FEBRUARY 2015 - VOL. 9

INSIGHT BY AXIOM ADVISORS

IN THIS ISSUE

Fighting Fraud in Fixed Operations Real Solutions to Detect - and Deter - Real Schemes.

By Marilou C. Vroman, CPA, CFE

In nearly twenty five years of working in the automotive industry, I've investigated a myriad of fraud schemes occurring within automotive dealerships, ranging from the ambitious to the creative to the absurd.

Interestingly, however, the notion of dealer fraud is most often focused on the risks associated with the dealer's vehicle sales department and administrative functions. For example, the classic scenario of a salesperson skimming down payment cash from customers, and then revising a buyer's order to show no down payment due. Or, the office manager who has diverted unclaimed property refunds to his personal credit card. Given the popularity of these schemes, you'd think that they account for the lion's share of the deception lurking in a dealership's operations. But make no mistake, the Parts, Service and Body Shop departments, all offer ample opportunities for fraud. The healthy margins that are available to absorb the cost of inappropriate activity is a likely factor. With labor grosses averaging 75% of sales, there is plenty of room to "sweep losses under the rug" and go virtually undetected.

That being said, let's shift gears and focus on fraud in fixed operations. Here are some scenarios I've encountered, along with ways to detect and prevent them from occurring.

REPAIRS PERFORMED FOR CASH

With dealership labor rates often exceeding $100 per hour and technicians getting paid $15 - $25 per hour, it's no surprise that an unscrupulous technician or service advisor might rationalize diverting cash payments from customers for vehicle repairs.

For example, a customer may be inclined to accept an offer from a service advisor or technician to enjoy a reduced labor rate if the repairs are paid for in cash. The technician and the service advisor stand to earn more for that repair than if compensated by the dealer according to their pay plan. If the technician and the service advisor are in collusion, they each may take a portion of the cash proceeds before the funds can be deposited into the dealership's account. The risk of repairs performed for cash is even greater when service advisors are responsible for cashiering functions where both recording the sale and the receipt of cash are in control of a single employee.

Taking this scenario one step further, a cashier or service advisor may be the beneficiary of a customer's cash payment even when a service advisor and a technician have performed and recorded the repairs appropriately. In some DMS's, a repair order can be reprinted several times before it is closed. Each time the RO is reprinted, the terms of the transaction

continued on page 2

continued from page 1

may be changed. A customer may be presented a repair order showing a $200 deductible due, the customer pays cash, and leaves. After the customer has left the dealership, however, the repair order may be altered to reduce the labor sale to absorb the $200, or to charge the balance to policy expense or to a discount code which will get charged to advertising or gross. The $200 is then pocketed by the employee at the end of the day.

How to Stop It

Here are some tell-tale indicators of repairs being performed for cash:

1. Excess discounts or charges to policy expense without authorization.
2. Parts on repair orders without a labor charge.
3. Frequent voided repair orders without explanation.
4. Unexplained decrease in weekly flat rate hours produced by a technician.
5. Unexplained parts shortages or minus adjustments.
6. Frequent reprinted repair orders. Management should be reviewing several reports on a regular basis including: Exception reports, expense trends, technician hour trends, parts inventory adjustments and voided document reports.

PAY PLAN MANIPULATION

It is said that pay plans motivate actions. Unfortunately, those actions may become fraudulent. Pay plan manipulation can take several forms. At its core, pay plan manipulation occurs when an employee knowingly and intentionally structures certain transactions in a way that will yield a personal financial gain for himself or others which otherwise would not occur in the ordinary course of business. For example, technician labor hours can be manipulated to pay extra time to technicians for repairs which were not performed or overcharging customers. For example, if a brake job normally pays two flat rate hours, one technician may be paid three hours for the same repair. While the customer may be paying the repair, the excess time may be also discounted or charged to policy expense. The excess compensation may be rewarded with personal favors to the service advisor or the service manager who has been facilitating the excess pay. In another example, labor or parts cost may be reduced to artificially inflate gross profit in the service or parts departments which may impact management bonuses.

In an alternate scenario, service advisor bonuses can be manipulated by overstating labor and parts sales. I once observed an instance where a service advisor systematically billed excess labor or parts on a repair order and when the hours were reversed, a miscellaneous former advisor number would be used. Essentially, the advisor would be paid for the sale, but would not be impacted by the reversal. This can also be accomplished by billing repairs that have not been performed, or adding parts to an RO that have not been used.

