Smarter Lease Accounting for Oil and Gas

An industry focus on lease accounting and compliance with IFRS 16 and ASC 842

NAKISA
LeaseAdministration

Navigating Shifting Landscapes

Pricing pressures, emerging innovations and regulatory changes are part of the shifting landscape facing oil and gas companies. A wave of significant financial reporting changes, particularly new lease accounting standards – IFRS 16 and ASC 842 – have brought new challenges to the accounting profession in the oil and gas industry. Effective January of 2019, the new lease accounting standards require nearly all leases to move onto company balance sheets. This will require a significant amount of attention to ensure that compliance with the lease accounting standards is timely, accurate, and transparent to financial statement users.

In the oil and gas industry, companies make pervasive use of leases to secure the geographically-dispersed assets they employ in their operations. These assets include the land from which producers extract resources, the equipment used in the production process, and the facilities used to store and transport product. IFRS 16 and ASC 842 brings most of these leases onto balance sheets, exposing billions in lease liability across the industry. One of the biggest impacts on this industry is going to be a compliance exercise. Lease accounting technology can help identify if a contract contains a lease, determine if any contracts meet any of the exemptions, such as low value or short-term leases, and perform necessary disclosures. Once this process is complete, it becomes a complex operations exercise to manage the lease lifecycle.

> “ **Because of the number and magnitude of contracts they will need to evaluate and potentially recognize on their balance sheets, oil and gas entities should start to accumulate information that will be necessary to evaluate agreements that may contain lease components, particularly drilling contracts, transportation or capacity arrangements, storage agreements and downstream retail land, building and equipment rental contracts.**
> – EY, A Summary of IFRS 16 and Its Effects

The new lease accounting standards fundamentally change the accounting for lease transactions across all industries, and is having significant business implications for organizations in the oil and gas sector. These impacts of the new rules extend beyond the requirement to recognize operating leases on the balance sheet as right-of-use assets and accompanying lease liabilities. Other implications include whether joint operation or similar arrangements provide control over assets which must be accounted for as leases and whether transactions with related parties providing access to pipelines or storage tanks must be accounted for according to their form or substance.

For many companies, adopting an on-balance sheet lease accounting model is a significant challenge by itself because of the requirement to capture and record substantially all leases. For oil and gas businesses, however, some activities create industry-specific complexities for the ongoing application of the new lease rules. For example:

- Oil and gas companies engage in strategically significant service contracts which often involve the use of an asset as an integral element of the service. Examples include transportation, storage, and drilling contracts. Because the new accounting rules require companies to record leases as right-of-use assets based on economic benefit, oil and gas operators must evaluate these service arrangements to determine whether they contain embedded leases.

- Often, access to a material asset such as a drilling rig is arranged through a bundled service contract. These contracts include the asset together with employees who operate the rig and materials such as concrete and piping associated with drilling the well. When these agreements contain features that meet the definition of a lease in the new accounting rules, the lessee will need to implement systematic and rational methods for determining the standalone value of each of the lease and non-lease components.

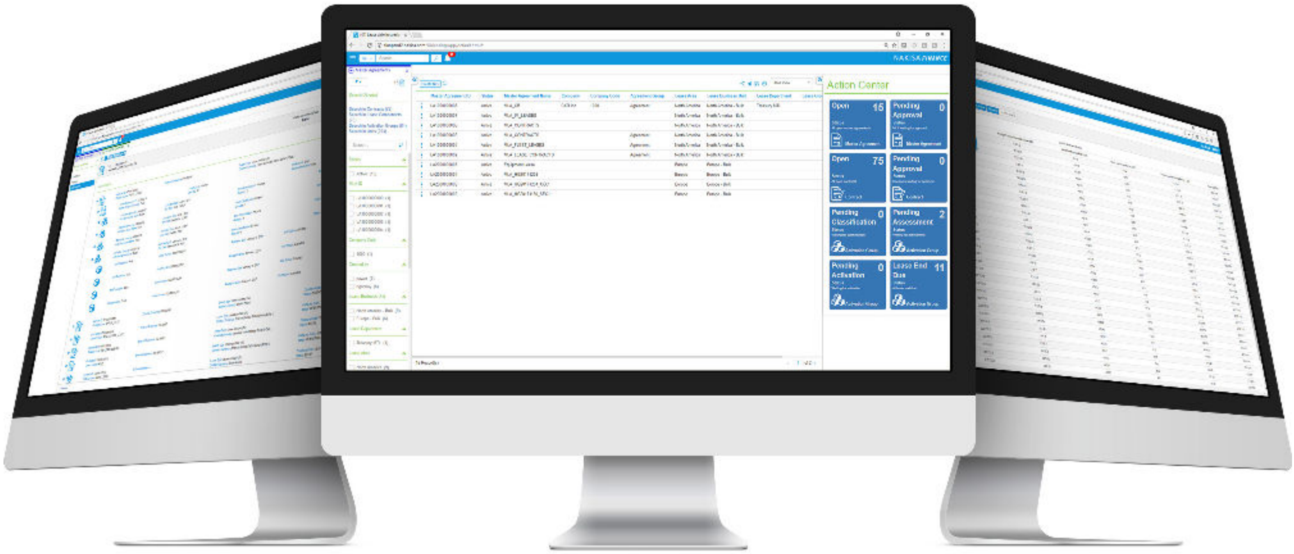
- Oil and gas entities often enter into joint operating agreements to gain access to assets, such as drill rigs, that are currently being leased by another oil and gas entity. Under a joint operating agreement, it needs to be determined whether to record the embedded lease on a gross or net method.

