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Walldorf, December 05, 2016

Consultation regarding IFRS 16

Dear Sir or Madam,

First of all, on behalf of SAP, we want to thank you for initiating this consultation regarding the new Leasing Standard IFRS 16.

SAP's initial assessment of IFRS 16 is that it meets the technical criteria for endorsement. We do strongly recommend the endorsement of IFRS 16 and – based on the current status of our analysis - believe it will have no material impact on our operating, financing and investing activities.

It is our strong belief that endorsement will improve consistency, comparability and transparency of the information, and not endorsing this standard would result in higher costs to our company and could even negatively impact financial stability in Europe.

We are glad to contribute to the consultation and thus to the endorsement of IFRS 16 by giving our point of view from the software industry on the new standard as of today's situation, which is very supportive for the endorsement of the standard.

With kind regards,

Christian Kastler and Maren Leisurs (on behalf of SAP)

IFRS 16
Consultation
Questionnaire

#	Question	Answer
1	Do you have any information or evidence on the extent to which leases (that you are party to or otherwise aware of) will be eligible for each of the short-term and low-value assets exceptions identified in paragraph 24? If so, please provide details. If you are a preparer, do you expect to use the exceptions? If so, please: (i) quantify the number and annual lease payments for each category; (ii) indicate the proportion of your leases (by volume and/or value) you estimate to be covered by each of the exceptions.	We intend to make use of the practical expedients offered by new the IFRS 16. We are currently in the process of gathering data on transactions that are eligible for either the "short term" and / or "low value" exceptions. Due to the ongoing analysis (not for all of our leasing contracts there is a central repository), we currently can't quantify numbers / proportions (we consider compiling a full inventory of the leasing contracts to be one of the main challenges of the new standard). Overall, we appreciate the expedients offered by the standards, but we believe that the benefits will to some extent be offset / cannibalized by the need to make additional disclosures required if the practical expedients are used. However, if we are able to track the short-term and low-value rental expenses in separate GL accounts, disclosure effort might not be significant. Once we capitalize the buildings/cars/equipment, the remaining Rent Expense might not be material enough for disclosure.
2	If you are a preparer, which approach to transition do you expect to take? Please explain your reasons for this decision.	Based on our initial discussions (prior to a final decision), we are currently looking at the **pros and cons** of the different options: - The **full retrospective** approach (IFRS 16, C5(a)) would be the most advantageous option from a financial and comparability point of view. However, the transition costs incurred when applying this option retrospectively to an enormous number of lease contracts would be significantly higher than the other options. - When considering both **modified retrospective** options, it is clear that the comparability is reduced since prior period information will not be restated. However, when considering the practical application of either modified option, it will be more feasible and also less costly to apply them to an extensive portfolio of prior operating lease contracts. Although we have to consider to make additional disclosures in order to explain the non-comparability of the periods prior and after initial application of IFRS 16. However, the preparation of these disclosures would - from a practical / cost-benefit point of view - most likely result in less effort / cost compared to applying the full retrospective approach. - Nevertheless, when choosing between modified retrospective **option 1** (IFRS 16, C8(b)(i)) and **option 2** (IFRS 16, C8(b)(ii)), option 1 gives a more complete picture by using more historical information than option 2. Also, option 1 generally arrives at a lower depreciation expense than option 2 due to the lower carrying value of the right-of-use asset, which would be beneficial from a financial perspective. Option 2 on the other hand would be easier to apply since it mainly makes use of data available as of initial application.
