

# Revenue Recognition: Dealerships

January 24, 2018

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# Today's Speakers

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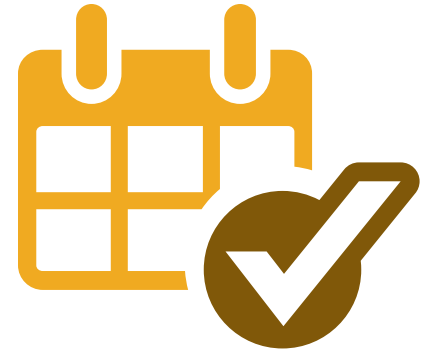
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Crowe Horwath LLP



# Agenda

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- Topic 606: Revenue from Contracts with Customers
- Presentation and Disclosure
- Key Takeaways From Implementations

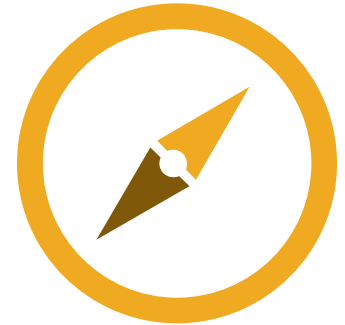


# Objectives

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As a result of this session, you should be able to:

- Discuss the new revenue recognition standard as it applies to audit dealerships
- Recognize and evaluate the impact of the changes on their dealership or their clients' dealerships



# Polling Question #1

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Do you thinking Topic 606: Revenue from Contracts with Customers will impact your companies or clients?

