



IFRS16 – Tackling the challenge

Your company will have to comply with the new IFRS16 standard? Your respective processes are not yet clearly defined? This paper explains the key challenges you will be facing and how an optimized tool support should look like. It discusses why most of the existing solutions are not ideally suited to support IFRS16. And it concludes by presenting an interesting, SAP-based lease management solution.

IFRS16 – What’s the change?

In early 2016 the International Accounting Standards Board (IASB) issued ‘IFRS 16 Leases’. It sets out principles for the recognition, measurement, presentation and disclosure of leases for both the lessee and the lessor.

In IAS 17 a lease had to be classified by the lessee as either finance lease or operating lease. When a lease was identified as being economically similar to a purchase of the asset, this lease was classified as a finance lease and had to be reported on the balance sheet. All other leases were treated as operational leases and not shown on the balance sheet (‘off-balance-sheet-leases’).

This changes rapidly with IFRS16. Instead of the distinction of operating and finance leases, all leases that exceed certain thresholds with regards to contract durations and lease values have to be reported on the balance sheet.

When IFRS16 becomes effective on 1st January 2019, a lessee will need to ...

- ✓ capitalize the right to use the underlying asset (‘Right of Use ROU’)
- ✓ recognize the financial liability representing the obligation for future lease payments
- ✓ separate the depreciation part of the lease assets from interest on lease liabilities in the income statement

... for all contracts that are to be considered leasing contracts.

About the author



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	Balance Sheet Implications			Income Statement Implications		
	IAS 17	IAS 17	IFRS 16	IAS 17	IAS 17	IFRS 16
	Finance leases	Operating leases	All leases	Finance leases	Operating leases	All leases
Assets	→	---	→	x	x	x
Liabilities	\$\$	---	\$\$\$\$\$\$	---	Single expense	---
Off balance sheet rights / obligations	---	→	---	---	---	↑↑
Depreciation and amortisation	---	---	---	Depreciation	---	Depreciation
Operating profit	---	---	---	---	---	↑
Finance costs	Interest	---	---	Interest	---	Interest
Profit before tax	---	---	---	---	---	↔

Source: International Accounting Standards Board® (IASB®)

IFRS16 will have implications to central KPIs like debt ratio and EBITDA, and it will negate some of the reporting effects that were pursued with sales-and-lease-back strategies.

IFRS16 – What’s the challenge for companies?

If we look into the way leasing contracts have been treated in many companies up to now, we typically find a rather decentralized approach. There are hardly any standardized processes on how leasing contracts are handled, especially when it comes to tracing the economic development of the underlying lease asset during the operations phase of the contract. Neither are there many standardized system implementations in this area.

IFRS16 calls for a fundamental change to how leasing is handled in complex organizations. Due to the reporting obligations that go along with IFRS16, the full lifecycle of a leased asset needs to be controlled. In the **initialization phase** of the contract, the right of use needs to be identified and capitalized correctly, with any service components being separated from lease components. Based on the resulting lease liability, payment schedules need to be calculated that distinguish depreciations and interest portions for the duration of the contract.

In the **operating phase** of a contract, depreciations and interest payments need to be posted. Whereas this is a regular and standardizable process, special challenges arise whenever there are **critical events** to the contract or the underlying asset. For example damages, repairs or casualties need to be analyzed for their influence on the right of use, the liability and the payment schedule. Any adjustments need to be administrated centrally and from a reporting point-of-view.

In many organizations IFRS16 will require a new definition of lease administration processes.

IFRS16 – Why many tools are no perfect fit

It is not exaggerated to state that most existing ERP-systems are not prepared to support the administration of leasing contracts very well. The problem is not to book assets, liabilities, interest and depreciation, but to administrate the contract details throughout their lifecycle. A suitable system should support the full spectrum of lease management in one central solution. Minimum requirements should be:

- ✓ Offer a central storage for all lease contracts and respective documents or assign links to document management systems.
- ✓ Provide all data points required by IFRS16.
- ✓ Possibility to handle multiple assets per contract to slim down administration.
- ✓ Calculate ROU and respective liabilities as well as future payment schedules. Fees and charges should be assigned to separate items like delivery, setup, insurance, service, etc.
- ✓ Provide functionality to handle critical events in a lease lifecycle, e.g. early termination, casualties, transfers etc.
- ✓ Allow a direct integration with ERP-based master data to link assets/equipment, cost centers, vendors etc. to lease contracts and vice versa.

An external calculation tool is not enough. What is required is a dedicated “subledger” for leasing

- ✓ Allow a direct integration with ERP-systems to push lease related bookings into the general ledger and/or accounts payables. Make sure all relevant data are pushed into ERP, e.g. including cost center or creditor information.
- ✓ Support Multi-GAAP environments / multiple ledgers.
- ✓ Reuse currency exchange logic from ERP wherever possible.
- ✓ Provide user authorizations and approval workflows.