3	Are you aware of: (i) any contracts that you consider to be leases that would not be classified as leases under IFRS 16; or (ii) any contracts that you consider to be service contracts (or other non-lease contracts) that would be classified as leases under IFRS 16? If so, please provide details of these contracts and why you consider that the classification would not be appropriate.	Based on the current status of our analysis (the equipment / facility leasing contracts the group entities enter into are rather straight forward), we don't believe to see material impacts here (in either direction).
4	EFRAG is interested in understanding whether leases of intangible assets (other than rights held by a lessee under licensing agreements within the scope of IAS 38) are common. Do you have any information or evidence as to how frequently such leases of intangible assets arise in practice? If so, please provide information about the types of intangible assets that are subject to leases and the significance in operating and monetary terms.	We, since operating in the Software industry, appreciate the fact the intangibles are not within the mandatory scope of IFRS 16. Occasionally, we rent licenses to our customers and - from an economic point of view - we consider the sale of e.g. a one year term license to substantially give our customers the same rights as under a rental model.
5	Do you have any comments on the comparison of IFRS 16 with IAS 17?	The new standard is a major revision of lease accounting and in general, we consider the new guidance to be an improvement (but we also see that the transition to the new standard and the application of the new guidance going forward results in one-off and ongoing costs / results in an administrative burden). Whereas the accounting by lessors remains substantially unchanged, the lease accounting by lessees (our group entities are mainly lessees in leasing arrangements) will change significantly as all leases need to be recognized on a company's balance sheet as assets and liabilities (in the primary financial statements). For our group, the vast majority of the impact is expected to come from our facility leases and we are currently analyzing the effects of adopting the standard and whether or not those effects will be material. We are also currently evaluating to which extent we want to make use of the practical expedients included in the standard (as stated above, we are currently planning to make use of the practical expedients offered by IFRS 16). The financial impact of the new standard will depend on the lease agreements in effect at the time of adoption. It is expected that operating profit will increase as costs that were treated as operating expenses in the past will now be recorded as interest expense. It is also expected that total assets / liabilities will increase as right-of-use assets / lease liabilities will have to be recorded for those items that were previously “off balance sheet".
6	Do you have any views or information on how IFRS 16 can be expected to affect the behaviour of investors and/or lenders? If so, do you have any views or information on whether and how IFRS 16 could, for European companies that apply IFRS, positively or negatively affect: (i) the overall cost of capital; (ii) access to finance and cost of credit? Please provide any available evidence.	In general, the change to IFRS 16 should not directly affect the cost of capital/debt as well as our access to (debt) capital markets. These aspects are mainly dependent on our creditworthiness, which should, if at all, not significantly change due to the implementation of IFRS 16. Nevertheless, the rating agencies consider operating leases in their rating process in order to assess our solvency/creditworthiness. However, mainly historical annual figures are applied which are multiplied with a factor in order to determine the adjusted level of debt which in turn is considered in the determination of key figures and in the assessment of solvency. In this regard, we are not aware of a change in the rating process. Furthermore, in our documentation of credits, no financial covenants are included which may be harmed by the change in the leasing reporting. In general, operating leases are however included in the calculation of the weighted average cost of capital (WACC) which again has an impact on the company value and the investment appraisals. Nevertheless, in 2015 these were only 1.7% of total capital. Thus, in case the amount of operating leases will change, the impact will not be significant.

