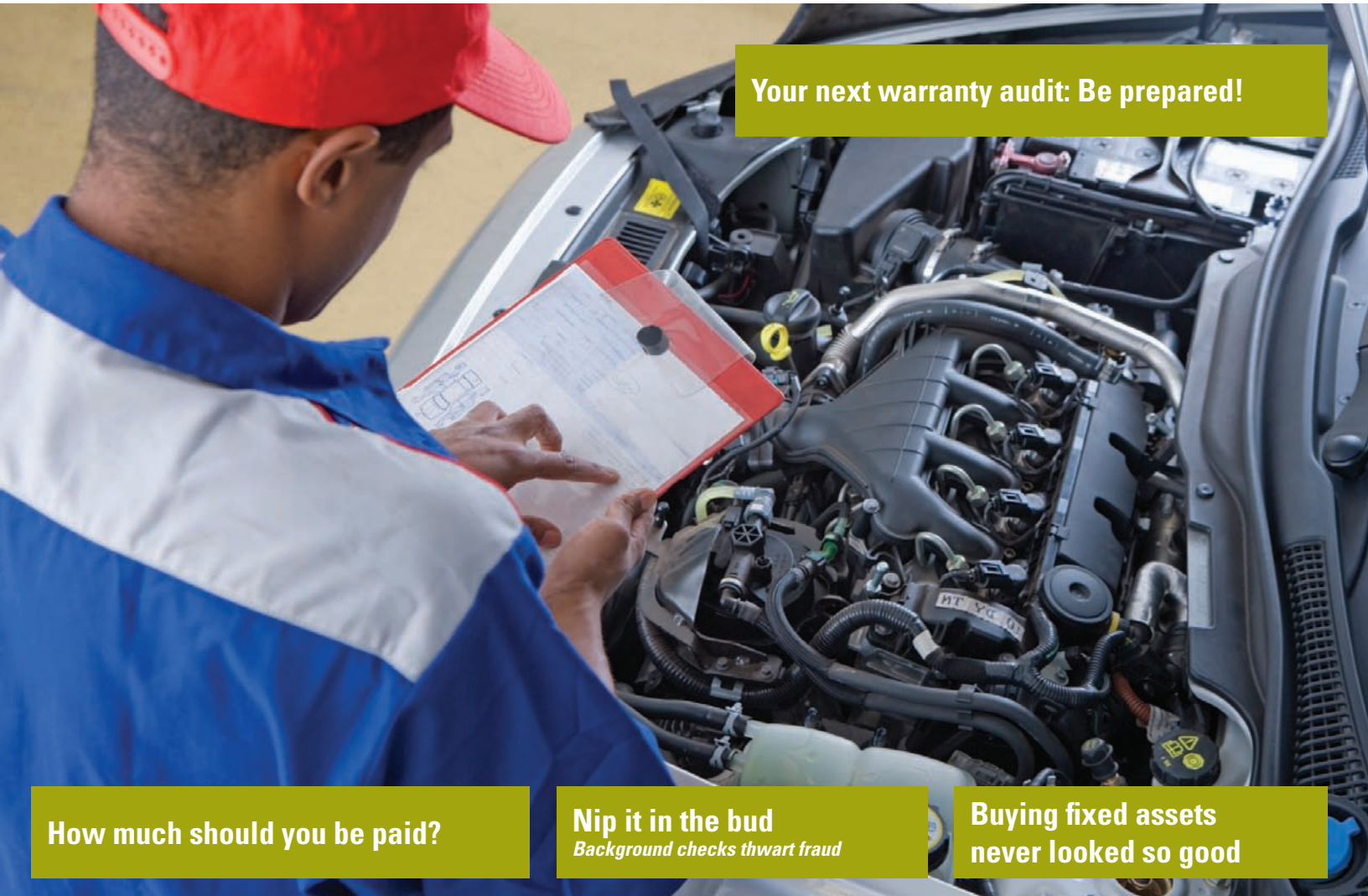


AUTO FOCUS

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Nip it in the bud

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**Buying fixed assets
never looked so good**

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CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS CONSULTANTS

For more information about the ideas presented in this newsletter, or to help answer a specific question you may have, please contact one of these experienced CPAs in our Automotive Dealership Group at 503.221.0141 or 800.819.0141

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Your next warranty audit: Be prepared!

