# Accounting and Audit Updates: How Will They Impact Dealers?

Smaller dealers generally prepare their financial statements on the income tax basis of accounting so they can see how bad their tax answer is going to be. However larger dealers, especially those with bank reporting requirements, follow GAAP accounting rules issued by the Financial Accounting Standards Board (FASB). The FASB has issued several Accounting Standards Updates (ASUs) which may have an impact on dealer's financial statements over the next few years. While accounting rules change regularly, we have prepared a list of updates that we think are particularly impactful on dealer financial statements.

***ASU 2016 -02 Leases (Operating and Capital):*** Effective in the year 2020 for private companies, new lease guidance requires lessees to record all leases, which are 12 months or longer, as debt on their balance sheet. The present value of any lease payment stream is recorded as a liability, and a "Right to Use" asset of equal amount is recorded in the fixed asset section. The liability and fixed asset are then amortized over the life of the lease.

*The Impact:* Property and equipment leases that dealers sign become debt on their books and will require significant work to document all leases, determine the present value, and maintain appropriate schedules to amortize the payments. Additionally, there is potential for a major impact on financial statement covenants (ex. debt to equity ratio).

***ASU 2014-09 Revenue:*** Effective in the year 2019 for private companies, revenue guidance has been completely overhauled with all industry specific guidance removed and replaced with general principles for revenue recognition. The primary issue is when something is sold with multiple deliverables. The guidance requires the transaction price be allocated amongst the various performance components and revenue only recognized when each of the performance components are delivered and completed.

*The Impact:* Warranties are exempt from these new revenue recognition rules provided the warranty is not above and beyond industry norm (10 year warranty versus a 3 year warranty). However, revenue recognition for other add-on products may be affected. (ex. free oil changes)

***ASU 2016-13 Financial Instruments – Credit Losses:*** Effective in the year 2021 for private companies, new guidance on financial instruments applies to (1) loans, accounts receivable, trade receivables, and other financial assets measured at amortized cost, (2) loan commitments and certain other off-balance sheet credit exposures, (3) debt securities and other financial assets measured at fair value through other comprehensive income, and (4) beneficial interests in securitized financial assets. This new guidance requires the allowance for credit losses be future looking rather than backward looking, covering all expected future losses in the current portfolio.

*The Impact:* This new guidance primarily affects Buy Here, Pay Here dealers and finance companies and will require detailed historical loss measures and sophisticated future predictive loss models. You may use historical indicators like a static pool allowance but such estimates must be adjusted to account for changes in credit quality and other factors in the portfolio that may cause future losses to differ from current losses.

***ASU 2016-01 Financial Instruments:*** Effective in the year 2019 for private companies, this new guidance eliminates the accounting distinction between investments in equity securities that are trading investments or available for sale investments. Historically, trading investments were measured at fair market value with changes in the investments being recorded on the income statement while available for sale securities were historically adjusted through equity (other comprehensive income).

*The Impact:* Under this new guidance, all investments in equity securities will be recorded at fair market value with changes in their values recorded through the income statement.

***ASU 2014-15 Going Concern:*** For entities where some doubt exists about the entity's ability to continue for the foreseeable future (generally one year from the date of financial statement issuance), management is now required to evaluate whether there is substantial doubt. This new guidance went into effect in year 2016 for private companies.

*The Impact:* When appropriate, management must disclose in the notes to the financial statements the conditions or events leading to substantial doubt and plans to mitigate the impact of those conditions or events.

Some of these rules are rather technical and not ever dealer will understand the effect that these rules may have on their financials. As such we encourage dealers to discuss these rules with their accountants so that when these rules become effective, there are no surprises!

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