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Take advantage of the lease return surge

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How COVID-19 is affecting auditing and financial reporting

The COVID-19 pandemic has affected virtually every area of business for most auto dealers. Since it began in the spring, questions have arisen about the crisis's impact on auditing and financial reporting. A list of frequently asked questions (FAQs), compiled by the American Institute of Certified Public Accountants (AICPA), helps answer some of those questions.

Disclosing risks and uncertainties

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 275, *Risks and Uncertainties*, requires disclosures of risks and uncertainties that could significantly affect near-term amounts reported in financial statements. These can arise from several different areas, including the use of significant estimates and current vulnerabilities due to certain concentrations.

The effects of the COVID-19 pandemic could negatively impact such estimates while exacerbating vulnerabilities due to certain concentrations. The disclosure of significant estimates should be made on financial statements when known information indicates that *both* of the following criteria have been met:

- It's at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation or set of circumstances that existed at the date of the financial statements will change in the near future due to one or more future confirming events, and
- The effect of the change would be material to the financial statements.

Meanwhile, vulnerability from concentrations may arise when a business is exposed to a greater risk of loss than it would have been had it mitigated risk through diversification. These risks manifest themselves differently and vary in significance depending on the nature of the concentration.

Concentration vulnerabilities should be disclosed in financial statements if known information indicates that *all* of the following criteria have been met: 1) the concentration exists at the date of the financial statements, 2) the concentration makes the entity vulnerable to the risk of near-term severe impact and 3) it's at least reasonably possible the events that could cause the severe impact will happen in the near term.

The FAQs give several examples of concentration vulnerabilities likely to be affected by the pandemic. They include specific markets or geographic areas where the business conducts operations, a diminishing volume of transactions with a particular customer or supplier and a limited supply of material or labor availability.

Evaluating subsequent events

Dealerships that haven't yet issued their 2019 financial statements may need to evaluate

The AICPA addresses going concern disclosure requirements

A representative list of frequently asked questions (FAQs) compiled by the AICPA answering some common questions related to the COVID-19 pandemic also addresses issues related to a business's ability to continue as a going concern under U.S. Generally Accepted Accounting Principle.

Management is required to evaluate the business's ability to continue as a going concern within one year of issuance of the financial statements. If there's substantial doubt about this ability, or if management has specific plans that alleviate this doubt, disclosure must be made in the financial statement notes. Modification of the auditors' report may be necessary.

The ability of a business to continue as a going concern could be impacted by many different factors, and some of these could be influenced by the pandemic. This, in turn, could result in deterioration of the business's finances.

As a result, you may need to consider recent pertinent information in relation to your assessment of the going concern — including the effect of the COVID-19 crisis on your operating results and financial position.

whether the consequences of the pandemic meet the definition of a subsequent event. FASB ASC 855, *Subsequent Events*, defines these as events or transactions that take place after the balance sheet date but before financial statements are issued or available to be issued.

There are two main types of subsequent events: recognized and non-recognized events. The latter are events that arose subsequent to the date of the balance sheet, such as the COVID-19 pandemic. Financial statement disclosure may be required for this event to prevent statements from being misleading. In this situation, disclosure should include:

- The nature of the event, and
- An estimate of the financial statement effect of the event, or a statement that the estimate can't be made.

Some events like the COVID-19 crisis are so significant that disclosure can best be made by supplementing the historical financial statements with pro forma financial data that treats the event as if it had taken place on the date of the balance sheet. In this situation, the AICPA FAQs recommend that a pro forma balance sheet only be prepared in columnar form and presented on the face of the historical statements.

If your dealership received Payroll Protection Program loan proceeds, the loan's key terms should also be disclosed as a subsequent event in your 2019 financial statements. *Note:* Even if a dealership expects to receive forgiveness, the accounting standards don't permit the liability to be derecognized until the loan is formally forgiven. If forgiveness happens after 2020 but prior to the issuance of your 2020 financial statements, additional subsequent disclosures may be required.

Seek professional guidance

This is a brief overview of some of the auditing and financial reporting issues that could be affected by the COVID-19 crisis. Consult with your accounting professional for more details and specific guidance for your particular situation.

Strategic planning

"For tomorrow belongs to those who prepare for it"

This African proverb resonates in the current environment. Strategic planning is key to an auto dealership's long-term viability. This article will spotlight a few areas to focus on as you create a strategic plan that can help drive success.

