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Goodman & Company, a Mid-Atlantic regional certified public accounting firm working with dealerships representing virtually every manufacturer, delivering quality accounting, tax and specialized services.

Think like an IRS agent

Beware of 9 red flags that invite an audit

With the IRS auditing about 1.3 million returns each year, dealers must stay on their toes. Obviously, the agency can't audit every return, so it relies on key indicators — red flags — to narrow the scope.

The best way to avoid trouble is to think like an IRS agent while examining your dealership's business and tax-filing practices. Here are nine of those red flags to look for:

1. Mistakes. The first thing an IRS agent sees is your dealership's basic information. Double-check your federal employer identification number, address, and date of incorporation or formation.

Math errors and missing signatures also are signs of a sloppy return. IRS computers spit out incomplete and incorrect returns for a closer look by a human, who's likely to review it with a skeptical eye. Don't give the agency a chance to pick low-hanging fruit.

2. Unreported income. Agents — or their computerized tools — look to see whether all income listed on your 1099s and W2s is reported on your returns. There seems to be a crackdown on tracking down and matching 1099 forms over the past few years.

3. Owners' salaries. The IRS is reviewing owners' compensation for S corporations and LLCs to determine if adequate wages are being paid to shareholders. If not, the IRS can impute wages and collect employment taxes. If you own a C corporation you may be at risk for having compensation deemed "unreasonable" by the IRS. If your dealership is subject to these risks, align your salaries with industry benchmarks. If you find your owners' salaries are too high or too low based on the benchmarks, you should consult your tax advisor.



4. Undocumented business travel. The IRS has always been concerned with travel deductions. Keep detailed travel and meal expense logs and be able to justify the business-use percentage. Remember, if you travel for business and take a family member who does not work in the dealership, only *your* trip expenses are deductible. Around town, be sure to keep a record of business mileage. In the last year, IRS agents have kept their eyes especially wide open for the personal use of company vehicles and trips that are not 100% business.

5. Untracked cash sales. The IRS is much more likely to audit businesses with frequent cash transactions. Most of these probably take place in your parts department. Make sure you properly report each one on your tax return.

6. Unusually heavy business losses. Although any dealership has its ups and downs, large business loss deductions may catch an IRS reviewer's eye. If your dealership is an S corporation, LLC or partnership and has had significant losses, you may be unable to fully deduct your losses unless you have basis in the company equal to the losses' amount. You should consult with your tax advisor to determine what can be done to ensure that your losses are deductible.

7. Questionable deductions or credits. Employee tool reimbursement plans have been promoted for several years, but the IRS has recently been ruling that most of these plans do not meet the accountability requirements for employee expense reimbursement.

8. A failure to acknowledge today's hot-button tax issues. When it comes to dealerships, the IRS has had several areas of particular interest in recent years. With Congress revisiting the use of the last-in, first-out (LIFO) inventory method, the agency started taking a closer look at records connected to the calculation of indices last year.

The IRS also has increasingly asked about the relationships between

advertising agencies and dealerships. Reviewers want to know which of the two parties spent any shared funds, why the money was spent and when.

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Additionally, agents have been checking for unreported income, such as management fees or unspent advertising funds returned to the dealership. Finally, they've taken an interest in overreported expenses, such as advertising costs that were counted twice.

9. Disorganization. Do you keep your receipts in an empty motor oil can? Keeping good documentation

and carefully reviewing your return are critical to avoiding an audit — or passing one without penalties. Should the taxman knock on your door, sound documentation may help limit your liability or avoid it altogether.

One remedy for the disorganized dealer is software that tracks certain information, such as data related to the LIFO inventory method mentioned above. Such an application also can facilitate accurate electronic file storage, reporting and retrieval.

In recent years, the IRS has been vocal about closing “the tax gap” — the amount Americans owe in taxes but don't pay. The government estimates the gap to be as high as \$345 billion a year, a strong incentive for beefed-up enforcement. Thus, preparation and documentation are more important than ever in steering your dealership clear of an audit. 🚗

Special financing Q & A

Primer on subprime loans addresses pluses, minuses

If you approach it with your eyes wide open, special financing can benefit both dealer and customer. Your business can profit from the revenue stream while customers with financial potential, but less-than-stellar credit histories, get a second chance. Here are some frequently asked questions — and answers — about this increasingly popular selling tool.

