Checklist: Getting ready for financial year end

Getting the financials right now sets the basis for the next trading year

By STEVE BRAGG
and WAYNE PEARSON

■ **WITH** the Easter holidays over, you are probably now focussed on how your dealerships will perform in the final three months of the financial year. While the dealerships' operational results are key, it's just as important to focus on one of your largest expenses, your year-end tax bill.

It won't be long until June 30 comes and goes - but the one thing we do know is that your June 30 financial results will live with you for the next 12 months. Whether it's refinancing, selling or buying, how your June 30 accounts look will influence how people see your business.

Here are some key items that have a significant impact on your tax and financial year-end. Getting them right can have a major impact on your reporting season.

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FIRST and most importantly "don't let the 13th month surprise you".

Monthly reconciliations must be up to date and any issues that have been carried forward from month to month need to be dealt with by the May month end.

The following accounts should be fully reconciled and any issues resolved:

- Review all scheduled accounts
    - ☐ Review all scheduled accounts for cleanliness
    - A telltale sign of a problem is when inventory and clearing account schedules are burdened with unmatched entries
    - Balances which are still on the schedule indicate the transaction was incorrectly recorded at the time of sale. These items may represent additional costs or losses which are only recognized in the 13th month.
    - <u>Accounts Receivable and Doubtful debts</u>
    - ☐ Review the receivable schedules for unmatched items and any aged or non-performing customer accounts
    - Apply the methodology or calculation adopted by your dealership group's accounting policies and take the hit for any items that require provisioning…TAX TIP - don't forget to include items written off as uncollectible as a deduction in your tax return
    - <u>Factory receivables</u>
    - With new programs starting and ceasing every week, it is very difficult for dealers to keep up. The financial controller must set up controls to monitor this area, the factory will charge back if the dealership violates a provision of a program, and they can audit at any time. It's important to get this right as the factory programs and bonuses represent a large part of your bottom line these days.
    - <u>Inventory accounts</u>
    - ☐ Review scheduled accounts cleaning up any credit or debit balances not correctly booked or unmatched when initially recorded
    - Provisions for Demonstrator, Used and Parts inventory should be reviewed in the April/May month-ends to ensure June year-end is smooth and efficient. The provisions should be guided by your accounting policies methodology and calculations. Ensure the provisions are adequate to cover anticipated adjustments to stock to market value or replacement price for 30 June.

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Getting the financials right now sets the basis for the next trading year *(continued)*

- ☐ Review the floorplan schedule and account reconciliation for debit balances
  - We are often amazed by the number of units which are paid off more than once or have been incorrectly overpaid and no one in the dealership has the time to follow-up the finance company to return the funds.
- ☐ Ensure there are no unintended conversion issues. If conversion is identified, get onto the front foot and notify the financier and rectify the issue immediately. It's better to have this tidied up before year end as it will sit in your published accounts for the next 12 months.

- Review all accruals and prepayments accounts and schedules for any errors or adjustments required.
  - ☐ Review all accruals for adequacy and compliance with your group's accounting policies
  - ☐ Ensure there are no general provisions and that a legitimate liability exists for the accrual booked
  - ☐ Obtain your warranty statements or reports etc. from suppliers to reconcile your warranty provisions
  - ☐ Update the used vehicle statutory warranty accrual for the May month end to ensure the June reconciliation and adjustment will not have a significant impact
  - ☐ Update the annual leave and long service leave provisions to May month-end payroll reports
  - ☐ Re-visit your prepayments to ensure they are updated and correctly reflecting the prepayment positions with suppliers…TAX TIP - ensure these prepayments are in-fact legitimate/actual prepayments and seek advice from your advisor for tax deductibility
- Accounting for leases is a mystery to most. This is an area where an unexpected adjustment often occurs, therefore, it is prudent to revisit your lease accounting entries and balances to ensure they are correct by the May period.

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Clean up your accounts, you will live with it for 12 months

YOUR year end accounts are a snapshot of your business on one day out of 365.

The key is to present an accurate position on this one particular day, as you will live with this for the next 12 months. This is important, particularly if you are planning big things in 2018.

