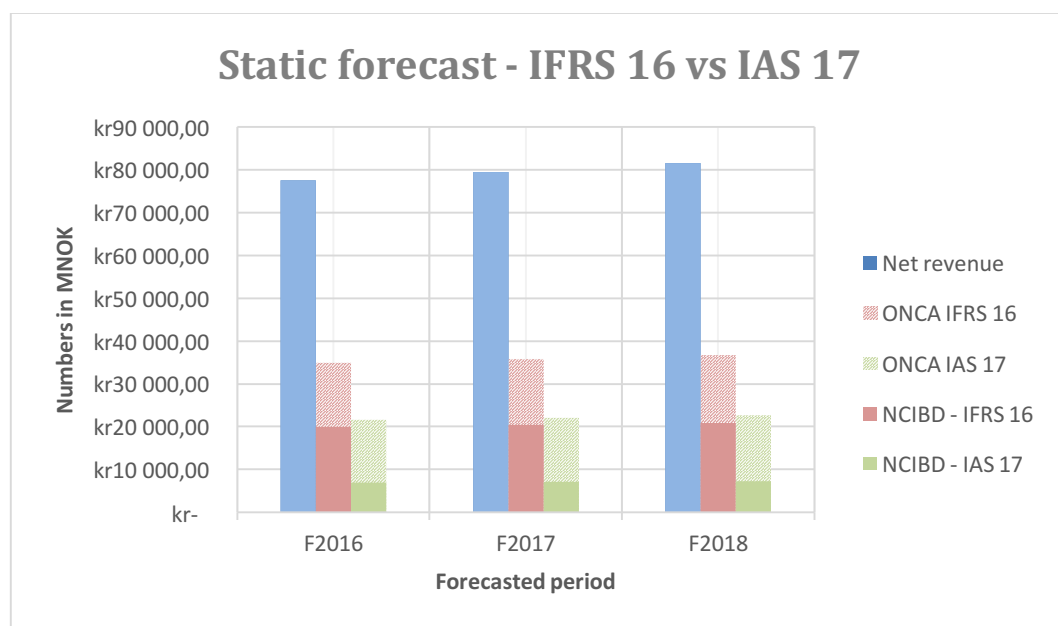


Graph 1 Dynamic scenario – Forecasted measures (IFRS 16 vs IAS 17). The stacked columns explain the added value to the balance sheet as a result of IFRS 16.

As mentioned, we wish to illustrate a high-growth company with a dynamic balance sheet to examine the effects of IFRS 16. Since our forecast only covers a period of three years, we assume that all investments partly yield returns in the same year to reflect growth in both revenues and the balance sheet. Historically, a revenue growth ranging from six to nine percent is considered to be a “normal” level for European firms (Palepu, Healy & Peek, 2013). Bearing in mind the competitive situation, and the historical growth numbers for NorgesGruppen, we consider a growth rate of 6,5%, 7,5% and 8,5% over the forecasted period to be sufficient to showcase a dynamic company. To emphasize increased investment rates, the operating non-current asset turnover (ONCA turnover) is estimated to

slightly drop from 2.1 to 2 under IFRS 16 from 2016 to 2018, respectively. The estimated drop in ONCA turnover under IAS 17 is calculated to conform to the same growth in ONCA as under IFRS 16, and thus declines from 3.40 to 3.24. The implicit increase in ONCA and non-current interest-bearing debt (NCIBD) is shown in Graph 1, as well as the impact from IFRS 16, which is illustrated through the added column on top of ONCA/NCIBD. The difference between the group’s long-term assets and long-term debt after capitalizing operating leases indicates an annual growth of 61% and 185%, respectively. Whether the dynamic scenario will have a different effect, compared to the static scenario, on relevant measures included in bonus contracts will be examined at the end to his chapter.

7.3.4 Static scenario



Graph 2 Static Scenario – Forecasted measures (IFRS 16 vs. IAS 17). The stacked columns explain the added value to the balance sheet as a result of IFRS 16.

The static scenario intends to reflect a future without any significant growth in revenues or the balance sheet. As mentioned earlier, we have chosen to illustrate such a scenario by holding net revenue growth equal to the Norwegian inflation

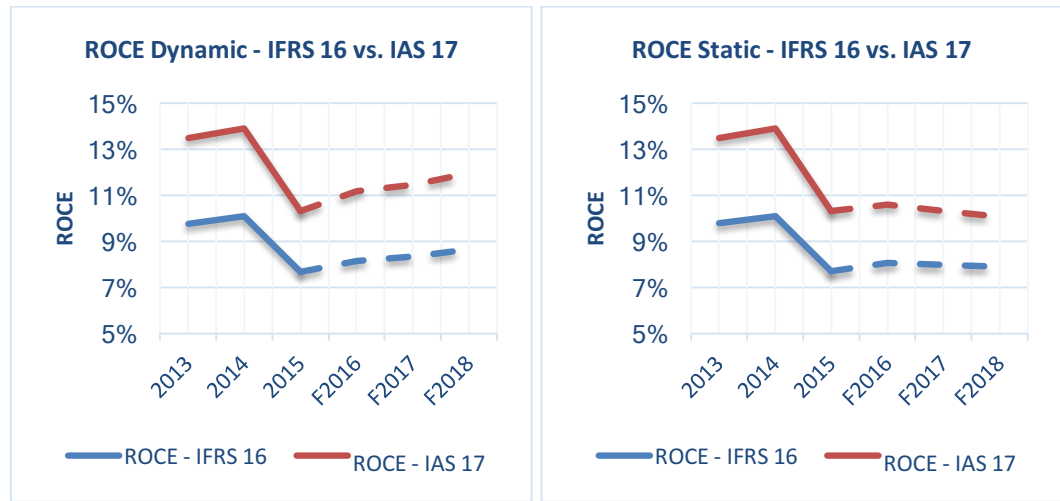
target of 2.5%. The group's ONCA turnover is kept constant at a level of 2.10 under IFRS 16 (3.45 under IAS 17) throughout the forecasted period. As shown in graph 2, this results in relatively stable development in ONCA and NCIBD, which implicitly means that no long-term investments are being made. The overall effects suggest that the company is in a maturation phase, with moderate revenue growth and coinciding development in the group's balance sheet. Whether this will have a noticeable different impact on NorgesGruppen's key performance measures compared to the dynamic conditions will be analyzed in the next section.

7.3.5 Comparison of key performance measures in bonus contracts

In this comparison of NorgesGruppen's performance measures related to the group's bonus contracts under different growth scenarios, we have chosen to call attention to the group's ROCE, ROIC and EVA, while disregarding both EBITDA and EBIT. The latter two are considered relatively simple economic measures, and an analysis of the effects of IFRS 16 would not intuitively provide any significant substance.

ROCE

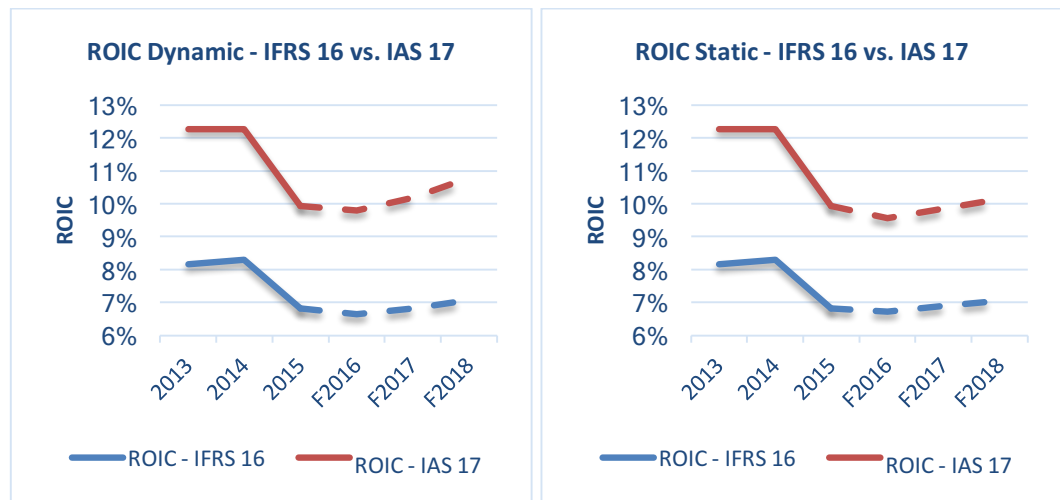
When comparing the group's ROCE over the forecasted period, illustrated in the graph below, there is nothing suggesting that the performance measure develops differently across the two accounting standards. A high-growth company will experience increased return on their capital employed regardless of whether their operating leases are capitalized. A stagnant company, without growth in the balance sheet, will experience a slight decrease in ROCE with somewhat more evident exposure under IAS 17.



Graph 3 Comparison of the development of ROCE under different conditions

ROIC

The development in ROIC under different conditions is, however, a more intriguing discovery. As shown in graph 4, ROIC is indicating an increasing tendency under both growth and non-growth conditions. This applies to both before and after capitalization of operating leases. The forecasted ROIC under IFRS 16 are showing almost identical development. The underlying cause of this concurrence is the premise that the asset turnover under the dynamic condition is steadily declining, while the asset turnover under the static condition is held constant. The effects from the decreasing asset turnover are offset by a higher profit margin in the growth scenario.



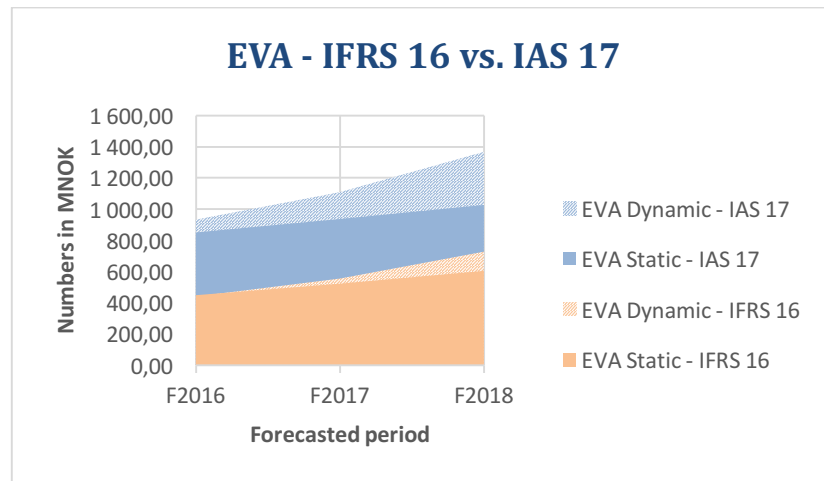
Graph 4 Comparison of the development in ROIC under different conditions

The interesting observation appears when comparing growth and non-growth condition under IAS 17. Graph 4 demonstrates improving ROIC in both scenarios, but with different steepness of the curve. Intuitively, a growth company will experience a more improved ROIC over time, compared to a non-growth company. However, it appears that IFRS 16 seemingly diminishes the effects of growth on ROIC. Keeping operating leases off-balance sheet seems to improve the performance of a growing company to a greater extent than if the leases were capitalized under IFRS 16 compared to a no-growth company.

EVA

Another interesting discovery can be seen in graph 5 in the comparison of the forecasted EVA under different growth scenarios. All curves demonstrate positive trends from 2016 to 2018. The intriguing aspect of this graph is, like ROIC, the relationship between the dynamic EVA under IAS 17 and IFRS 16, i.e. before and after the capitalization. A similar diminishing effect appears for EVA, as for ROIC, when a company experiences *growth under IFRS 16*. This is mostly due to a lower ROIC, with an enhancing effect from a higher WACC, compared to growth under IAS 17. The same concluding point applies here as under ROIC: a

growing company keeping their operating leases off-balance sheet will appear more profitable than if the leases were capitalized under IFRS 16, compared to a none-growth company. For further details about the forward-looking approach, see Appendix A: 10.1.12 – 10.1.17.



Graph 5 Comparison of the development in EVA under different conditions. The striped area marks the added value from the growth scenario.

Up until now, we have conducted our own analyzes of the effects from IFRS 16 through extensive examination of historical and forward-looking financial data. In addition, we have obtained and analyzed the content of bonus contracts in the Norwegian retail market. In the upcoming chapter, two interviews with experts on IFRS 16 representing two of “the Big Four” audit firms will be presented to add a professional perspective to our findings.

8 Experts’ assessment of IFRS 16

8.1 Introduction

This chapter will supplement the findings in previous chapters as well as give further insight and new perspectives regarding the standard, and its effects on

bonus systems and other practical consequences. Two interviews have been conducted with state authorized public accountants at two of “the Big Four” accounting firms. In one of the interviews (interview/experts A) there were two respondents, respectively a partner and a senior manager, whereas one manager was the case for the other interview (interview/expert B). The respondents possess in-depth knowledge of IFRS in general and are affiliated with the firms’ *Department of Professional Practices*. They all work closely with IFRS 16 and have issued several reports and held seminars about the standard. The respondents, and their employers, will be held anonymous. It must be stressed that their answers and comments represent their personal opinions. Rather than reciting the interviews question by question, the obtained responses will be expressed through conceptual subchapters. All statements, assessments and opinions in the following chapter origin from the respondents, unless else is explicitly stated. The exact questions asked can be found in Appendix B.

8.2 Effects on financial performance metrics

The interview objects agree that IFRS 16 will have the potential to impact a company’s financial metrics, especially in a leasing-intensive industry such as retail. The impact depends on several factors, including the number of lease arrangements, their durations and payments. An illustrative example was given in interview A: Imagine two different chain stores for fashion clothing competing in the budget segment. The first company (chain 1) aims to be located in popular shopping streets and in city centers. As a consequence of their strategy, the number of stores is few and the lease contracts are expensive. The second company (chain 2), on the other hand, has a great number of stores located at shopping malls outside the city center. For that reason, the lease contracts are considered cheaper. Due to large differences in lease expenses, the contracts for chain 1’s stores are often a fraction of the length of chain 2’s less expensive contracts. Accordingly, the present value for all future lease payment obligations

for chain 2 is likely to be substantially larger than for chain 1, leading to a stronger impact on their financial performance metrics when capitalizing operating leases. This is a clear example of how a company's strategic leasing policy will influence the impact on financial metrics.

A vital challenge for affected companies, identified by all three interviewees, is how to properly communicate the upcoming changes of their key financial metrics to the market and to the companies' stakeholders. The company of expert B is currently analyzing information about IFRS 16 and its expected impact, as disclosed in the financial statements for 2016 of entities listed on Oslo Stock Exchange. According to the experts, it is a reason to believe that non-professional users of financial statements, to a significant lesser extent than professionals, are aware of what impact IFRS 16 will have on key ratios. Even though professionals have adjusted for OBS leases in the past, a possible complication is that sophisticated stakeholders' valuation of OBS lease contracts will differ from the valuation according to IFRS 16. This can lead to variations in calculated metrics derived from accounting numbers. It is stressed in the interviews that proactivity is a recommended strategy, both in terms of the purely technical aspects and communication to the market regarding these technicalities. If analysts' calculations differ from the company's own valuation, then explicit communication on the matter is necessary. The same point applies for communication to lenders and stakeholders in general. By giving accurate and precise information, the risk for undesirable reactions from the market is decreased.

8.3 Effects on bonus contracts

With the effects on financial performance metrics in mind, further assessment of the effects on bonus contracts can be made. It was ascertained in interview A, that the causal effect IFRS 16 has on bonus remuneration is dependent on the structure

of a given bonus contract. They stated that a well-designed bonus contract should be robust and strive to reward on the basis of the underlying economic reality and relative performance, i.e. a contract based on performance relative to peers. This type of contract should not be affected by changes in accounting standards, such as IFRS 16, or other similar circumstances that does not change the true economic position of a company.

To illustrate the previous point given in interview A: Think of a CEO, or other members of the executive management, with a bonus plan based on the company's stock price. Assuming that the market is booming, then the stock price is likely to increase even if the company's performance is below average. However, one can ask the rhetorical question whether the CEO should be awarded if his/her company is a weaker performing company relative to their peer group, despite an increase in market value. This point is also valid if the market faces a downward trend. Granted that a company is outperforming their peer group, even in cases of shrinking stock price, one can justify bonus remuneration in return for good leadership in difficult times. These scenarios related to bonus remuneration based on stock-prices are linked to the concept of non-controllable risk. An efficient bonus system should, like explained thoroughly in chapter 5, to the greatest extent minimize this type of risk.

As emphasized in interview A, relative performance evaluation is the most efficient approach to bonus remuneration. The interviewees could tell that from their experience and knowledge, the most professional companies tend to draw their bonus contracts so that remuneration reflects performance relative to peers and the economic reality. However, they continued to tell that a great number of companies base their bonus systems solely on financial metrics derived from the reported financial statements. The authors' sit-downs regarding bonus contracts in the Norwegian retail (as described in chapter 7) strengthens this statement. Additionally, existing research indicates that bonus committees in general does

not account for operating leases when drawing bonus contracts. This gives reasons to expect that IFRS 16 will have the power to impact these types of bonus systems, unless alteration is done in advance. A hypothetical, but plausible, scenario in this setting is that management is aware of the new standard's effect on applicable financial metrics included in their bonus contracts. An opportunity to use leasing, or avoidance of leasing, emerges in order to tweak the metrics in desired direction. When asked about this, the answers in both interviews were that deliberate alteration of metrics via leasing/non-leasing decisions poses as a possible threat for companies. The most inconspicuous technique mentioned was the use of service contracts rather than lease arrangements. The main difference between service contracts and leasing contracts in this matter is the amount of control transferred, i.e. the right of use of the asset, and/or whether there is an identifiable underlying asset. A concrete example on choosing service contracts over leasing was given in interview B. Instead of leasing and operating a fleet of trucks for distribution of goods, the retailer may enter into a contract where the supplier can decide which trucks to use and how they will be used. From this perspective, IFRS 16's impact on financial measures has the capability to influence management's leasing decisions. In the chapter of incentives and bonus systems, distortion is a key property. The concept of distortion is relevant as leasing can actively be used to benefit the management while the company's best interest is put aside. A decisive factor in this context is the characteristics of the human being and the management's personal integrity. Expert B gave an interesting comment on the use of service contracts rather than leasing: a weakness of IFRS 16 is that the distinction between a service contract and a lease arrangement may seem arbitrary. Two arrangements that are the same with respect to the outcome, i.e. products and services received, can be classified and accounted for differently, depending on the level of control over the underlying asset(s) transferred to the "lessee", the identifiability of underlying assets and the judgment applied by management.

There are different ways to approach the impact IFRS 16 has on bonus systems. It is discrepancy between two suggested alternatives from respectively the former CFO of NorgesGruppen and the interviewed experts. In the sit-down with the former, he stated that he would have recommended that NorgesGruppen adjust the target for the decisive measure in the bonus contract, *ROCE*, to a degree so that it reflects the increase in the balance sheet and capital employed. He sketched a scenario where the bonus system for NorgesGruppen continues as it is today, with application of IAS 17, for two years after the implementation of IFRS 16. These two years will give the bonus committee time to make proper assessment of the effects on the applicable financial metrics, so that corresponding adjustments can be made. The experts in interview A had a completely different perspective. Accounting standards will continue to be subject to changes and renewal, which in turn might have the capability to impact financial performance measures. It is inefficient to analyze the degree of impact a new change of accounting standard has on financial measures every time it occurs. The suggested solution is that the affected bonus systems are redesigned to be more robust, i.e. that the underlying economic reality is decisive when assessing performance, and not a simple reallocation of numbers in the financial statements.

8.4 General effects and economic consequences

Considering that lease accounting has been a disputed subject for decades, the interviewees acknowledge the need for a new, more precise standard with less room for interpretation. In the eyes of the experts in both interviews, the discussion and criticism towards IAS 17 has dealt more about the use and practice of the standard, than the standard itself. Their prime example is the use of multiples for estimation of the present value for all future lease payments. Consensus among analysts has historically been a multiple of eight times the future lease payments. Experts A had less adamant conception and state that this practice could fail to capture the true value of future lease obligations. The experts

elaborated this with an analysis presented at an attended seminar. The analysis indicated that a multiple value of 8 might be misleading. Given a scenario where all relevant information is available in the reported financial statements, the multiple could be closer to four. The general opinion in both interviews was that in a real-life situation, all necessary information is rarely available and the consequence is that estimation by multiples can lead to inaccurate valuation of future lease payments.

