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New Revenue Recognition Standard Will Impact Auto Dealers

AUTOMOBILE, SCHNEIDER DOWNS, TRANSPORTATION & LOGISTICS
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In May 2014, the Financial Accounting Standards Board (FASB) issued accounting standard update (ASU) 2014-09, Revenue from Contracts with Customers, intended to provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices and clarify disclosure requirements.

Under the new standard, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. The principles in the standard should be applied using a five-step model that includes: 1) identifying the contract(s) with a customer; 2) identifying the performance obligations in the contract; 3) determining the transaction price; 4) allocating the transaction price to the performance obligations in the contract; and 5) recognizing revenue when (or as) the performance obligations are satisfied.

The standard also requires disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In addition, it amends existing requirements for the recognition of a gain or loss on the transfer of nonfinancial assets that are not in a contract with a customer (e.g., sale of real estate) to be consistent with the standard's guidance on recognition and measurement, including the constraint on revenue.

The FASB subsequently issued several amendments to the standard, including clarification on principal versus agent guidance, identifying performance obligations, and immaterial goods and services in a contract.

This accounting standard update is effective for reporting periods beginning after December 15, 2018 for non-public entities, and must be applied using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a modified retrospective approach with the cumulative effect of initially adopting the standard recognized at the date of adoption (which requires additional footnote disclosures).

Public companies had to implement this guidance last year; this year, nonpublic companies are working through the implementation. The standard will arguably have a bearing on all industries, and automobile dealers could see an impact on financial reporting as a result, especially in the following areas:

- Sales of finance and insurance contracts

- Customer loyalty programs (free car washes, oil changes, etc.)
- Service and maintenance, including body shop repairs
- Dealer warranties

Dealers, though, should review *all* revenue sources to see if there are material changes that need to be implemented. Here's the process one company followed:

We adopted the standard using the modified retrospective approach, applied only to contracts not completed as of the date of adoption, with no restatement of comparative periods and a cumulative effect adjustment recognized as of the date of adoption.

As part of our implementation process, we performed an analysis to identify accounting policies that needed to change and additional disclosures that will be required. We considered factors like customer contracts with unique revenue recognition considerations, the nature and type of goods and services we offer, the degree to which contracts include multiple performance obligations or variable consideration, and the pattern in which revenue is currently recognized, among other things. We evaluated all revenue streams, and noted that similar performance obligations will result under the new standard as compared with deliverables and separate units of accounting currently identified. As a result, the timing of our revenue recognition for most of our revenue streams will generally remain the same. We have, however, identified certain revenue streams that will be affected by the new standard.

First, the timing of revenue recognition associated with customer loyalty programs offered in certain stores will be deferred. We currently accrue the incremental cost of loyalty points awarded under current guidance. Under the new standard, a loyalty program that provides a customer with a material right is accounted for as a separate performance obligation, with revenue recognized when the loyalty points are redeemed. Second, the timing of revenue recognition for automotive repair and maintenance services will be accelerated, as we have determined that these performance obligations are satisfied over time under the new standard. Lastly, a portion of the transaction price related to sales of finance and insurance contracts is considered variable consideration and subject to accelerated recognition.

The new standard requires an entity to estimate variable consideration and apply the constraint in determining transaction price. We are finalizing our cumulative effect adjustment and expect that all changes to our revenue recognition methods as a result of adopting the new standard will result in a net, after-tax cumulative effect adjustment to retained earnings as of January 1, 2019 in the range of $XXX to $XXX.

We do not expect a significant impact in the amount or timing of gain or loss recognition related to our periodic sales of real estate. We've also evaluated the changes in controls and processes necessary to implement the new standard; no material changes were required.

The above example may be helpful in determining areas in your organization that could be significantly impacted. As you go through implementation, please feel free to reach out if you have any questions.

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