Manufacturers conduct periodic warranty audits to ensure dealers follow their reimbursement protocol. Audits also have become more frequent as manufacturers seek ways to compensate for more dealer-friendly warranty laws that some states have passed to increase warranty reimbursement rates and eliminate manufacturer surcharges. Every dealer gets audited at least once, so it's best to be prepared.

Best defense is strong offense

No one likes dealing with warranty red tape. But pushing this administrative task to the lowest level of the priority totem pole might decrease the number of repairs that qualify as warrantable — and increase your chances of being audited.

Assign an experienced technical individual to handle warranty claims from start to finish. Train this warranty administrator on how to effectively process claims using your manufacturer's online warranty systems. These systems often are DOS-based and require the use of dozens of parts and labor codes.

Proactive owners mock-audit themselves each month by reviewing a random sample of warranty repair orders.

Your warranty administrator also should be familiar with all current technician service bulletins (TSBs), because they recommend service solutions for common customer complaints



and address whether the fixes are warrantable. TSBs are available through each manufacturer's service portal.

Service technicians also require training in warranty protocol, including how to write a comprehensive customer concern description and how to split time between warranty and other repair work. You're more likely to be audited if you submit more claims per vehicle serviced (CPVS) — or if your technicians spend more time completing the work — than other dealers.

Examples of paperwork blunders in protocol include missing customer signatures, mileage readings that end in 000, and ambiguous customer concern descriptions. Verbiage that implies wear and tear — such as "bent, cut, dented or torn" — also raises a red flag.

Prevention is key

Proactive owners don't wait for the dreaded "We're coming . . ." letter. They mock-audit themselves each month by reviewing a random

sample of warranty repair orders. Evaluate each claim as if you're an outside auditor. (See below.) Also check the repair backlog to ensure timely completion of warranty claims.

Consider asking your manufacturer's rep for an honest assessment of your warranty claims processing. If the rep spends hours each visit helping the warranty administrator code simple claims, pick a new administrator. Your rep is there to evaluate more complex claims that require the manufacturer's approval. Routine fixes often can be self-authorized online with proper coding.

Manufacturers reward preparedness

Organized dealers with dedicated warranty administrators have less to worry about when factory auditors arrive. They anticipate auditor requests, have paperwork and faulty parts ready to go and set ground rules when factory personnel arrive. Keep in mind that most manufacturers require dealers to keep records for a minimum of 12 to 24 months.

Auditors will tour the shop to look for obvious concerns — packaging from aftermarket parts in your trash, for example — and then sift through a sample of warranty claims, looking at the three C's: complaint, cause and correction. In addition to incomplete descriptions and administrative omissions, common reasons for expensive chargebacks include nonwarrantable add-on repairs, repeat claims and improper handling of battery claims.

Learn and move forward

A few weeks after your audit is over, your manufacturer's rep will meet with you to discuss any proposed chargebacks and ways to improve your claims processing. Don't be afraid to appeal unfair warranty audit findings, however.

Sometimes chargebacks are a wake-up call. View the warranty audit not as a battle with your franchisor but as a learning opportunity. Inefficient claims processing hurts both you and the manufacturer. Work together to preserve profits and build goodwill. ■

How much should you be paid?

Among the tough decisions dealer-owners face at year end are how much money they should take out of the business and how they should split that amount between salaries, bonuses and dividends. Although owners' compensation is somewhat discretionary, it needs to withstand IRS scrutiny.

Competing business objectives

Let's start with the basics. Your compensation is affected by the amount of cash in your dealership's bank account. But just because your

financial statements report a profit, it doesn't necessarily mean you'll have cash available to pay owners a salary or make annual distributions. Net income and cash on hand aren't synonymous.

Other business objectives — such as buying new equipment, repaying debt and sprucing up your showroom — vie for your kitty. So, it's a balancing act between owners' compensation and dividends on the one hand and capital expenditures, expansion plans and financing goals on the other.

C corporation issues

If you operate as a C corporation, your dealership is taxed twice. First, business income is taxed at the corporate level. Then it's taxed again at the personal level as you draw dividends — an obvious disadvantage to those owning a C corporation.

