

Proposed Changes to Lease Accounting Possible Effects on Financial Reporting for Dealerships

If your dealership has entered into any type of lease contract (e.g. building, office equipment, etc.), there are potential changes to the financial reporting of lease contracts that could have a significant impact to your dealership.

In a June 2005 report by the SEC, they estimated that the current lease accounting rules allow publicly traded companies to exclude from their balance sheets *\$1.25 trillion in undiscounted future cash obligations* related to lease obligations.

As part of the transition from US Generally Accepted Accounting Principles (US GAAP) to International Financial Reporting Standards (IFRS), the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) continued discussions in March 2009 to discuss lease accounting rules. The plan is to develop a shared standard on the reporting of assets and liabilities on financial statements as a result of a lease contract.

The current discussion is focused on lessee accounting. The issues surrounding lessors will be discussed at a later date as the current focus is on lessees.

Current US GAAP Lease Accounting Methods

Operating Lease

An operating lease is only recorded as an expense when payment is made, and the related asset and future obligations are not recorded on the balance sheet of a dealership.

Capital Lease

A capital lease is recorded as an asset of the lessee and has a corresponding liability for the outstanding payments on the balance sheet. Expenses are recorded over the life of the lease in the form of interest expense and depreciation expense as opposed to rent expense.

A lease is generally recorded as a capital lease under current US GAAP if it meets one of the following criteria:

1. Transfer of ownership occurs at the end of a lease term
2. The lease includes a bargain purchase option
3. The lease term equals 75% or more of the economic life, or
4. The present value of the lease payments is equal to 90% or more of the fair market value

The topics being discussed relate to these criteria as well as lease renewal options, contingent renewals, and residual value guarantees.

Possible Impact on your Dealership

A significant impact to your dealership will be in effect if the criteria require more leases to be treated as capital leases.

For example, if you lease a copy machine at the dealership, you most likely account for this as an operating lease under current guidelines. Some members of the FASB and IASB believe that since the entity has an obligation to make payments under this lease, that an asset for the right to use the leased item and a liability for its obligation to make payments should be included on the balance sheet. Depending on the asset value, useful life, terms of payment, and contractual obligations, this could have a significant impact on your financial situation and debt covenants. This rule would apply to all leases (buildings, signs, etc).

The boards have not yet discussed the method of transition or the effective date. Those issues will be discussed after comments are received on this discussion, and included in the provisions of a subsequent exposure draft of the proposed standard.

Stay Informed

Since this is currently in the discussion stage, there is no action that your dealership needs to perform now other than to stay informed of the potential impact a change in lease accounting rules will have on your dealership. Accounting rules are not meant to run a business, but it is possible that you might change the structure of your leases depending on what the final rules are on lease accounting.

For additional information on how these proposed lease changes could impact your dealership, please contact your [trusted advisor](#) or the Dixon Hughes Dealers Services Group via phone, 877.DLR.CPAs or e-mail, dsg@dixon-hughes.com.

For additional information regarding the Dixon Hughes Dealer Services Group, please contact us at dsg@dixon-hughes.com or visit us on the web at www.dixon-hughes.com/dsg.

About the Dixon Hughes Dealer Services Group

The Dealer Services Group of Dixon Hughes, one of the nation's top 20 accounting firms, has over 135 dedicated professionals working exclusively with some of the largest heavy truck and automobile dealerships across the country. Providing our clients with industry thought leaders in our Assurance, Tax and Risk Service Groups, we consult on best practices to help maximize efficiencies, decrease costs and understand risk management. Dealerships need an independent CPA firm to provide an objective view to take their business to the next level. At Dixon Hughes, we deliver on both sides of the service equation. A fact you might find a plus.