The new lease accounting standard has an enhanced requirement of information disclosed in the notes, in comparison to IAS 17. According to the interviewees, there are two opposite views on what is necessary to include in the notes. Critical voices claim that the development of an increasing amount of information in financial statement reports is superfluous. They believe that the average user does not grant the notes much attention due to a lack of knowledge for interpreting the information. On the contrary, financial reports are made especially for users that are expected to understand the content. Expert B stated that the IASB, based on deliberations and outreach activities, have determined disclosure requirements that provide users of financial statements with relevant information. But, preparers of financial statements are not required to provide all of the disclosures specified in a standard. Depending on the specific leasing agreements of an entity, some of the disclosure requirements could be immaterial and therefore ignored. Digitalization is emerging in every field of business, and annual reports and other financial statements are no exception. When asked to comment on this development, experts A stated that it is likely that financial reports will be purely interactive and digitally coded, so that the users themselves can customize the content. Expert B could elaborate that the IASB are already involved in this process by preparing an IFRS Taxonomy and the European Securities and Markets Authority (ESMA) has decided that from 2020 annual financial reports containing IFRS consolidated financial statements, have to be marked-up with XBRL tags according to the IFRS Taxonomy.

The transition to IFRS 16 has the potential to be a costly affair for retail companies with a substantial amount of lease contracts. When asked to identify the greatest challenges, the interviewees' answers could sum up to a threefold process: i) First and foremost, solid IT-systems to process every lease contract is needed. Large corporations, such as Reitangruppen and NorgesGruppen, have a number of leases that makes the current spreadsheet treatment impractical; ii) the companies affected need to educate their accountancy department on the new standard on a technical level. The standard is comprehensive, and thorough knowledge is key to an efficient implementation; iii) perhaps the most time consuming and difficult part of the transition is the estimations and calculations regarding number of periods and present value of future lease payments. Their impression as auditors was similar for the interviewed experts regarding typical problems for their clients. Technical issues, such as the correct discount rate to use, are demanding and the accounting firms have noticed an increased demand for consultancy on this matter. IFRS 16 is an intricate standard. Due to the degree of complexity for affected companies, the transition and implementation will be demanding for the auditors as well. Apart from the technical aspect, an important and challenging task for the accounting firms is to get their clients aware of the magnitude of the standard, and importance of starting preparations early. The time span of three years from issuance of the final standard to implementation date has conceivably made companies underestimate the necessary workload it takes. A trend is that IFRS 15 *Revenue from Contracts with Customers*, which is to be applied from 1 January 2018, has taken a lot of the companies' attention. In addition, due to the standard's complexity, a common tendency is that companies are waiting for other similar companies to resolve the issues, reaching a stalemate situation. One possible solution for this time pressure, according to expert B, is to implement IFRS 16 using the modified retrospective approach, which entails not restating comparative information but recognize the cumulative effect of initially

applying IFRS 16 as an adjustment to opening equity at the date of initial application.

Bearing in mind the impact IFRS 16 has on financial measures, the experts were asked about potential consequences for companies' covenants. In interview A, the same points as for bonus contracts were stated. Sophisticated stakeholders and professional institutions often account for OBS leases or make debt contracts so that changes in the economic reality are decisive. However, as discussed previously in this chapter, the use of multiples has its drawbacks as different institutions may use different multiple values. Since all leases are to be capitalized, the interviewees expect companies, with a strong financial position, to more often choose purchase over lease, if it is the cheaper alternative. On the other hand, companies in a tight economic situation may be forced to continue to use leasing as a financing method. A concrete example was given in interview A: a client, whom already was concerned regarding the capitalization of its leases, was forced to continue to use leasing as a financing method. They were unable to debt-finance purchases of new assets, since their covenants would be breached. In this scenario, IFRS 16 could make matters worse as they might have to choose the more expensive alternative. Even if the IFRS Foundation in their *IFRS 16 Effects Analysis* state that covenants will be unaffected, experts A believe that the transition to IFRS 16 may complicate this subject as well – an assessment agreed to by expert B.

9 Conclusion and further research

The purpose of this thesis has been to examine the scope of IASB's new standard for lease accounting, IFRS 16 *Leases*, how it will impact earnings and financial figures, hereunder key ratios, for companies applying IFRS. Further on, our scope has been extended to assess whether the standard will have any possible effects on bonus compensation contracts for Norwegian retail companies, and other

subsequent economic consequences that may arise. To achieve this, a comprehensive examination of IFRS 16 was carried out. Furthermore, an extensive review of modern academic research on bonus compensation for executive management has been conducted, in addition to acquiring first-hand knowledge of the content of bonus contracts in the Norwegian retail industry. The succeeding steps were a case study of respectively NorgesGruppen and Reitangruppen, as well as completing interviews with experts from two of “the Big Four” audit firms. Throughout this thesis, the following answers have been obtained:

IFRS 16 sets aside the binary classification of leases and requires that all leases are recognized on the balance sheet. Exemptions may apply for low-value leases and agreements shorter than 12 months. The initial recognition of assets shall be measured at the present value of all future lease payments, with the accompanying obligations recognized as liabilities. Rather than recognizing the entire lease expense to operating costs, as done according to IAS 17, IFRS 16 allocates the expense proportionally to depreciation and interest. The transition to the new standard does not change a company’s economic position. Large professional credit institutions may be familiar with this reality, and it is thus not expected that debt covenants, or similar contracts, will be affected. However, there exist certain risks that less professional institutions have failed to derive contracts in which the economic reality is decisive, leading to a scenario where IFRS 16 might have an unfortunate impact.

The retail industry appears to be one of the most affected industries. Accordingly, our case companies are characterized by large amounts of operating lease expenses, which consequently will have a sizable impact on their financial statements when capitalized. Our results confirm that depreciation and interest expenses will rise significantly, whereas operating expenses will decrease with a corresponding amount, creating a zero-sum game (net income being unaffected).

The reallocation of costs will have an enormous impact on EBITDA, and to a lesser extent on EBIT and NOPAT. Regarding the balance sheet, the capitalization of leases has on average increased NorgesGruppen's non-current assets with approximately 36% the last three years, with an equivalent increase in non-current interest-bearing debt. No changes of interesting character were detected in the cash flow statements.

Proper incentives for the management have historically been an important element in modern academic research on management control systems. The importance of balancing the three dimensions in the incentive formula, namely distortion, risk and manipulability, is crucial when designing bonus contracts. With a combination of literature and sit-downs with key personnel affiliated with NorgesGruppen and Reitangruppen, we found that the following measures can be expected to be included in bonus contracts for the Norwegian retail industry: *EBITDA*, *EBIT*, *NOPAT*, *ROIC*, *ROCE* and *EVA*. An initial finding was that the decisive measures are different at different hierarchical levels. Mid-level management in Reitangruppen tends to solely use operational metrics, with *EBIT* as the key example. Senior executives are evaluated by financial measures and capital efficiency. NorgesGruppen uses *EBITDA* and *ROCE* in the assessment of performance at this level. In the mentioned sit-downs, it was confirmed that the given measures, or measures of similar character, are the industry norm.

The analysis of the chosen measures reveals that capitalization of operating leases will with great power affect measures typically used in bonus systems. Operational measures derived from the income statement (*EBITDA*, *EBIT*, *NOPAT*) are expected to increase notably. On the other hand, the financial measures analyzed (*ROIC*, *ROCE*, *EVA*), are likely to undergo a solid decline. The central explanation for this is the companies' recognition of the obligations to pay all future lease payments as financial liabilities. This increases their reported

debt on the balance sheet substantially, which in turn affects the profitability and efficiency ratios used.

Considering an estimated forecasted period of three years, our analysis of NorgesGruppen's future prospects, given two different scenarios, shows interesting discoveries regarding both EVA and ROIC. A growth company with significant rise in both revenues and investments will intuitively experience a more improved ROIC/EVA over time, compared to a non-growth company. However, our analysis reveals that IFRS 16 appears to have a diminishing growth effect on ROIC/EVA. Keeping operating leases off-balance seems to improve the performance of a growing company to a greater extent than if the leases were capitalized under IFRS 16, compared to a no-growth company.

In the experts' assessment of the criticism of IAS 17, a point was that the criticism has been towards the leasing practice, rather than the standard itself. Analysts adjusting for OBS leases have used different multiples in their calculations, making the risk of inaccurate estimations present, due incomplete information regarding lease contracts. The experts are certain that leasing intensive companies will have their financial metrics affected, although the extent of impact will differ depending on a given company's leasing policy and lease portfolio. Clear and accurate communication to stakeholders is believed to be the most important action, as it is vital that stakeholders understand that the underlying economic reality remains unaffected. Regarding impacted bonus contracts, the experts claimed that the best solution should be to restructure the design of the bonus contracts to make them more robust. The audit firms experience that it is difficult to make their clients aware of the time pressure and magnitude of the standard. To ease the workload for audit providers, the professionals' identified three great challenges for affected companies concerning the implementation and transition of the standard. Firstly, they will have to acquire new IT-systems capable of processing large numbers of lease contracts. Secondly, adequate education on the

new standard must be provided to the accountancy personnel. Lastly, and perhaps most time-consuming, they will have to identify every appropriate discount rate in all lease contracts when estimating the present value of future lease payments.

Regarding further research, several perspectives could be of interest. One obvious approach would be to conduct similar case studies in other affected industries, with intention to assess the effects on industry-specific contracts. Another possibility could be to conduct a post-implementation review of IFRS 16. This could be done to empirically test various effects, such as examining implementation costs across industries, examination of changes in behavior regarding the financing assets, and whether IFRS 16 paves the way for new methods to avoid recognition of assets to the balance sheet. Another interesting field of study could be to examine the robustness of contracts by studying how changes of accounting standards affect the elements included, and whether the contracts have to be adjusted in the aftermath.

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11 Appendix

11.1 Appendix A: NorgesGruppen / Reitangruppen – Financial Data

11.1.1 Original Income statement

| Reitangruppen | | | |
|--|--------------|--------------|--------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| Net revenue | 62 284 | 60 133 | 57 247 |
| Other revenue | 1 340 | 1 389 | 1 212 |
| Net gain (loss) | 55 | 80 | 248 |
| Value change investment property | 155 | 32 | 48 |
| Results from TS and FKV | 238 | 105 | 202 |
| Cost of goods | -49 987 | -48 614 | -45 748 |
| Salaries | -2 892 | -2 681 | -2 963 |
| Other operating expenses | -6 651 | -6 436 | -6 061 |
| EBITDA | 4 542 | 4 008 | 4 185 |
| Amortization and impairment of immaterial assets | -92 | -77 | -76 |
| Depreciation and impairment of fixed assets | -1 024 | -1 027 | -1 068 |
| EBIT | 3 426 | 2 904 | 3 041 |
| Financial income | 37 | 48 | 52 |
| Financial expenses | -288 | -384 | -433 |
| Net other financial items | -62 | -187 | -59 |
| Profit before tax | 3 113 | 2 381 | 2 601 |
| Tax on the profit for the year | -680 | -552 | -601 |
| Net profit for the year | 2 433 | 1 829 | 2 000 |

| OTHER COMPREHENSIVE INCOME | | | |
|--|------------|-------------|------------|
| Remeasurement of pension liability, net after tax | -8 | -142 | -40 |
| Share of expanded earnings in TS and FKV | -19 | 0 | |
| Items that cannot be reclassified to the income statement | -27 | -142 | -40 |

| | | | |
|---|--------------|--------------|--------------|
| Revaluation of investments held for sale | 1 363 | 1 168 | 756 |
| Share of expanded earnings in TS and FKV | -1 | 4 | -1 |
| Translation differences | 332 | 313 | 487 |
| Items that may be reclassified to the income statement | 1 694 | 1 485 | 1 242 |
| Other comprehensive income after tax | 1 667 | 1 343 | 1 202 |
| | | | |
| TOTAL COMPREHENSIVE INCOME | 4 100 | 3 172 | 3 202 |
| | | | |
| <i>Net income for the year allocated</i> | | | |
| Shareholders in the parent company | 2 253 | 1 743 | 1 867 |
| Non-controllable interests | 180 | 86 | 133 |
| Sum allocated net income | 2 433 | 1 829 | 2 000 |
| <i>Total comprehensive income for the year allocated</i> | | | |
| Shareholders in the parent company | 3 910 | 3 073 | 3 051 |
| Non-controllable interests | 190 | 99 | 151 |
| Sum allocated total comprehensive income | 4 100 | 3 172 | 3 202 |

| NorgesGruppen | | | |
|---------------------------------------|----------------|----------------|----------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| Net revenue | 72 746 | 68 508 | 64 592 |
| Other revenue | 3 478 | 2 883 | 2 803 |
| Sum operating revenues | 76 224 | 71 391 | 67 396 |
| Cost of goods | -56 163 | -52 636 | -49 610 |
| Salaries | -8 885 | -8 363 | -8 110 |
| Other operating expenses | -6 448 | -6 035 | -5 777 |
| Depreciation and impairments | -1 847 | -1 678 | -1 625 |
| Income from investments in affiliates | 289 | 266 | 362 |
| Sum operating expenses | -73 054 | -68 446 | -64 760 |
| | | | |
| EBIT | 3 170 | 2 945 | 2 636 |
| | | | |

| | | | |
|--------------------------------|--------------|--------------|--------------|
| Financial revenues | 145 | 112 | 149 |
| Financial expenses | -314 | -441 | -380 |
| Net financial items | -169 | -328 | -231 |
| | | | |
| Profit before tax | 3 001 | 2 616 | 2 405 |
| Tax on the profit for the year | -640 | -686 | -612 |
| Net profit for the year | 2 361 | 1 930 | 1 793 |
| | | | |
| Minority share | 28 | 24 | 24 |
| Majority share | 2 333 | 1 907 | 1 769 |
| <i>Result per share</i> | <i>60</i> | <i>49</i> | <i>45</i> |

| | | | |
|--|--------------|--------------|--------------|
| OTHER COMPREHENSIVE INCOME | | | |
| Actuarial gains and losses on pension plans | 6 | -43 | -36 |
| Other comprehensive income items | 2 | -2 | -42 |
| Items that cannot be reclassified to the income statement | 9 | -45 | -78 |
| | | | |
| Securing | -33 | -122 | 39 |
| Foreign currency translation | 35 | 58 | 17 |
| Equity effect from affiliated companies | -26 | -13 | |
| Tax on comprehensive income items | 7 | 44 | -0 |
| Items that may be reclassified to the income statement | -17 | -33 | 55 |
| Other comprehensive income after tax | -9 | -79 | -23 |
| | | | |
| TOTAL COMPREHENSIVE INCOME | 2 352 | 1 851 | 1 770 |
| <i>Total comprehensive income for the year allocated</i> | | | |
| Minority share | 16 | 26 | 29 |
| Majority share | 2 336 | 1 826 | 1 742 |
| Sum allocated total comprehensive income | 2 352 | 1 851 | 1 770 |

11.1.2 Original Balance Sheet

| Reitangruppen | | | | |
|---|------|---------------|---------------|---------------|
| All numbers in MNOK | | 2015 | 2014 | 2013 |
| Non-current assets | | | | |
| Deferred tax asset | ONCA | 306 | 359 | 403 |
| Intangible assets | ONCA | 5 307 | 4 952 | 4 709 |
| Investment property | ONCA | 8 645 | 7 021 | 6 166 |
| Tangible assets | ONCA | 5 581 | 5 156 | 5 121 |
| Investments in TS and FKV | FNCA | 2 557 | 2 300 | 2 266 |
| Financial investments | FNCA | 256 | 3 922 | 2 748 |
| Pension funds | ONCA | 0 | 1 | 13 |
| Derivatives | FNCA | | | 2 |
| Receivables | ONCA | 597 | 538 | 411 |
| Non-current assets | | 23 249 | 24 249 | 21 839 |
| Current assets | | | | |
| Inventories | OCA | 2 816 | 3 040 | 3 613 |
| Trade receivables and other receivables | OCA | 7 528 | 6 944 | 6 726 |
| Financial investments | FCA | 5 035 | 0 | |
| Derivatives | FCA | 28 | 33 | 14 |
| Cash and cash equivalents | FCA | 1 514 | 1 365 | 1 694 |
| Current assets | | 16 921 | 11 382 | 12 047 |
| Total assets | | 40 170 | 35 631 | 33 886 |

| LIABILITIES AND EQUITY AT 31 DECEMBER | | | | |
|--|---|---------------|---------------|---------------|
| Equity | | | | |
| Share capital | E | 3 | 3 | 3 |
| Share premium | E | 6 270 | 6 270 | 6 270 |
| Other equity unrecognized | E | 4 645 | 2 961 | 1 489 |
| Retained earnings | E | 6 877 | 5 116 | 3 669 |
| Equity assigned to the parent company | | 17 795 | 14 350 | 11 431 |
| Non-controllable interests | M | 2 190 | 2 025 | 1 945 |
| Total equity | | 19 985 | 16 375 | 13 376 |

| | | | | |
|-------------------------------------|------------|---------------|---------------|---------------|
| Non-current liabilities | | | | |
| Deferred tax | P / (NCOL) | 981 | 851 | 818 |
| Pension | NCIBD | 106 | 105 | 221 |
| Other provisions | P / (NCOL) | 618 | 600 | 639 |
| Non-current debt | NCIBD | 6 463 | 6 636 | 7 933 |
| Derivatives | P / (NCOL) | 268 | 283 | 126 |
| Other debt | P / (NCOL) | 2 | 7 | 4 |
| Non-current liabilities | | 8 438 | 8 482 | 9 741 |
| Current liabilities | | | | |
| Other current provisions | COL | 76 | 139 | 70 |
| Tax payable | COL | 398 | 286 | 340 |
| Current debt | CIBD | 946 | 1 138 | 1 050 |
| Derivatives | COL | 26 | 16 | 13 |
| Trade payable and other debt | COL | 10 301 | 9 195 | 9 296 |
| Current liabilities | | 11 747 | 10 774 | 10 769 |
| Total Liabilities | | 20 185 | 19 256 | 20 510 |
| Total Liabilities and equity | | 40 170 | 35 631 | 33 886 |

| NorgesGruppen | | | | |
|--|------|---------------|---------------|---------------|
| All numbers in MNOK | | 2015 | 2014 | 2013 |
| Non-current assets | | | | |
| Intangible assets | ONCA | 4 905 | 4 760 | 4 813 |
| Deferred tax asset | ONCA | 267 | 371 | 333 |
| Tangible assets | ONCA | 13 932 | 12 387 | 11 490 |
| Investment property | ONCA | 655 | 1 369 | 1 179 |
| Investments in associates | FNCA | 2 966 | 2 600 | 2 556 |
| Investments in shares | FNCA | 92 | 161 | 65 |
| Other financial assets | FNCA | 0 | 6 | 8 |
| Other long-term receivables | ONCA | 1 319 | 963 | 725 |
| Non-current assets | | 24 136 | 22 616 | 21 169 |
| Current assets | | | | |
| Inventory | OCA | 5 682 | 5 191 | 4 766 |
| Trade receivables and other short-term receivables | OCA | 4 715 | 5 245 | 4 567 |
| Other financial assets | FCA | 66 | 64 | 9 |
| Bank deposit and cash | FCA | 505 | 400 | 403 |
| Current assets | | 10 968 | 10 899 | 9 745 |

| | | | |
|---------------------|---------------|---------------|---------------|
| Total assets | 35 104 | 33 515 | 30 914 |
|---------------------|---------------|---------------|---------------|

| LIABILITIES AND EQUITY AT 31 DECEMBER | | | | | |
|--|------------|---------------|---------------|---------------|--|
| Equity | | | | | |
| Share capital | E | 1 826 | 1 826 | 1 823 | |
| Retained earnings | E | 12 749 | 10 937 | 9 398 | |
| Minority interests | M | 245 | 244 | 235 | |
| Total equity | | 14 820 | 13 007 | 11 455 | |
| Non-current liabilities | | | | | |
| Long-term debt | NCIBD | 6 206 | 5 622 | 4 929 | |
| Other financial liabilities | NCIBD | 184 | 206 | 100 | |
| Pensions | NCIBD | 438 | 431 | 381 | |
| Deferred tax liabilities | P / (NCOL) | 808 | 948 | 876 | |
| Non-current liabilities | | 7 637 | 7 207 | 6 285 | |
| Current liabilities | | | | | |
| Trade payables | COL | 4 671 | 5 162 | 4 338 | |
| Other short-term debt | COL | 7 184 | 7 485 | 8 279 | |
| Tax payable | COL | 677 | 590 | 546 | |
| Other financial liabilities | CIBD | 116 | 64 | 10 | |
| Current liabilities | | 12 647 | 13 300 | 13 174 | |
| | | | | | |
| Total Liabilities | | 20 284 | 20 508 | 19 459 | |
| Total Liabilities and equity | | 35 104 | 33 515 | 30 914 | |