- Over the course of a lease, any number of events may arise to alter the likelihood that a lessee will exercise renewal and other options within their control. For example, oil and gas companies must routinely make economic decisions based on expected commodity prices. The new accounting rules require lessees to evaluate whether these events trigger a reassessment of the lease's operating vs. financing classification. These events could also involve a revaluation of the right-of-use asset and related lease liability. Further, there will be cases where these factors require oil and gas industry participants to record impairment charges for their right-of-use assets. It will be important for these companies to install processes and controls to monitor these types of triggering events and factor them into multiple accounting workstreams.

Paving the Road to Compliance

Oil and gas companies require access to accurate, real-time leasing data. Organizations must be able to identify leases, including value, payments and depreciation, and be able to produce required disclosure reports. This information is crucial in order for organizations to comply with the new standards. However, with the standards now in effect, the challenges facing the oil and gas industry are immense.

The most efficient way for accounting and finance to manage accounting challenges and achieve compliance is to leverage lease management and accounting technologies that centralize lease data and automate lease accounting. Instead of sifting through spreadsheets with duplicated or lacking information, a single system for lease management helps to streamline and simplify accruals, payments, reconciliation, and financial reporting on leases.



Benefits of Lease Accounting Software:

Insights

Gain insight into contractual data to identify lease exposure and analyze the impact on financial statements. Understand financial implications and make informed decisions.

Visibility

Centralize contract data in a single repository to provide a global view of lease contracts. Gain clear visibility into leasing data including liabilities and commitments.

Compliance

Handle comprehensive lease accounting requirements and support compliance. Software allows organizations to transition to the new standards, process required accounting lookback, and fulfill reporting requirements.

Efficiency

Reduce costs by making lease data accessible and actionable for stakeholders. Automate finance and accounting through push and pull ERP integration.

Nakisa Offers a Smarter Solution for Lease Accounting

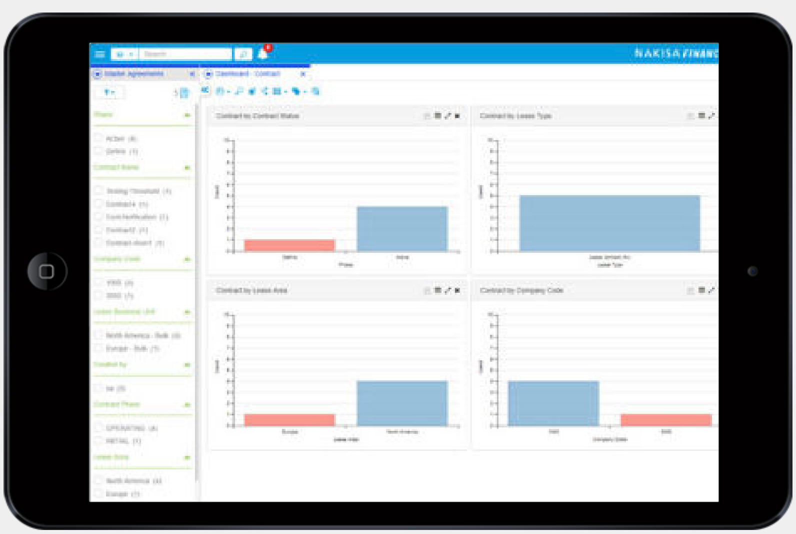
Nakisa Lease Administration is a lease management and accounting solution designed to accelerate compliance with IFRS 16 and ASC 842 by automating, centralizing, and simplifying lease accounting operations. The ability to consolidate data, group together leases, and provide disclosure reports in compliance with leasing standards, makes it the solution of choice for leading oil and gas companies.

Key Value Drivers of Nakisa Lease Administration

Nakisa Lease Administration enables accounting and finance teams to centralize and optimize their global lease portfolios while assisting in compliance efforts with the new lease accounting regulations, IFRS 16 and ASC 842. With Nakisa Lease Administration, lease accounting is simplified and streamlined. Leveraging a single system for accruals, payments, reconciliation, and financial reporting on leases, oil and gas companies can use the solution to maintain an audit trail of all changes and decisions for traceability.

With Nakisa Lease Administration, you can:

- ✓ Enable compliance with new lease accounting standards IFRS 16 and ASC 842
- ✓ Achieve global visibility through end-to-end lease contract management, compliance reporting, and audit trail maintenance
- ✓ Streamline contract management, lease accounting, and compliance reporting efforts
- ✓ Reduce costs by leveraging powerful automation and ERP integration technology



Phased Deployment

Nakisa Lease Administration is deployed in the cloud to help streamline implementation and accelerate adoption. The solution can be deployed with full integration to your ERP or in a phased deployment model in standalone mode to shorten deployment timelines. In this scenario, deployment is simplified by abstracting data from specific organizational units using a combined effort from project teams and ready-to-use configuration templates. Before integration is configured in the phased deployment model, lease accounting technology can be used to amortize ROU assets and lease liability schedules internally. However, the benefits of ERP integration become much more significant as lease liabilities and ROU assets go through frequent remeasurements due to changes in the lease terms and conditions and also due to changes in user decisions in terms of extension and termination.

Why Industry Leaders Trust Nakisa

- ✓ Global leader in enterprise business solutions for accounting and compliance
- ✓ Experience with the world's most renowned brands
- ✓ Proven solution for end-to-end lease management and accounting
- ✓ Validated by the Big 4 accounting firms

About Us

A global leader in cloud business solutions for Organization Transformation and Accounting & Compliance, Nakisa delivers innovative, forward-thinking and robust human resource and financial management solutions that advance your business strategies.

Nakisa serves 800+ enterprise customers and over 4 million subscribers in 24 industries. Nakisa is proud to work with some of the world's most renowned brands

Contact Us

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