C corporation owners might be tempted to classify all the money they take out as salaries or bonuses to avoid being double-taxed on dividends. But the IRS is wise to this strategy. It's on the lookout for excessive compensation to owners and will reclassify above-market compensation as dividends, potentially resulting in additional income tax as well as interest and penalties.

In addition to the annual owners' compensation expense, the IRS monitors a C corporation's accumulated earnings. Similar generally to retained earnings on your balance sheet, accumulated earnings measure the buildup of undistributed



earnings. If these earnings get too high and can't be justified as needed for such things as a planned expansion, the IRS will assess a tax on them.

Flow-through entity issues

S corporations, limited liability companies and partnerships are examples of flow-through entities, which aren't taxed at the entity level.

Instead, income flows through to the owners' personal tax returns, where it's taxed at the individual level.

Dividends (typically called "distributions" for flow-through entities) are tax-free to the extent that an owner has tax basis in the business. Simply put, basis is a function of capital contributions, net income and owners' distributions.

So, the IRS has the opposite concern with flow-through entities: Agents are watchful of dealer-owners who *underpay* themselves to avoid payroll taxes on owners' compensation. If the IRS thinks you're downplaying compensation in favor of payroll-tax-free distributions, it will reclassify some of your distributions as salaries. In turn, while income taxes won't

Others who care

Other parties have a vested interest in how much you're getting paid. Lenders, franchisors and minority shareholders might think you're impairing future growth by paying yourself too much. If a lender, dealer operations manager or silent partner, for example, decides your showroom looks shabby and sees flat sales, your salary expense and dividends might become the subject of debate.

If you or your dealership is involved in a lawsuit, the courts also might impute reasonable (or replacement) compensation expense. This is common in divorces and minority shareholder disputes. The amount the court prescribes for your compensation affects business value, which, in turn, affects damages awards and asset distributions. In divorce, reasonable compensation also affects child support and alimony awards.

When the court imputes reasonable compensation, it typically considers compensation studies and other factors, including your salary history, responsibilities, experience, geographic location and dealership's performance.

change, you'll owe more in payroll taxes than you planned — plus potentially interest and penalties.

A tangled web

Above- or below-market compensation raises a red flag to the IRS, and that's definitely undesirable. Not only will the agency evaluate your compensation expense — potentially imposing extra taxes, penalties and interest — but a zealous IRS agent might turn up other challenges to your records.

What's more, it might cause a domino effect, drawing attention in the states where you do

business. Many state and local governments face budget shortages and are hot on the trail of the owners' compensation issue.

Professional guidance

There's more that goes into deciding your take-home pay than whim and the availability of cash. Your CPA can review factors to consider when taking cash out of the business and classifying it between salaries and dividends. He or she also can provide objective sources of compensation data to support your deductions and deal directly with IRS inquiries at his or her office, keeping IRS agents off dealership premises. ■

Nip it in the bud

Background checks thwart fraud

It's important to take steps to prevent employee fraud *before* a new worker walks in your door. Why? Once the new person is hired, it may be too late: Sales employees will have access to new and used cars. Parts department workers will be able to order anything that can be put on a vehicle. F&I employees will be surrounded by customers' credit information.

No matter how strong your internal controls, you need to "begin at the beginning" with complete employee background checks. It's one of the best ways to protect your business and your customers, although you still need to be careful with your final decision.

Follow the rules

Background checks need to be performed without violating privacy rights and other laws, which vary from state to state and evolve frequently. Be sure to consult an attorney before beginning your quest.

The Fair Credit Reporting Act, for instance, defines the standards for using credit checks in employment screening. Before requesting a credit (or "consumer") report, an employer must:

- Disclose clearly and conspicuously to the employee or applicant (in a separate document that doesn't refer to other subjects) that a report may be requested, and
- Obtain the employee's or applicant's written consent.

In many states only law enforcement agencies, financial institutions, debt collectors, and insurance and surety businesses can check credit reports.

The Electronic Communications Privacy Act does, however, permit credit history inquiries by other types of employers if they're related to a "bona fide occupational requirement" of a particular position or group of employees.