How to Stop It

1. Comparing flat rate labor hours billed per labor operation or per part number.
2. Comparing total monthly flat rate hours by a technician and looking for unusual spikes.
3. Observing excess "plus" adjustments of certain parts which never physically left the shelf but have been billed to an RO.
4. Investigating frequent parts physical overages.
5. Isolating repair orders by service advisor and investigating any transactions recorded using the number an inactive service advisor number.

EMPLOYEE VEHICLE REPAIRS

It is not uncommon for employees to seek discounted repairs for their personal vehicles at the dealership or for technicians to work on their own vehicles in the shop. I always recommend that a repair order is opened for liability purposes any time a vehicle is in the shop. Management should encourage employees to disclose any time they bring in a personal, family or friend's vehicle into the shop. While this can be a great benefit to employees, it can come at a great cost to the dealer. I've seen technicians and service advisors servicing numerous vehicles that go well beyond the employee repair policy in which the dealership sells no parts or labor, or sells these items at a heavily discounted rate.

How to Stop It

Reviewing the number of VIN's in a single customer's service history is a good start. It would be unusual for one person to have four or more vehicles under his or her name. The general manager or controller should periodically review the effective labor rate ("ELR") on a per RO basis and compare to historical performance. A review of the repair order billing setup in the dealer management system ("DMS") is also recommended to see if there have been any unauthorized changes. However, this will only reveal the setup at a moment in time and not necessarily demonstrate that the labor setup was changed and reverted back to the correct amount.

SHOP SUPPLIES ABUSE

Most dealers record the distribution of shop supplies through a parts counter ticket, which is closed and charged to supplies expense on a monthly basis. These parts counter tickets typically have items like brake cleaner, wheel weights, and various fluids billed as used by the technicians. At times, the shop supplies ticket can be used to write off other items that would typically not be considered shop supplies.

For example, I've noted shop supply tickets with brake pads, ECU's, headlamps and tires billed and written off to supplies expense.

While some of these items likely should have been charged to policy as a customer accommodation, or in a worst case scenario, the customer paid cash for the items but the funds were diverted. I have found other cases where parts were missing from inventory and written off as a supply.

This is simply an easy cover up of potential asset misappropriation. Since many dealers recover the cost of supplies through supplemental shop supply charges on repair orders that are passed on to the customer, this additional expense may go undetected.

How to Stop It

This scheme can be detected and deterred when a service manager reviews and approves the charges to shop supplies on a monthly basis. The accounting department should also be wary of changes in the supplies expense trend and periodically inspect internal counter tickets for large dollar value parts that are being written off without valid explanation.

PARTS OBSOLESCENCE AND EBAY

Parts managers typically evaluate their inventories at year-end for potential obsolescence. Certain obsolescence criteria may be established, such as parts which have not been purchased or sold in the last 12 months. These parts may be eligible to be scrapped and written-off. Accordingly, the accounting department will record an entry to remove the parts from inventory and record a write-off. I have found instances where the obsolete parts are not actually scrapped, but either sold for personal gain on an online auction such as eBay, or the parts are left in the bin in the parts department and sold over the counter for cash.

How to Stop It

Require a management approved list of the obsolete parts be given to the accounting department as support for the write-off. Parts may be added back into the inventory at a cost of $.01 for tracking purposes. The disposition of the parts would then be required to be recorded on a parts counter ticket and signed by the parts manager. The inventory should be periodically examined for adjustments to return these obsolete parts to inventory for sale. Also, perform periodic searches online for these scrapped parts being sold in the local market.

FICTITIOUS REFUNDS

The parts department is at high risk of credit memos being created for fraudulent purposes by a parts counterperson. An example of a fictitious refund would be a sale of a part to a customer and recording a credit memo shortly thereafter, which shows a part has been returned to the inventory and a refund due to the customer. However, the part has never been returned and the counter person takes cash from the cash drawer or requests a check to reimburse the customer. Once the counterperson receives the signed check, he or she cashes it or endorses it for deposit. This scheme can be detected by observing frequent shortages in the inventory, or frequent credit memos shortly after the sale of a part.