During the financial year-end reporting season there are items in the balance sheet which the Owners/Directors of the dealership group need to consider.

- Impairment of Goodwill or other intangible assets (trademarks, company names, etc.)
- Impairment of Land and Buildings - fair value accounting and valuation analysis
  - Potentially you may require independent valuations on a rotation basis, ensure these valuations are up to date or comparable to the current financial year end
  - Accounting for ‘fair value’ adjustments of investment properties through the P&L
- Impairment in investments in related companies
  - Also consider impairment or any provisions required for intercompany loans
- Loan Covenants and balance sheet accounts classification
  - The classification of certain assets and liabilities have a significant effect on covenant calculations, hence are very important for the Owners/Directors to consider at year end to ensure the covenants are calculated correctly
  - Certain liabilities that are refinanced within 12 months of Balance Sheet date - Consider the 30 June classification
- Stock write-downs adequacy and tax exposure
- Debit Loan Accounts and tax exposure
- Any lifestyle assets in the balance sheet and tax exposure
- Going concern/Solvency considerations
  - Working Capital Deficits
  - Deficiency in Net Assets
  - Ability for the company to meet its obligations in the next 12 months

Don’t be fooled with overstated assets or understated liabilities in your balance sheet. They have a direct relationship to the profitability of the dealership. A good way to ensure your balance sheet accounts are reasonable is to compare them to your adjusted prior year-end balances for any indication of balances are over or under stated.

New lease accounting standard AASB 16… BE PREPARED!

THE new leases standard, AASB 16, significantly changes the accounting for leases and introduces complexity, judgment and continuous reassessment requirements for subsequent accounting over the term of the lease.

Dealership groups need sufficient time in order to identify and quantify the impact of the new standard on the information they provide to key stakeholders, such as financiers, shareholders and also their external advisors. Identifying the potential impact of the standard BEFORE entering into new contracts may reduce the risk of any unintended consequences.

What are the implications?

- 'Grossing up' of assets and liabilities relating to operating leases
- Change in profit and amortization profile (more finance expense, early expense recognition profile)
- Change to key financial ratios and balances
    - EBITDA
    - Total assets; and
    - Total Indebtedness
- Changes to debt covenant calculations and compliance
- Executive remuneration calculations for listed entities and private equity
- Tax balances (ie Thin Capitalisation for foreign owned entities)
- Dividend payment in early years of the lease term

When do you need to act?

NOW!

- The first June year-end the standard is effective for is 2020 (2019 for December year-ends)
- Comparatives are required, depending on your transition option, for periods beginning 1 July 2018 (1 January 2018 for December year-ends)
- Dealership groups, however, already need to consider the impacts of the new standard when
    - Renegotiating or entering into new lease contracts
    - Refinancing or entering into new borrowing arrangements
    - Disclosing the impact of the new standard in their current financial statements
    - Budgeting for profit and loss results for future years
    - When considering new acquisitions

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New lease accounting standard AASB 16… BE PREPARED! *(continued)*

What key actions must Dealership Groups take?

- Prepare a complete listing of all leases held (including service contracts that may contain elements that meet the definition of a lease (for leases)
- Quantify impact of the change in the new lease standard on key financial metrics, including EBITDA, Total Assets and Debt Covenants
- Determine which transition option is more beneficial to apply to your dealership group
- Inform key stakeholders (banks and shareholders) of the impact of the change
- Renegotiate existing contracts to consider the impacts of the change in the leasing standard (eg debt covenants)
- Prepare disclosure for financial statements identifying the impacts of the change

"The key is being prepared and to assess the GAP and IMPACT of the changes in the new leases standard."

The key is being prepared and to assess the GAP and IMPACT of the changes in the new leases standard. The summary of the changes and potential impacts must be shared and discussed with the owners/directors and executive management of the dealership group.

If you need a hand, we can help with the impact assessment, implementation process, systems support and calculations, assurance over the compliance with the standard through accounting advice and training your finance team and key personnel.