Currently a number of tools are coming up that can calculate the numbers and accounts that need to be booked for leasing contracts. These tools, mainly originating from an EPM background, are not ideally suited to support complex organizations in their lease administration, as they only fulfill parts of the mentioned requirements. They are typically able to administrate leasing contracts and to do the necessary calculations (NPV, IRR etc.), but they are not integrated with the ERP-systems that hold relevant master data and that need to receive final bookings. An ideal solution, however, should neither be an isolated lease administration tool nor a pure booking extension to a finance tool. Instead, it should work like a distinct “subledger” for leasing contracts, which combines special lease administration functionality with a direct ERP-integration. As companies can have several ERP-systems from different vendors in their architecture, the central lease administration tool needs to be able to connect different organizational units to different systems. A separate tool is therefore preferable compared to a solution within one of the existing ERP systems.

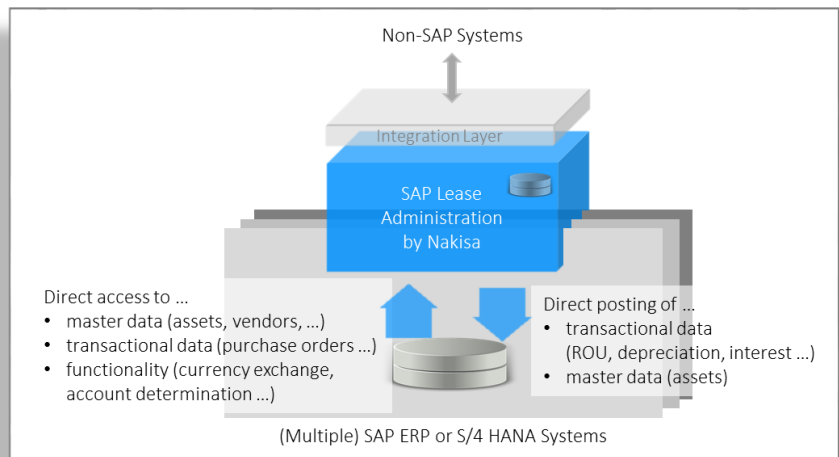
What „SAP Lease Administration by Nakisa“ offers

In the SAP product portfolio, lease management is handled by a solution that is delivered by Canadian company Nakisa Inc (www.nakisa.com). “SAP Lease Administration by Nakisa” (SLAN) provides a web-based solution that can directly integrate into SAP ERP systems and that can also be used as a standalone tool providing interfaces to non-SAP-products.

The SAP Lease Administration solution serves as a centralized repository for all details associated with leased assets, contracts, accounting events, and payments. It fulfills all of the above-mentioned requirements for a lease solution. It can be directly integrated into one or several SAP ERP systems. SLAN supports all lease guideline

questions that are required for a proper classification. Fixed Assets can be created in real time, with Cost Center assignments and proper asset accounting entries. General ledger entries are posted, potentially also into a multi-ledger environment. All master data can be read from the source system. The currency conversion logic and exchange rates are reused directly from the underlying ERP-system, avoiding double maintenance and inconsistencies.

In Non-SAP- or heterogeneous system environments not all company codes will be directly linked to a SAP ERP system. In that case SLAN can be used standalone, i.e. an interface layer will provide all required postings in the form of export files.



The SAP Lease Administration solution tracks all modifications to existing contracts, leases, and assets while still maintaining the original data. It includes a strong audit trail with contract, payment, and amortization schedules. SLAN provides the ability to manage and journalize both lease and non-lease components on a single lease record. Users can upload files and attach them to a specific contract, lease, or leased asset.

On top of the IFRS16 data points, SLAN allows for a flexible extension of the solution by adding dynamic fields. Thus the system can be easily customized for company-specific reporting requirements.

Extensive analytical reports round up the solution, making it the leading end-to-end lease administration system in the market.

Summary - Tackling the challenge

Complying with IFRS16 will require a combined process- and IT-approach. Organizations need to define harmonized administration processes for lease contracts and the underlying assets. These processes need to be implemented in a suitable IT-solution. This solution will ideally be company-wide, integrate into the company's ERP-system(s) or provide respective interface files for external systems.

Stampa Partners is strategic implementation partner for SAP Lease Administration by Nakisa in Europe. Contact us for IFRS16 reference projects in various industries or for a demo and discussion of the SLAN solution.

For additional information refer to www.stampa.partners or contact us directly at: andreas.krueger@stampagroup.com



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