The **Impact of COVID-19** on Lease Accounting: Building Resilience in a **Challenging Economy**

NAKISA

LeaseAdministration

Understanding the Challenge

The World Health Organization (WHO) declared the coronavirus disease (COVID-19) a world pandemic on March 11, 2020. Since, the pandemic has had sweeping effects on individuals, families, and organizations across every industry.

Everyone, it seems, has been touched by these events to some degree.
It is undeniable that the COVID-19 pandemic has also significantly impacted current global financial markets, resulting in an unforeseen, unbudgeted market decrease. Reponses to this downward turn have included:

- Industries seeking government bailouts
- Companies leveraging technology for flexibility and efficiency
- Organizations adapting processes to cut costs

Key Impacts to Lease Accounting

As a result of the COVID-19 outbreak, the operational performance of organizations around the world has been severely impacted, drastically altering financials, forecasts, and disclosures. The trickle-down repercussions of this turn in the economy also affects accounting and reporting processes.

Specifically, lease accounting processes disrupted by the pandemic may include temporary property closures and supply-chain disruptions, among others. What is unique about this from a lease accounting standpoint is that these events will take place in mass volume. Organizations must consider the impact of the outbreak on accounting conclusions and disclosures related to the following:

- Impairment
- Abandonment of ROU assets
- Lessee discount rates / incremental borrowing rates (IBR)
- Lessee modifications

The Economic Impact of the Pandemic by Industry

Health and safety precautions, such as quarantines, travel restrictions, and government-recommended social isolation have been enforced in multiple countries worldwide.

Despite being necessary to contain further outbreaks, these measures have nonetheless disrupted many industries. Below are three examples of industries that have been hit by the pandemic to date, and a brief description of how this impact has played out.

Oil and Gas

"Disruption in the sector may lead to numerous financial disclosure implications, and companies may need to make the necessary assessments across their business — from the value of assets to liquidity and other risk disclosures."

PwC, COVID-19: What it Means for the Energy Industry

- Prior to the pandemic, the industry was already impacted by the Russia-OPEC price war.
- Travel restrictions and production disruptions have lowered the demand for oil and gas.
- The cost of production is more than the selling price and the selling price is dropping. January 1, 2020, the WTI price was $63 per barrel. By April 1, 2020 it was at $20.40 per barrel, a 68.2% drop.
- The industry may require government bailouts.

Retail

"Whether this situation lasts weeks or months, it is clear that the global response to this virus has fundamentally changed the reality for retailers. It's time to face that fact and start adapting."

KPMG, The Realities of Retailing in a COVID-19 World

- Over 90 major U.S. retailers have been temporarily closed since of March 23, 2020.
- Retail stores in China dropped by 20.5% after coronavirus hit.
- Research conducted by CommerceNext shows that 64% of retailers are not yet seeing sales shift from stores to e-commerce.

Airlines

"Given the unknown variables in how the COVID-19 pandemic will play out and when containment will be achieved, commercial airlines should expect to brace for a trying period and plan for a recovery."

PwC, COVID-19: What it Means for the Aerospace and Defense Industry

- In a revenue-gaining strategy, American Airlines Group (as well as a number of others) have spoken of plans to turn passenger jets to cargo planes.
- The U.S. Senate voted unanimously on March 25, 2020 to approve a $2.2 trillion stimulus bill with $58 billion in financial assistance for U.S. airlines, broadly matching what the industry had requested.
- More packages are expected worldwide.

Business Resilience for Lessees in a Challenging Economy

Automated research and reporting allow users to analyze costs versus benefits for informed decision-making. In order to strategize for lease accounting sustainability, these five lease management tools are essential:

1. Visualization of Lease Portfolios / Data

- Easily review list of lease contracts with future payments split by years.
- Identify, analyze, and decide whether the lease of higher-costing premises or equipment may be scaled down or eradicated.
- A dynamic and scalable system allows users to execute large-scale modifications of their entire lease portfolios in order better manage incentives/concessions.

2. Impairment and Abandoned Assets

- Government-sanctioned closures impact all industries.
- Companies are likely to immediately trigger impairment of assets of which the economic value may be significantly reduced by negative market conditions.
- A critical feature of the current climate is that **mass impairment and abandonment** is likely to occur, which is quite significant, unusual, and new.
- Appropriately accelerate depreciation for abandoned assets is going to be a new reality, and it will be a requirement to have the technology to perform these modifications.

3. Discount Rate / Lease Modification

- Discount rates (including IBR) are **likely to decrease** due to government stimulus efforts.
- Rapidly changing discount rates will need to be reflected in the IBR table and applied during lease modifications.
- Together, these tools allow users to actively manage discount rates which will affect the value of the lease at the date of the modification.

4. Financial Analysis Dashboard

- Budgets, financial modeling, and scenario testing will have to be quickly amended, and probably actively amended given the uncertainty of the duration of the pandemic.
- A Financial Planning & Analysis (FP&A) dashboard enables users to actively forecast and plan cash flows per lease, currency, and asset class **in real time,** including:
    - Accounting for and reporting mass material modifications
    - Investor updates
    - Fluctuating stock markets

5. Critical Actions for Early Terminations & Lease Renewals

- Review and analyze the lease that are due for termination and renewal.
- Re-classify the likelihood of renewals and terminations that are already embedded into the lease.
- Make informed decisions about whether to terminate or renew the leases.

Nakisa Lease Administration: Visualize to Strategize

A sophisticated lease accounting solution is essential for customers to navigate our rapidly changing conditions. Nakisa Lease Administration allows users to visualize their total lease accounting portfolios, review lease termination options, and easily identify and offload any redundant leases in order to shed avoidable costs.

Nakisa's solution also incorporates disparate data into a single report, saving users time and effort so that they may begin negotiations with the lessor as soon as possible. The solution empowers users to make informed decisions in order to best manage their leases and assets, helping organizations stay resilient in the face of change.

If you think Nakisa Lease Administration can help your organization navigate this challenging time, please email us directly at info@nakisa.com.

About Us

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

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