11.1.3 Original Cash Flow Statement

| Reitangruppen | | | |
|---|-------------|-------------|-------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| EBT | 3 113 | 2 381 | 2 601 |
| Recognized dividends from financial investments | -139 | -121 | -104 |
| Net gain/loss extr. ord. exchange gain/loss from operations | 23 | -55 | -248 |
| Results from TS and FKV | -238 | -105 | -202 |

| | | | |
|--|---------------|---------------|---------------|
| Revaluation investment property | -155 | -32 | -48 |
| Amortization and impairment of intangible assets | 1 024 | 1 027 | 1 068 |
| Depreciation and impairment of tangible assets | 92 | 77 | 76 |
| Net financial items | 313 | 523 | 440 |
| Changes in pensions | -10 | -299 | 12 |
| Inventory | 224 | 573 | -589 |
| Trade receivables and other receivables | -663 | -383 | 256 |
| Trade payables and other debt | 1 045 | -84 | 1 208 |
| Gross CF from operations | 4 629 | 3 502 | 4 470 |
| Interest paid | -267 | -358 | -407 |
| Tax paid | -409 | -491 | -472 |
| Net CF from operations | 3 953 | 2 653 | 3 591 |
| Purchase of intangible assets | -324 | -177 | -127 |
| Sale of intangible assets | 4 | 1 | 12 |
| Purchase of investment property | -1 556 | -826 | -916 |
| Sale of investment property | 270 | 104 | 74 |
| Purchase of tangible assets | -1 518 | -1 067 | -1 379 |
| Sale of tangible assets | 126 | 85 | 80 |
| Purchase of TS and FKV | -177 | -400 | -542 |
| Sale of TS and FKV | 29 | 344 | 180 |
| Sale of financial investments | 0 | -9 | -16 |
| Payments on receivables on parent company | 10 | 37 | 490 |
| Interest received | 37 | 48 | 52 |
| Dividend received | 235 | 264 | 148 |
| Net CF from investments | -2 864 | -1 596 | -1 944 |

| | | | |
|---|--------------|---------------|--------------|
| New debt | 963 | 1 194 | 1 073 |
| Repayment of debt | -1 414 | -2 344 | -1 332 |
| Dividend to shareholders | -275 | -176 | -139 |
| Dividend paid to non-controllable interests in subsidiary | -20 | -20 | -15 |
| Net CF from financial activities | -746 | -1 346 | -413 |
| | | | |
| Changes in cash and cash equivalents | 343 | -289 | 1 234 |
| | | | |
| Net cash and cash equivalents per 01.01 | 1 160 | 1 424 | 181 |
| Exchange gain/loss on net cash and cash equivalents | 1 | 25 | 9 |
| Net cash and cash equivalents per 31.12 | 1 504 | 1 160 | 1 424 |

| NorgesGruppen | | | |
|--|--------------|--------------|--------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| EBT | 3 001 | 2 616 | 2 405 |
| Tax paid | -590 | -546 | -555 |
| Depreciation | 1 664 | 1 570 | 1 430 |
| Impairment | 184 | 109 | 195 |
| Revaluation of financial instruments | 14 | -5 | -12 |
| Pension cost without cash effect | 13 | 7 | -8 |
| Loss/gain on sale of operating assets and financial assets | -166 | 6 | -38 |
| Revenue on investments in associates | -289 | -266 | -362 |
| Dividend received from associates | 196 | 206 | 143 |
| Changes in inventory | -492 | -425 | -352 |
| Changes in trade receivables | -71 | -216 | -103 |
| Changes in trade payables | -491 | 824 | 660 |
| Changes in other accruals | 691 | -632 | -551 |
| Net CF from operations | 3 665 | 3 248 | 2 852 |
| | | | |

| | | | |
|---|---------------|---------------|---------------|
| Payments on sale of tangible assets and investment property | 1 106 | 165 | 243 |
| Payments on sale of intangible assets | | | 3 |
| Payments on purchase of tangible assets and investment property | -3 435 | -2 844 | -2 598 |
| Payments on purchase of intangible assets | -329 | -40 | -43 |
| Payments on sale of financial non-current assets | 153 | 220 | 370 |
| Payments on purchase of financial non-current assets | -352 | -247 | -833 |
| Changes in debt to associates | -229 | -179 | -323 |
| Changes in long-term receivables | -128 | -58 | -87 |
| Net CF from investments | -3 212 | -2 983 | -3 267 |
| Payments on new long-term debt | 5 512 | 2 185 | 1 440 |
| Repayment on long-term debt | -5 024 | -1 152 | -634 |
| Changes in short-term debt | -286 | -1 002 | 14 |
| Purchase of own shares | -16 | -48 | -86 |
| Dividend | -524 | -251 | -451 |
| Net CF from financial activities | -337 | -268 | 283 |
| | | | |
| Net changes in cash and cash equivalents | 115 | -3 | -131 |
| | | | |
| Cash and cash equivalents per 01.01 | 400 | 403 | 534 |
| Cash and cash equivalents per 31.01 | 515 | 400 | 403 |

11.1.4 Reformulated Income Statement

| Reitangruppen | | | |
|--|--------------|--------------|--------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| Operating revenues | 62 284 | 60 133 | 57 247 |
| Cost of goods sold | -49 987 | -48 614 | -45 748 |
| Salaries | -2 892 | -2 681 | -2 963 |
| Other operating expenses | -6 651 | -6 436 | -6 061 |
| EBITDA | 2 754 | 2 402 | 2 475 |
| Amortization and impairment of immaterial assets | -92 | -77 | -76 |
| Depreciation and impairment of fixed assets | -1 024 | -1 027 | -1 068 |

| | | | |
|--|--------------|--------------|--------------|
| OPERATING PROFIT FROM CORE ACTIVITIES (EBIT) | 1 638 | 1 298 | 1 331 |
| Tax items | | | |
| Tax for the year | -680 | -552 | -601 |
| Tax on net financial items | -85 | -141 | -123 |
| Tax on non-recurring and non-operating items | 483 | 434 | 479 |
| Tax on operating activities | -282 | -260 | -245 |
| NOPAT | 1 356 | 1 038 | 1 086 |
| Non-recurring and non-operating items | | | |
| Other revenue | 1 340 | 1 137 | 960 |
| Net gain (loss) | 55 | 80 | 248 |
| Value change investment property | 155 | 32 | 48 |
| Results from TS and FKV | 238 | 105 | 202 |
| Transition from benefit pension to contribution pension in Rema 1000 | | 252 | 252 |
| Total non-recurring and non-operating items | 1 788 | 1 606 | 1 710 |
| Tax on non-recurring and non-operating items | -483 | -434 | -479 |
| Earnings before interests, after special items | 2 661 | 2 211 | 2 317 |
| Financial income | 37 | 48 | 52 |
| Financial expenses | -288 | -384 | -433 |
| Net other financial items | -62 | -187 | -59 |
| Total FINANCIAL ITEMS, NET | -313 | -523 | -440 |
| Tax on net financial items | 85 | 141 | 123 |
| TOTAL FINANCIAL ITEMS, NET OF TAX | -228 | -382 | -317 |
| | | | |
| PROFIT OF THE PERIOD | 2 433 | 1 829 | 2 000 |
| Other comprehensive income for the period, net of tax | 1 667 | 1 343 | 1 202 |
| TOTAL COMPREHENSIVE INCOME FOR THE PERIOD | 4 100 | 3 172 | 3 202 |
| | | | |
| | 2015 | 2014 | 2013 |
| Marginal Tax Rates | 27 % | 27 % | 28 % |

| | | |
|----------------------|--|--|
| NorgesGruppen | | |
|----------------------|--|--|

| All numbers in MNOK | 2015 | 2014 | 2013 |
|---|--------------|--------------|--------------|
| Net revenue | 72 746 | 68 508 | 64 592 |
| Other revenue | 2 832 | 2 883 | 2 803 |
| Cost of goods | -56 163 | -52 636 | -49 610 |
| Salaries | -8 885 | -8 363 | -8 110 |
| Other operating expenses | -6 448 | -6 035 | -5 777 |
| EBITDA | 4 083 | 4 357 | 3 899 |
| Depreciation and impairments | -1 847 | -1 678 | -1 625 |
| OPERATING PROFIT FROM CORE ACTIVITIES (EBIT) | 2 236 | 2 679 | 2 274 |
| Tax items | | | |
| Tax for the year | -640 | -686 | -612 |
| Tax on net financial items | -46 | -89 | -65 |
| Tax on non-recurring and non-operating items | 252 | 72 | 101 |
| Tax on operating activities | -433 | -703 | -575 |
| NOPAT | 1 802 | 1 976 | 1 698 |
| Non-recurring and non-operating items | | | |
| Income from investments in affiliates | 289 | 266 | 362 |
| Sale of shopping malls to Scala Retail Property AS | 646 | | |
| Total non-recurring and non-operating items | 935 | 266 | 362 |
| Tax on non-recurring and non-operating items | -252 | -72 | -101 |
| Earnings before interests, after special items | 2 484 | 2 170 | 1 959 |
| Financial income | 145 | 112 | 149 |
| Financial expenses | -314 | -441 | -380 |
| Total FINANCIAL ITEMS, NET | -169 | -328 | -231 |
| Tax on net financial items | 46 | 89 | 65 |
| TOTAL FINANCIAL ITEMS, NET OF TAX | -124 | -240 | -166 |
| PROFIT OF THE PERIOD | 2 361 | 1 930 | 1 793 |
| Other comprehensive income for the period, net of tax | -9 | -79 | -23 |
| TOTAL COMPREHENSIVE INCOME FOR THE PERIOD | 2 352 | 1 851 | 1 770 |
| | 2015 | 2014 | 2013 |
| Marginal Tax Rates | 27 % | 27 % | 28 % |

11.1.5 Reformulated Balance Sheet

| Reitangruppen | | | |
|---|---------------|---------------|---------------|
| TA-FORMAT | | | |
| All numbers in MNOK | 2015 | 2014 | 2013 |
| ONCA (operating non-current assets) | 20 436 | 18 027 | 16 823 |
| OCA (operating current assets) | 10 344 | 9 984 | 10 339 |
| TOTAL OPERATING ASSETS | 30 780 | 28 011 | 27 162 |
| FCA (financial current assets) | 6 577 | 1 398 | 1 708 |
| FNCA (financial non-current assets) | 2 813 | 6 222 | 5 016 |
| TOTAL ASSETS | 40 170 | 35 631 | 33 886 |
| <i>Equity and Liabilities</i> | | | |
| E (equity to majority shareholders) | 17 795 | 14 350 | 11 431 |
| M (equity to minority) | 2 190 | 2 025 | 1 945 |
| P / NCOL | 1 869 | 1 741 | 1 587 |
| NCIBD (non-current interest-bearing debt) | 6 569 | 6 741 | 8 154 |
| CIBD (current interest-bearing debt) | 946 | 1 138 | 1 050 |
| COL (current operating liabilities) | 10 801 | 9 636 | 9 719 |
| TOTAL EQUITY AND LIABILITIES | 40 170 | 35 631 | 33 886 |
| CE-FORMAT | | | |
| All numbers in DKK 1 000 | 2 015 | 2 014 | 2 013 |
| <i>Assets</i> | | | |
| NOA (net operating assets) core | 18 110 | 16 634 | 15 856 |
| FA | 9 390 | 7 620 | 6 724 |
| TOTAL | 27 500 | 24 254 | 22 580 |
| <i>Equity and Liabilities</i> | | | |
| E (equity to majority shareholders) | 17 795 | 14 350 | 11 431 |
| M (equity to minority) | 2 190 | 2 025 | 1 945 |
| (NCIBD+CIBD) | 7 515 | 7 879 | 9 204 |
| TOTAL CAPITAL EMPLOYED | 27 500 | 24 254 | 22 580 |
| NOA/IC-FORMAT | | | |
| All numbers in DKK 1 000 | 2 015 | 2 014 | 2 013 |
| NOA (NET OPERATING ASSETS) | 18 110 | 16 634 | 15 856 |
| E (equity to majority shareholders) | 17 795 | 14 350 | 11 431 |

| | | | |
|-------------------------------------|---------------|---------------|---------------|
| M (equity to minority) | 2 190 | 2 025 | 1 945 |
| Net IBD (Net interest bearing debt) | -1 875 | 259 | 2 480 |
| IC (INVESTED CAPITAL) | 18 110 | 16 634 | 15 856 |

| NorgesGruppen | | | |
|---|---------------|---------------|---------------|
| TA-FORMAT | | | |
| All numbers in MNOK | 2015 | 2014 | 2013 |
| ONCA (operating non-current assets) | 21 079 | 19 849 | 18 540 |
| OCA (operating current assets) | 10 397 | 10 435 | 9 333 |
| TOTAL OPERATING ASSETS | 31 476 | 30 284 | 27 873 |
| FCA (financial current assets) | 571 | 464 | 412 |
| FNCA (financial non-current assets) | 3 057 | 2 767 | 2 629 |
| TOTAL ASSETS | 35 104 | 33 515 | 30 914 |
| <i>Equity and Liabilities</i> | | | |
| E (equity to majority shareholders) | 14 574 | 12 763 | 11 221 |
| M (equity to minority) | 245 | 244 | 235 |
| P / NCOL | 808 | 948 | 876 |
| NCIBD (non-current interest-bearing debt) | 6 829 | 6 259 | 5 410 |
| CIBD (current interest-bearing debt) | 116 | 64 | 10 |
| COL (current operating liabilities) | 12 532 | 13 237 | 13 164 |
| TOTAL EQUITY AND LIABILITIES | 35 104 | 33 515 | 30 914 |
| CE-FORMAT | | | |
| All numbers in DKK 1 000 | 2 015 | 2 014 | 2 013 |
| <i>Assets</i> | | | |
| NOA (net operating assets) core | 18 136 | 16 100 | 13 834 |
| FA | 3 628 | 3 231 | 3 041 |
| TOTAL | 21 764 | 19 330 | 16 875 |
| <i>Equity and Liabilities</i> | | | |
| E (equity to majority shareholders) | 14 574 | 12 763 | 11 221 |
| M (equity to minority) | 245 | 244 | 235 |
| (NCIBD+CIBD) | 6 944 | 6 323 | 5 420 |
| TOTAL CAPITAL EMPLOYED | 21 764 | 19 330 | 16 875 |
| NOA/IC-FORMAT | | | |
| All numbers in DKK 1 000 | 2 015 | 2 015 | 2 015 |
| NOA (NET OPERATING ASSETS) | 18 136 | 16 100 | 13 834 |

| | | | |
|-------------------------------------|---------------|---------------|---------------|
| E (equity to majority shareholders) | 14 574 | 12 763 | 11 221 |
| M (equity to minority) | 245 | 244 | 235 |
| Net IBD (Net interest bearing debt) | 3 316 | 3 092 | 2 379 |
| IC (INVESTED CAPITAL) | 18 136 | 16 100 | 13 834 |

11.1.6 Reformulated Cash Flow Statement

| Reitangruppen | | | |
|---|--------------|--------------|--------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| CASH FLOW FROM OPERATING ACTIVITIES | | | |
| EBT | 3 113 | 2 381 | 2 601 |
| Tax paid | -409 | -491 | -472 |
| Amortization and impairment of intangible assets | 1 024 | 1 027 | 1 068 |
| Depreciation and impairment of tangible assets | 92 | 77 | 76 |
| Results from TS and FKV | -238 | -105 | -202 |
| Net gain/loss extr. ord. exchange gain/loss from operations | 23 | -55 | -248 |
| Revaluation investment property | -155 | -32 | -48 |
| CASH FLOW BEFORE CHANGES IN WORKING CAPITAL | 3 450 | 2 802 | 2 775 |
| Changes in pensions | -10 | -299 | 12 |
| Inventory | 224 | 573 | -589 |
| Trade receivables and other receivables | -663 | -383 | 256 |
| Trade payables and other debt | 1 045 | -84 | 1 208 |
| CASH FLOW FROM CONTINUING OPERATIONS (A) | 4 046 | 2 609 | 3 662 |
| CASH FLOW FROM INVESTING ACTIVITIES | | | |
| Purchase of intangible assets | -324 | -177 | -127 |
| Sale of intangible assets | 4 | 1 | 12 |
| Purchase of investment property | -1 556 | -826 | -916 |
| Sale of investment property | 270 | 104 | 74 |
| Purchase of tangible assets | -1 518 | -1 067 | -1 379 |
| Sale of tangible assets | 126 | 85 | 80 |
| Purchase of TS and FKV | -177 | -400 | -542 |
| Sale of TS and FKV | 29 | 344 | 180 |
| Sale of financial investments | 0 | -9 | -16 |
| Payments on receivables on parent company | 10 | 37 | 490 |
| Dividend received | 235 | 264 | 148 |

| | | | |
|---|---------------|---------------|---------------|
| Recognized dividends from financial investments | -139 | -121 | -104 |
| CASH FLOW FROM INVESTING ACTIVITIES (B) | -3 040 | -1 765 | -2 100 |
| | | | |
| FREE CASH FLOW (A + B) | 1 006 | 844 | 1 562 |
| | | | |
| CASH FLOW FROM FINANCING ACTIVITIES | | | |
| New debt | 963 | 1 194 | 1 073 |
| Repayment of debt | -1 414 | -2 344 | -1 332 |
| Dividend to shareholders | -275 | -176 | -139 |
| Dividend paid to non-controllable interests in subsidiary | -20 | -20 | -15 |
| Interest paid | -267 | -358 | -472 |
| Interest received | 37 | 48 | 52 |
| Net financial items | 313 | 523 | 440 |
| CASH FLOW FROM FINANCING ACTIVITIES (C) | -663 | -1 133 | -393 |
| | | | |
| CHANGE IN CASH AND CASH EQUIVALENTS (A+B+C) | 343 | -289 | 1 169 |

| NorgesGruppen | | | |
|--|--------------|--------------|--------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| CASH FLOW FROM OPERATING ACTIVITIES | | | |
| EBT | 3 001 | 2 616 | 2 405 |
| Tax paid | -590 | -546 | -555 |
| Depreciation | 1 664 | 1 570 | 1 430 |
| Impairment | 184 | 109 | 195 |
| Revaluation of financial instruments | 14 | -5 | -12 |
| Pension cost without cash effect | 13 | 7 | -8 |
| CASH FLOW BEFORE CHANGES IN WORKING CAPITAL | 4 285 | 3 750 | 3 454 |
| Changes in inventory | -492 | -425 | -352 |
| Changes in trade receivables | -71 | -216 | -103 |
| Changes in trade payables | -491 | 824 | 660 |
| Changes in other accruals | 691 | -632 | -551 |
| CASH FLOW FROM CONTINUING OPERATIONS | 3 922 | 3 302 | 3 108 |

| | | | |
|---|---------------|---------------|---------------|
| (A) | | | |
| CASH FLOW FROM INVESTING ACTIVITIES | | | |
| Payments on sale of tangible assets and investment property | 1 106 | 165 | 243 |
| Payments on sale of intangible assets | | | 3 |
| Payments on purchase of tangible assets and investment property | -3 435 | -2 844 | -2 598 |
| Payments on purchase of intangible assets | -329 | -40 | -43 |
| Payments on sale of financial non-current assets | 153 | 220 | 370 |
| Payments on purchase of financial non-current assets | -352 | -247 | -833 |
| Changes in debt to associates | -229 | -179 | -323 |
| Revenue on investments in associates | -289 | -266 | -362 |
| Dividend received from associates | 196 | 206 | 143 |
| Loss/gain on sale of operating assets and financial assets | -166 | 6 | -38 |
| Changes in long-term receivables | -128 | -58 | -87 |
| CASH FLOW FROM INVESTING ACTIVITIES (B) | -3 470 | -3 037 | -3 523 |
| | | | |
| FREE CASH FLOW (A + B) | 452 | 265 | -415 |
| | | | |
| CASH FLOW FROM FINANCING ACTIVITIES | | | |
| Payments on new long-term debt | 5 512 | 2 185 | 1 440 |
| Repayment on long-term debt | -5 024 | -1 152 | -634 |
| Changes in short-term debt | -286 | -1 002 | 14 |
| Purchase of own shares | -16 | -48 | -86 |
| Dividend | -524 | -251 | -451 |
| CASH FLOW FROM FINANCING ACTIVITIES (C) | -337 | -268 | 283 |
| | | | |
| CHANGE IN CASH AND CASH EQUIVALENTS (A+B+C) | 115 | -3 | -131 |