Of course, you'll want to factor in the COVID-19 pandemic as you create your plan. Given the uncertainty of the crisis, you'll probably want to use a shorter telescope as you look to the future — in other words, plan for shorter intervals than the three-to-five-year timeframes of the past.

Where is your competition?

Analyzing your competition is a good place to start. Your strategic plan should include a detailed competitive analysis that answers such questions as:

- What strengths do you leverage to differentiate your organization from competitors and compete effectively for customers?
- What new competitors have entered your market area recently, in particular, with fully web-based options?
- What brands are these and long-standing competitors selling and how do they compare from a price, quality and reliability standpoint to your brands?
- How visible are these competitors in the marketplace from an advertising and publicity perspective?

Based on the answers to these and other questions, you can devise strategies for competing successfully in your current environment.

Are you technologically competitive?

Perhaps there are certain technologies that your competitors use better than you do, or technological improvements you can make that will give you a leading edge.

Much of selling has moved online during the pandemic. In April alone, the percentage of vehicles sold online jumped from less than 10% pre-pandemic to 27%, according to a survey conducted by the National Automobile Dealers Association (NADA).

How have your customers liked the move to enhanced online communication? Consider integrating some digital tools, such as videoconferencing, into your operations permanently. Where do you see room for digital improvements?

What about growth and expansion?

Most owners hope to grow their dealerships, but many haven't planned strategically for this growth. And growing without a plan can be worse than not growing at all. In today's environment, you may want your short-term growth goals to be relatively modest.

However, if you *are* considering an expansion, factor in what your organization will require to make it work. Successfully operating a $60-million dealership obviously requires a different level of management sophistication, internal controls, and accounting and financial processes than operating a $20-million dealership does. So, your strategic plan should detail not only how you plan to grow your dealership, but also how you'll manage growth once it's achieved.

Could a SWOT analysis benefit you?

It can be useful to perform a SWOT analysis as part of the strategic planning process. This exercise will examine your dealership's unique Strengths, Weaknesses, Opportunities and Threats.

Once you have a firm understanding of your strengths and weaknesses, it'll be easier to formulate strategies that capitalize on your strengths and minimize the impact of your weaknesses. And when you have a clear picture of the potential opportunities and threats you're facing, you'll be better equipped to make tactical decisions.

Do you need a business succession plan?

Have you given thought to what will happen to your dealership when you're ready to retire or do something different? Usually, the main succession options are to sell your dealership to an outside buyer, transfer it to employees or managers, or pass it on to family members or heirs. Your succession strategies will be driven largely by which of these options you plan to pursue.

Ideally, you should start succession planning at least three to five years before you want to exit the dealership. This will give you time to explore all your options and begin laying the groundwork for a smooth transition to new ownership.

Roadmap to your future

Certain factors affecting your dealership's success can't be controlled, such as novel infectious diseases, the state of the economy and credit availability. However, you can — and should — give serious forethought to the direction you want your dealership to take and create a clear roadmap to get you there.

On the road to recovery: 5 ways to boost revenue

Many U.S. auto dealerships have suffered falling revenue as a direct result of the COVID-19 crisis. And major automakers reported sharp drops in vehicle sales during the second quarter of the year when shelter-in-place orders were in effect in many parts of the nation. However, now that these orders have largely been relaxed, car-buying activity has picked up.

If your dealership has suffered declining auto sales during the pandemic, you might be looking for ways to recoup revenue and generate cash flow. Doing so may require out-of-the-box thinking from your management team.

Recouping lost sales

Here are five suggestions to help make up for lost vehicle sales:

1. Offer paintless dent repair (PDR) and auto glass service. Many dealerships hire a specialist

to perform PDR on used vehicles before putting them on the lot for sale. Instead of outsourcing PDR, you can boost profitability by training at least one service tech in the craft. Consider having the technician sign a noncompete agreement that restricts his or her ability to leave your dealership and perform this work for competitors within a certain timeframe.

Auto glass repair and replacement is a similar service you can offer in-house to boost revenue. As with PDR, you may want your auto glass technician to sign a noncompete agreement to protect your training investment. And it might make sense to offer a bonus or spiff to keep your PDR and glass repair techs on board for the long term.

2. Provide key cutting and fob replacement. This is another attractive revenue-enhancing opportunity. It also can boost your bottom line, given the high profit margins associated with these services. Of course, you'll have to purchase programming equipment, which will represent an upfront cost. But once you've made the investment, offering this service could provide steady income for years to come.

Instead of outsourcing paintless dent repair services, you can boost profitability by training at least one service technician in the craft.

