HEADLIGHTS

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POINTERS FOR PURCHASE OF PARTS INVENTORY

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Many times in a dealership buy–sell, the acquisition of parts inventory is almost an afterthought. While the parts inventory may not be the largest dollar amount in the transaction, it is an essential element to most buy–sell agreements. Over the years we have reminded clients that the parts in inventory are like dollar bills stacked on the dealer's shelves. Every part in inventory requires the dealer to invest capital. Buying parts that are not selling is simply giving away money.

We have observed several approaches in buy–sell agreements as to how a parts inventory is to be purchased. Most buy–sell agreements state that a parts physical inventory be taken and that the result be the purchase price. Many agreements will specify which parts are and are not to be included in the purchase. Examples of nonreturnable parts include parts with containers that have been opened, damaged containers, damaged parts and parts not in the current catalog. To avoid purchasing old or non-returnable parts, be careful how your agreement is written. Agreements usually exclude parts that are not in the current manufacturer catalog. But the seller's inventory may include parts purchased from other dealers. Although these parts may still be in the catalog, the manufacturer may not allow them to be returned by anyone other than the original dealer. If so, you may be purchasing parts that are nonreturnable.

Many questions should be asked regarding parts during a buy–sell. Does the manufacturer allow

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for a special return privilege associated with the buy–sell? Does such privilege apply to all parts or to just certain types of parts? Does the buyer return the parts, or is the seller responsible to make the return? If the seller has unused return credit, does the acquiring dealer retain it? Is the buyer required to be the returning dealer? It is necessary for the buyer and seller to agree on these items and to understand the answers. The understanding with the manufacturer would also be good to have in writing.

It is essential to know how the selling dealer's inventory system works. Most software systems used in dealerships produce management reports for the parts inventory. These reports show the different categories of parts, ages of parts and gross profits realized by the parts department. Is the inventory aging properly? If the management report shows more than 20% of the inventory at greater than 12 months with no sale, you may have a problem. Does the seller's parts department personnel have the ability to change the number of days a part is in stock?

Make sure you are buying a reasonable level of inventory. Many experts agree that 30 days at dealer's cost is a good level based on the number of days' supply in stock.

Many headaches in an acquisition can be avoided if you pay attention to the parts inventory before the deal is closed. Even if you are not going through a buy–sell, the above information can be a reminder to give the parts department some attention rather than simply assume that all is well. Contact an AutoCPAGroup member if you would like to discuss this further. ✍

WHY YOUR PRIORITY LIST SHOULD INCLUDE CLEAN ACCOUNTING RECORDS

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Dealers regularly tell new-car buyers to have their vehicles checked and serviced regularly to mitigate the risks of preventable problems. Keeping clean accounting records and performing preventive maintenance on your dealership accounting systems will provide the same benefits.

The benefits of maintaining clean accounting records include managing cash flow effectively, collecting receivables timely, computing pay plans correctly at month-end, reporting accurate profits to the manufacturers and aiding your CPA in year-end tax planning.

The usual standards for clean accounting records (up-to-date reconciliations and schedules with minimal exceptions) still apply. Reconcile cash daily, reconcile vehicle inventories weekly and reconcile all other key accounts (holdback, finance reserves, parts paid, parts open account, floor plan, etc.) no less than monthly.

In today's environment, clean accounting records go beyond the general ledger and the DMS. For example:

- ✔ Have you conducted and documented compliance audits?
- ✔ Do you have proper IT security? (A lapse in this could outweigh all the benefits discussed in this article.)
- ✔ Are you updating depreciation standard entries more than once a year?
- ✔ Are all expenses accrued in the correct period?
- ✔ Do you limit arbitrary spreading of expenses?
- ✔ Are you properly estimating and accounting for reserves of loyalty programs?
- ✔ Are you properly securing customer data (both paper and electronic)?

✔ Are all in-force contracts organized and readily accessible?

✔ Are factory reports regarding facility compliance and operating results organized and readily accessible?

✔ Are nondealership assets excluded from the balance sheet?

✔ Are off-balance-sheet assets tracked and quantified as well as potential earnings from same?

Your internally prepared financial statements need to be as accurate as possible and your controls over key exposure areas as tight as possible if you are to minimize financial risk and take full advantage of the opportunities that exist in today's market.

Also note that the cleaner and more organized the records, the easier it will be for certain types of fraud to be exposed. In many cases, it is not a matter of *if* fraud will occur, but when. In the unfortunate event that fraud does occur, you want to put yourself in a position to identify it as quickly as possible.

Contact an AutoCPAGroup member to talk about keeping your accounting records clean. ✍

LAW CHANGES FOR DEALER REINSURANCE COMPANIES

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Dealership owners have long utilized controlled foreign corporations (CFCs) to reinsure products sold to customers at the time of the sale of the vehicles. CFCs are small insurance companies that receive special treatment by making an IRS code section 831(b) election whereby they are only taxed on their investment income. The Protecting Americans from Tax Hikes Act (PATH Act) signed by President Obama in December 2015 made some changes to their operations.

Effective January 1, 2017, the amount of 831(b) net written premium maximum will increase. The maximum premium ceded to the dealer's reinsurance company has increased from $1,200,000 to $2,200,000. The new amount will be adjusted for inflation. This substantial increase will benefit larger dealer groups and companies pushing the current threshold.

The PATH Act also added a new diversification requirement that must be met to achieve the benefits of the 831(b) election. This is aimed directly at limiting these types of companies as a wealth transfer tool. One of two different tests must be met to meet this requirement.

The first test is that no more than 20% of the electing company's net premium (or if greater, direct written premium) can be attributable to one policyholder. For this purpose, all policyholders who are related or part of a controlled group would be treated as one policyholder. A potential problem that could arise is in the definition of "policyholder." Is it each consumer purchasing a policy, or is it simply the ceding company? The latter would be a problem for most dealers, and currently most advisers assume that for this test, the policyholder is each consumer. We expect this to be further defined in the future.

If the first test is not met, the second test looks at the common ownership of the reinsurance company and the dealerships to determine if heirs or spouses own more of the reinsurance company than the dealership does. Note, however, that if the company passes the first test, there will be no need to look at the second test.

Any company making the 831(b) election will also have to furnish information to the IRS

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LAW CHANGES FOR DEALER REINSURANCE COMPANIES

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on request reflecting compliance with the new diversification requirements.

Note that many commentators on the PATH Act have stated that this is a far from perfectly drafted law. Important parts of this law need further clarification, which may come from the IRS interpreting the law. Clarifications or changes made through additional legislation or through IRS audits that lead to court cases could be many years away.

Contact your **AutoCPAGroup** member for updates and further discussions as to how this legislation could affect your reinsurance company. ✍