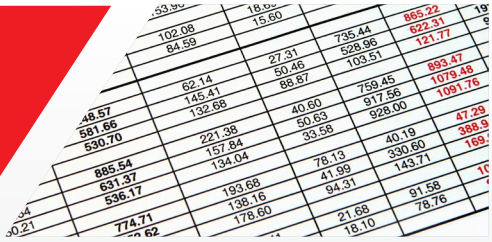
How to Stop It

One method of deterring this behavior is to ensure only a manager is allowed to issue a credit memo and all refunds are in the form of a check and mailed to the customer. The timing, frequency and dollar amount of credit memos should be monitored by accounting and brought to management's attention. Cancelled customer refund checks should also be reviewed for irregular endorsements.

This list is only a small sample of areas where a dealer can be subjected to fraud in fixed operations. With ample gross profit to absorb occasional losses, these types of fraud often go undetected. The best advice I can offer is to inspect what you expect, but be aware that effectively rooting out fraud requires a closer investigation.

Tools For Analyzing Dealership Data In Excel

By George Woloszczuk



Perhaps one of the most daunting tasks for those who review transactions in the dealership environment is the analysis of large amounts of transactional data. A typical dealership will produce thousands of rows of GL data in a day, as well as vehicle sales, service, and parts data.

While a thorough review of a dealership's transactions can seem almost impossible there is hope. Excel includes many analytical tools that the average user may not know. In this article I will explore three of the more useful tools to help reviewers sort through and analyze large amounts of data.

These include sorts and filters, conditional formatting, and PivotTables.

Sorts and Filters

The user needs a quick way to sort and filter the data that a dealership management system ("DMS") produces. This can be achieved using the AutoFilter tool available in Excel. The AutoFilter provides clickable dropdown arrows next to each of the headers that can be used to sort and filter the data. The AutoFilters can be toggled on and off of a spreadsheet with the following two steps. First select all of the data. This can be done by holding down the left mouse button and dragging the cursor over all of the data. This can also be done by pressing the "CTRL+SHIFT+8" keys. When all cells are highlighted, click the "Filter" button under the "Data" toolbar or press the "CTRL+SHIFT+L" keys. The icon will appear next to each column header, and clicking on the icon provides sort and filter options.

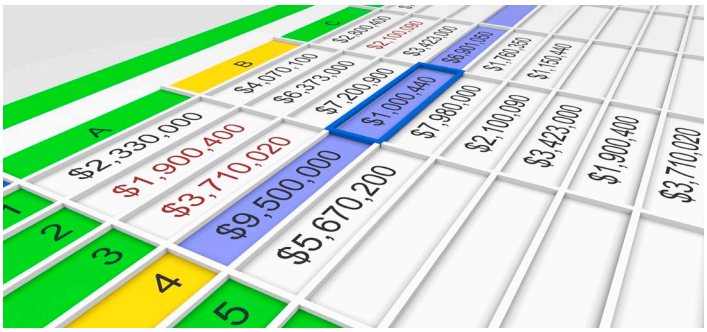
The ability to filter reduces the amount of time spent searching through data. For example, the user can filter GL data to a specific account, or a specific account type, and then sort the posting amount from largest to smallest. This helps to identify unusually large entries posted to that account. Another example is to filter sales data to display only deals which sold for a loss, and then sort by sales manager or by sales person to determine if there is a pattern of losses which may be attributed to an employee.

Conditional Formating

Excel's conditional formatting tools offer another way to identify unusual transactional items. Conditional formatting enables the user to change the format of a cell (color, font, borders, etc.) when certain conditions are met. Although this may sound complicated, in practice it is both easy and useful. Clicking on the "Conditional Formatting" button under the "Home" menu in Excel shows all the different conditional formatting options available. In order to apply conditional formatting to a spreadsheet, the user will need to highlight a column of data and select a rule in the "Conditional Formatting" menu. Under the "Highlight Cells Rules" option there are many different formatting rules. For example the "Duplicate Values…" rule can be used to highlight duplicate cells a different color. This can be applied to the vehicle sales file to identify customers who have purchased multiple vehicles. Another application of conditional formatting is to use the "Less Than…" option with the service data to identify repair order transactions that were billed at less than the dealer's stated labor rate. The "Top/Bottom Rules" are also useful. These can be used to highlight items that are above or below average. For example, this rule can be used with the parts data file to identify instances where an above average amount of oil was billed to an RO.