11.1.7 Lease calculations

| Reitangruppen | | | |
|---|-------------|-------------|-------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| The Group's obligations regarding operating leases | | | |
| Due within 1 year | 2 944 | 2 842 | 2 639 |
| Due between 1 and 5 years | 8 585 | 8 475 | 7 908 |

| | | | |
|---|-----------------|-----------------|-----------------|
| Due later than 5 years | 8 032 | 6 999 | 6 337 |
| Total obligations regarding operating leases | 19 561 | 18 316 | 16 884 |
| | | | |
| All numbers in MNOK | 2015 | 2014 | 2013 |
| Lease and sublease payments recognized in the period | | | |
| Expensed minimum lease | 2 849 | 2 701 | 2 610 |
| Contingent lease | 134 | 106 | 101 |
| Total leasing expenses | 2 983 | 2 807 | 2 711 |
| <i>as % of other operating expenses</i> | <i>44,85 %</i> | <i>43,61 %</i> | <i>44,73 %</i> |
| | | | |
| All numbers in MNOK | 2015 | 2014 | 2013 |
| | | | |
| Depreciation of capitalized leases | -2 514 | -2 276 | -2 036 |
| <i>Interest rate</i> | <i>2,4%</i> | <i>2,9%</i> | <i>4,0%</i> |
| Interest expenses on capitalized leases | -469 | -531 | -675 |
| <i>Depreciation rate</i> | <i>12,85 %</i> | <i>12,43 %</i> | <i>12,06 %</i> |
| | | | |
| All numbers in MNOK | 2015 | 2014 | 2013 |
| Changes in key figures | | | |
| EBITDA before | 2 754 | 2 402 | 2 475 |
| EBITDA after | 5 737 | 5 209 | 5 186 |
| Difference | 2 983 | 2 807 | 2 711 |
| <i>Difference in %</i> | <i>108,32 %</i> | <i>116,86 %</i> | <i>109,54 %</i> |
| | | | |
| EBIT before | 1 638 | 1 298 | 1 331 |
| EBIT after | 2 107 | 1 829 | 2 006 |
| Difference | 469 | 531 | 675 |
| <i>Difference in %</i> | <i>28,66 %</i> | <i>40,92 %</i> | <i>50,74 %</i> |
| | | | |
| NOPAT before | 1 356 | 1 038 | 1 086 |

| | | | |
|------------------------|----------------|----------------|----------------|
| NOPAT after | 1 699 | 1 426 | 1 572 |
| Difference | 343 | 388 | 486 |
| <i>Difference in %</i> | <i>25,27 %</i> | <i>37,34 %</i> | <i>44,79 %</i> |
| Net profit before | 2 433 | 1 829 | 2 000 |
| Net profit after | 2 433 | 1 829 | 2 000 |
| Difference | 0 | 0 | 0 |

| NorgesGruppen | | | |
|---|----------------|----------------|----------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| The Group's obligations regarding operating leases | | | |
| Due within 1 year | 1 889 | 1 704 | 1 656 |
| Due between 1 and 5 years | 6 408 | 5 688 | 5 386 |
| Due later than 5 years | 4 756 | 4 187 | 4 051 |
| Total lease commitments | 13 053 | 11 578 | 11 094 |
| All numbers in MNOK | | | |
| Lease and sublease payments recognized in the period | | | |
| Expensed minimum lease | 1 783 | 1 717 | 1 791 |
| Expensed variable lease | 94 | 88 | 78 |
| Net leasing expenses | 1 877 | 1 805 | 1 869 |
| <i>as % of other operating expenses</i> | <i>29,11 %</i> | <i>29,91 %</i> | <i>32,36 %</i> |
| All numbers in MNOK | | | |
| Depreciation of capitalized leases | -1 472 | -1 411 | -1 448 |
| <i>Interest rate</i> | <i>3,10 %</i> | <i>3,40 %</i> | <i>3,80 %</i> |
| Interest expenses on capitalized leases | -405 | -394 | -422 |
| <i>Depreciation rate</i> | <i>11,3%</i> | <i>12,2%</i> | <i>13,1%</i> |

| All numbers in MNOK | 2015 | 2014 | 2013 |
|-------------------------------|--------------|--------------|--------------|
| Changes in key figures | | | |
| EBITDA before | 4 083 | 4 357 | 3 899 |
| EBITDA after | 5 960 | 6 162 | 5 769 |
| Difference | 1 877 | 1 805 | 1 869 |
| <i>Difference in %</i> | <i>46,0%</i> | <i>41,4%</i> | <i>47,9%</i> |
| EBIT before | 2 236 | 2 679 | 2 274 |
| EBIT after | 2 640 | 3 073 | 2 695 |
| Difference | 405 | 394 | 422 |
| <i>Difference in %</i> | <i>18,1%</i> | <i>14,7%</i> | <i>18,5%</i> |
| NOPAT before | 1 802 | 1 976 | 1 698 |
| NOPAT after | 2 098 | 2 263 | 2 002 |
| Difference | 295 | 287 | 304 |
| <i>Difference in %</i> | <i>16,4%</i> | <i>14,5%</i> | <i>17,9%</i> |
| Net profit before | 2 361 | 1 930 | 1 793 |
| Net profit after | 2 361 | 1 930 | 1 793 |
| Difference | 0 | 0 | 0 |

11.1.8 Income Statement after capitalization

| Reitangruppen | | | |
|---|--------------|--------------|--------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| Operating revenues | 62 284 | 60 133 | 57 247 |
| Cost of goods sold | -49 987 | -48 614 | -45 748 |
| Salaries | -2 892 | -2 681 | -2 963 |
| Other operating expenses | -3 668 | -3 629 | -3 350 |
| EBITDA | 5 737 | 5 209 | 5 186 |
| Amortization and impairment of immaterial assets | -92 | -77 | -76 |
| Depreciation and impairment of fixed assets | -3 538 | -3 303 | -3 104 |
| OPERATING PROFIT FROM CORE ACTIVITIES (EBIT) | 2 107 | 1 829 | 2 006 |
| Tax items | | | |
| Tax for the year | -680 | -552 | -601 |

| | | | |
|--|--------------|---------------|---------------|
| Tax on net financial items | -211 | -285 | -312 |
| Tax on special items | 483 | 434 | 479 |
| Tax on operating activities | -409 | -403 | -435 |
| NOPAT | 1 699 | 1 426 | 1 572 |
| Non-recurring and non-operating items | | | |
| Other revenue | 1 340 | 1 137 | 960 |
| Net gain (loss) | 55 | 80 | 248 |
| Value change investment property | 155 | 32 | 48 |
| Results from TS and FKV | 238 | 105 | 202 |
| Transition from benefit pension to contribution pension in Rema 1000 | | 252 | 252 |
| Total non-recurring and non-operating items | 1 788 | 1 606 | 1 710 |
| Tax on non-recurring and non-operating items | -483 | -434 | -479 |
| Earnings before interests, after special items | 3 004 | 2 599 | 2 803 |
| Financial income | 37 | 48 | 52 |
| Financial expenses | -757 | -915 | -1 108 |
| Net other financial items | -62 | -187 | -59 |
| Total FINANCIAL ITEMS, NET | -782 | -1 054 | -1 115 |
| Tax on net financial items | 211 | 285 | 312 |
| TOTAL FINANCIAL ITEMS, NET OF TAX | -571 | -770 | -803 |
| | | | |
| PROFIT OF THE PERIOD | 2 433 | 1 829 | 2 000 |
| Other comprehensive income for the period, net of tax | 1 667 | 1 343 | 1 202 |
| TOTAL COMPREHENSIVE INCOME FOR THE PERIOD | 4 100 | 3 172 | 3 202 |
| | | | |
| | 2015 | 2014 | 2013 |
| Marginal Tax Rates | 27 % | 27 % | 28 % |

| NorgesGruppen | | | |
|----------------------------|-------------|-------------|-------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| Net revenue | 72 746 | 68 508 | 64 592 |
| Other revenue | 2 832 | 2 883 | 2 803 |

| | | | |
|---|--------------|--------------|--------------|
| Cost of goods | -56 163 | -52 636 | -49 610 |
| Salaries | -8 885 | -8 363 | -8 110 |
| Other operating expenses | -4 571 | -4 230 | -3 907 |
| EBITDA | 5 960 | 6 162 | 5 769 |
| Depreciation and impairments | -3 319 | -3 090 | -3 073 |
| OPERATING PROFIT FROM CORE ACTIVITIES (EBIT) | 2 640 | 3 073 | 2 695 |
| Tax items | | | |
| Tax for the year | -640 | -686 | -612 |
| Tax on net financial items | -155 | -195 | -183 |
| Tax on special items | 252 | 72 | 101 |
| Tax on operating activities | -543 | -809 | -693 |
| NOPAT | 2 098 | 2 263 | 2 002 |
| Non-recurring and non-operating items | | | |
| Sale of shopping malls to Scala Retail Property AS | 646 | 0 | 0 |
| Income from investments in affiliates | 289 | 266 | 362 |
| Total non-recurring and non-operating items | 935 | 266 | 362 |
| Tax on non-recurring and non-operating items | -252 | -72 | -101 |
| Earnings before interests, after special items | 2 780 | 2 457 | 2 263 |
| Financial income | 145 | 112 | 149 |
| Financial expenses | -719 | -834 | -801 |
| Total FINANCIAL ITEMS, NET | -574 | -722 | -652 |
| Tax on net financial items | 155 | 195 | 183 |
| TOTAL FINANCIAL ITEMS, NET OF TAX | -419 | -527 | -470 |
| | | | |
| PROFIT OF THE PERIOD | 2 361 | 1 930 | 1 793 |
| Other comprehensive income for the period, net of tax | -9 | -79 | -23 |
| TOTAL COMPREHENSIVE INCOME FOR THE PERIOD | 2 352 | 1 851 | 1 770 |
| | | | |
| | 2015 | 2014 | 2013 |
| Marginal Tax Rates | 27 % | 27 % | 28 % |

11.1.9 Balance Sheet after capitalization

| Reitangruppen | | | |
|---|---------------|---------------|---------------|
| TA-FORMAT | | | |
| All numbers in MNOK | 2015 | 2014 | 2013 |
| ONCA (operating non-current assets) | 39 997 | 36 343 | 33 707 |
| OCA (operating current assets) | 10 344 | 9 984 | 10 339 |
| TOTAL OPERATING ASSETS | 50 341 | 46 327 | 44 046 |
| FCA (financial current assets) | 6 577 | 1 398 | 1 708 |
| FNCA (financial non-current assets) | 2 813 | 6 222 | 5 016 |
| TOTAL ASSETS | 59 731 | 53 947 | 50 770 |
| <i>Equity and Liabilities</i> | | | |
| E (equity to majority shareholders) | 17 795 | 14 350 | 11 431 |
| M (equity to minority) | 2 190 | 2 025 | 1 945 |
| P / NCOL | 1 975 | 1 846 | 1 808 |
| NCIBD (non-current interest-bearing debt) | 26 024 | 24 952 | 24 817 |
| CIBD (current interest-bearing debt) | 946 | 1 138 | 1 050 |
| COL (current operating liabilities) | 10 801 | 9 636 | 9 719 |
| TOTAL EQUITY AND LIABILITIES | 59 731 | 53 947 | 50 770 |
| CE-FORMAT | | | |
| All numbers in MNOK | 2015 | 2014 | 2013 |
| <i>Assets</i> | | | |
| NOA (net operating assets) core | 37 565 | 34 845 | 32 519 |
| FA | 9 390 | 7 620 | 6 724 |
| TOTAL | 46 955 | 42 465 | 39 243 |
| <i>Equity and Liabilities</i> | | | |
| E (equity to majority shareholders) | 17 795 | 14 350 | 11 431 |
| M (equity to minority) | 2 190 | 2 025 | 1 945 |
| (NCIBD+CIBD) | 26 970 | 26 090 | 25 867 |
| TOTAL CAPITAL EMPLOYED | 46 955 | 42 465 | 39 243 |
| NOA/IC-FORMAT | | | |
| All numbers in MNOK | 2015 | 2014 | 2013 |
| NOA (NET OPERATING ASSETS) | 37 565 | 34 845 | 32 519 |
| E (equity to majority shareholders) | 17 795 | 14 350 | 11 431 |
| M (equity to minority) | 2 190 | 2 025 | 1 945 |
| Net IBD (Net interest bearing debt) | 17 580 | 18 470 | 19 143 |
| IC (INVESTED CAPITAL) | 37 565 | 34 845 | 32 519 |

| NorgesGruppen | | | |
|---|---------------|---------------|---------------|
| TA-FORMAT | | | |
| All numbers in MNOK | 2015 | 2014 | 2013 |
| ONCA (operating non-current assets) | 34 131 | 31 428 | 29 634 |
| OCA (operating current assets) | 10 397 | 10 435 | 9 333 |
| TOTAL OPERATING ASSETS | 44 528 | 41 863 | 38 967 |
| FCA (financial current assets) | 571 | 464 | 412 |
| FNCA (financial non-current assets) | 3 057 | 2 767 | 2 629 |
| TOTAL ASSETS | 48 157 | 45 093 | 42 008 |
| <i>Equity and Liabilities</i> | | | |
| E (equity to majority shareholders) | 14 574 | 12 763 | 11 221 |
| M (equity to minority) | 245 | 244 | 235 |
| P / NCOL | 1 246 | 1 379 | 1 256 |
| NCIBD (non-current interest-bearing debt) | 19 443 | 17 407 | 16 123 |
| CIBD (current interest-bearing debt) | 116 | 64 | 10 |
| COL (current operating liabilities) | 12 532 | 13 237 | 13 164 |
| TOTAL EQUITY AND LIABILITIES | 48 157 | 45 093 | 42 008 |
| CE-FORMAT | | | |
| All numbers in MNOK | 2015 | 2015 | 2015 |
| <i>Assets</i> | | | |
| NOA (net operating assets) core | 30 750 | 27 247 | 24 547 |
| FA | 3 628 | 3 231 | 3 041 |
| TOTAL | 34 379 | 30 478 | 27 588 |
| <i>Equity and Liabilities</i> | | | |
| E (equity to majority shareholders) | 14 574 | 12 763 | 11 221 |
| M (equity to minority) | 245 | 244 | 235 |
| (NCIBD+CIBD) | 19 559 | 17 470 | 16 133 |
| TOTAL CAPITAL EMPLOYED | 34 379 | 30 478 | 27 588 |
| NOA/IC-FORMAT | | | |
| All numbers in MNOK | 2015 | 2015 | 2015 |
| NOA (NET OPERATING ASSETS) | 30 750 | 27 247 | 24 547 |
| E (equity to majority shareholders) | 14 574 | 12 763 | 11 221 |
| M (equity to minority) | 245 | 244 | 235 |
| Net IBD (Net interest bearing debt) | 15 931 | 14 240 | 13 092 |
| IC (INVESTED CAPITAL) | 30 750 | 27 247 | 24 547 |

11.1.10 Cash Flow Statement after capitalization

| Reitangruppen | | | |
|---|---------------|---------------|---------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| CASH FLOW FROM OPERATING ACTIVITIES | | | |
| EBT net of operating lease expenses | 6 096 | 5 188 | 5 312 |
| Tax paid | -409 | -491 | -472 |
| Amortization and impairment of intangible assets | 1 024 | 1 027 | 1 068 |
| Depreciation and impairment of tangible assets | 2 606 | 2 353 | 2 590 |
| Results from TS and FKV | -238 | -105 | -202 |
| Net gain/loss extr. ord. exchange gain/loss from operations | 23 | -55 | -248 |
| Revaluation investment property | -155 | -32 | -48 |
| CASH FLOW BEFORE CHANGES IN WORKING CAPITAL | 8 947 | 7 885 | 8 000 |
| Changes in pensions | -10 | -299 | 12 |
| Inventory | 224 | 573 | -589 |
| Trade receivables and other receivables | -663 | -383 | 256 |
| Trade payables and other debt | 1 045 | -84 | 1 208 |
| CASH FLOW FROM CONTINUING OPERATIONS (A) | 9 543 | 7 692 | 8 887 |
| CASH FLOW FROM INVESTING ACTIVITIES | | | |
| Purchase of intangible assets | -324 | -177 | -127 |
| Sale of intangible assets | 4 | 1 | 12 |
| Purchase of investment property | -1 556 | -826 | -916 |
| Sale of investment property | 270 | 104 | 74 |
| Purchase of tangible assets | -1 518 | -1 067 | -1 379 |
| Sale of tangible assets | 126 | 85 | 80 |
| Purchase of TS and FKV | -177 | -400 | -542 |
| Sale of TS and FKV | 29 | 344 | 180 |
| Sale of financial investments | 0 | -9 | -16 |
| Payments on receivables on parent company | 10 | 37 | 490 |
| Dividend received | 235 | 264 | 148 |
| Recognized dividends from financial investments | -139 | -121 | -104 |
| CASH FLOW FROM INVESTING ACTIVITIES (B) | -3 040 | -1 765 | -2 100 |

| | | | |
|---|---------------|---------------|---------------|
| FREE CASH FLOW (A + B) | 6 503 | 5 927 | 6 787 |
| CASH FLOW FROM FINANCING ACTIVITIES | | | |
| New debt | 963 | 1 194 | 1 073 |
| Repayment of debt | -1 414 | -2 344 | -1 332 |
| Dividend to shareholders | -275 | -176 | -139 |
| Dividend paid to non-controllable interests in subsidiary | -20 | -20 | -15 |
| Interest paid | -267 | -358 | -472 |
| Interest received | 37 | 48 | 52 |
| Net financial items | 313 | 523 | 440 |
| Increase in financial expenses | -469 | -531 | -675 |
| Increase in repayments on financial leases | -5 027 | -4 552 | -4 549 |
| CASH FLOW FROM FINANCING ACTIVITIES (C) | -6 159 | -6 216 | -5 617 |
| CHANGE IN CASH AND CASH EQUIVALENTS (A+B+C) | | | |
| | 343 | -289 | 1 169 |

| NorgesGruppen | | | |
|--|--------------|--------------|--------------|
| All numbers in MNOK | 2015 | 2014 | 2013 |
| CASH FLOW FROM OPERATING ACTIVITIES | | | |
| EBT net of operating lease expenses | 4 877 | 4 421 | 4 274 |
| Tax paid | -590 | -546 | -555 |
| Depreciation | 3 136 | 2 981 | 2 878 |
| Impairment | 184 | 109 | 195 |
| Revaluation of financial instruments | 14 | -5 | -12 |
| Pension cost without cash effect | 13 | 7 | -8 |
| Revenue on investments in associates | -289 | -266 | -362 |
| Dividend received from associates | 196 | 206 | 143 |
| CASH FLOW BEFORE CHANGES IN WORKING CAPITAL | 7 542 | 6 906 | 6 553 |
| Changes in inventory | -492 | -425 | -352 |
| Changes in trade receivables | -71 | -216 | -103 |
| Changes in trade payables | -491 | 824 | 660 |
| Changes in other accruals | 691 | -632 | -551 |

| | | | |
|---|---------------|---------------|---------------|
| CASH FLOW FROM CONTINUING OPERATIONS (A) | 7 179 | 6 458 | 6 207 |
| CASH FLOW FROM INVESTING ACTIVITIES | | | |
| Payments on sale of tangible assets and investment property | 1 106 | 165 | 243 |
| Payments on sale of intangible assets | | | 3 |
| Payments on purchase of tangible assets and investment property | -3 435 | -2 844 | -2 598 |
| Payments on purchase of intangible assets | -329 | -40 | -43 |
| Payments on sale of financial non-current assets | 153 | 220 | 370 |
| Payments on purchase of financial non-current assets | -352 | -247 | -833 |
| Changes in debt to associates | -229 | -179 | -323 |
| Loss/gain on sale of operating assets and financial assets | -166 | 6 | -38 |
| Changes in long-term receivables | -128 | -58 | -87 |
| CASH FLOW FROM INVESTING ACTIVITIES (B) | -3 378 | -2 977 | -3 305 |
| FREE CASH FLOW (A + B) | 3 801 | 3 481 | 2 902 |
| CASH FLOW FROM FINANCING ACTIVITIES | | | |
| Payments on new long-term debt | 5 512 | 2 185 | 1 440 |
| Repayment on long-term debt | -5 024 | -1 152 | -634 |
| Changes in short-term debt | -286 | -1 002 | 14 |
| Purchase of own shares | -16 | -48 | -86 |
| Dividend | -524 | -251 | -451 |
| Increase in financial expenses | -405 | -394 | -422 |
| Increase in repayments on financial leases | -2 944 | -2 823 | -2 896 |
| CASH FLOW FROM FINANCING ACTIVITIES (C) | -3 686 | -3 485 | -3 034 |
| CHANGE IN CASH AND CASH EQUIVALENTS (A+B+C) | 115 | -3 | -131 |

