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HEADLIGHTS

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LIBOR CHANGES, SOFR/BSBY: IMPACT ON DEALERS

Financial changes are fast approaching, and here is what dealers need to be aware of.

Why the changes? After the 2008 financial crisis and later in 2012, it was found that banks had the ability to manipulate the LIBOR (London Inter Bank Offered Rate). Due to this, the Federal Reserve Board put together a team called the Alternative Reference Rate Committee (ARRC) to find alternatives. LIBOR is the overnight borrowing costs to banks. It is calculated from an average of banks that participate in overnight lending to each other.

Debra Hogan, Dealer Services Team, Rosenfield and Company, PLLC

Secured Overnight Financial Rate (SOFR) is the actual cost of lending and borrowing in all markets; it is collateralized by Treasury securities. It is volatile at month-end, quarter-end and year-end. The first valuation date was April 1, 2018.

Bloomberg Short-Term Bank Yield Index (BSBY) is a proprietary index calculated daily and published at 7:00 a.m. (EST) each U.S. business day. The index was developed to address the needs of the market by providing a series of credit-sensitive reference rates that incorporate bank credit spreads and define a forward term structure.

BSBY seeks to measure the average yields at which large global banks access USD senior unsecured marginal wholesale funding (*Bloomberg Professional Services*).

LIBOR and SOFR: The Differences

Important Dates for LIBOR/SOFR/BSBY:

✔ **12/31/2021:** Last date LIBOR will be published.

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INVENTORY INTERNAL CONTROL PROCEDURES

EMPLOYEE RETENTION TAX CREDIT: AN OVERVIEW

	LIBOR	SOFR	BSBY
	Unsecured Rate	Secured Borrowing Rate	Unsecured Rate
	Forward Looking	Overnight Borrowing Rate	Forward Looking
Today's rates	0.12	0.05	0.07
Average rate 2020	0.97	1.45	NA*
Average rate 2019	2.37	2.43	NA*

**BSBY introduced 2020.*

✔ **01/01/2022:** First date to use new index.

✔ **06/30/2023:** LIBOR deactivated and ends matured contracts.

LIBOR/SOFR/BSBY: What Should You Be Aware Of?

✔ Changes are well underway. Originally, most banks were going to move to SOFR, but after watching all indexes there is a feeling that BSBY is closer to LIBOR, so they have chosen BSBY as their index. Most banks have the capability to use both.

✔ Current floor plan levels are low, as we all know. This might seem like a nonissue and not impactful. As allocations and inventory increase, all dealers will be affected in all transactions with their lenders.

✔ Monthly billing on your adjustable rate facilities (i.e., floor plan, term notes, swap agreements).

• Floor plan billing usually comes the following month, so you will see changes starting with your January bill delivered in February.

• Remember, as rates change with an imminent federal rate increase, all adjustable lending will increase.

✔ Be aware of your maturity dates. Expect to see new documents with the new indices and/or some fallback language. The following is one bank's example of typical language that could be used, but there will be many versions.

> "Consultations proposed that, following a trigger event, the product would pay interest at a SOFR-based rate, with an adjustment so that the successor rate would be more comparable to LIBOR."

✔ Identify any lending agreements that need to be amended. Master agreements need to be reviewed, as well.

✔ Understand the spread between the LIBOR, SOFR and BSBY and the impact on monthly payments, residuals, payouts, etc.

✔ Seek direct communication with your bankers so that you have clarity as to how these changes apply to your specific lending agreements.

For any questions please contact our members at the AutoCPAGroup. ✍

INVENTORY INTERNAL CONTROL PROCEDURES

Jeff Jensen, CPA
Jensen & Associates, P.C.

The uncertainty of the last two years due to the pandemic it causes me to consider what comes next and how to prepare for it. Inventory shortages, rising inflation, rising interest rates and difficulty in finding employees makes the preparation very difficult. Also, current world events may cause the market to be even more volatile. Dealers who look forward and develop a plan will be the winners.