Q: WHAT IS “SPECIAL FINANCING” IN TODAY'S MARKET?

A: Special financing, also known as subprime lending or B-paper, is the practice of making auto loans to buyers who aren't eligible for the best market interest rates. Many dealers are considering special financing as a means of drawing in more customers and retaining previous buyers.

Special finance loans generally have higher interest rates (ranging from 12% to 29%), higher initiation fees and lower down payments as a percentage of the price than traditional auto loans. They're also likely to have longer loan terms, steeper loan-to-value ratios and higher retail turn rates.

Q: WHO'S THE CUSTOMER?

A: The typical special financing customer is one who can't qualify for traditional financing for a variety of reasons: a bad credit score, lack of credit history, previous vehicle repossession, low income, inability to come up with a down payment or recent bankruptcy.

The definition of a subprime borrower varies from lender to lender. Usually, a credit score of less than 650 — some say 620 — puts a customer into this category. Subprime borrowers may have no other avenue for buying a vehicle, so they're frequently willing to pay higher loan rates and fees.

Q: WHO IS THE LENDER?

A: In some cases, dealerships participate in a buy-here/pay-here business model by directly floating notes to customers and getting paid back over time.

Under this arrangement, the dealer acts as the lender rather than as the middleman between the borrower and a third party. Of course, you'd need cash to support the note balances while they're being collected.



Subprime auto loans vs. subprime mortgages

When dealers hear the term “special financing,” the first thing that may come to mind is the disastrous subprime mortgage market of the last year or two. Yet subprime auto loan providers are exposed to considerably less risk than subprime home mortgage lenders. Reasons for this include:

- Auto loans typically have fixed rates,
- Subprime auto borrowers are usually renters, so they aren’t part of the current mortgage crisis,
- Because most people need a car to get to work, they’re more likely to honor a car-loan obligation longer than other debts, and
- Repossession, though still involving some loss, is a safeguard.

Nonetheless, some Wall Street analysts have predicted that the subprime mortgage crisis could eventually contribute to a similar crisis in subprime auto lending.

The analysts point out that, if the limited number of subprime mortgage holders who also have subprime auto loans cannot make their mortgage payments, many of them may also default on their auto loans. Although little evidence of this has been reported so far, it remains a possibility.

Q: WHAT ABOUT OUTSIDE LENDERS?

A: You may choose to have an outside lender shoulder the risks instead. In this case, be prepared for your employees to work more closely with the lending institution to finance the subprime loan than they would with A-paper. With special financing, more information is needed and more paperwork is customarily required.

Some lenders offer options in which the dealership earns a portion of the interest income through program activity. Details vary from lender to lender, but you can often get paid for the contract on the vehicle’s sale, so you actually have the cash while the contract earns out. Interest income can be accumulated in a pool of as many as 100 customers.

Q: WHAT VEHICLES SHOULD WE OFFER?

A: Special financing is more prevalent with used-car buying than new car purchases. Therefore, you’ll want to make sure you stock a good selection of

affordable, used vehicles including older, low-end autos with higher mileage.

Nonetheless, because unreliable vehicles can trigger loan defaults, you should employ the same reconditioning standards for a subprime-loan vehicle as you would for its prime-loan counterpart.

Q: WHAT ABOUT COLLECTIONS AND REPOSSESSIONS?

A: Whoever is financing the loan normally handles the collection process. If it’s your dealership, you’ll want a strong collection team. With some customers, special financing requires overseeing collections from paycheck to paycheck. You’ll also need a computer system that effectively monitors collections.

Typically, the finance lender also manages repossessions. A loss from a repossession equals the outstanding loan balance minus the vehicle’s value at repossession. Unless it employs its own team, the dealership would need to hire a repossession company.

Recovery fees are usually included in the loss amount. Naturally, any such losses will take a bite out of your interest income earnings, so you should take them into account when creating your business model.