11.1.11 Ratios before and after capitalization

Reitangruppen

| ROE | 2015 | 2014 | 2013 |
|-----|------|------|------|
| | | | |

| | | | |
|-------------------------------------|----------------|----------------|----------------|
| PROFIT OF THE PERIOD | 2 433 | 1 829 | 2 000 |
| Book value of equity incl. minority | 19 985 | 16 375 | 13 376 |
| ROE | 13,38 % | 12,30 % | 16,92 % |

| | Before capitalization of leases | | | After capitalization of leases | | | Change in % after capitalization (in comparable years) | | |
|---|---------------------------------|---------------|---------------|--------------------------------|---------------|---------------|--|--------------|--------------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| Operating revenues | 62 284 | 60 133 | 57 247 | 62 284 | 60 133 | 57 247 | - | - | - |
| NIBD | -1 875 | 259 | 2 480 | 17 580 | 18 470 | 19 143 | 1038 % | 7031 % | 672 % |
| Invested capital (NIBD + Equity) | 18 110 | 16 634 | 15 856 | 37 565 | 34 845 | 32 519 | 107 % | 109 % | 105 % |
| Invested capital (tot. op. ass. - tot. op. lia) | 18 110 | 16 634 | 15 856 | 37 565 | 34 845 | 32 519 | | | |
| NOPAT | 1 356 | 1 038 | 1 086 | 1 699 | 1 426 | 1 572 | 25 % | 37 % | 45 % |
| ROIC | 7,49 % | 6,24 % | 6,85 % | 4,52 % | 4,09 % | 4,83 % | -40 % | -34 % | -29 % |
| Profit margin (PM) | 2,18 % | 1,73 % | 1,90 % | 2,73 % | 2,37 % | 2,75 % | 25 % | 37 % | 45 % |
| ATO | 344 % | 362 % | 361 % | 166 % | 173 % | 176 % | -52 % | -52 % | -51 % |
| ROIC | 7,49 % | 6,24 % | 6,85 % | 4,52 % | 4,09 % | 4,83 % | -40 % | -34 % | -29 % |

| | Before capitalization of leases | | | After capitalization of leases | | | Change in % after capitalization (in comparable years) | | |
|------------------|---------------------------------|---------------|---------------|--------------------------------|---------------|---------------|--|--------------|--------------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| EBIT | 1 638 | 1 298 | 1 331 | 2 107 | 1 829 | 2 006 | 29 % | 41 % | 51 % |
| Capital employed | 27 500 | 24 254 | 22 580 | 46 955 | 42 465 | 39 243 | 71 % | 75 % | 74 % |
| ROCE | 5,96 % | 5,35 % | 5,89 % | 4,49 % | 4,31 % | 5,11 % | -25 % | -20 % | -13 % |

| | Before capitalization of leases | | | After capitalization of leases | | | Change in % after capitalization (in comparable years) | | |
|-------|---------------------------------|--------|--------|--------------------------------|--------|--------|--|--------|-------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| NIBD= | -1 875 | 259 | 2 480 | 17 580 | 18 470 | 19 143 | 1038 % | 7031 % | 672 % |
| BVE= | 19 985 | 16 375 | 13 376 | 19 985 | 16 375 | 13 376 | - | - | - |

| | | | | | | | | | |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| r_d= | 2,40 % | 2,90 % | 4,00 % | 2,40 % | 2,90 % | 4,00 % | - | - | - |
| Tax= | 27 % | 27 % | 28 % | 27 % | 27 % | 28 % | - | - | - |
| r_e = r_f + Beta_eq * (r_m - r_f) | 4,70 % | 5,67 % | 6,20 % | 8,05 % | 9,12 % | 9,99 % | 72 % | 61 % | 61 % |
| Beta UL= | 0,69 | 0,62 | 0,61 | 0,69 | 0,62 | 0,61 | - | - | - |
| Beta levered = Beta UL * (1 + NIBD/eq)= | 0,63 | 0,63 | 0,72 | 1,30 | 1,32 | 1,48 | 107 % | 109 % | 105 % |
| MRP= | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % | - | - | - |
| r_f= | 1,57 % | 2,52 % | 2,58 % | 1,57 % | 2,52 % | 2,58 % | - | - | - |
| WACC= | 5,00 % | 5,61 % | 5,68 % | 5,11 % | 5,41 % | 5,81 % | 2 % | -4 % | 2 % |
| ROIC | 7,49 % | 6,24 % | 6,85 % | 4,52 % | 4,09 % | 4,83 % | -40 % | -34 % | -29 % |
| WACC | 5,00 % | 5,61 % | 5,68 % | 5,11 % | 5,41 % | 5,81 % | 2 % | -4 % | 2 % |
| IC | 18 110 | 16 634 | 15 856 | 37 565 | 34 845 | 32 519 | 107 % | 109 % | 105 % |
| EVA = (ROIC - WACC) * IC | 451 | 105 | 185 | (219) | (458) | (316) | -149 % | -537 % | -271 % |

NorgesGruppen

| ROE | 2015 | 2014 | 2013 |
|-------------------------------------|----------------|----------------|----------------|
| PROFIT OF THE PERIOD | 2 361 | 1 930 | 1 793 |
| Book value of equity incl. minority | 14 820 | 13 007 | 11 455 |
| ROE | 15,93 % | 14,84 % | 15,65 % |

| | Before capitalization of leases | | | After capitalization of leases | | | Change in % | | |
|------------------|---------------------------------|----------------|----------------|--------------------------------|----------------|---------------|--------------|--------------|--------------|
| ROCE | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| EBIT | 2 236 | 2 679 | 2 274 | 2 640 | 3 073 | 2 695 | 18 % | 15 % | 19 % |
| Capital employed | 21 764 | 19 330 | 875 | 34 379 | 478 | 27 588 | 58 % | 58 % | 63 % |
| ROCE | 10,27 % | 13,86 % | 13,47 % | 7,68 % | 10,08 % | 9,77 % | -25 % | -27 % | -27 % |
| | Before capitalization of leases | | | After capitalization of leases | | | Change in % | | |
| ROIC | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| Net revenues | 75 578 | 71 391 | 67 396 | 75 578 | 71 391 | 67 396 | - | - | - |

| | | | | | | | | | |
|---|---------------|----------------|----------------|---------------|---------------|---------------|--------------|--------------|--------------|
| NIBD | 3 316 | 3 092 | 2 379 | 15 931 | 14 240 | 13 092 | 380 % | 360 % | 450 % |
| Invested capital (NIBD + Equity) | 18 136 | 16 100 | 13 834 | 30 750 | 27 247 | 24 547 | 70 % | 69 % | 77 % |
| Invested capital (tot. op. ass. - tot. op. lia) | 18 136 | 16 100 | 13 834 | 30 750 | 27 247 | 24 547 | 70 % | 69 % | 77 % |
| NOPAT | 1 802 | 1 976 | 1 698 | 2 098 | 2 263 | 2 002 | 16 % | 15 % | 18 % |
| Total ROIC | 9,94 % | 12,27 % | 12,28 % | 6,82 % | 8,31 % | 8,16 % | -31 % | -32 % | -34 % |
| Profit margin (PM) core | 2,38 % | 2,77 % | 2,52 % | 2,78 % | 3,17 % | 2,97 % | 16 % | 15 % | 18 % |
| ATO | 416,73 % | % | % | 246 % | 262 % | 275 % | -41 % | -41 % | -44 % |
| ROIC | 9,94 % | 12,27 % | 12,28 % | 6,82 % | 8,31 % | 8,16 % | -31 % | -32 % | -34 % |

| | Before capitalization of leases | | | After capitalization of leases | | | Change in % | | |
|--|---------------------------------|---------------|---------------|--------------------------------|---------------|---------------|--------------|--------------|--------------|
| | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 | 2015 | 2014 | 2013 |
| NIBD= | 3 316 | 3 092 | 2 379 | 15 931 | 14 240 | 13 092 | 380 % | 360 % | 450 % |
| BVE= | 14 574 | 12 763 | 11 221 | 14 574 | 12 763 | 11 221 | - | - | - |
| r_d*= | 3,10 % | 3,40 % | 3,80 % | 3,10 % | 3,40 % | 3,80 % | - | - | - |
| Tax= | 27 % | 27 % | 28 % | 27 % | 27 % | 28 % | - | - | - |
| r_e = | 5,80 % | 6,37 % | 6,28 % | 8,79 % | 9,08 % | 9,19 % | 51 % | 42 % | 46 % |
| Beta UL= | 0,69 | 0,62 | 0,61 | 0,69 | 0,62 | 0,61 | - | - | - |
| Beta levered = Beta UL * (1 + NIBD/eq)= | 0,85 | 0,77 | 0,74 | 1,44 | 1,31 | 1,32 | 71 % | 70 % | 79 % |
| MRP*= | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % | - | - | - |
| r_f*= | 1,57 % | 2,52 % | 2,58 % | 1,57 % | 2,52 % | 2,58 % | - | - | - |
| WACC = | 5,15 % | 5,61 % | 5,66 % | 5,38 % | 5,60 % | 5,71 % | 5 % | 0 % | 1 % |
| ROIC | 9,94 % | 12,27 % | 12,28 % | 6,82 % | 8,31 % | 8,16 % | -31 % | -32 % | -34 % |
| WACC | 5,15 % | 5,61 % | 5,66 % | 5,38 % | 5,60 % | 5,71 % | 5 % | 0 % | 1 % |
| IC (Yearly average) | 18 136 | 16 100 | 13 834 | 30 750 | 27 247 | 24 547 | 70 % | 69 % | 77 % |
| EVA = (ROIC - WACC) * IC | 869 | 1 072 | 916 | 443 | 738 | 599 | -49 % | -31 % | -35 % |

11.1.12 Forecasting – Dynamic (IAS 17)

| NorgesGruppen | | | | | | |
|---|---------------------------|--------------|--------------|---------------------|--------------|--------------|
| All numbers in MNOK | DYNAMIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| FORECAST INCOME | | | | | | |
| STATEMENT | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| Net revenue | 90 364 | 83 285 | 77 475 | 72 746 | 68 508 | 64 592 |
| Other revenue | 4 369 | 3 711 | 3 212 | 2 832 | 2 883 | 2 803 |
| Cost of goods | -69 581 | -64 130 | -59 655 | -56 163 | -52 636 | -49 610 |
| Salaries | -11 024 | -10 161 | -9 452 | -8 885 | -8 363 | -8 110 |
| Other operating expenses | -8 009 | -7 382 | -6 867 | -6 448 | -6 035 | -5 777 |
| EBITDA | 6 120 | 5 325 | 4 712 | 4 083 | 4 357 | 3 899 |
| Depreciation and impairments | -2 549 | -2 265 | -2 030 | -1 847 | -1 678 | -1 625 |
| OPERATING PROFIT FROM CORE ACTIVITIES (EBIT) | 3 571 | 3 059 | 2 683 | 2 236 | 2 679 | 2 274 |
| Tax items | | | | | | |
| Tax for the year | -1 155 | -1 025 | -930 | -640 | -686 | -612 |
| Tax on net financial items | -122 | -90 | -63 | -46 | -89 | -65 |
| Tax on special items | 313 | 289 | 269 | 252 | 72 | 101 |
| Tax on operating activities | -964 | -826 | -724 | -433 | -703 | -575 |
| NOPAT | 2 607 | 2 233 | 1 958 | 1 802 | 1 976 | 1 698 |
| Non-recurring and non-operating items | | | | | | |
| Income from investments in affiliates | | | | 289 | 266 | 362 |
| Sale of shopping malls to Scala Retail Property AS | | | | 646 | 0 | 0 |
| Total non-recurring and non-operating items | 1 161 | 1 070 | 995 | 935 | 266 | 362 |
| Tax on non-recurring and non-operating items | -313 | -289 | -269 | -252 | -72 | -101 |
| Earnings before interests, after special items | 3 454 | 3 015 | 2 685 | 2 484 | 2 170 | 1 959 |
| Financial income | 180 | 166 | 155 | 145 | 112 | 149 |
| Financial expenses | -633 | -500 | -387 | -314 | -441 | -380 |
| Total FINANCIAL ITEMS, NET | -452 | -334 | -233 | -169 | -328 | -231 |
| Tax on net financial items | 122 | 90 | 63 | 46 | 89 | 65 |

| | | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|--------------|
| TOTAL FINANCIAL ITEMS, NET OF TAX | -330 | -244 | -170 | -124 | -240 | -166 |
| | | | | | | |
| PROFIT OF THE PERIOD | 3 124 | 2 771 | 2 515 | 2 361 | 1 930 | 1 793 |
| | | | 2 015 | 2 014 | 2 013 | |
| Marginal Tax Rates | 27 % | 27 % | 27 % | 27 % | 27 % | 28 % |

| Forecasted Balance sheet (TA format) | | | | | | |
|---|---------------|---------------|---------------|----------------------------|---------------|---------------|
| All numbers in MNOK | F2018 | F2017 | F2016 | 2 015 | 2 014 | 2 013 |
| ONCA (operating non-current assets) | 27 903 | 25 090 | 22 784 | 21 079 | 19 849 | 18 540 |
| OCA (operating current assets) | 12 909 | 11 898 | 11 068 | 10 397 | 10 435 | 9 333 |
| TOTAL OPERATING ASSETS | 40 812 | 36 988 | 33 852 | 31 476 | 30 284 | 27 873 |
| FCA (financial current assets) | 786 | 699 | 605 | 571 | 464 | 412 |
| FNCA (financial non-current assets) | 4 455 | 3 962 | 3 430 | 3 057 | 2 767 | 2 629 |
| TOTAL ASSETS | 46 054 | 41 649 | 37 887 | 35 104 | 33 515 | 30 914 |
| <i>Equity and Liabilities</i> | | | | | | |
| E (equity to majority shareholders) | 20 461 | 18 274 | 16 335 | 14 574 | 12 763 | 11 221 |
| M (equity to minority) | 345 | 308 | 275 | 245 | 244 | 235 |
| P / NCOL | 1 004 | 925 | 861 | 808 | 948 | 876 |
| NCIBD (non-current interest-bearing debt) | 9 040 | 8 128 | 7 381 | 6 829 | 6 259 | 5 410 |
| CIBD (current interest-bearing debt) | 143 | 132 | 123 | 116 | 64 | 10 |
| COL (current operating liabilities) | 15 061 | 13 881 | 12 912 | 12 532 | 13 237 | 13 164 |
| TOTAL EQUITY AND LIABILITIES | 46 054 | 41 649 | 37 887 | 35 104 | 33 515 | 30 914 |
| FORECASTED GROWTH / RATIOS | | | | HISTORICAL NUMBERS: | | |
| All numbers in MNOK | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |

| | | | | | | |
|--|------------------------------------|-------------|-------------|----------------------------|-------------|-------------|
| ATO ONCA | 3,24 | 3,32 | 3,40 | 3,45 | 3,45 | 3,48 |
| ATO OCA | 7,00 | 7,00 | 7,00 | 7,00 | 6,57 | 6,92 |
| Provisions | 1 004 | 925 | 861 | 808 | 948 | 876 |
| ATO COL | 6,00 | 6,00 | 6,00 | 5,80 | 5,18 | 4,91 |
| Dividend | -937 | -831 | -755 | -605 | -524 | -509 |
| Payout ratio | 30 % | 30 % | 30 % | 26 % | 27 % | 28 % |
| FORECASTED | | | | | | |
| GROWTH / RATIOS (All percentages in absolute values) | REALISTIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| Net sales growth | 8,5% | 7,5% | 6,5% | 6,2% | 6,1% | 4,0% |
| Other revenue (margin) | 4,8% | 4,5% | 4,1% | 3,9% | 4,2% | 4,3% |
| COGS (margin) | 77,0% | 77,0% | 77,0% | 77,2% | 76,8% | 76,8% |
| Salaries (margin) | 12,2% | 12,2% | 12,2% | 12,2% | 12,2% | 12,6% |
| Other operating expenses (margin) | 8,9% | 8,9% | 8,9% | 8,9% | 8,8% | 8,9% |
| Depreciation and impairments (margin) | 2,8% | 2,7% | 2,6% | 2,5% | 2,4% | 2,5% |
| EBIT (margin) | 4,0% | 3,7% | 3,5% | 3,1% | 3,9% | 3,5% |
| NOPAT (margin) | 2,9% | 2,7% | 2,5% | 2,5% | 2,9% | 2,6% |
| Total NR and NO items (margin) | 1,28 % | 1,28 % | 1,28 % | 1,28 % | 0,39 % | 0,56 % |
| Financial income (margin) | 0,2% | 0,2% | 0,2% | 0,2% | 0,2% | 0,2% |
| Financial expenses (margin) | 0,7% | 0,6% | 0,5% | 0,4% | 0,6% | 0,6% |
| Profit margin | 3,5% | 3,3% | 3,2% | 3,2% | 2,8% | 2,8% |