Preparing for your tax year-end

TAX planning is imperative to the success of your business and critically important in managing your second largest expense.

The key is to manage the tax issues typical in a dealership, such as:

Used and Demonstrator vehicles valuations
The tax legislation allows for three methods of valuing trading stock; they are:

- Cost
- Replacement value
- Market value

IT 2648 provides guidance on various tax issues relevant to the motor vehicle industry. With regards to replacement value, the ruling states that it requires an Independent valuation or the use of an independent source such as red book or Glass' guide.

Demonstrator vehicles require an independent valuation as the red book and Glass' guide cannot estimate the value since the vehicle is too new.

Used vehicles can use either red book/Glass' guide or independent valuations. The valuation approach can change from year to year.

Independent valuations must be truly independent (refer IT2648). The valuer cannot be an associate of the dealer. The valuer must be qualified and not an individual the dealership deals with in the normal course of business.

It is the responsibility of the dealership's management to ensure the valuation/provision booked for tax represents market value and isn't too aggressive or inappropriate.

Lastly, the independent valuer must be paid and a tax invoice issued to the dealership.

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Preparing for your tax year-end *(continued)*

Tax Tips:

- ☐ Ensure GST is deducted from the valuation (i.e. the GST exclusive value is used).
- ☐ Ensure all reconditioning costs are included in the vehicle costs prior to valuation.
- ☐ Ensure the valuer signs every page of the valuation schedule.
- Tools of trade are not trading stock (e.g. Parts utes, vans, courtesy buses …these are depreciable items).
- Likewise, you cannot depreciate your trading stock.

Refer to the annexure: Independent Valuation Wording per IT2648

Spare parts valuation

Management of the dealership should identify obsolete stock or stock that is becoming obsolete. Typically, this would be parts stock aged 12 months with no movement. Determine if it can be returned to the manufacturer for a credit or whether it is required to be scrapped?

An important aspect to the tax election for obsolete parts stock (section 70-50) is solid support. Therefore, dealership management should obtain a report from the parts manager of the realizable value of the parts stock at June 30.

For obsolete parts stock, a specific tax election under section 70-50 of ITAA 1997 allows for a deduction of the obsolescence to be obtained if:

- The stock becomes less marketable because of changed circumstances; and
- A true reflection of the tax payer's taxable income for an income tax year will not be achieved if the stock on hand at the end of the year is valued at cost.

This election is a must for all dealership groups.

Refer to the annexure: Suggested wording for Trading Stock Election Pursuant to Section 70-50 of ITAA 97

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Preparing for your tax year-end *(continued)*

Holdback per IT2648

Holdback income can be deferred for unsold new vehicle inventory (no change from normal end of month treatment). However, no deferral can be claimed for demonstrator vehicles and the holdback income attached to demonstrators are treated as an addition to your taxable income calculation.

Bad debts

Doubtful debt provisions are not tax deductible and must be added back in your taxable income calculation. However, if your dealership has debts that are unrecoverable (and the necessary steps to recover the debt have taken place), a tax deduction can be taken per TR92/18.

- The bad debt must be physically written off and documented on or before 30 June on the debtors ledger or by resolution by the directors
- TIP: Don't forget to claim back the GST

Dealership specific items

There are dealership specific items that need to be considered for the tax year end.

Key dealership provisions - not deductible until paid and therefore the movements in the provisions year on year are tax assessable/deductions in the current tax year, for example:

- Harrier National provision (IT2648)
- First service provision
- Used Vehicle statutory warranty
- Long Service Leave
- Annual Leave
- Sick Leave
- Other general provisions

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Preparing for your tax year-end *(continued)*

Typical Non-deductible items for dealership groups are as follows:

- Goodwill impairment
- Amortisation of intangible assets (possible rate differential between accounting & tax)
- Fines
- Entertainment that is not subject to FBT
- 50/50 method
- Actual
- Some building depreciation

Some typical Deductible/Non-assessable items for dealerships are as follows:

- Work in Process Labour
- Prepayments are generally not deductible with exception to payments under $1,000 or those required by law, for example:
- Workers compensation
- Land tax and council rates
- Registration/CTP payments
- Warranty Income (IT2648)
- Div 43 Capital Works deductions (i.e. building write-off)

Factory Bonuses are assessable if they are definitive ('earned') and calculable at 30 June. Remember, demonstrator bonuses are assessable.

