

## DEALERSHIP VALUATIONS

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price your blue sky so that it does not drive off qualified buyers. If you do not know what is reasonable, consult with those that have been involved in actual buy-sells before you price the dealership. If your price is “too high” based on your prior profit history, or if your dealership has a large amount of “upside” profit potential, then make your case in writing to potential buyers why the profits of the dealership have room for substantial improvement. If you are trying to buy a dealership and the pricing is “silly” or extremely high, have patience, let the selling dealer know you have an interest, but the prices do not “work” for you. Once he or she has driven off most of the other potential buyers, you might have a reasonable chance of purchasing the dealership. ☛

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## TAX AND REGULATORY UPDATE: WHAT'S NEW SINCE LAST YEAR?

**A** resource many dealership accountants use to stay up to date is the National Auto Dealership Conference presented by the American Institute of Certified Public Accountants. At the conference in October, I served on a panel that included Paul Metrey, director of regulatory affairs for NADA, and Terri Harris, the motor vehicle technical advisor for the IRS. We covered several developments that have taken place in the past year. The FTC Safeguards Rule took effect May 23rd and deals with how dealers must protect information about finance and lease customers. Specifically, dealerships must develop, implement and maintain a security program that includes oversight of service providers. Failure to comply with the requirements may subject you to substantial penalties.

The FTC has taken the first steps to check compliance. Several dealerships have received a “nonpublic inquiry” from the agency to see if

they’re following the Safeguards Rule.

In addition, the USA Patriot Act was enacted after 9/11 to fight terrorism and money laundering. The law applies to dealerships, which are considered to be financial institutions, in the areas of cash reporting, information sharing and establishment of anti-money-laundering programs (AMLPs). The

cash reporting aspects of the law call for businesses like auto dealerships to continue reporting cash transactions of more than \$10,000 using Form 8300. The form was modified to include filing with the Financial Crimes Enforcement Network (FinCEN),

although dealers will continue to file directly with the IRS to meet this requirement.

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**SPECIAL NADA ISSUE:  
JANUARY 2004**

**CONTROLLING SPECIAL-ORDER  
PARTS IN YOUR DEALERSHIP  
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A bigger impact will be the requirement to establish an AMLP. Mandatory features of the program include the designation of a compliance officer, development of internal policies and controls, ongoing employee training in these controls and an independent audit process to test the program. Thankfully, dealers have time to deal with all of the extra red tape involved with the mandatory provisions of the Patriot Act, as they currently meet an exemption from the AMLP requirements. This exemption may be short-lived, as the FinCEN is currently considering whether this exemption should continue to apply to vehicle sellers.

Even without the requirement of an AMLP, this is a good time to revisit your cash-reporting policies. Consider whether they're sufficient, if employees are following them and whether employees received the needed training. The IRS is clearly sensitive to compliance with the cash-reporting rules in their

## CONTROLLING SPECIAL-ORDER PARTS IN YOUR DEALERSHIP

One of the biggest challenges in operating an automobile dealership is controlling and managing cash flow. There are many areas that can tie up a sizeable amount of cash if left unchecked. One of these areas is special-order parts.

Parts ordered for a customer that end up sitting on a shelf in the parts department create problems for a dealership. Unsold special orders not only hurt customer service and dealership profit



audit activity, as trumpeted in a front-page headline in the October *Automotive News*.

Another subject addressed was the proliferation of cost-segregation studies, which review construction costs of a real estate project and allocate a portion of those costs to shorter depreciation lives. This quicker depreciation provides a tax deferral and therefore a present-value benefit. A proper study includes a review of the drawings and site plans, and must be based on contemporaneous records. A cost-segregation study is an acceptable way to reduce your current income taxes. The IRS has assembled a task force to examine the issue.

Finally, some dealers got unexpected help to merchandise some of their product: the Bush tax cuts, which include an expanded election for some businesses to write off the entire cost of eligible assets in the year purchased. Notably, a "bonus" depreciation feature was increased from 30% to 50%. ☞

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potential, they also contribute significantly to parts-department obsolescence. The parts department and the service department are often at odds with each other as to whose responsibility it is to follow up on special-order parts. The parts department suffers if the parts remain on a shelf unsold, but the service department suffers if a part is returned before the customer can be scheduled to come back in to the dealership. How can a dealership solve this problem?

First, a set of policies and procedures needs to be established assigning responsibility and accountability for these special-order parts. Rather than viewing the problem as a parts issue or a service issue, the two departments should work together to ensure that the customers come back in for these parts. Some suggestions are as follows:

- ✓ When ordering a part for a service customer, obtain an estimated date of arrival for the part and, when possible, schedule an appointment for the customer to return for installation, allowing a few extra days for the part to arrive. If a customer is presched-

uled, he or she is more likely to come back for the part, and the dealership only has to contact him or her if the part is on backorder or delayed.

- ✓ Have the customer prepay, if possible.
- ✓ Have the service manager approve special parts orders.
- ✓ When a part comes in for a customer who was not prescheduled, the service advisor responsible for generating the customer's special order contacts the customer and sets up an appointment.
- ✓ Consider holding the service department and the service advisor responsible for the part and any

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When new-vehicle dealerships become available for sale, it is usually due to two main reasons. The first reason is the current owners have decided it is time to sell due to their approaching retirement age or they are just tired of the business. The second reason a dealership becomes available is due to a lack of profits or the need for additional capital and not being able to obtain additional capital.

Once a dealer has decided to sell the dealership, he or she needs to set a price for the two groups of assets a dealership has to sell. The first group of assets being sold is the tangible assets of a dealership, which include accounts receivable, new-vehicle inventory, used-vehicle inventory, parts and other inventory, and office, parts, service and body-shop equipment. The second group of assets being sold is the intangible assets of the dealership, which include blue sky, franchise and goodwill.

When many dealers first think about becoming a seller, they do not really know how much to ask for blue sky. In the process to price the blue sky, I find that if the initial asking price for blue sky is very high, the selling dealer will end up "driving off" bona fide buyers. Based on not "driving or running off" bona fide buyers, selling dealers need to ask as high a blue sky amount as they can that will not seem "silly" to most qualified buyers. As I have written in the past, there are several "rules of thumb" for pricing blue sky. In many cases these rules do not

chargeback fee to provide additional motivation for getting the customer back into the dealership.

- ✓ Keep all special-order parts in a separate bin in the parts department. Assign responsibility to parts department personnel for weekly follow-up.
- ✓ Utilize the special-order system on your dealership's computer.

The key to any policy or procedure is constant review and accountability. Contact an AutoCPA Group member to help establish a special-order parts policy for your dealership. Don't let your cash be tied up in a bin full of special-order parts. ☞

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work for all dealerships. Some of these rules for pricing blue sky are as follows:

1 Two to six percent of total annual dollar sales. For the average dealership, this works out to be from one to three years of expected annual future average profits.

2 One to four times annual actual net profits. This does not work for a dealership that is a much below average profit performer since one to four times very little profit is close to zero. I find most qualified buyers will pay based on their expected profits, not the prior poor profit history of the dealership.

3 Two thousand dollars per annual new vehicle sold. This amount can vary by a large amount depending on the facts and circumstances of the franchise involved, expense structure of the dealership and many other factors.

As a summary, if you are a selling dealer, try to

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