- A. Yes
- B. No
- C. I don't know



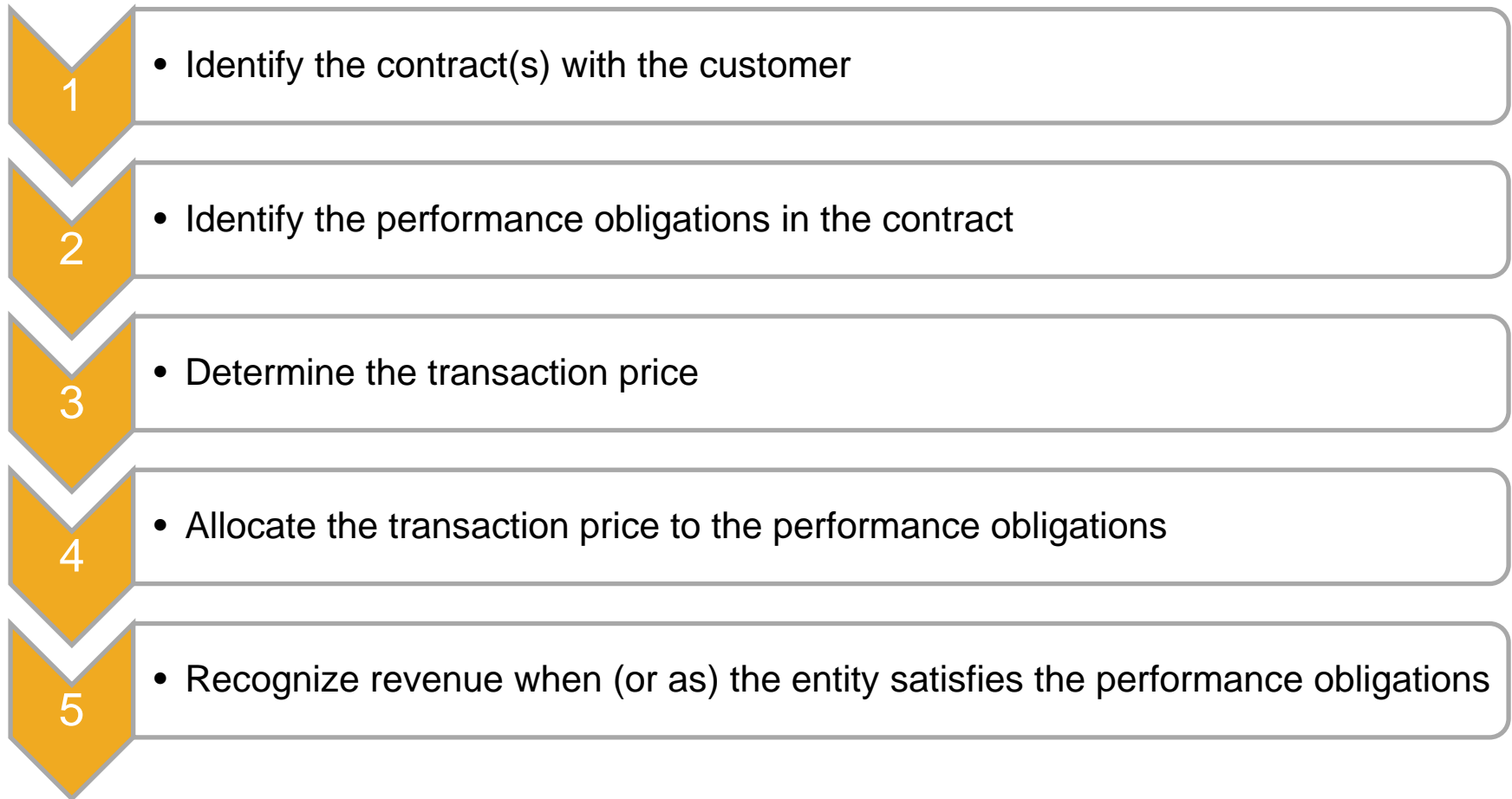


# Topic 606: Revenue from Contracts with Customers



# Topic 606: The Five Steps of Revenue Recognition

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# Lines of Revenues and Contracts

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- Types of revenue
  - New, used and wholesale cars
  - Externally sourced lending, insurance, maintenance, and other services contracts
  - Internally performed lending, insurance, leasing, maintenance, and other services contracts
  - Parts
  - Repairs, services, and body shop work
  - Other

## Polling Question #2

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When was the last time your dealership or your client's dealership has reviewed its revenue recognition policy.

- A. We have a formal revenue recognition policy that is reviewed annually or when new revenue lines are identified.
- B. We informally review our revenue recognition policies when new lines are identified, but rarely reassess the past.
- C. See my reviewed or audited financial statements, footnote one.
- D. We are supposed to have what?



# New, Used and Wholesale Cars

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- Identify the contract(s) with the customer
  - Buyers order with individual or company
- Identify the performance obligations in the contract
  - Provide the new, used or whole sale car
  - Provide other promises
    1. Dealership warranty
    2. Delivery of the car
    3. Free oil changes or free car washes
    4. Accessories (roof racks, clear bras, paint sealants)
    5. We owes
    6. Filing of title and license
  - Will we end up with
    - Several performance obligations with the same revenue recognition pattern limited the need for further consideration
    - Performance obligations that will have different revenue recognition patterns from the car sale and need to be considered separately
  - Is the performance obligation
    - Distinct and separate
    - Material to the customer

# New, Used and Wholesale Cars

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- Identify the performance obligations in the contract
  - Provide the new, used or whole sale car
  - Provide other promises
    1. Dealership warranty
    2. Delivery of the car
    3. Free oil changes or free car washes
    4. Accessories (roof racks, clear bras, paint sealants)
    5. We owes
    6. Filing of title and license
- Determine the transaction price
  - Explicit in the buyers order or estimated based on common practice
- Allocate the transaction price to the performance obligations
- Recognize revenue when (or as) the entity satisfies the performance obligations
  - Generally at time of delivery for the car but consider other obligations discussed