11.1.13 Forecasting – Dynamic (IFRS 16)

| NorgesGruppen | | | | | | |
|--------------------------|----------------------------------|--------------|--------------|----------------------------|--------------|--------------|
| All numbers in MNOK | DYNAMIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| FORECAST INCOME | | | | | | |
| STATEMENT | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| Net revenue | 90 364 | 83 285 | 77 475 | 72 746 | 68 508 | 64 592 |
| Other revenue | 4 369 | 3 711 | 3 212 | 2 832 | 2 883 | 2 803 |
| Cost of goods | -69 581 | -64 130 | -59 655 | -56 163 | -52 636 | -49 610 |
| Salaries | -11 024 | -10 161 | -9 452 | -8 885 | -8 363 | -8 110 |
| Other operating expenses | -5 678 | -5 233 | -4 868 | -4 571 | -4 230 | -3 907 |
| EBITDA | 8 451 | 7 473 | 6 711 | 5 960 | 6 162 | 5 769 |

| | | | | | | |
|---|--------------|--------------|--------------|--------------|--------------|--------------|
| Depreciation and impairments | -4 428 | -3 998 | -3 641 | -3 319 | -3 090 | -3 073 |
| OPERATING PROFIT FROM CORE ACTIVITIES (EBIT) | 4 023 | 3 476 | 3 070 | 2 640 | 3 073 | 2 695 |
| Tax items | | | | | | |
| Tax for the year | -1 156 | -1 025 | -930 | -640 | -686 | -612 |
| Tax on net financial items | -244 | -203 | -167 | -155 | -195 | -183 |
| Tax on special items | 313 | 289 | 269 | 252 | 72 | 101 |
| Tax on operating activities | -1 086 | -938 | -829 | -543 | -809 | -693 |
| NOPAT | 2 937 | 2 537 | 2 241 | 2 098 | 2 263 | 2 002 |
| Non-recurring and non-operating items | | | | | | |
| Income from investments in affiliates | | | | 289 | 266 | 362 |
| Sale of shopping malls to Scala Retail Property AS | | | | 646 | 0 | 0 |
| Total non-recurring and non-operating items | 1 161 | 1 070 | 995 | 935 | 266 | 362 |
| Tax on non-recurring and non-operating items | -313 | -289 | -269 | -252 | -72 | -101 |
| Earnings before interests, after special items | 3 784 | 3 318 | 2 967 | 2 780 | 2 457 | 2 263 |
| Financial income | 180 | 166 | 155 | 145 | 112 | 149 |
| Financial expenses | -1 084 | -916 | -775 | -719 | -834 | -801 |
| Total FINANCIAL ITEMS, NET | -904 | -750 | -620 | -574 | -722 | -652 |
| Tax on net financial items | 244 | 203 | 167 | 155 | 195 | 183 |
| TOTAL FINANCIAL ITEMS, NET OF TAX | -660 | -548 | -453 | -419 | -527 | -470 |
| | | | | | | |
| PROFIT OF THE PERIOD | 3 124 | 2 771 | 2 515 | 2 361 | 1 930 | 1 793 |
| | | | | | | |
| Marginal Tax Rates | 27 % | 27 % | 27 % | 27 % | 27 % | 28 % |

| Forecasted | | | | | | |
|---|----------------------------------|---------------|---------------|----------------------------|---------------|---------------|
| Balance sheet (TA format) | | | | | | |
| All numbers in MNOK | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| ONCA (operating non-current assets) | 45 182 | 40 627 | 36 893 | 34 131 | 31 428 | 29 634 |
| OCA (operating current assets) | 12 909 | 11 898 | 11 068 | 10 397 | 10 435 | 9 333 |
| TOTAL OPERATING ASSETS | 58 091 | 52 525 | 47 960 | 44 528 | 41 863 | 38 967 |
| FCA (financial current assets) | 781 | 696 | 604 | 571 | 464 | 412 |
| FNCA (financial non-current assets) | 4 424 | 3 945 | 3 424 | 3 057 | 2 767 | 2 629 |
| TOTAL ASSETS | 63 297 | 57 165 | 51 989 | 48 157 | 45 093 | 42 008 |
| <i>Equity and Liabilities</i> | | | | | | |
| E (equity to majority shareholders) | 20 461 | 18 274 | 16 335 | 14 574 | 12 763 | 11 221 |
| M (equity to minority) | 345 | 308 | 275 | 245 | 244 | 235 |
| P / NCOL | 1 548 | 1 427 | 1 327 | 1 246 | 1 379 | 1 256 |
| NCIBD (non-current interest-bearing debt) | 25 739 | 23 144 | 21 017 | 19 443 | 17 407 | 16 123 |
| CIBD (current interest-bearing debt) | 143 | 132 | 123 | 116 | 64 | 10 |
| COL (current operating liabilities) | 15 061 | 13 881 | 12 912 | 12 532 | 13 237 | 13 164 |
| TOTAL EQUITY AND LIABILITIES | 63 297 | 57 165 | 51 989 | 48 157 | 45 093 | 42 008 |
| FORECASTED | | | | | | |
| GROWTH / RATIOS | DYNAMIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| All numbers in MNOK | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| ATO ONCA | 2,00 | 2,05 | 2,10 | 2,13 | 2,18 | 2,18 |
| ATO OCA | 7,00 | 7,00 | 7,00 | 7,00 | 6,57 | 6,92 |
| Provisions | 1 548 | 1 427 | 1 327 | 1 246 | 1 379 | 1 256 |
| ATO COL | 6,00 | 6,00 | 6,00 | 5,80 | 5,18 | 4,91 |
| Dividend | -937 | -831 | -754 | -605 | -524 | -509 |
| Payout ratio | 30 % | 30 % | 30 % | 26 % | 27 % | 28 % |
| FORECASTED | | | | | | |
| | DYNAMIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |

| GROWTH / RATIOS | | | | | | |
|---|--------------|--------------|--------------|-------------|-------------|-------------|
| (All percentages in absolute values) | | | | | | |
| | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| Net sales growth | 8,5% | 7,5% | 6,5% | 6,2% | 6,1% | 4,0% |
| Other revenue (margin) | 4,8% | 4,5% | 4,1% | 3,9% | 4,2% | 4,3% |
| COGS (margin) | 77,0% | 77,0% | 77,0% | 77,2% | 76,8% | 76,8% |
| Salaries (margin) | 12,2% | 12,2% | 12,2% | 12,2% | 12,2% | 12,6% |
| Other operating expenses (margin) | 6,3% | 6,3% | 6,3% | 6,3% | 6,2% | 6,0% |
| Depreciation and impairments (margin) | 4,9% | 4,8% | 4,7% | 4,6% | 4,5% | 4,8% |
| EBIT (margin) | 4,5% | 4,2% | 4,0% | 3,6% | 4,5% | 4,2% |
| NOPAT (margin) | 3,2% | 3,0% | 2,9% | 2,9% | 3,3% | 3,1% |
| Total NR and NO items (margin) | 1,28 % | 1,28 % | 1,28 % | 1,28 % | 0,39 % | 0,56 % |
| Financial income (margin) | 0,2% | 0,2% | 0,2% | 0,2% | 0,2% | 0,2% |
| Financial expenses (margin) | 1,2% | 1,1% | 1,0% | 1,0% | 1,2% | 1,2% |
| Profit margin | 3,5% | 3,3% | 3,2% | 3,2% | 2,8% | 2,8% |

11.1.14 Forecasting – Static (IAS 17)

| NorgesGruppen | | | | | | |
|---|---------------------------------|--------------|--------------|----------------------------|--------------|--------------|
| All numbers in MNOK | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| FORECAST INCOME | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| STATEMENT | | | | | | |
| Net revenue | 78 340 | 76 429 | 74 565 | 72 746 | 68 508 | 64 592 |
| Other revenue | 3 284 | 3 125 | 2 975 | 2 832 | 2 883 | 2 803 |
| Cost of goods | -60 322 | -58 850 | -57 415 | -56 163 | -52 636 | -49 610 |
| Salaries | -9 557 | -9 324 | -9 097 | -8 885 | -8 363 | -8 110 |
| Other operating expenses | -6 943 | -6 774 | -6 609 | -6 448 | -6 035 | -5 777 |
| EBITDA | 4 801 | 4 606 | 4 419 | 4 083 | 4 357 | 3 899 |
| Depreciation and impairments | -2 023 | -1 974 | -1 926 | -1 847 | -1 678 | -1 625 |
| OPERATING PROFIT FROM CORE ACTIVITIES (EBIT) | 2 778 | 2 632 | 2 493 | 2 236 | 2 679 | 2 274 |
| Tax items | | | | | | |
| Tax for the year | -979 | -934 | -891 | -640 | -686 | -612 |
| Tax on net financial items | -42 | -41 | -40 | -46 | -89 | -65 |

| | | | | | | |
|---|--------------|--------------|--------------|--------------|--------------|--------------|
| Tax on special items | 272 | 265 | 259 | 252 | 72 | 101 |
| Tax on operating activities | -750 | -711 | -673 | -433 | -703 | -575 |
| NOPAT | 2 028 | 1 921 | 1 820 | 1 802 | 1 976 | 1 698 |
| Non-recurring and non-operating items | | | | | | |
| Sale of shopping malls to Scala Retail Property AS | | | | 289 | 266 | 362 |
| Income from investments in affiliates | | | | 646 | 0 | 0 |
| Total non-recurring and non-operating items | 1 006 | 982 | 958 | 935 | 266 | 362 |
| Tax on non-recurring and non-operating items | -272 | -265 | -259 | -252 | -72 | -101 |
| Earnings before interests, after special items | 2 763 | 2 638 | 2 519 | 2 484 | 2 170 | 1 959 |
| Financial income | 156 | 152 | 149 | 145 | 112 | 149 |
| Financial expenses | -313 | -306 | -298 | -314 | -441 | -380 |
| Total FINANCIAL ITEMS, NET | -157 | -153 | -150 | -169 | -328 | -231 |
| Tax on net financial items | 42 | 41 | 40 | 46 | 89 | 65 |
| TOTAL FINANCIAL ITEMS, NET OF TAX | -115 | -112 | -109 | -124 | -240 | -166 |
| | | | | | | |
| PROFIT OF THE PERIOD | 2 648 | 2 526 | 2 410 | 2 361 | 1 930 | 1 793 |
| | | | | | | |
| Marginal Tax Rates | 27 % | 27 % | 27 % | 27 % | 27 % | 28 % |
| | | | | | | |
| Forecasted Balance sheet (TA format) | | | | | | |
| All numbers in MNOK | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| ONCA (operating non-current assets) | 22 707 | 22 153 | 21 613 | 21 079 | 19 849 | 18 540 |
| OCA (operating current assets) | 11 191 | 10 918 | 10 652 | 10 397 | 10 435 | 9 333 |

| | | | | | | |
|---|---------------------------------|---------------|---------------|----------------------------|---------------|---------------|
| TOTAL OPERATING ASSETS | 33 899 | 33 072 | 32 265 | 31 476 | 30 284 | 27 873 |
| FCA (financial current assets) | 1 159 | 922 | 697 | 571 | 464 | 412 |
| FNCA (financial non-current assets) | 6 568 | 5 225 | 3 949 | 3 057 | 2 767 | 2 629 |
| TOTAL ASSETS | 41 626 | 39 219 | 36 911 | 35 104 | 33 515 | 30 914 |
| <i>Equity and Liabilities</i> | | | | | | |
| E (equity to majority shareholders) | 19 883 | 18 029 | 16 261 | 14 574 | 12 763 | 11 221 |
| M (equity to minority) | 335 | 304 | 274 | 245 | 244 | 235 |
| P / NCOL | 870 | 849 | 828 | 808 | 948 | 876 |
| NCIBD (non-current interest-bearing debt) | 7 356 | 7 177 | 7 002 | 6 829 | 6 259 | 5 410 |
| CIBD (current interest-bearing debt) | 124 | 121 | 118 | 116 | 64 | 10 |
| COL (current operating liabilities) | 13 057 | 12 738 | 12 427 | 12 532 | 13 237 | 13 164 |
| TOTAL EQUITY AND LIABILITIES | 41 626 | 39 219 | 36 911 | 35 104 | 33 515 | 30 914 |
| FORECASTED | | | | | | |
| GROWTH / RATIOS | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| All numbers in MNOK | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| ATO ONCA | 3,45 | 3,45 | 3,45 | 3,45 | 3,45 | 3,48 |
| ATO OCA | 7,00 | 7,00 | 7,00 | 7,00 | 6,57 | 6,92 |
| Provisions | 870 | 849 | 828 | 808 | 948 | 876 |
| ATO COL | 6,00 | 6,00 | 6,00 | 5,80 | 5,18 | 4,91 |
| Dividend | -794 | -758 | -723 | -605 | -524 | -509 |
| Payout ratio | 30 % | 30 % | 30 % | 26 % | 27 % | 28 % |
| FORECASTED | | | | | | |
| GROWTH / RATIOS | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| (All percentages in absolute values) | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| Net sales growth | 2,5% | 2,5% | 2,5% | 6,2% | 6,1% | 4,0% |
| Other revenue (margin) | 4,2% | 4,1% | 4,0% | 3,9% | 4,2% | 4,3% |
| COGS (margin) | 77,0% | 77,0% | 77,0% | 77,2% | 76,8% | 76,8% |
| Salaries (margin) | 12,2% | 12,2% | 12,2% | 12,2% | 12,2% | 12,6% |
| Other operating expenses (margin) | 8,9% | 8,9% | 8,9% | 8,9% | 8,8% | 8,9% |
| Depreciation and impairments (margin) | 2,6% | 2,6% | 2,6% | 2,5% | 2,4% | 2,5% |

| | | | | | | |
|-----------------------------------|--------|--------|--------|--------|--------|--------|
| EBIT (margin) | 3,5% | 3,4% | 3,3% | 3,1% | 3,9% | 3,5% |
| NOPAT (margin) | 2,6% | 2,5% | 2,4% | 2,5% | 2,9% | 2,6% |
| Total NR and NO items (margin) | 1,28 % | 1,28 % | 1,28 % | 1,28 % | 0,39 % | 0,56 % |
| Financial income (margin) | 0,2% | 0,2% | 0,2% | 0,2% | 0,2% | 0,2% |
| Financial expenses (margin) | 0,4% | 0,4% | 0,4% | 0,4% | 0,6% | 0,6% |
| Profit margin | 3,4% | 3,3% | 3,2% | 3,2% | 2,8% | 2,8% |

11.1.15 Forecast – Static (IFRS 16)

| NorgesGruppen | | | | | | | |
|---|--------------|--------------------------|--------------|--------------|---------------------|--------------|--|
| All numbers in MNOK | | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| FORECAST INCOME | | | | | | | |
| STATEMENT | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 | |
| Net revenue | 78 340 | 76 429 | 74 565 | 72 746 | 68 508 | 64 592 | |
| Other revenue | 3 284 | 3 125 | 2 975 | 2 832 | 2 883 | 2 803 | |
| Cost of goods | -60 322 | -58 850 | -57 415 | -56 163 | -52 636 | -49 610 | |
| Salaries | -9 557 | -9 324 | -9 097 | -8 885 | -8 363 | -8 110 | |
| Other operating expenses | -4 922 | -4 802 | -4 685 | -4 571 | -4 230 | -3 907 | |
| EBITDA | 6 822 | 6 578 | 6 343 | 5 960 | 6 162 | 5 769 | |
| Depreciation and impairments | -3 575 | -3 487 | -3 402 | -3 319 | -3 090 | -3 073 | |
| OPERATING PROFIT FROM CORE ACTIVITIES (EBIT) | | | | | | | |
| | 3 248 | 3 090 | 2 940 | 2 640 | 3 073 | 2 695 | |
| Tax items | | | | | | | |
| Tax for the year | -979 | -934 | -891 | -640 | -686 | -612 | |
| Tax on net financial items | -169 | -165 | -161 | -155 | -195 | -183 | |
| Tax on special items | 272 | 265 | 259 | 252 | 72 | 101 | |
| Tax on operating activities | -877 | -834 | -794 | -543 | -809 | -693 | |
| NOPAT | 2 371 | 2 256 | 2 147 | 2 098 | 2 263 | 2 002 | |
| Non-recurring and non- operating items | | | | | | | |
| Sale of shopping malls to Scala Retail Property AS | | | | 646 | 0 | 0 | |

| | | | | | | |
|---|--------------|--------------|--------------|--------------|--------------|--------------|
| Income from investments in affiliates | | | | 289 | 266 | 362 |
| Total non-recurring and non-operating items | 1 006 | 982 | 958 | 935 | 266 | 362 |
| Tax on non-recurring and non-operating items | -272 | -265 | -259 | -252 | -72 | -101 |
| Earnings before interests, after special items | 3 105 | 2 973 | 2 846 | 2 780 | 2 457 | 2 263 |
| Financial income | 156 | 152 | 149 | 145 | 112 | 149 |
| Financial expenses | -783 | -764 | -746 | -719 | -834 | -801 |
| Total FINANCIAL ITEMS, NET | -627 | -612 | -597 | -574 | -722 | -652 |
| Tax on net financial items | 169 | 165 | 161 | 155 | 195 | 183 |
| TOTAL FINANCIAL ITEMS, NET OF TAX | -458 | -447 | -436 | -419 | -527 | -470 |
| | | | | | | |
| PROFIT OF THE PERIOD | 2 648 | 2 526 | 2 410 | 2 361 | 1 930 | 1 793 |
| | | | | | | |
| Marginal Tax Rates | 27 % | 27 % | 27 % | 27 % | 27 % | 28 % |

| Forecasted Balance sheet (TA format) | | | | | | |
|---|---------------|---------------|---------------|---------------|---------------|---------------|
| All numbers in MNOK | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| ONCA (operating non-current assets) | 36 779 | 35 882 | 35 007 | 34 131 | 31 428 | 29 634 |
| OCA (operating current assets) | 11 191 | 10 918 | 10 652 | 10 397 | 10 435 | 9 333 |
| TOTAL OPERATING ASSETS | 47 971 | 46 801 | 45 659 | 44 528 | 41 863 | 38 967 |
| FCA (financial current assets) | 1 158 | 921 | 696 | 571 | 464 | 412 |
| FNCA (financial non-current assets) | 6 564 | 5 221 | 3 945 | 3 057 | 2 767 | 2 629 |
| TOTAL ASSETS | 55 693 | 52 943 | 50 301 | 48 157 | 45 093 | 42 008 |
| <i>Equity and Liabilities</i> | | | | | | |

| | | | | | | |
|---|---------------------------------|---------------|---------------|----------------------------|---------------|---------------|
| E (equity to majority shareholders) | 19 883 | 18 030 | 16 261 | 14 574 | 12 763 | 11 221 |
| M (equity to minority) | 335 | 304 | 274 | 245 | 244 | 235 |
| P / NCOL | 1 342 | 1 309 | 1 277 | 1 246 | 1 379 | 1 256 |
| NCIBD (non-current interest-bearing debt) | 20 952 | 20 441 | 19 942 | 19 443 | 17 407 | 16 123 |
| CIBD (current interest-bearing debt) | 124 | 121 | 118 | 116 | 64 | 10 |
| COL (current operating liabilities) | 13 057 | 12 738 | 12 427 | 12 532 | 13 237 | 13 164 |
| TOTAL EQUITY AND LIABILITIES | 55 693 | 52 943 | 50 301 | 48 157 | 45 093 | 42 008 |
| FORECASTED | | | | | | |
| GROWTH / RATIOS | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| ATO ONCA | 2,13 | 2,13 | 2,13 | 2,13 | 2,18 | 2,18 |
| ATO OCA | 7,00 | 7,00 | 7,00 | 7,00 | 6,57 | 6,92 |
| Provisions | 1 342 | 1 309 | 1 277 | 1 246 | 1 379 | 1 256 |
| ATO COL | 6,00 | 6,00 | 6,00 | 5,80 | 5,18 | 4,91 |
| Dividend | -794 | -758 | -723 | -605 | -524 | -509 |
| Payout ratio | 30 % | 30 % | 30 % | 26 % | 27 % | 28 % |
| FORECASTED | | | | | | |
| GROWTH / RATIOS | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| (All percentages in absolute values) | F2018 | F2017 | F2016 | 2015 | 2014 | 2013 |
| Net sales growth | 2,5% | 2,5% | 2,5% | 6,2% | 6,1% | 4,0% |
| Other revenue (margin) | 4,2% | 4,1% | 4,0% | 3,9% | 4,2% | 4,3% |
| COGS (margin) | 77,0% | 77,0% | 77,0% | 77,2% | 76,8% | 76,8% |
| Salaries (margin) | 12,2% | 12,2% | 12,2% | 12,2% | 12,2% | 12,6% |
| Other operating expenses (margin) | 6,3% | 6,3% | 6,3% | 6,3% | 6,2% | 6,0% |
| Depreciation and impairments (margin) | 4,6% | 4,6% | 4,6% | 4,6% | 4,5% | 4,8% |
| EBIT (margin) | 4,1% | 4,0% | 3,9% | 3,6% | 4,5% | 4,2% |
| NOPAT (margin) | 3,0% | 3,0% | 2,9% | 2,9% | 3,3% | 3,1% |
| Total NR and NO items (margin) | 1,28 % | 1,28 % | 1,28 % | 1,28 % | 0,39 % | 0,56 % |
| Financial income (margin) | 0,2% | 0,2% | 0,2% | 0,2% | 0,2% | 0,2% |
| Financial expenses (margin) | 1,0% | 1,0% | 1,0% | 1,0% | 1,2% | 1,2% |
| Profit margin | 3,4% | 3,3% | 3,2% | 3,2% | 2,8% | 2,8% |