Programs with outside lenders frequently are set up to protect you against shortfalls if repossession losses are more than interest-income earnings. If you go this route, review these details carefully.

Q: WHAT EXACTLY ARE THE RISKS?

A: By definition, special financing is riskier than conventional auto lending. (It is, however, less risky than subprime mortgage lending. See “Subprime auto loans vs. subprime mortgages” at left.)

Therefore, this is a practice for only those dealerships comfortable with taking risks. That toxic combination of a high interest rate with an applicant’s poor credit history — and a possibly adverse financial situation during the loan’s life — can all too easily lead to default. In addition, there’s a potential for increased charge-offs on subprime loans.

Also consider that your community’s perception of your dealership might change. If you start charging some customers higher interest rates for auto loans (or a lender serving you does), will these buyers think they’re being gouged? Are you prepared to explain the practice to irate patrons — or even defend it in the media?

Q: HOW CAN I PROTECT MY DEALERSHIP?

A: To keep special financing from leaving you feeling less than special, you need to create a sound business model and then stay within its parameters.

One of your first steps should be to decide what “credit-challenged” means to your dealership — and which customers are too risky to take on. You’ll want to focus on individuals who, though they may have blemished credit pasts, show financial potential now.

Operationally, many successful dealers create a separate department to handle special-financing leads. Trained staffers — both sensitive to delicate financial matters and knowledgeable of the legalities — know how to ask the right questions about a customer’s lower credit score and current obligations.

The bottom-line question is: What monthly payment can the customer afford without overextending him- or herself?

Although special financing is, by its nature, risky, the risk can be worth it. By offering financially challenged customers the opportunity to buy a vehicle and, perhaps, rebuild their credit standing, you can create a new revenue stream while expanding your customer base.

But any effort to offer special financing should be preceded by thorough due diligence into the feasibility of this practice for your dealership. Your CPA can help you look at the numbers and make the right decision. 🚗

VoIP marries computers with telephones



Voice over Internet Protocol (VoIP), a technology that provides phone service via the Internet, is hot and getting hotter. Some dealerships find it saves them money while creating efficiencies in the showroom that traditional telephone service never could. But before you ring wedding bells for Ma Bell and Papa PC, consider these points:

Costs. Because a VoIP system connects callers via the Internet, there are often no additional costs for long-distance service — an impressive savings. When you get bids from VoIP providers, however, make sure the quotes cover end-to-end design and all equipment.

Functionality. If you integrate VoIP into your computer system, your staff can send and receive voice mails online just as you do e-mails. And customers can reach you — and you them — more easily.

For example, you can forward calls to both phones and computers with little effort, allowing employees who use several computers to receive calls at any of their workstations. This will help salespeople catch callbacks from open leads immediately and, you hope, profitably.

A dealership, featured in the June issue of *Computerworld*, designed a wireless VoIP system to be part of its new second showroom. The general manager said they coupled the VoIP system with their existing switchboard and voice mail, easing communication between the two locations. Employees have to dial only a four-digit extension to reach each other. And the change to VoIP reportedly freed up everyone to spend more time on the floor.

Risks. Uniting your phone and Internet services means that, if your Internet connection goes down, so do your phones. So, looking carefully for a reliable provider is key.

Also, your phone system may become more susceptible to hackers. Because a VoIP server works similarly to an e-mail server, outsiders could figure out how to illegally access your system and send thousands of spam messages to random numbers. The right security software can protect you against this, though.

Making the switch to a VoIP system could boost your dealership’s bottom line by cutting expenses while improving its ability to communicate both internally and externally. Before falling in love with this new technology, however, be diligent about weighing its pros and cons.

Should a third party handle your most important asset?

In today's business environment, where ways to cut costs while improving performance are revered, the outsourcing of many operating functions is widespread. But when it comes to the service-oriented world of the auto dealership, should you let a third party handle your most important asset — your people?

An increasing number of dealerships are doing just that, turning to professional employment organizations (PEOs) to hire and fire employees, handle the related HR paperwork, and provide employee benefits. Should you join them?