PivotTables

Perhaps the most extensive and powerful tool that Excel has to offer is the PivotTable, which allows the user to cross-tabulate large amounts of data in a matter of seconds. PivotTables have the benefit of being a powerful data analytic tool, as well as, having



an intuitive and easy to understand user interface. To create a PivotTable, highlight the data to be analyzed and select the "PivotTable" option in the "Insert" toolbar. An empty PivotTable is created, and now the user can drag and drop fields into different locations on the table and generate summaries of large amounts of data. Complete and easy to understand instructions for creating and modifying PivotTables can be found in a multitude of books and online resources. Pivot tables can be used to cross reference transactional data and summarize large amounts of data in an easy to understand table. For example, when reviewing GL data, a reviewer can cross reference the users and GL accounts to identify a user posting to an unusual account. The reviewer can also cross reference customer information in the vehicle sales file. This can be done to find unrelated customers with identical contact information. As another example, the PivotTable can be used with check register data to identify multiple checks issued to the same individual in a short period of time. The speed and flexibility of the PivotTable tool opens up a multitude of possibilities.

Conclusion

We've taken a look at three powerful tools to facilitate dealership financial data analysis. Incorporating these analytic tools into their review processes can help the reviewer see the 'forest through the trees' and identify the big picture patterns that the transactional data alone may not otherwise reveal.

What to Expect From Buffett Acquiring Van Tuyl Dealer Group

By Phil Villegas

As featured in WARDSAUTO

In a WardsAuto Megadealer 100 analysis I wrote in May, I predicted major changes would occur this year among the ranking's top 10. The following month, No. 9 Lithia Motors announced plans to acquire DCH Automotive.

While that deal was surprising to some people, news that Warren Buffett's publicly traded Berkshire Hathaway investment company plans to acquire the Van Tuyl Group is a shocker. Van Tuyl ranks No. 6 on the WardsAuto Megadealer 100.

In that May analysis, I raised the question whether Van Tuyl would still be a privately held company by next year. I had sensed something was going to happen, but I did not anticipate Warren Buffett's involvement.

So what does this mean for the industry? What can we expect? From a dealer's perspective, this is great news. It not only provides an endorsement of the viability and stability of auto retailing, but it also gives our industry an immediately recognizable and trusted spokesperson in Buffett.

This should take some of the pressure off and air time away from Mike Jackson, CEO of AutoNation, the country's largest dealership chain.

The other great news for dealers is the additional attention from all those professionals, investors, bankers, tech people and others who reverently follow billionaire Buffett's moves. He's considered a visionary investor. If the industry is good enough for him, how can it not be good enough for them?

I anticipate blue sky and goodwill multiples will increase on the heels of this news, and with good reason. We have already seen a hot dealership buy-sell market this year. This sure adds to that, and, in turn, will drive up the asking price of stores.

But dealers looking to acquire stores should not lose their heads. They should essentially follow Buffett's advice and invest sensibly. His approach is to not meddle with the companies he acquires, and I expect this to hold true in this case. But I wonder if there is more to the Van Tuyl deal than simply acquiring one of the best-managed dealer groups in the country.

Let's not forget Buffett has a significant investment in BYD, a major Chinese automaker. Berkshire Hathaway recently said BYD is poised to enter the US market. It's too early from our end to consider if this is even a viable end game. But consider the possibilities.

We have seen some foreign automakers struggle to enter the U.S. market.

Whether directly or through a distributor, it costs hundreds of millions of dollars to build a distribution network and infrastructure. A few years ago, Indian automaker Mahindra scratched plans to do business in the U.S.