# Oil Change Example

Common Practice	2017 Sale of Vehicle	2017 1 Oil Change	2017 Closing Entry	2018 4 Oil Change	2018 Closing Entry	2019 5 Oil Change	2018 Closing Entry	Total
Receivable	\$ 30,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 30,000
Inventory	(25,000)	(40)	-	(160)	-	(200)	-	(25,400)
Accrued expenses	(500)	-	50	-	200	-	250	-
Accrued payroll	-	(10)	-	(40)	-	(50)	-	(100)
Deferred revenue	-	-	-	-	-	-	-	-
Vehicle revenue	(30,000)	-	-	-	-	-	-	(30,000)
Cost of vehicle	25,000	-	-	-	-	-	-	25,000
Oil change revenue	-	-	-	-	-	-	-	-
Cost of oil change	500	50	(50)	200	(200)	250	(250)	500
<b>Gross margin (profits)</b>	<b>(4,500)</b>	<b>50</b>	<b>(50)</b>	<b>200</b>	<b>(200)</b>	<b>250</b>	<b>(250)</b>	<b>(4,500)</b>

New GAAP	2017 Sale of Vehicle	2017 1 Oil Change	2017 Closing Entry	2018 4 Oil Change	2018 Closing Entry	2019 5 Oil Change	2018 Closing Entry	Total
Receivable	\$ 30,000	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 30,000
Inventory	(25,000)	(40)	-	(160)	-	(200)	-	(25,400)
Accrued expenses	-	-	-	-	-	-	-	-
Accrued payroll	-	(10)	-	(40)	-	(50)	-	(100)
Deferred revenue	(1,000)	100	-	400	-	500	-	-
Vehicle revenue	(29,000)	-	-	-	-	-	-	(29,000)
Cost of vehicle	25,000	-	-	-	-	-	-	25,000
Oil change revenue	-	(100)	-	(400)	-	(500)	-	(1,000)
Cost of oil change	-	50	-	200	-	250	-	500
<b>Gross margin (profits)</b>	<b>(4,000)</b>	<b>(50)</b>		<b>(200)</b>		<b>(250)</b>		<b>(4,500)</b>

# Externally Sourced Lending, Insurance, Maintenance, and Other Contracts

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- Identify the contract(s) with the customer
  - Buyers order or individual contracts
- Identify the performance obligations in the contract
  - Ensure the customer and third party are connected and entered into contract agreements
- Determine the transaction price
  - Explicit in the buyers order or estimated based on common practice
- Allocate the transaction price to the performance obligations
- Recognize revenue when (or as) the entity satisfies the performance obligations
  - Generally at time of delivery of the car.

# Internally Lending, Insurance, Leasing, Maintenance, and Other Contracts

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- Excluded from ASC 606
  - Financial instruments
  - Insurance products
- Identify the contract(s) with the customer
  - Buyers order or individual contracts
- Identify the performance obligations in the contract
  - Oil changes and servicing
- Determine the transaction price
  - Based on the stand alone selling price for each
- Allocate the transaction price to the performance obligations
- Recognize revenue when (or as) the entity satisfies the performance obligations
  - At the time service is provided



## Polling Question #3

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How many of you or your clients sell internally performed contracts.

- A. We sell these products under the dealership's name.
- B. We sell these products, but through a separate captive.
- C. We don't sell these products as we don't want the risk exposure and now also because of the new revenue recognition standards.



# Service Contract Example

		Individual Pricing	Total	
Oil changes	9	\$ 100	\$ 900	32%
15,000 mile servicing	3	650	1,950	68%
			<u>2,850</u>	<u>100%</u>
Transaction price				

Contract price \$ 1,998

		Individual Pricing	Total	
Oil changes	9	\$ 70	\$ 630	32%
15,000 mile servicing	3	\$ 456	1,368	68%
			<u>1,998</u>	<u>100%</u>
Allocated price				