These limited exceptions exist for jobs that involve the following:

- Access to personal, financial or confidential information; trade secrets; or national or state security information,
- Unsupervised access to cash or certain assets valued at \$2,500 or more,
- Bonding or security required by state or federal law, and
- Signatory power over business assets of \$100 or more per transaction.

An exception also exists for managerial duties that involve setting the direction or control of the business.

Beware of other limitations

The Driver's Privacy Protection Act regulates how information from state motor vehicle department records can be released and shared. The departments generally will make the job candidate's driving records available, usually for a small fee.

Choose your background check company carefully, and know what you're getting.

Most schools, however, won't release records without the student's consent, and some schools will release records only to the student.

You also may need the candidate's consent before performing a criminal background check. In general, it's illegal to inquire about arrests — you can inquire only about convictions.

Choose an agency or investigator carefully

An employer may personally conduct a background check, and free general advice is available from the Small Business Administration and other organizations. But often the more convenient



approach is to hire an outside agency such as a background check vendor, private investigator or credit agency.

Choose your background check company carefully, however, and know what you're getting. There are many start-up companies in this field, and a less experienced or thorough company might search, for example, for a criminal history only in one or two states where an applicant has lived.

Most criminal records are available by county and then reported to the state. Thorough agencies generally check all of the counties in which someone has lived, worked or gone to school over the last 10 years.

Also be wary of Web-based companies that offer "instant" checks. There isn't one national database that contains *all* federal and state convictions. Finding criminal records can be a fragmented task across multiple jurisdictions and courthouses. Furthermore, many e-businesses offer low rates for public record searches, but the advertised rates may be deceiving; the more jurisdictions you want to search, the more you're likely to pay.

It's your responsibility

You have a responsibility to protect your business and your customers from fraudulent behavior in your workplace. A misstep in hiring new employees can adversely affect your daily operations, your bottom line and your reputation. ■

Buying fixed assets never looked so good

Unkle Sam hopes his expanded Section 179 and bonus depreciation deductions will spark the economy by encouraging businesses to purchase equipment and other “fixed assets.” But you’ll need to act fast — the window of greatest opportunity may be limited.

Considering depreciation

Buy a paper clip, and it’s expensed in the current tax year. But a larger purchase that provides value beyond this year is capitalized as a “fixed asset” on the balance sheet and gradually depreciated (or deducted from taxable income) over the asset’s useful life.

Examples of fixed assets include service lifts, diagnostic equipment, showroom furniture and lighting, and accounting software. The IRS prescribes useful lives and depreciation schedules for each category of fixed assets.

Sec. 179 expensing and bonus depreciation essentially allow you to accelerate your deduction for a fixed asset purchase by taking more of it — or even all of it — in the year the asset is placed in service. Of course, this means you’ll get less of a deduction — or no deduction — for the asset in future years. So Sec. 179 expensing and bonus depreciation don’t avoid income tax. Rather, they defer it to future periods.

Using Section 179

This year, you can immediately expense up to \$500,000 of new or used fixed asset purchases under Sec. 179, subject to a total purchase limit of \$2 million. In 2012, these limits are scheduled to fall to \$125,000 and \$500,000 respectively (both indexed for inflation). To qualify for the

higher Sec. 179 limits, assets must be acquired and placed in service in your tax year beginning in 2010 or 2011.

Sec. 179 also is limited by taxable income; the deduction can’t reduce it below \$0 or increase a loss. A dealer with \$100,000 in taxable income, for example, can deduct only \$100,000 of qualifying asset purchases under Sec. 179. If Sec. 179 acquisitions exceed taxable income, you can carry forward the unused portion to the next year, however.

Getting a bonus

With the exception of used equipment, the same assets that qualify for Sec. 179 expensing generally qualify for bonus depreciation. And 100% bonus depreciation generally is available for assets acquired and placed in service before Jan. 1, 2012. The break is scheduled to drop back to 50% for 2012, but an extension has been proposed. (Check with your tax advisor for the latest information.)



Bonus depreciation has a couple of advantages over Sec. 179 expensing: It’s not subject to annual dollar limits, and it can be used to create or increase a net operating loss deduction.

Countdown to savings

Contact your tax advisor now for more information about Sec. 179 and bonus depreciation. These opportunities may decrease dramatically on New Year’s Day. ■

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