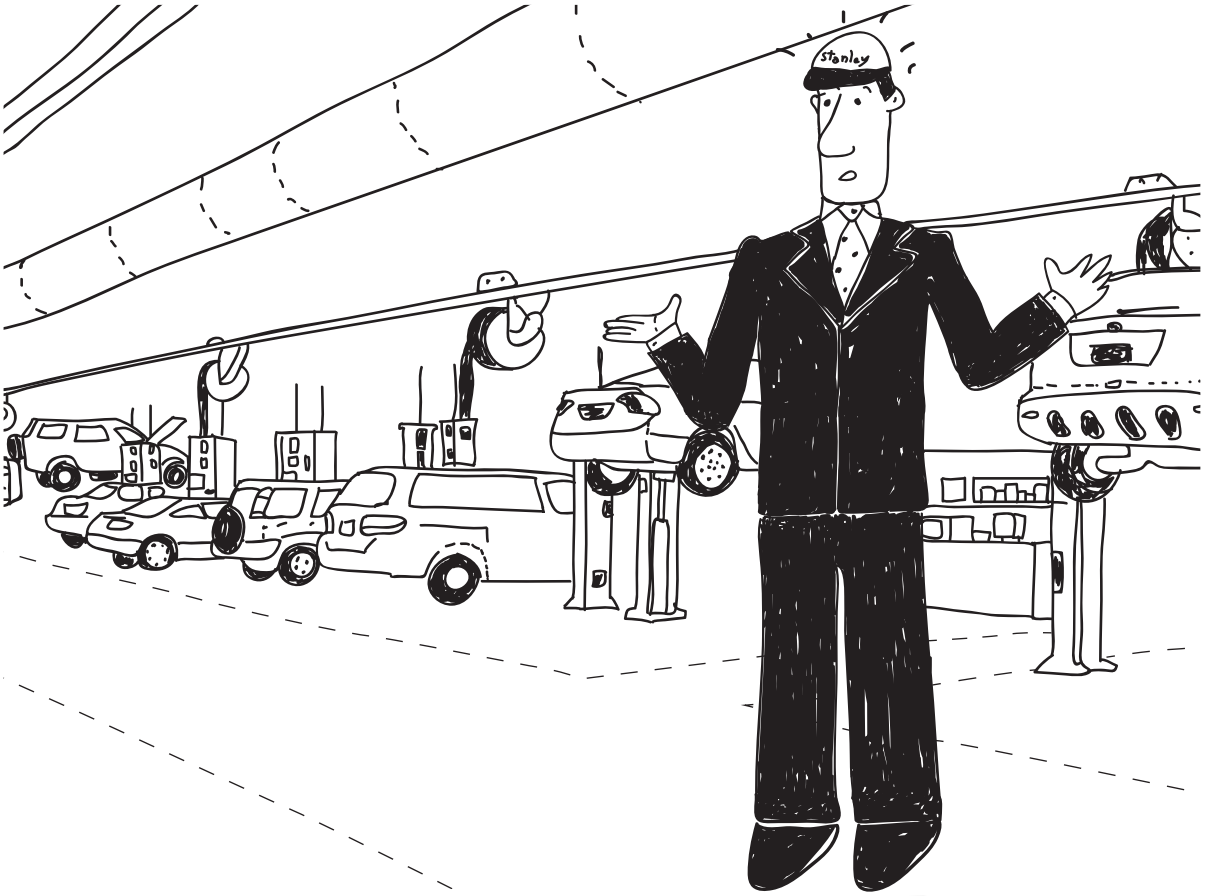
In addition to the costs, there can be adversity factors relating to dealers, facilities and state franchise laws.

Now, consider that Berkshire will now have a network of 78 dealerships in 10 states. It presents a unique opportunity for a wise investor who happens to hold a major stake in BYD. This idea may be dismissed as overreaching, but maybe not.

The main argument against it is that selling BYD directly through Berkshire Hathaway Automotive would violate state franchise laws. But Elon Musk has shown with Tesla that this is not entirely the case. Some states have allowed Tesla's direct-sales approach that bypasses the traditional franchised- dealer system. Other states have allowed Tesla "galleries" that show vehicles but aren't allowed to sell them. Customers instead place online orders.

In 2011, Musk laughed when a reporter asked if he considered BYD as a potential competitor. The future can only tell if there is a bigger BYD move. What's pretty certain is that things will get interesting.

"HOW CAN MY PROFITS BE DOWN, WHILE ALL THE LIFTS ARE UP?"



We're GROWING!

Axiom has moved to a new and larger office. This new home will provide the Axiom team an optimal environment to not only continue to expand and improve our services, but to also attract top level talent to meet increasing demand for the highest quality service.

Note Our New Address:
520 Brickell Key Drive
Suite O-307
Miami, FL 33131

Call 888-9AXIOM9
or visit www.axiom-auto.com

AXIOM ADVISORS

Innovative.Automotive.Insight.

Axiom Advisors was formed in the spirit of providing a fresh, new alternative to meet the specialized needs of retail automotive dealers.

What makes Axiom Advisors different? Our team of professionals has the unique combination of over 60 years of hands-on retail automotive industry experience working directly in dealerships, paired with the assurance of professional accounting experience. Our advisors are "car guys" who speak the language of the industry and truly understand the complexities of your business.

Axiom Advisors specializes in Enterprise Management, Mergers and Acquisitions, and Litigation Support. For more information or a complimentary consultation please contact us at 888-9AXIOM9 or visit us online at www.axiom-auto.com.

Phil Villegas
pv@axiom-auto.com

Marilou C. Vroman, CPA, CFE
mv@axiom-auto.com