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## CONSULTING



## IMPACT OF ASC 842, IFRS 16 ON SAP FIXED ASSETS AND LEASE MANAGEMENT: What Do These Changes Mean to You?

Are you ready for ASC 842 affecting Lease Accounting in the US? How about IFRS 16 to handle your new Lease Accounting requirements abroad? Many companies are still in the investigation and planning phase.

In a recent QBR with one of our AMS customers, we asked if they were ready to adopt the new standards for ASC 842 and IFRS 16; we know it will impact our support teams. The controller shrugged and responded, “we’re waiting for direction from Corporate!”

We were alarmed!

They are a global manufacturer with thousands of assets worth millions in operating leases for equipment, forklifts, automobiles, and other devices. These assets are affected by the new reporting regulations. The conversion effort is a herculean task!

To summarize for those not familiar with the **new** lease accounting standards:

- The standards are for **ASC 842 and IFRS 16** and are effective January 2019.
- Businesses worldwide are required to bring **most** leases on their balance sheet as obligations and liabilities by January of 2019.

The impact of the regulations affects the Financial Statements, Systems, Procedures, Asset and Lease Reporting, and Change Management. The date is coming quickly, and a recent survey indicated that the majority of companies have low-confidence if they had to convert today.

By comparison, many companies are struggling with the revenue recognition changes, IFRS 15, and with this as a backdrop may struggle to meet the effectivity dates for IFRS 16.



### Who does this effect?

Any public company that has property and operating leases for property, equipment, vehicles, and possibly devices, for example. Companies like Walgreens, CVS, McDonald’s, Verizon, AT&T, CDW, and Xerox are affected by this regulation. Walgreens alone has over 33,000 properties worth 100’s of millions of dollars. This has an enormous impact on the balance sheet!

### What must happen?

The lease portion of the contract needs to be set up on the balance sheet as an asset and an offsetting liability. The analysis of the operating lease follows these conditions:

- Do you have the right to use the property – Right of Use (RoU)
- Does SAP Lease Accounting address the requirements?
- The first thing to consider, “Are you the lessor or the lessee?”

### What are my options with SAP?

If you are the lessee of equipment, automobiles, or devices which is a large portion of our audience, you have a few options. Of course, it depends upon which release of SAP you use.

Generally,

- ECC – requires either a 3<sup>rd</sup> party solution or customized integration to Fixed Assets and Lease Accounting.
- S/4 HANA 1709 on-premise – has Lease Accounting, but will need either 3<sup>rd</sup> party integration or customization.
- S/4 1802 cloud edition (CEE) – According to the release notes, the Lease Accounting module addresses ASC 842 and IFRS 16.



There are a few 3<sup>rd</sup> party solutions on the market. Nakisa is SAP's certified solution for integration to ECC and S/4 HANA.

If you are the lessor of the property, you will need to use SAP Real Estate (REFX). We will address the REFX components in a separate article.

### **What else is different about the new regulations?**

The use of present value (PV) of future cash flows. The present value of the asset and liability is recorded on the books rather than at historical cost. For example, if you have a contractual payment of \$50,000 over five years, the present value of the cash payments, assume \$45,000, is the recorded value.

### **What impact does this have on your SAP Financials System?**

- 1 – New Lease GL Accounts for Assets and Liabilities
- 2 – New Asset Class for Right of Use Assets – RoU Assets
- 3 – The migration and restatement of the financial statements.

### **What are some of the 'Aha's with the migration?**

To start, collecting the detailed information could be significant. Each lease that qualifies under the new regulations will require the interest rate, payment schedule, termination and extension clauses, and statements validating the right of use. In some situations, if this information is captured, it is retained in multiple locations or departments and at best on spreadsheets.

Also, the payment for each lease needs to separate the equipment and services components. The service component of a lease is not capitalized. For example, payment for an equipment lease may include a service component. The service component is an operating expense and excluded from the new asset and liability.

### **Is there a Change Management Impact?**

From a business change management perspective, ASC 842 and IFRS 16 will have a massive impact on your Lease, Accounting, and Operations teams. Does your current CAPEX approval process include leases in the process? Does the process capture the information to record the asset and liability at present value? For many companies we spoke to, operating leases are not included in the CAPEX approval process.

Fortunately, in the US, the FASB (Financial Accounting Standards Board) has relieved some of the reporting requirements for prior reporting periods. FASB is now saying that prior period restatement is not a requirement.

Even though this is no longer a requirement, many CFO's and investors will want to see the comparative impact of the balance sheet and P&L.

See our Detailed Accounting Guidelines for handling ASC 842 and IFRS 16 at <https://www.titanconsulting.net/march-2018-06/>.

The effort to convert your current operating leases could be a monumental task and time is running out. Do you need help evaluating the impact and options of these new regulations? Our Advisory Services team can assess your Lease Accounting requirements and recommend safe and efficient methods for adapting to ASC 842 and IFRS 16. For help, contact Warren Norris, [warren@titanconsulting.net](mailto:warren@titanconsulting.net), 972.679.5183; or, contact your Titan Consulting Director. You can also see additional information on our Advisory Services page at [www.titanconsulting.net](http://www.titanconsulting.net).