A client and friend always told his general managers to plan ahead. Living in Utah, he knew that with winter comes lower sales during those dark, cold months. Market fluctuations, like Utah winters, make inventory policies and planning essential to allow a dealership to perform efficiently. One specific item is that used vehicles do not improve with age and in fact, cost the dealership money. Too many days' supply of any inventory limits a dealership's efficiency. In our current market, obtaining enough inventory of new, used and even parts is all but impossible. My concern is that the tables will turn fast, and most dealers will not be able to react in time, leading to potentially devastating results for a dealership.

Through my experience with many dealers, those that adhere to strict days' inventory internal controls of new, used and even parts give the dealership flexibility to adjust as needed. Pushback is all but expected by managers not wanting to incur wholesale losses; however, we have seen that even though there may be more wholesale loss transactions in volume, the total wholesale loss for a year can end up being less. Inventory internal control procedures allowed dealerships to survive the extremely high interest rate hikes in the early 1980s. They allowed dealerships to retain employees and produce profits during the economic turmoil of the late 2010s.

The last few years have been very good to the automotive industry as a whole. Number of units sold have been down, yet grosses are up across the board. It is easy to forget the importance of inventory control when inventory has been so hard to obtain.

Setting inventory control standards and expectations now and setting the precedent within a given dealership or group are now essential.

The last two years of uncertainty due to the pandemic—and now geopolitical chaos—make us all wonder, "What comes next?" Results of the pandemic, such as inventory shortages, rising inflation, rising interest rates, and difficulties obtaining and keeping employees, make it difficult to create and maintain internal policies. It is my belief that dealerships that are not only able to implement strict inventory controls but maintain integrity of said controls will be best suited for whatever comes next.

Contact one of your local AutoCPAGroup members for guidance in setting up effective inventory controls. ✍

EMPLOYEE RETENTION TAX CREDIT: AN OVERVIEW

Justin Burchill, CPA
Brady Martz & Associates

One of the COVID relief items passed by Congress, the employee retention tax credit (ERTC), was intended to assist employers to retain employees during the period of uncertainty caused by the pandemic. Over the past several months, we have received many questions from clients regarding the qualifications to obtain the ERTC.

The ERTC allows dealerships who meet certain qualifications to receive a refund on the payroll taxes it pays.

The maximum credit:

✔ For 2020, the refund is 50% of up to $10,000 of qualified wages per quarter, per employee.

✔ For 2021, the refund increased to 70% of up to $10,000 of qualified wages per quarter, per employee. The credit expired effective September 30, 2021.

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Qualified wages:

✔ For 2020, if a dealership had fewer than 100 full-time employees *ALL* wages and health care expenses paid were qualified wages. With more than 100 full-time employees, only wages and health care expenses attributable to time *NOT* working were qualified wages.

✔ For 2021, if a dealership had fewer than 500 full-time employees *ALL* wages and health care expenses paid were qualified wages. With more than 500 full-time employees, only wages and health care expenses attributable to time *NOT* working were qualified wages.

A dealership may qualify if it meets one of the following requirements:

✔ 2021 gross receipts have declined by more than 20% compared to the same quarter in 2019.

✔ 2020 gross receipts declined by more than 50% compared to the same quarter in 2019.

✔ The dealership experienced a partial or full shutdown due to a government order limiting commerce, travel or group meetings.

A dealership may be eligible in a calendar quarter if it either meets the gross receipts reduction test or is subject to a government-ordered shutdown in that quarter.

Use of the government-ordered shutdown criteria is controversial, and it is questionable whether many dealers qualify. To qualify under the government-ordered shutdown, a dealership must document the specific government order that qualifies the dealership for the ERTC. There are tax credit consultants who have taken an aggressive position that all dealerships in the industry qualify for ERTC based on the government-ordered shutdown criteria. Each dealership needs to review its specific circumstances to determine whether it will qualify. Before signing an agreement with any of these consultants, dealerships should consider the risks that come along with applying for this credit. These credits can add up to significant dollar amounts, so caution should be taken before filing for the credit.

The credit is claimed on a dealer's quarterly 941 forms. A corresponding amount is also included on the dealership entity tax return as a reduction in the amount of expenses claimed. Amended forms and returns can filed for quarters that have already been completed. These amended tax returns can be filed for up to 3 years from the time the original return was filed.

Consult your AutoCPAGroup member to discuss the application of ERTCs to your dealership. ✍