3. Offer concierge service for car repairs and servicing. The service department has been a lifesaver for some dealerships that have experienced severe slowdowns in vehicle sales. Consider adding to your service department revenue by offering to pick up and deliver customers' vehicles for service and repairs. This can help ease the COVID-19-related concerns some customers have about visiting their dealership. However, it's important to determine a geographic radius within which it's reasonable and cost-effective to offer this service.

4. Pay vendors using a purchasing card (p-card). Today, many vendors and suppliers accept p-card payments and using p-cards can improve your cash flow. For example, suppose your dealership makes annual vendor payments of $2 million. If you make these payments using a p-card that offers 1.5% cash back, you could earn $30,000 a year with no effort.

5. Take advantage of refunds for late-delivered packages and shipments. Most dealerships send out a high volume of packages containing documents to financial institutions and customers, especially since the pandemic began. In addition, dealerships with wholesale parts operations usually ship out a high volume of parts to other dealerships each year.

You might not be aware that carriers, including Federal Express and UPS, offer full or partial refunds if shipments and packages aren't delivered within the guaranteed window. You usually

need to make claims within 15 days of the shipment, and you may need to re-file your claim.

Third-party service providers can audit your shipments and manage the claim submission and recovery process. In exchange, they charge a fee that typically ranges between 25% and 50% of the recovery amount.

A financial boost

No one knows exactly when vehicle sales will return to pre-pandemic levels. In the meantime, think about how these strategies can help improve your dealership's financial performance during the COVID-19 crisis — and beyond.

Take advantage of the lease return surge

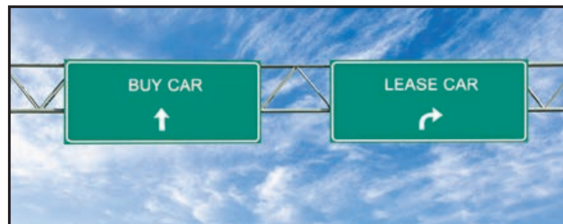
During the COVID-19 pandemic, many motorists who were leasing vehicles got their lease terms extended. Now, as those extensions expire, millions of vehicles are coming off lease.

In its 2020 U.S. End of Lease Satisfaction Study, J.D. Power notes that competition will be fierce for these returning lease customers. "Retaining lease customers is crucial for dealer and lender profitability as they navigate a constricting market and economic downturn," the report states.

Your dealership can take advantage of this situation by being proactive in renewing lease customers or converting them to buyers. According to the J.D. Power study, dealerships should focus on specific indicators of lease satisfaction to encourage renewals. Examples include:

- Ease of the inspection process, scheduling vehicle returns and the turn-in process itself,
- Lease termination, and
- Deals offered at lease end.

The study also notes that first-time lessees are less loyal to leasing than returning lessees. Barely half (53%) of first-time lessees re-leased their vehicle, compared to more than two-thirds (68%) of returning lessees. Keep this in mind as



you attempt to renew vehicle leases with each of these customer segments.

Alternatively, you can try to convert some returning lease customers into car buyers. Start by emphasizing finance incentives for buying vs. leasing, given that many automakers are still offering attractive finance offers for car buyers. Also explain the value difference of owning vs. leasing a car — especially for customers who plan to hold onto their vehicles for a long time.

And don't forget to tell these customers about the benefits of certified preowned vehicles (CPOs). CPOs offer enhanced reliability, because they're subjected to a rigorous inspection process. But they're still *used* vehicles, so buyers avoid the significant first-year drop in value associated with new cars. Compare a CPO and lease payment schedule side by side to show customers the value CPOs offer.

Talk to your sales managers now about how your dealership can capitalize on the lease return boom.

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Proven expertise in helping dealerships build success

In automotive accounting, as in other specialized practice areas, experience matters. That's why dealerships throughout Massachusetts turn to Paul A. Cerrone, CPA for their tax, accounting and auditing needs.

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- Gift and estate planning
- Representation before tax authorities

Paul A. Cerrone, CPA, MST, CVA, managing partner, is an ADP Certified CPA with more than 30 years of experience in serving automotive dealers. He specializes in helping clients minimize taxes, maximize profits and achieve their business and personal financial goals. Paul can be reached at 508-845-7600 or pcerrone@cgscpas.com.

We would welcome the opportunity to put our expertise to work for you, your family and your company.

Please call us at 508-845-7600 and let us know how we can help drive your success to the next level.