11.1.16 Forecasted Ratios – Dynamic

IAS 17

| ROE | DYNAMIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
|-------------------------------------|---------------------------|----------------|----------------|---------------------|----------------|----------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| PROFIT OF THE PERIOD | 3 124 | 2 771 | 2 515 | 2 361 | 1 930 | 1 793 |
| Book value of equity incl. minority | 20 806 | 18 582 | 16 610 | 14 820 | 13 007 | 11 455 |
| ROE | 15,01 % | 14,91 % | 15,14 % | 15,93 % | 14,84 % | 15,65 % |

| ROIC | DYNAMIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
|---|---------------------------|----------------|---------------|---------------------|----------------|----------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| Operating revenues | 94 734 | 86 997 | 80 686 | 75 578 | 71 391 | 67 396 |
| NIBD | 3 942 | 3 599 | 3 469 | 3 316 | 3 092 | 2 379 |
| Invested capital (NIBD + Equity) | 24 748 | 22 182 | 20 079 | 18 136 | 16 100 | 13 834 |
| Invested capital (tot. op. ass. - tot. op. lia) | 24 748 | 22 182 | 20 079 | 18 136 | 16 100 | 13 834 |
| NOPAT | 2 607 | 2 233 | 1 958 | 1 802 | 1 976 | 1 698 |
| ROIC | 10,53 % | 10,07 % | 9,75 % | 9,94 % | 12,27 % | 12,28 % |
| Profit margin (PM) | 2,75 % | 2,57 % | 2,43 % | 2,38 % | 2,77 % | 2,52 % |
| ATO | 382,80 % | 392,20 % | 401,85 % | 416,73 % | 443,43 % | 487,19 % |
| ROIC | 10,53 % | 10,07 % | 9,75 % | 9,94 % | 12,27 % | 12,28 % |
| | | | | | | |
| ROCE | DYNAMIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| EBIT | 3 571 | 3 059 | 2 683 | 2 236 | 2 679 | 2 274 |
| Capital employed | 29 846 | 26 711 | 23 991 | 21 649 | 19 267 | 16 865 |

| ROCE | 11,96 % | 11,45 % | 11,18 % | 10,33 % | 13,91 % | 13,48 % |
|---|-----------------|-----------------|---------------------|---------------|-----------------|---------------|
| DYNAMIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | | |
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| NIBD= | 3 942 | 3 599 | 3 469 | 3 316 | 3 092 | 2 379 |
| BVE= | 20 806 | 18 582 | 16 610 | 14 820 | 13 007 | 11 455 |
| r_d= | 3,00 % | 3,00 % | 3,00 % | 3,10 % | 3,40 % | 3,80 % |
| Tax= | 27 % | 27 % | 27 % | 27 % | 27 % | 28 % |
| r_e = r_f + Beta_eq * (r_m - r_f) | 5,67 % | 5,69 % | 5,74 % | 5,79 % | 6,36 % | 6,26 % |
| Beta UL= | 0,69 | 0,69 | 0,69 | 0,69 | 0,62 | 0,61 |
| Beta levered = Beta UL * (1 + NIBD/eq)= | 0,82 | 0,82 | 0,83 | 0,84 | 0,77 | 0,74 |
| MRP= | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % |
| r_f= | 1,57 % | 1,57 % | 1,57 % | 1,57 % | 2,52 % | 2,58 % |
| WACC= | 5,12 % | 5,12 % | 5,13 % | 5,15 % | 5,61 % | 5,66 % |
| ROIC | 10,53 % | 10,07 % | 9,75 % | 9,94 % | 12,27 % | 12,28 % |
| WACC | 5,12 % | 5,12 % | 5,13 % | 5,15 % | 5,61 % | 5,66 % |
| IC | 24 748 | 22 182 | 20 079 | 18 136 | 16 100 | 13 834 |
| EVA = (ROIC - WACC) * IC | 1 339,91 | 1 097,57 | 928,90 | 868,82 | 1 072,46 | 915,94 |

IFRS 16

| DYNAMIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | | |
|---|----------------|----------------|---------------------|----------------|----------------|----------------|
| ROE | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| PROFIT OF THE PERIOD | 3 124 | 2 771 | 2 515 | 2 361 | 1 930 | 1 793 |
| Book value of equity incl. minority | 20 806 | 18 582 | 16 610 | 14 820 | 13 007 | 11 455 |
| ROE | 15,02 % | 14,91 % | 15,14 % | 15,93 % | 14,84 % | 15,65 % |

| DYNAMIC FORECAST HORIZON: | | | | HISTORICAL NUMBERS: | | |
|---|---------------|---------------|---------------|---------------------|----------------|---------------|
| ROIC | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| Operating revenues | 94 734 | 86 997 | 80 686 | 75 578 | 71 391 | 67 396 |
| NIBD | 20 677 | 18 635 | 17 111 | 15 931 | 14 240 | 13 092 |
| Invested capital (NIBD + Equity) | 41 483 | 37 217 | 33 721 | 30 750 | 27 247 | 24 547 |
| Invested capital (tot. op. ass. - tot. op. lia) | 41 483 | 37 217 | 33 721 | 30 750 | 27 247 | 24 547 |
| NOPAT | 2 937 | 2 537 | 2 241 | 2 098 | 2 263 | 2 002 |
| ROIC | 7,08 % | 6,82 % | 6,65 % | 6,82 % | 8,31 % | 8,16 % |
| Profit margin (PM) | 3,10 % | 2,92 % | 2,78 % | 2,78 % | 3,17 % | 2,97 % |
| ATO | 228,37 % | 233,75 % | 239,28 % | 245,78 % | 262,02 % | 274,56 % |
| ROIC | 7,08 % | 6,82 % | 6,65 % | 6,82 % | 8,31 % | 8,16 % |
| DYNAMIC FORECAST HORIZON: | | | | HISTORICAL NUMBERS: | | |
| ROCE | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| EBIT | 4 023 | 3 476 | 3 070 | 2 640 | 3 073 | 2 695 |
| Capital employed | 46 544 | 41 726 | 37 626 | 34 379 | 30 478 | 27 588 |
| ROCE | 8,64 % | 8,33 % | 8,16 % | 7,68 % | 10,08 % | 9,77 % |
| DYNAMIC FORECAST HORIZON: | | | | HISTORICAL NUMBERS: | | |
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| NIBD= | 20 677 | 18 635 | 17 111 | 15 931 | 14 240 | 13 092 |
| BVE= | 20 806 | 18 582 | 16 610 | 14 574 | 12 763 | 11 221 |
| r_d= | 3,00 % | 3,00 % | 3,00 % | 3,10 % | 3,40 % | 3,80 % |
| Tax= | 27 % | 27 % | 27 % | 27 % | 27 % | 28 % |
| r_e = r_f + Beta_eq * (r_m - r_f) | 8,45 % | 8,48 % | 8,57 % | 8,79 % | 9,08 % | 9,19 % |
| Beta UL= | 0,69 | 0,69 | 0,69 | 0,69 | 0,62 | 0,61 |
| Beta levered = Beta UL * (1 + NIBD/eq)= | 1,38 | 1,38 | 1,40 | 1,44 | 1,31 | 1,32 |
| MRP= | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % |

| | | | | | | |
|-------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| r _f = | 1,57 % | 1,57 % | 1,57 % | 1,57 % | 2,52 % | 2,58 % |
| WACC= | 5,33 % | 5,33 % | 5,33 % | 5,38 % | 5,60 % | 5,71 % |
| ROIC | 7,08 % | 6,82 % | 6,65 % | 6,82 % | 8,31 % | 8,16 % |
| WACC | 5,33 % | 5,33 % | 5,33 % | 5,38 % | 5,60 % | 5,71 % |
| IC | 41 483 | 37 217 | 33 721 | 30 750 | 27 247 | 24 547 |
| EVA = (ROIC - WACC) * IC | 726,06 | 553,29 | 441,97 | 442,64 | 737,64 | 599,41 |

11.1.17 Forecasted Ratios – Static

IAS 17

| ROE | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
|--|--------------------------|----------------|----------------|---------------------|----------------|----------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| PROFIT OF THE PERIOD | 2 648 | 2 526 | 2 410 | 2 361 | 1 930 | 1 793 |
| Book value of equity incl. minority | 20 218 | 18 333 | 16 535 | 14 820 | 13 007 | 11 455 |
| ROE (profit of the period/avg. eq.) | 13,10 % | 13,78 % | 14,57 % | 15,93 % | 14,84 % | 15,65 % |

| ROIC | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
|---|--------------------------|---------------|---------------|---------------------|----------------|----------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| Operating revenues | 81 623 | 79 554 | 77 540 | 75 578 | 71 391 | 67 396 |
| NIBD | (246) | 1 151 | 2 474 | 3 316 | 3 092 | 2 379 |
| Invested capital (NIBD + Equity) | 19 972 | 19 485 | 19 009 | 18 136 | 16 100 | 13 834 |
| Invested capital (tot. op. ass. - tot. op. lia) | 19 972 | 19 485 | 19 009 | 18 136 | 16 100 | 13 834 |
| NOPAT | 2 028 | 1 921 | 1 820 | 1 802 | 1 976 | 1 698 |
| ROIC | 10,15 % | 9,86 % | 9,57 % | 9,94 % | 12,27 % | 12,28 % |
| Profit margin | 2,48 % | 2,41 % | 2,35 % | 2,38 % | 2,77 % | 2,52 % |

| | | | | | | |
|---|-----------------|----------------|----------------|----------------|----------------|----------------|
| (PM) core | | | | | | |
| ATO | 408,70 % | 408,30 % | 407,90 % | 416,73 % | 443,43 % | 487,19 % |
| ROIC | 10,15 % | 9,86 % | 9,57 % | 9,94 % | 12,27 % | 12,28 % |
| STATIC FORECAST HORIZON: | | | | | | |
| ROCE | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| EBIT | 2 778 | 2 632 | 2 493 | 2 236 | 2 679 | 2 274 |
| Capital employed | 27 574 | 25 510 | 23 537 | 21 649 | 19 267 | 16 865 |
| ROCE | 10,07 % | 10,32 % | 10,59 % | 10,33 % | 13,91 % | 13,48 % |
| STATIC FORECAST HORIZON: | | | | | | |
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| NIBD= | (246) | 1 151 | 2 474 | 3 316 | 3 092 | 2 379 |
| BVE= | 20 218 | 18 333 | 16 535 | 14 574 | 12 763 | 11 221 |
| r_d= | 3,00 % | 3,00 % | 3,00 % | 3,10 % | 3,40 % | 3,80 % |
| Tax= | 27 % | 27 % | 28 % | 27 % | 27 % | 28 % |
| r_e = r_f + Beta_eq * (r_m - r_f) | 4,98 % | 5,24 % | 5,54 % | 8,79 % | 9,08 % | 9,19 % |
| Beta UL= | 0,69 | 0,69 | 0,69 | 0,69 | 0,62 | 0,61 |
| Beta levered = Beta UL * (1 + NIBD/eq)= | 0,68 | 0,73 | 0,79 | 1,44 | 1,31 | 1,32 |
| MRP= | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % |
| r_f= | 1,57 % | 1,57 % | 1,57 % | 1,57 % | 2,52 % | 2,58 % |
| WACC= | 5,01 % | 5,06 % | 5,10 % | 7,58 % | 7,79 % | 8,06 % |
| ROIC | 10,15 % | 9,86 % | 9,57 % | 9,94 % | 12,27 % | 12,28 % |
| WACC | 5,01 % | 5,06 % | 5,10 % | 7,58 % | 7,79 % | 8,06 % |
| IC | 19 972 | 19 485 | 19 009 | 18 136 | 16 100 | 13 834 |
| EVA = (ROIC - WACC) * IC | 1 026,91 | 935,82 | 850,97 | 427,33 | 721,59 | 583,49 |

IFRS 16

| ROE | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
|--|--------------------------|----------------|----------------|---------------------|----------------|----------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| PROFIT OF THE PERIOD | 2 648 | 2 526 | 2 410 | 2 361 | 1 930 | 1 793 |
| Book value of equity incl. minority | 20 218 | 18 333 | 16 535 | 14 820 | 13 007 | 11 455 |
| ROE (profit of the period/avg. eq.) | 13,10 % | 13,78 % | 14,58 % | 15,93 % | 14,84 % | 15,65 % |

| ROIC | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
|---|--------------------------|---------------|---------------|---------------------|----------------|---------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| Operating revenues | 81 623 | 79 554 | 77 540 | 75 578 | 71 391 | 67 396 |
| NIBD | 13 354 | 14 420 | 15 419 | 15 931 | 14 240 | 13 092 |
| Invested capital (NIBD + Equity) | 33 572 | 32 753 | 31 954 | 30 750 | 27 247 | 24 547 |
| Invested capital (tot. op. ass. - tot. op. lia) | 33 572 | 32 753 | 31 954 | 30 750 | 27 247 | 24 547 |
| NOPAT | 2 371 | 2 256 | 2 147 | 2 098 | 2 263 | 2 002 |
| ROIC | 7,06 % | 6,89 % | 6,72 % | 6,82 % | 8,31 % | 8,16 % |
| Profit margin (PM) core | 2,90 % | 2,84 % | 2,77 % | 2,78 % | 3,17 % | 2,97 % |
| ATO | 243,13 % | 242,89 % | 242,66 % | 245,78 % | 262,02 % | 274,56 % |
| ROIC | 7,06 % | 6,89 % | 6,72 % | 6,82 % | 8,31 % | 8,16 % |
| | | | | | | |
| ROCE | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| EBIT | 3 248 | 3 476 | 3 070 | 2 640 | 3 073 | 2 695 |
| Capital employed | 41 170 | 41 726 | 37 626 | 34 379 | 30 478 | 27 588 |
| ROCE | 7,89 % | 8,33 % | 8,16 % | 7,68 % | 10,08 % | 9,77 % |

| | STATIC FORECAST HORIZON: | | | HISTORICAL NUMBERS: | | |
|---|--------------------------|---------------|---------------|---------------------|---------------|---------------|
| | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 |
| NIBD= | 13 354 | 14 420 | 15 419 | 15 931 | 14 240 | 13 092 |
| BVE= | 20 218 | 18 333 | 16 535 | 14 574 | 12 763 | 11 221 |
| r_d= | 3,00 % | 3,00 % | 3,00 % | 3,10 % | 3,40 % | 3,80 % |
| Tax= | 27 % | 27 % | 27 % | 27 % | 27 % | 28 % |
| r_e = r_f + Beta_eq * (r_m - r_f) | 7,30 % | 7,73 % | 8,24 % | 8,79 % | 9,08 % | 9,19 % |
| Beta UL= | 0,69 | 0,69 | 0,69 | 0,69 | 0,62 | 0,61 |
| Beta levered = Beta UL * (1 + NIBD/eq)= | 1,15 | 1,23 | 1,33 | 1,44 | 1,31 | 1,32 |
| MRP= | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % | 5,00 % |
| r_f= | 1,57 % | 1,57 % | 1,57 % | 1,57 % | 2,52 % | 2,58 % |
| WACC= | 5,27 % | 5,29 % | 5,32 % | 5,38 % | 5,60 % | 5,71 % |
| ROIC | 7,06 % | 6,89 % | 6,72 % | 6,82 % | 8,31 % | 8,16 % |
| WACC | 5,27 % | 5,29 % | 5,32 % | 5,38 % | 5,60 % | 5,71 % |
| IC | 33 572 | 32 753 | 31 954 | 30 750 | 27 247 | 24 547 |
| EVA = (ROIC - WACC) * IC | 602,57 | 522,21 | 446,80 | 442,64 | 737,64 | 599,41 |

11.2 Appendix B: Interview questions

Questions regarding IFRS 16 in general:

1. Would you say that IFRS 16 is capable of solving the problems and challenges IAS 17 has been criticized for?
2. Are there any elements with IFRS 16 you disagree with? If you were involved in the standard setting process, is it anything you would have done differently?

3. As auditors, what do you think will be your greatest challenges with the new standard – in the time period until implementation; the period after implementation and in the long-term?
4. Do you believe the transition to IFRS 16 will be costly regarding implementation costs?
5. A change IFRS 16 entails is the increased requirements for the notes in the annual report. From an auditor's point of view, are the increased requirements necessary or superfluous?
6. What do you believe will the greatest challenges with IFRS 16 for Norwegian retail companies, and which advices do you give to you clients to solve them – in the period until implementation; regarding the practical transition to the new standard and potential long-term challenges?

Questions regarding financial performance measures and bonus contracts:

7. To what extent do you expect IFRS 16 to impact financial measures?
8. Do you think the changes in applicable financial measures can affect companies' bonus systems, and if so, how? How do you believe this can affect bonus systems based on the following measures?
 - EBITDA and EBIT
 - NOPAT
 - ROIC and ROCE
 - EVA
9. Do you think changes in these measures and potential consequences for the bonus systems can have influence for the discussion of purchase vs. leasing?
10. Do you think changes in these measures can give consequences for a company's relationship to:
 - Creditors
 - Investors (both professionals and non-professionals)
11. With IFRS 16, do you think there are ways to avoid recognition of leased assets on the balance sheet? Do you believe that that there are circumstances

around the transition to IFRS 16 that indicates that active avoidance of recognition of leased assets on the balance sheet can impact a company's bonus contracts with their employees?

11.3 Appendix C: Preliminary Master Thesis Report

Preliminary Master Thesis Report

BI Norwegian Business School

IFRS 16 *Leases* and its Effects on Management Compensation Systems in the Norwegian Retail Industry

Program:

Master of Science in Business

Major in Business Law, Tax and Accounting

Supervisor:

Erlend Kvaal

Hand-in date:

01.03.2017

Campus:

BI Norwegian Business School Oslo

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Program: Master of Science in Business, Major in Business Law, Tax and Accounting

Name of supervisor: Erlend Kvaal

1. Introduction

1.1 Background

Publicly available information derived from the company's financial statements is deemed to be the most valuable component in an investor's decision making. It is therefore crucial that all available information is reported with reliability and accuracy. To ensure that companies follow the same set of rules and regulation, the European Union (EU) adopted in 2005 the International Financial Reporting Standards (IFRS) as the required financial reporting standard for the consolidated financial statements for all publicly listed companies within EU and the European Economic Area (EEA).

IFRS is published and updated regularly by International Accounting Standards Board (IASB), with a primary purpose to fortify the harmonization of financial accounting and reporting standards as a response to globalization of capital markets (Andersen et al, 2001). The preparation of IFRS has been, and continues to be, a dynamic process ever since its establishment in the 70s - a time where the use of leasing as a source of financing had started to take roots in certain capital-intensive industries (Gritta, Lippman, and Chow, 1994). There did not exist any specific regulations concerning lease accounting at that time. All agreements made between lessees and lessors were recognized as operational leases. This implied that lessor still retained the legal ownership of the assets, while lessee was entitled to the right to use the asset for an agreed period of time in return for a given rent. In lack of appropriate guidelines, lease financing was utilized to fund or refinance firms' operations outside the balance sheet, known as off-balance sheet (OBS) financing.