7	Do you have views or information on how IFRS 16 might affect entities' use of leasing? For example, do you expect lessees to: (i) reduce their use of leases with a corresponding increase in purchases of assets; (ii) reduce their use of leases without a corresponding increase in purchases of assets; (iii) seek to change the terms of new or existing leases? Please provide any available evidence.	We do not intend to change our behavior when it comes to the decision "lease vs. purchase" (investment decisions will continue to be based on e.g. a DCF analysis and thus not be impacted by the new model as such).
8	Do you have any additional information or views on how the endorsement of IFRS 16 can be expected to affect the leasing industry in Europe? EFRAG is particularly looking for views from the leasing industry. Please provide any available evidence.	N/A as our group of entities is not significantly operating in the leasing industry as a lessor (the only potential impact we could think of is that - with the main advantage of having operating leases "off balance sheet" being eliminated under IFRS 16 - lessors might have to add additional services to their portfolio to convince their customers to still enter into leasing agreements).
9	Do you have any information or views on how the endorsement of IFRS 16 can be expected to affect SMEs in Europe? Please provide any available evidence.	N/A
10	Do you have any information or views on whether IFRS 16 is likely to endanger financial stability in Europe? Please provide any available evidence.	It is our strong belief that financial stability will not be endangered by the new standard. When it comes to future cash outflows, there are no or no material changes resulting from IFRS. Items that were only visible in the Notes to the consolidated FS before (financial commitments) are now brought "on balance sheet" (i.e. included into the primary financial statements) which increases visibility of the effects leasing agreements have on the net assets, financial positions and results of operations of entities. Thus, we conclude and strongly believe that financial stability will even be strengthened through improved transparency when applying IFRS 16.
11	What is your view on the relative costs of applying IFRS 16 and US GAAP? Do you have any other views as to the advantages or disadvantages of IFRS 16 compared to US GAAP? Please provide any available evidence.	We believe that the application of US GAAP (Topic 842) would be more difficult (and therefore more expensive) than IFRS 16. The primary reasons for this are: 1) Topic 842 requires the differentiation between operating and finance leases. This effort is not required by IFRS 16. IFRS 16 simplifies the accounting by treating all leases in the same way that Topic 842 treats finance leases. 2) Under Topic 842, the accounting for operating leases requires a straight-line cost. Straight-line may sound easier. However, the total of interest expense and depreciation expense needs to remain constant over the lease term (annuity method). Since interest expense decreases over time, the depreciation expense (net of interest expense) will increase over time (so that the total is constant). In the attached example (see worksheet "Topic 842 Example"), two methods have been identified that achieve the Topic 842 goal of straight-line cost. Either way (method 1 or method 2), the calculation of operating lease expense would be easier under IFRS 16 (since depreciation and interest are calculated independently of each other). There is no difference for finance leases. 3) IFRS 16 has an exemption for leases of assets with values less than 5K EUR. Topic 842 does not have this exemption. Not having to apply lease accounting to small value assets is an advantage for IFRS 16.
12	What is your view on the one-off and ongoing costs for preparers? (Please indicate whether you are (a) a lessee; (b) a lessor; (c) both a lessee and a lessor or (d) neither a lessee nor a lessor). Will preparers that already report finance leases have lower costs than preparers without finance leases? Please provide any evidence you have on the expected magnitude of the costs.	As a **lessee** with mainly operational facility leases we did neither identify material one-off nor ongoing costs. Following you can find a list of overall immaterial one-off/ongoing costs to be incurred due to the implementation of IFRS 16: **One-off costs:** - There are certainly resources needed and thus costs incurred in order to understand the standard itself and the respective transition aspects. However, these costs are most likely not significant since no extra costs are incurred with regard to hiring additional staff/advisors. - System changes - the development of the group's lease accounting tool needs be considered. Extensive costs are incurred for development, implementation, sales etc. - There is a need to change lease contracts which incurs costs as well. - Furthermore, one-off costs are incurred to enter and process the (contract) data needed for transition/implementation of the new lease accounting. - Additional resources/costs are incurred for writing/updating an internal leases accounting policy. - Another part of one-off costs relates to the transition from IAS 17 to IFRS 16 in applying the modified retrospective method once which requires extra time and resources. - We expect to incur costs when inventorying our (decentralized) lease contracts (this is needed to calculate the transition effects etc.,) / creating a central repository for our leasing agreements (or collecting the necessary data from our subsidiaries). **Ongoing costs:** - Keeping the inventory up to date / collecting the data for additional disclosures will most likely also result in ongoing costs. - Ongoing costs are mainly related to applying the standard and to process the data required for the accounting and reporting of leases - most likely not significantly more expensive than ongoing costs under IAS 17.
13	If you are a user, are you aware of any costs in addition to those identified by EFRAG in paragraphs 116 to 118 of Appendix 3? Please quantify if possible and provide any available evidence.	Please see our answer to question 12 (we have tried to summarize our relevant one-off / ongoing costs here).
14	If a lessee has to develop new systems to support the accounting for leases, to what extent do you, as a lessee, expect internal benefits from the information provided by the new information? Please quantify to the extent possible. Do you agree with the benefits for users and preparers identified above? Are there any additional benefits for users and preparers? Please provide any available evidence.	We are a software company and thus have to - on top of implementing the new guidance internally - provide solutions to our customers. Internally, we will use the same system that will be sold to our customers. By implementing the new software solution, we will aggregate all lease contracts in the database to gain an update of and a more detailed overview of the existing lease contracts. This will result in an initial investment, which however will be set-off by future benefits since we can then e.g. use the data for internal tracking and cash flow projections.
16	Are there any issues that have not been raised in this Preliminary Consultation Document that should be considered by EFRAG? Please explain your view.	From our point of view, all material aspects have been addressed in the Preliminary Consultation Document.