	2017 Sale of Maintenance	2017 3 Oil Changes	2017 15,000 mile Servicing	2018 3 Oil Changes	2018 15,000 mile Servicing	2019 3 Oil Changes	2019 15,000 mile Servicing	Total
New GAAP								
Receivable	\$ 1,998	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 1,998
Inventory	-	(120)	(150)	(120)	(150)	(120)	(150)	(810)
Accrued payroll	-	(30)	(100)	(30)	(100)	(30)	(100)	(390)
Deferred revenue	(1,998)	210	456	210	456	210	456	-
Serve revenue	-	-	(456)	-	(456)	-	(456)	(1,368)
Cost of service	-	-	250	-	250	-	250	750
Oil change revenue	-	(210)	-	(210)	-	(210)	-	(630)
Cost of oil change	-	150	-	150	-	150	-	450
<b>Gross margin (profits)</b>	-	(60)	(206)	(60)	(206)	(60)	(206)	(798)

# Parts

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- Identify the contract(s) with the customer
  - Invoice or implicit upon the counter sale
- Identify the performance obligations in the contract
  - Provide parts
- Determine the transaction price
  - Based on the stand alone selling price
- Allocate the transaction price to the performance obligations
- Recognize revenue when (or as) the entity satisfies the performance obligations
  - At the time the control of the parts transfers to the customer

# Service and Body Shop

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- Identify the contract(s) with the customer
  - Agreements between self pay customers, manufactures, third party contract holders or insurance companies.
- Identify the performance obligations in the contract
  - Providing services
- Determine the transaction price
  - Based on the stand alone selling price
- Allocate the transaction price to the performance obligations
- Recognize revenue when (or as) the entity satisfies the performance obligations
  - As the time service is provided



# Presentation and Disclosure

# Presentation of Contract Assets and Contract Liabilities

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A contract asset or liability is generated depending on the relationship between the entity's performance and the customer's payment.

- When an entity satisfies a performance obligation by transferring a promised good or service, the entity has earned a right to consideration from the customer.
- If an entity has an unconditional right to receive consideration from the customer, the right is accounted for as a receivable and presented separately from other contract assets. A right is unconditional if nothing other than the passage of time is required before payment of that consideration is due.
- If an entity has a conditional right to receive consideration from the customer, the right is accounted for as a contract asset. The right would be conditional, for example, when an entity first must satisfy another performance obligation in the contract before it is entitled to payment from the customer.
- When the customer performs first (e.g., by prepaying its promised consideration), the entity has a contract liability.

# Annual Disclosure Requirements

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The objective of the new disclosure requirements in the new standard is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows from contracts with customers.

To achieve that objective, an entity is required to disclose qualitative and quantitative information about all of the following:

- Its contracts with customers
- The significant judgments, and changes in the judgments, made in applying the guidance to those contracts
- Any assets recognized from the costs to obtain or fulfill a contract with a customer.

The detailed disclosure requirements of each of these topics differ for public and nonpublic entities.

# To Review

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- Key Areas We Expect to Change
  - Free anything sold with cars
  - Self performing long term contracts
  - Material performance obligations after the sale date
  - Significantly expanded revenue footnote
  - Includes break out of revenue by contract type
  - Revenue expected to be recorded by year for uncompleted performance obligations.





# Other Matters

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This is not a comprehensive list of the issues that entities face in applying the new rules:

- Internal control issues
- Audit and review issues, especially around subjective assessments and assumptions
- Impact on compensation arrangements
- Impact on other contracts (such as debt covenants)
- Income tax issues

# Revenue Risks – Process Level

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What are some of the revenue risks that need to be considered?

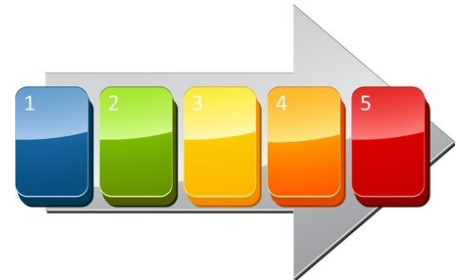
- Contract with customer is not identified, or not properly authorized
- All separate, or distinct, performance obligations are not identified
- Transaction price is not determined correctly
- Data used in estimates is not complete and accurate, or is not available
- Assumptions used in estimates are not correct
- Revenue is not collectible
- Performance obligations are not identified as satisfied, or revenue is recognized when performance obligations are not satisfied