Superannuation is deductible when paid and this is determined as and when the trustee receives the funds. Outstanding cheques or payments are not sufficient for the tax deduction, therefore it is important to ensure the payment is made with sufficient time to clear prior to 30 June.

Debit loan accounts - companies and trusts

Represented by a payment/loan to a shareholder or associate from the company or an unpaid present entitlement (UPE) from a trust to a corporate beneficiary.

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Preparing for your tax year-end *(continued)*

Post 4/12/1997, these loans and UPEs are addressed under Division 7A of the Tax Act and may be subject to the following:

- These loans must have a formal loan agreement in place:
- Terms and calculation of interest and principal must be in accordance with Div 7A
- The Agreement must be executed prior to the relevant date set out in Div 7A
- No interest or repayment is required in year 1
- The interest may be deductible to the borrower if the funds are used for income producing purposes
- Repayment of the loan may be accomplished by a cash injection by the shareholder or via a franked dividend. Note for dividends:
- Gap tax may be payable by the shareholder, dependent on tax rates.
- The effectiveness of dividends is contingent on the availability of franking credits and the extent the company is able to pay dividends under the Corporations Act.

The rules relating to UPEs owing to companies are extremely complex and it is recommended that you discuss this with your tax advisor should it apply to you. Planning is the key with regards to Division 7A so speak to your tax advisor sooner rather than later.

Superannuation Planning

Whilst not necessarily a tax planning matter for all dealerships, many dealerships are privately owned and superannuation forms a significant part of the wealth of the owners, which is often held in Self-Managed Super Funds.

Due to recent changes to the superannuation legislation, the upcoming year-end represents the final opportunity for many to maximise their contributions into super and also an opportunity to review super strategies during the transitional period leading up to 30 June 2017.

If applicable to you, we recommend that you contact your tax advisor as soon as possible to commence superannuation planning.

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Preparing for your tax year-end *(continued)*

What key actions should my dealership group take to prepare for year-end?
Start planning now! 'Spring clean' your balance sheet during May to identify any areas of concern and to ensure the 13th month adjustments are not a surprise.

For income tax, identify your non-deductibles and provisions that have a significant impact on your taxable income. Perform tax estimate calculations for your dealership group and determine possible tax liabilities to understand where you stand.

If you have discretionary trusts in your group, distribution determinations/resolutions need to be made prior to 30 June (or earlier if required by the Trust Deed). You should discuss a tax effective and commercial distribution strategy with your tax advisor well before year-end.

Do you have enough cashflow to pay the tax when it's due?

Have you prepared a cash flow projection to ensure the owners/directors are able to meet their tax obligations?

Make sure your accounts represent the best "view of you" as a business at year end, double checking valuations, debt covenants and working capital positions prior to year end will ensure you will look your best for the next 12 months.

Annexures

Independent valuation wording:
"I hereby confirm that the used vehicles and demonstrator stock inspected and detailed on the attached sheets has been valued on the following basis:

I have sighted the attached list of vehicles and consider the ***GST inclusive*** *replacement price of such units as at 30 June XX is the amount reflected beside the description of each individual unit – The replacement price is inclusive of GST.*

Yours faithfully

Parts Trading Stock Election:
"Trading Stock Election Pursuant to Section 70-50 of ITAA 97"

XYZ Motors Pty Limited "The Taxpayer" has valued a certain portion of spare parts at zero.

Given the age and condition of the sock and current market conditions the taxpayer deems itself unlikely to receive any consideration for these goods. As a result the taxpayer has claimed a deduction of $ in the 20XX year tax return.

In accordance with the legislation the taxpayer will remove the stock from its premises and have it destroyed.

All substantiation requirements have been met.

Dated this..... Day of 20XX

Article written by Steven Bragg and Wayne Pearson.