Based on interpretation from "KPMG Leases CFO Slides.pdf" in my local drive

Year 1	Year 2	Year 3	Year 4	Year 5	Total Cash Pmt.	Present Value	
100.000	105.000	110.000	115.000	120.000	550.000	460.909	
					10.000	10.000	Initial direct costs
					560.000	470.909	Right-of-use Asset
						6%	Interest Rate

Subsequent Measurement for Operating Leases (Finance leases are same as IFRS 16)

Method 1

Beginning Lease Liab.	Interest	Cash Payment	Ending Lease Liab.
(460.909)	(27.655)	100.000	(388.564)
(388.564)	(23.314)	105.000	(306.877)
(306.877)	(18.413)	110.000	(215.290)
(215.290)	(12.917)	115.000	(113.207)
(113.207)	(6.792)	120.000	0
	(89.091)	550.000	

ROU Asset Booked	Straight-line Cost	Less: Lease Accretion	Net Depreciation	Accumulated Depreciation	Net Book Value	Depr. + Interest Exp.	
470.909	112.000	(27.655)	84.345	(84.345)	386.564	112.000	
470.909	112.000	(23.314)	88.686	(173.032)	297.877	112.000	Operating leases have straight-line in total exp. while Finance leases are front loaded
470.909	112.000	(18.413)	93.587	(266.619)	204.290	112.000	Note: added complication of identifying operating vs. finance leases
470.909	112.000	(12.917)	99.083	(365.702)	105.207	112.000	Note: added complication in calculation
470.909	112.000	(6.792)	105.208	(470.909)	(0)	112.000	
	560.000	(89.091)	470.909			560.000	

Method 2

Beginning Lease Liab.	Interest	Payment	Ending Lease Liab.	Ending Lease Liab.	+Unamortized Initial Direct Costs (from below)	- Deferred Balance (from below)	ROU Asset Net Book Value	
(460.909)	(27.655)	100.000	(388.564)	388.564	8.000	(10.000)	386.564	Note that the NBV (and expense) is the same under both Method 1 and Method 2
(388.564)	(23.314)	105.000	(306.877)	306.877	6.000	(15.000)	297.877	
(306.877)	(18.413)	110.000	(215.290)	215.290	4.000	(15.000)	204.290	
(215.290)	(12.917)	115.000	(113.207)	113.207	2.000	(10.000)	105.207	
(113.207)	(6.792)	120.000	0	(0)	-	-	(0)	
	(89.091)	550.000						

Initial Direct Costs	Depreciation Expense	Accumulated Depreciation	Net Book Value
10.000	(2.000)	(2.000)	8.000
10.000	(2.000)	(4.000)	6.000
10.000	(2.000)	(6.000)	4.000
10.000	(2.000)	(8.000)	2.000
10.000	(2.000)	(10.000)	-
	(10.000)		

Cash Payment	Straight-line Expense	Difference	Deferred Balance
100.000	110.000	(10.000)	(10.000)
105.000	110.000	(5.000)	(15.000)
110.000	110.000	-	(15.000)
115.000	110.000	5.000	(10.000)
120.000	110.000	10.000	-