# HEADLIGHTS

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# UNDERSTANDING YOUR FINANCIAL STATEMENTS

**Richard Heider, CPA**
**Heider, Tanner & Dirks, Inc.**

Auto dealerships' monthly financial statements contain a lot of good information. What should a dealer be concentrating on in this review and what should you expect from your controller or CFO? Dealerships are really a number of businesses under one roof. New vehicles, used vehicles, parts, service, F&I and possibly a body shop provide many opportunities to understand your business.

There are many statistics to look at including net profit, gross per unit, gross profit percentages from service and parts sales, expense amounts and their relationship to sales for the month or year, other income and deductions, and more. But there is more to consider than just these amounts. Your controller or CFO can assist in identifying these and provide a discussion with the management team.

Just looking at gross profit and F&I per unit or gross profit percentages for a month does not reveal trends unless you compare them with prior months, prior years, budgets or relationships to other parts of your financial statement. This extends to expense amounts and their relation to sales. Being able to see these trends and bring them into focus for the management team can assist in identifying both positive and negative trends.

Parts inventory aging from your parts system is not on most dealer financial statements. This should be reviewed each month. Vehicle inventory aging, which on some financial statements is partially provided, does not give a full picture of your vehicle inventory aging as well as number of days in stock. Your controller or CFO can add this to the analysis at each month end.

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Like any other business, understanding cash flow in your dealership is as important as many other measures. Look at your monthly profit vs. the amount of cash you have at month end. Does the change in cash from the end of the prior month make sense relative to that profit and, if not, have the controller or CFO explain this. It could be that depreciation expenses, increase in owned inventory, slow or fast collection of customer and factory receivables, or purchase for cash of equipment are part of the explanation. This in turn can reveal other trends in your balance sheet, whether too little or too much inventory, or collection trends of your customer and factory receivables.

Aging of contracts in transit, vehicle and body shop receivables, warranty and dealer rebates should be reviewed. While these receivables are reviewed during the month, they should also be included in the month-end analysis.

Dealers and their management teams need to understand their financial statements, as well as other details not on the face of those statements. All of this is information to assist the dealership in being as successful as it can be. Contact an AutoCPAGroup member to talk about all aspects of your financial statements. ✍

# USED-VEHICLE FRAUD

**Dawn M. Lopez, CPA**
**Dwight Darby & Co.**

Because dealers are busy with the day-to-day operations of their businesses and want to trust their employees, they sometimes think that scams only happen in other dealerships ... until it happens to them. A dealer's best defense is knowing and watching for the latest trends in scamming. According to the Winter 2013 issue of "Auto Focus" by Thomson Reuters, some of the most frequent scams include


✔ **Falsified loan requirements and documentation:** Buyers with weak credit scores can be the best targets. These consumers are told that, because of their poor credit, the lender requires an extended warranty to secure the loan, thus fraudulently boosting the profit on the sale. Other buyers may be told that online financial institution lending (which the consumer secured before entering the dealership) cannot be accepted because these lenders take too long to pay the dealerships. This scam often persuades the consumer to use the dealership's financing instead, for fear of losing the ability to purchase the vehicle. This also gives the finance person the opportunity to charge a much higher interest rate.

✔ **Misrepresented vehicle history and condition:** Unscrupulous salespeople will try to close the deal at all costs, including lying about mileage, previous ownership and condition of the vehicle. Educated consumers will take the car to a mechanic to have it inspected or obtain a vehicle history report from a third party before buying the vehicle. But other consumers are at the dealership's mercy. Offer to provide a car history check as part of the sales process; that not only creates consumer confidence but also reinforces to employees the dealership's high ethical standards.

✔ **Excessive administrative fees:** Dealer prep and handling fees can be bumped up by simply misleading the customer about the standard charge.

Scams like these can lead your state attorney general to bring charges against your dealership for odometer tampering and for securities fraud related to falsified motor-vehicle titles. On top of that, you are paying out excessive commissions on boosted "fraudulently obtained" profits.

You may never realize how valuable your dealership's good reputation is until it is ruined by an unscrupulous employee. Be proactive by reviewing your used-car department's practices. One method involves hiring an investigator to pose as a new employee specifically to learn what is happening in the sales department. Hold fraud-awareness training sessions and conduct periodic audits of deal documentation. For more information, contact your AutoCPAGroup member. ✍

# TAX AND ECONOMIC BENEFITS OF USING A REINSURANCE COMPANY

**Richard Heider, CPA**
**Heider, Tanner & Dirks, Inc.**

Many dealers have their own reinsurance company that primarily offers extended service contracts but may also provide other products, such as GAP insurance, window etching and limited warranties. Income taxes on dividend distributions or share redemptions are currently taxed at the long-term capital gains tax rate of 20%. In addition, the 3.8% net investment income tax will be applicable to taxpayers with adjusted gross incomes of $250,000 or more if you file a joint return and $200,000 if you file as a single taxpayer.

Estate and income tax planning opportunities are available by having family members with lower incomes become owners in the reinsurance company. This is usually accomplished by having children own an interest in the reinsurance company. Trusts for a child of any age can be used for this ownership, although we typically see this most with children who are minors. For income tax purposes, note that children through the age of 23 can be subject to the "kiddie" tax and will be taxed at their parents' highest tax rate. For estate planning, the growth of this asset owned by another family member keeps it out of the dealer's estate.

The time to include children in ownership is when the reinsurance company is first formed. If the dealer wants or needs access to the money, the dealer can retain ownership until such time he or she doesn't think the future cash benefit is needed. Then he or she can start a new share or company, putting contracts from that date forward into the new share.

When a dealership is sold and no new contracts are being written into the reinsurance company, you have a choice as to what to do with this book of business. You can choose to let the book of business run out, that is, wait until the last contract's term ends, or sell the book of business, usually to the company you are using for the contracts.

If you elect a buyout of your book of business, the computation we typically see is very conservative in estimating future claims and contract cancellations. This makes sense as the purchaser wants to both protect themselves against unknown possible losses but also wants to make a profit on the purchase price. You need to analyze any such offer as to the amount of unearned premiums, amount

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## TAX AND ECONOMIC BENEFITS OF USING A REINSURANCE COMPANY

*(continued from page 3)*

of money held by your reinsurance company currently, and compare inception to date actual loss ratios with what the purchaser is using to better understand what possible profit you may be giving up by selling the book of business. If you don't need the money, I usually recommend letting the book of business run out to obtain the maximum amount of profits from this.

If you are in the process of setting up a reinsurance company or looking to end a book of business for any reason, contact your **AutoCPAGroup** member to analyze the best approach for you. ✍