# Internal Control Considerations

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- Implementation controls
  - Grouping of revenue streams
  - Review of contracts
  - System controls may need to be changed (e.g., new data or new processing)
  - Refreshing estimates or assumptions (i.e., what happens if a product or service has not historically had objective evidence available, but subsequently such information becomes available)





# Key Takeaways From Implementations

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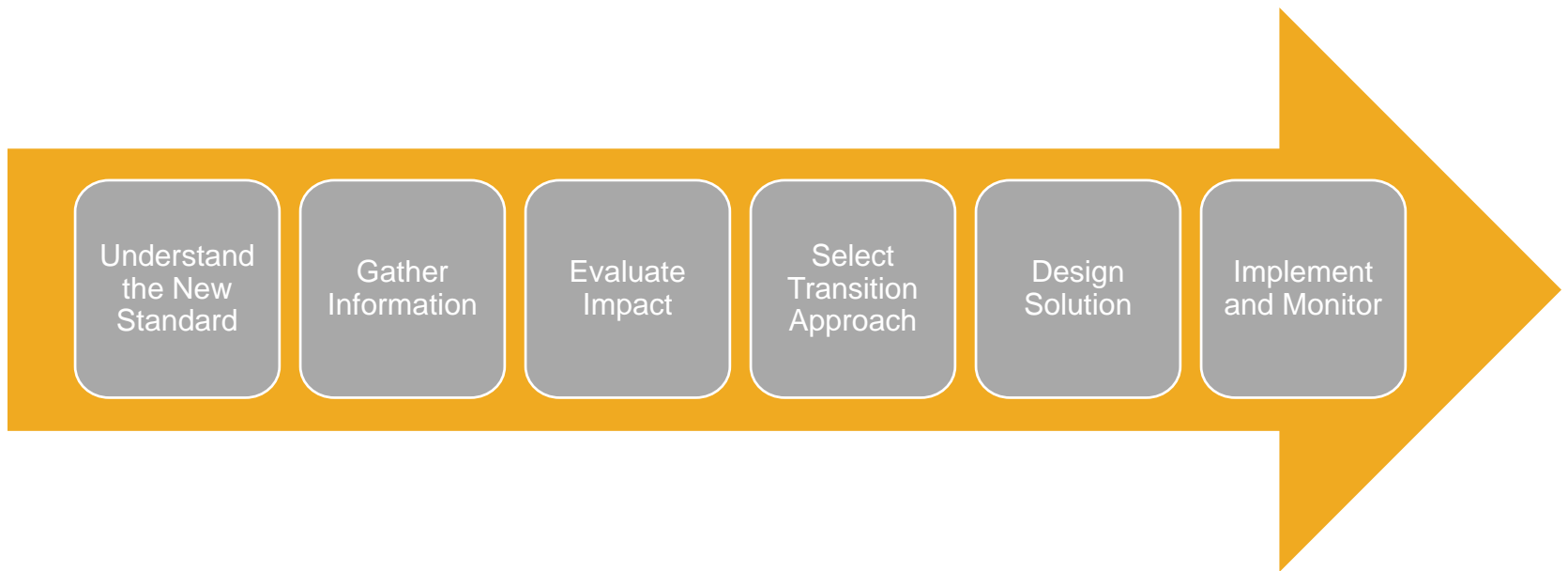
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Common challenges to timely implementation of the new revenue recognition standard:

- A lack of time and resources
- Assumption the new revenue recognition standard will have an immaterial effect on the company's financial statements
- Perception the standard is not finished and clarifications are not finalized

# Key Takeaways From Implementations

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# Polling Question #4

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Where are you in the implementation process?

- A. This education is step one for me and I am still learning.
- B. I have a good idea what we need to do, but there is a long ways to go.
- C. I fully comprehend what my company needs to do and I am at the screaming into a pillow phase.
- D. Early adoption for me baby!!





# Thank you

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