1.1.1 Issuance and criticism of IAS 17

To discourage entities from OBS financing to 'ensure that financial statements give a

complete, relevant, and accurate picture of transactions and events' (i.e. substance over form), the current lease accounting standard (IAS 17) was introduced in the early 1980s with effect from 1984. IAS 17 follows a binary categorization of lease contracts. Each lease agreement shall be defined as either operational or finance lease. This is determined in accordance with a set of criteria that shall ensure that the lease agreement's relevant asset is initially capitalized on the side of the contracting party that bears the substantial share of the economic risk and returns from the change in the valuation of the underlying asset (Kamath, Kerkar and Viswanath, 1990). If the lease agreement meets the requirements that transfers the risk and rewards on the lessee, the lease shall be classified as finance lease. Otherwise, the agreement shall be classified as an operating lease, and thus recognizes as an off-balance sheet item.

IAS 17 has long been criticized for failing to meet its original objective: standardizing financial performance of an entity with the intent of comparing it on a like-to-like basis with international peers. The criticism is particularly aimed at the sovereignty to determine the classification of the company's own leases. Kopf and Harr (2013) argues that the current lack of transparency regarding off-balance sheet items, and how this might allow agreements to be manipulated to garner an accounting treatment, does not present the economic realities of the agreement. The freedom to choose has led to a vast proportion of all the lease agreements signed in the World today are being classified as operational, and thereby not reflected in the lessee's balance sheet. Besides the fact that the users of financial statements may seem to be misled, the binary categorization of lease contracts reduces the comparability of financial statements across companies. The relevance of accounting ratios becomes problematic when operating leases are not capitalized, and most certainly unfair for non-leasing firms (Fahnestock and King, 2001).

1.1.2 A new standard

For about ten years, IASB and Financial Accounting Standards Board (FASB) have jointly worked towards a new lease accounting standard with intent to provide users of financial statements improved transparency and to create a more comprehensible picture of the entity's' leasing activities. After a series of exposure drafts and subsequent revisions, IFRS 16 leases was approved for issue by IASB in the beginning of 2016 with effective date of 1 January 2019 (IFRS, 2016). IFRS 16 introduces a single lessee accounting model, which eliminates the previously mentioned twofold classification as per the guidelines of IAS 17. All leases shall accordingly be treated as a finance lease and hence be recognized in lessee's balance sheet. Exemptions apply only for short-term leases under 12 month and low-value assets (EY, 2016).

1.2 Appraisal

With the new standard for lease accounting in the pipeline, a wide variety of industries will most likely be facing noticeable changes to their accounting figures, as all current and future operating leases are to be recognized as a right-of-use and liability in the company's balance sheet. According to a report prepared by EY (2016), some commonalities shared across selected industries being part of their business model will lead to a more significant impact than for entities in other sectors. The characteristics are often recurrent and relates largely to rental of premises, offices, machines and other equipment necessary for execution of core business processes. The EY report finds Oil & Gas, Construction & Engineering, and Retail & Consumer Products as some of the most exposed sectors. Considering the fact that the latter is deemed to be the most affected and with the expectation of highest level of effort to comply the upcoming changes, we will call attention to the retail industry, hereunder the Norwegian grocery market, in this research thesis.

1.3 Motivation for thesis subject

When we considered possible master thesis subjects, it was important for us to find a subject we had a common interest in. During our years at BI we both have developed a fascination of accounting as an academic field and when deciding our Major, Business Law, Tax and Accounting was the natural choice. Our graduate courses in the field have contributed to this interest and have given us greater understanding and different ways of employing our knowledge.

Writing a master thesis can be done with widely different approaches and methods. Analyzing a newly accepted IFRS standard that has yet to be implemented requires systematic effort, usage of prepossessed knowledge and the ability to find solutions to emerging problems and questions. Past experiences from academic projects and work has made us appreciate complex problems that needs cleverness and an analytical way of thinking to be solved.

The chosen thesis subject coincides well with our interests and preferred style of working, and we find the timing for this particular topic to be rather good. It seems that previous research on the topic has remained still the last years, pending on the acceptance of the new standard. Further on, we have found an exciting extension to previous work that has not yet been explored to the fullest.

2. Problem definition

This thesis aims to elucidate the scope of the newly approved IFRS 16 - Leases and how it will impact earnings and financial figures, hereunder key ratios, for companies applying IFRS. The new standard for leasing will not only affect the company's key figures, but may also have implications for certain contractual agreements depending on given targets in the company's financial statements. Our scope is extended to

include the effect to which the changes in accounting for leases will have on bonus compensation systems for companies significantly exposed to leases off balance sheet in the Norwegian retail industry. Our approach will include the effects on various forms of commitments that trigger remuneration for members of the board of directors, executive management and middle management, and the subsequent issues that may arise as a result of the arrival of IFRS 16.

Accordingly, the research question of this thesis is:

“How will the transition to IFRS 16 affect key financial ratios, and thus the bonus compensation system for retail companies in Norway?”

To give a thorough answer to the research question, we have derived it into several sub-questions:

- Which theoretical and practical accounting consequences will IFRS 16 entail?
- How are remuneration contracts structured in the retail sector, and which are the most important performance metrics?
- How will IFRS 16 impact the related financial KPIs?
- What are the possible economic consequences of the accounting changes and consequently potential alteration in bonus contracts?

3. Literature review

3.1 Managing the balance sheet with operating leases

As previously mentioned, IAS 17 has made way for companies to manage their balance sheet to easily achieve desired ratios in their financial statements. Cornaggia, Franzen and Simin conducted in 2012 a research to prove whether firms use

operating lease activity to strengthen their balance sheet. By using time series plot and regression analysis, their main hypotheses were that operating lease activity are explained by theoretical determinants (such as financial constraints, company size, marginal tax rate and asset value), and that unexplained operating lease activity is positively associated with incentives to keep debt off the balance sheet.

Their evidence suggest that the operating lease activity is greatest among firms that initially are not deemed to have a high propensity to lease assets. It therefore implies that firms without the traditional economic benefits of lease financing are those who choose OBS financing. However, they found that OBS leasing allows firms to circumvent existing debt covenants, and that operating lease activity increases with the existence of debt covenants that are limiting the company's ability for further borrowing.

Another interesting and counterintuitive observation made by Cornaggia et al. was that OBS leasing is more present in the least financially distressed companies - growth companies with high levels of R&D intensity. This contradicts the findings of Mills and Newberry in 2004, that companies with less favourable bond ratings or higher leverage ratios, in comparison with the industry norm, are more likely to use methods of structured financing to access lower costs or enhance their financial statement balance sheets. Mills and Newberry are supported by a study of the determinants of using operating leases in the hotel industry when it comes to companies with high leverage (Koh and Jang, 2009). However, they are inconsistent in terms of whether financially distressed companies are more likely to use operating leases, corresponding with the findings of Cornaggia et al.

3.2 Capitalization of operating leases and its impact on financial ratios

It is apparent that structured financing and how it affects the company's covenants has been a long debated topic within the accounting literature. It is obvious that OBS financing provides a plentiful environment for investigating how changes in financial key figures could impact any other forms of agreements involving operating leases being capitalized. Imhoff, Lipe and Wright (1993) published a research on whether decisions made by shareholders and executive compensation committees were influenced by the footnote disclosure concerning long-term non-cancellable operating leases. They found evidence suggesting that market participants using financial statements to assess the riskiness of the firm's shares do appear to capitalize OBS operating leases. On the contrary, there was no evidence supporting the hypothesis regarding that the compensation committees adjust reported amounts to take into account any footnote disclosure to reflect operating leases when establishing CEO cash compensation.

In conjunction with the evidence of market participants capitalizing OBS items when assessing equity risk, Imhoff, Lipe and Wright did a research on the adverse effects of capitalization of leases on key financial ratios in 1991. Using seven different pairs of high- and low-leasing firms in seven industries, the evidence demonstrates that operating leases can have a significant impact when comparing key financial statement ratios. For instance, the results indicate that when the leases are being capitalized, the average decrease in ROA for high lessees is 34 percent to ten percent for low lessees.

A number of other researchers, such as Beattie et al (1998), Kilpatrick and Wilburn (2006), and Bennett and Bradbury (2003), have documented the same effect of lease capitalization on financial ratios using by partly adopting the method developed by

Imhoff et al (1991). Beattie et al (1998) applied a modified procedure to capitalize the operating leases of 300 listed UK companies. The results showed a significant impact (on 1 percent level) on the companies' profit margin, return on assets, asset turnover, and three different measures of gearing.

Kilpatrick and Wilburn (2006) replicated the work of Imhoff et al (1991) using data from 2004 for the same nine different firms and compared it with the original data from 1987. The results showed that the capitalization impact on financial ratios increased since 1987, the average capitalized debt from operating leases increased with 1.9 billion (average increase of 267%) and 50% of the observed companies would have more than twice as much unreported lease liabilities than total reported liabilities if the leases were capitalized.

Duke, Hsieh and Su (2009) did also adopt the Imhoff et al (1991) method and opted to divided their sample into positive and negative income groups to examine the impact of lease capitalization on net income in the post-Enron era.. Their results show that the top quartile positive subgroup experienced 18% increase in income, while the top quartile negative subgroup yielding an income decline of 11%.

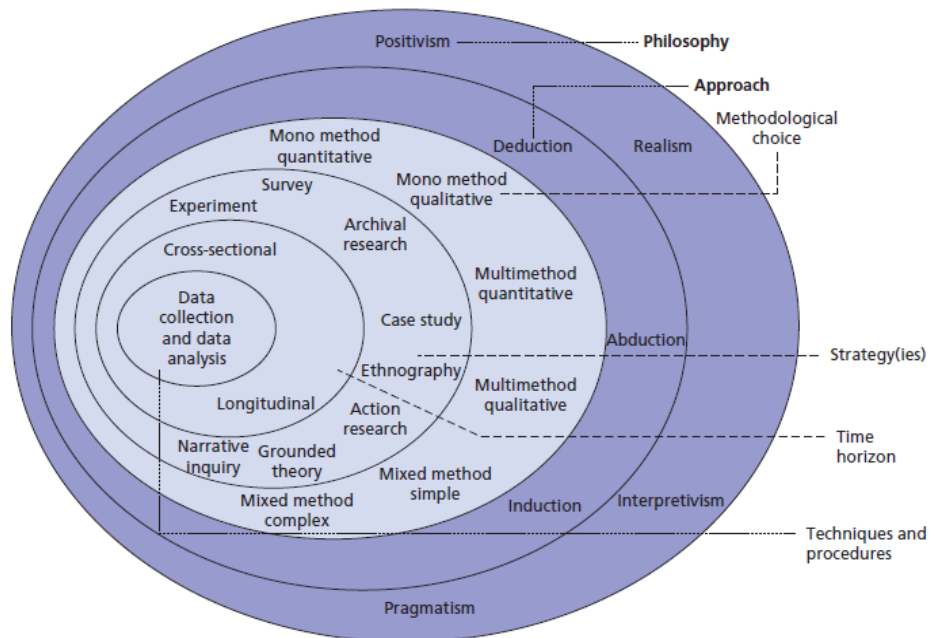
3.3 A thesis conducted on the German retail market

Mina Stanic (2016) did a study of IFRS 16 and its effect on management bonus systems in the German industry as a part of her master's degree at Copenhagen Business School. Her thesis was built on a case study of REWE Group - the second largest retailer in Germany, and supported with collected theory, as well as interviews, conducted with experts from the Big Four. Her reformulation of REWE Group's financial statements show that capitalizing operating leases contribute to both positive and negative effects on the most commonly used measures in bonus systems - measures obtained from a study of Peterson &

Plenborg (2007). Stanic highlights a variety of potential issues that may arise in the wake of the re-negotiation of bonus agreements, including principal-agent problems, manipulation of results and information, and investor reactions. The methodological chapter in Stanic’s thesis has been an inspirational source when planning our research project.

4. Methodology

This chapter describes the methodology we intend to use in our master thesis. Our choices regarding which methods to use and what structure to follow when answering our research question will be well-founded, and follow the framework of “the research onion” (Saunders et al, 2012). The research onion is an analogy for the procedural steps in a research project and is done to illustrate coherence. It consists of several layers in a fixed order, and choices made in the previous layer will often influence decisions in the next.



Figur 4: The research 'onion' (Saunders et al., 2012, p. 128)

4.1 Philosophy

Research philosophy is the outer layer, but unlike a real onion, the peel is not thrown away. It can be described as “... the assumptions about the way in which you view the world” and will influence which strategy and methods we choose (Saunders et al., 2012). The formulation of our research question is twofold and due to this reason, the research procedures will differ, meaning that more than one philosophic stance can be adopted. Combining more than one is a position itself: *Pragmatism*. Pragmatism is a practical oriented stance and gives flexibility when deciding research strategy. *Positivism* is a philosophy where only observable reality can yield reliable data. It focuses on causality and its aim is to create law-like generalizations. *Interpretivism*, on the other hand, is socially constructed, and states that reality has to be given subjective interpretation (Saunders et al., 2012). The analysis of how IFRS 16 will change accounting measures, and subsequently affect bonus systems is within the philosophy of positivism. Interpretivism needs to be adopted when assessing the possible economic consequences for the parties concerned by the new standard.

4.2 Approach

The following layer is which research approach to use. In this thesis, a combination of the deductive and inductive approach will be applied. A central characteristic of deduction, is the search to explain causal relationships between concepts and variables (Saunders et al., 2012). We intend to examine the potential causal effect the implementation of IFRS 16 will have on bonus compensation plans. The new standard will be thoroughly analyzed, and with the existing literature and research in mind, we will derive hypotheses of the consequences, and in turn test these in a case study with the largest Norwegian grocery groups. The results obtained in the case study will be supplemented with interviews of experts on IFRS 16 from employees in

two of the “big four” audit firms, as well as a multinational corporation. Their answers will additionally be of great importance when assessing the potential economic consequences of the new standard.

A central part of our work is to explore and analyze how bonus systems are composed in the retail sector and which components that triggers payouts. Detailed understanding of the subject is a prerequisite for the extension we intend to carry out compared to previous research on impacts of the new standard. The plan on how to acquire the necessary information and knowledge about the contracts is explained in the research strategy paragraph. It is within this part of the research we need to apply the inductive approach. Doing a simulation of capitalization according to IFRS 16 allows us to analyze the direct effect it has on bonus contracts as they are today. From this data, the end goal is to develop a set of theories on the economic consequences from this certain perspective. How will the affected parties in the contractual relation approach the changes and hence impact a potential renegotiation process - these are all examples of questions we seek to answer in this section of the thesis.

4.3 Methodological choice

The next three layers of the onion addresses research design and the transition from a research question to a research project. Methodological choice, i.e. the decision of choosing a quantitative, qualitative or multiple methods research design, is the third layer. Analyzing the effects IFRS 16 entails is done purely quantitative by reformulating the publicly available accounting numbers to the chosen companies. Quantitative research goes well with the deductive approach and is fitting when studying relationship between variables. Regarding philosophy, it is most often related to positivism, although highly appropriate with pragmatism as well. Even

though quantitative design will be the foundation in our research, a part of this study falls within interpretivism as a philosophy, making a qualitative method needed. Expert's opinions on the coming accounting changes and potential economic consequences, i.e. how parties concerned act in the aftermath of the standard approval among other things, will be acquired through interviews in which the results need qualitative assessment. This leads towards simple mixed method research.

The research design should reflect the purpose of the research; the way the research question is put into words. We wish to examine “how” IFRS 16 will influence bonus remuneration contracts and to what extent this brings consequences, from a behavioral perspective, for affected parties. Previous literature and research on capitalization of OBS lease contracts is extensive, but the particular scope and extension we have selected is substantially less explored. This makes an exploratory design well suited. When previous findings of a topic are limited, it may be challenging to outline a clear path regarding the research process and which expectations to have. With this design comes a certain risk that the obtained results are unrewarding in terms of revealing new knowledge on the topic. Nonetheless, a large advantage with the mentioned design is its flexibility and adaptability to change (Saunders et al., 2012). If we, somewhere during our research process, detect an additional scope worthy of being studied, the exploratory design makes it perfectly acceptable to deviate from the original scope. Similarly, it applies if findings on bonus remuneration contracts reveals that the coming changes are already accounted for in every conceivable way.

4.4 Strategy

The succeeding layer looks at different alternatives for the research strategy. Saunders et al. defines a strategy as a plan of action to achieve a goal. In other words, the strategy is a plan of the specific measures that are taken in order to answer the

research question and the sub-questions that arise. As mentioned in the exterior layers, a cornerstone of this thesis will be to test the hypotheses we derive from the literature review and the capitalization of OBS leases of the target companies in a case study. To enable us to assess the effects IFRS 16 imposes on bonus contracts, we must attain knowledge on how such contracts are structured. Gaining insight in such contracts, require benevolence from the companies. Realistically, it should be possible to be granted information about the technical aspects of bonus contracts, i.e. which ratios and/or key figures that triggers payouts. In case this is troublesome, an alternative tactic is to study standard drafts and standard elements included in bonus schemes, and a solution could be to do interviews and engage in conversation with attorneys specialized in business law. The case study strategy serves as a tool to explore the research topic within its real-life context (Saunders et al., 2012). This thesis will make use of the market leading Norwegian grocery chains (Norgesgruppen, Coop Norge and Reitangruppen) as context. Due to the fact that the three groups have widely different ownership structure, including all of them will enrich generalizability. Following the hypotheses tests in the case study, comes the more qualitative approach. The interviews function as a supplement to the quantitative analysis, enlightening the topic from a more technical perspective. As stated earlier in this chapter, the interview objects are experts in IFRS 16 and IFRS in general, and will hence be able to either amplify the findings we obtain or challenge them with a different interpretation, where both will strengthen the end result. Semi-structured interviews allow the respondents to give in-depth answers and the possibility for follow-up questions if a new, interesting angle is detected.

4.5 Time horizon, techniques and procedures

Second to the core of the onion is the research project's time horizon. This thesis is a cross-sectional study, as we investigate "*a particular phenomenon at a particular time*", due to the time constraint a master thesis has (Saunders et al., 2012, p. 190).

The final layer and the core of the research onion addresses the collection and analysis of data. Our empirical analysis will require that we obtain financial accounting data from the primary sources in terms of annual reports from the three largest retailers in Norway. Annual reports are deemed to be first-hand information and are therefore considered as primary data. Furthermore, other necessary primary data will be obtained from IFRS Foundation and IASB, such as the IFRS 16 report, to simulate the implementation of the new changes through a reformulation of the financial statements of our case objectives, as well as information received during interviews with executives and other interesting interviewees from financial institutions and law firms. Our secondary data will mainly consist of books, journals and other publications.

5. Overview of further progress

We are determined to deliver our preliminary thesis at the end of February and are further prepared to initiate the theory construction for the master thesis. At this stage, it will be crucial to ascertain whether our case objectives are willing to release necessary information about which key ratios/indicators triggering bonus remuneration for executives in the respective companies. Without proper access to such information, alternative means will be required (e.g. general contract condition compiled by law firms), and could change the approach to the thesis to some extent. We are also determined to gain a closer insight into our case objectives' leasing agreements beyond what is publicly available. With the theoretical underpinnings obtained, we will call attention to the case study of our three examples of lessees in the retail industry with the subsequent analysis of the contractual effects of IFRS 16. The results from our case study will be analyzed and accompanied with interviews of auditors from two large international audit firms, as well as another certified public accountant working as executive vice president in a large Norwegian listed company.

Furthermore, we will discuss and evaluate our results, and give a proposal for further research within our area of study. The most important findings will lastly be summarized as concluding remarks to provide the reader with a simplified overview.

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