Set yourself free

Outsourcing has its advantages. You can dump the drudgery of routine and recurring HR functions while keeping control of what responsibilities are important to you — for example, training, guiding and directing employees.

Outsource some or all

Depending on the PEO, you may opt to outsource your entire HR function or only select tasks. For instance, you may want to retain control over the administration of your overall HR management strategy but outsource time-consuming, everyday transactions, such as:

- Maintaining personnel information,
- Distributing payroll and paying the associated taxes,
- Managing health care and life insurance benefits,
- Administering retirement and savings plans,
- Filing workers' compensation claims,
- Recruiting, hiring, training, disciplining and firing employees, and
- Running employee assistance and counseling programs.

Outsourcing also can help you dig yourself out from under all that HR paperwork to focus on higher-value and more strategic dealership activities, such as improving customer service and increasing your employees' skills, efficiency and productivity.

Outsourcing can also improve employee retention. Many PEOs are large companies with better benefits than what you might be able to provide, and good benefits can improve employee satisfaction while lowering turnover rates.

Another key reason for outsourcing is to reduce overhead costs and boost your dealership's gross margin. Just be certain to perform a cost-benefit analysis before committing to a PEO, making sure that the switch will still be cost-effective after you pay the required fees.


Saving money, however, need not be your primary reason for outsourcing. Last year, Hewitt Associates, a benefits consulting firm, found that 45% of 129 companies it surveyed didn't deem cost savings as a top reason for changing to a PEO. Gaining outside HR expertise, improving service quality and having more time to focus on the core business were cited as the top three reasons for a switch.

Examine the down side

On the flip side, outsourcing does have some negative aspects. Naturally, moving your employees to another employer may trigger some fear and resentment.

Further, you may find it hard to turn over certain managerial responsibilities and important decisions, such as hiring or letting go of staff, and employees may be uncomfortable having sensitive employment issues handled externally.

Don't forget morale

In the end, to determine whether a PEO is right for your dealership, you'll need to weigh the pros and cons. If you decide to go this route, reassure your employees that, even though they'll technically have a new employer, their jobs are secure and you value them as much as ever. 

Cure customer complaints with a dose of insight

Every dealer knows the value of a loyal customer. But, unfortunately, every dealership doesn't view the complaint-handling process as the delicate operation it is. By responding to dissatisfied patrons in a healthy, informed manner, you and your staff can cure customer complaints without losing business.

What's the diagnosis, doc?

Thanks to near-constant technological advances, diagnosing the cause of a vehicle malfunction is easier than ever. So, when a customer contacts you with a complaint, focus immediately on discovering the source of the problem, rather than focusing on its symptoms.

Be careful: Some dealerships opt for quick fixes to try to immediately appease the customer. But when the same problem reoccurs, that buyer is left feeling worse — and often angrier — than he or she was before.

Who's the complainer?

Along with knowing what you're dealing with, you also need to know *whom* you're dealing with. Generally, there are several types of complainers.

Meek customers are those who won't say a word unless they absolutely have to — for instance, when their vehicle breaks down. Follow up closely and repeatedly with these customers, or they may silently show their underlying dissatisfaction by taking their car to another dealership or repair facility.

Aggressive customers are those who readily complain — often loudly and at length — and have a tendency to suspect they're being ripped off. Your service manager may need to make an extra effort to convince these customers of the value you're providing.

High-rollers are consumers who want the best service and, on the bright side, they're more than able to pay for it. The catch: They want lots of attention and lightning-fast turnaround, which you'll need to provide.

Finally, *rip-off artists* — and we hope you don't have many of them — are individuals who want something to which they're not entitled, such as a free oil change or complimentary vehicle accessories. Handle them with firm professionalism and don't be afraid of losing their business.



What's the Rx?

With the complainer's "type" in mind, your service staff should follow a certain protocol for resolving the issue.

For starters, the service manager should give his or her undivided attention to the person complaining. Next, the manager should apologize and agree that a problem does indeed exist. (Or, in the case of rip-off artists, he or she should remain objective and use accurate, quantifiable data as a response.)

In the end, your dealership needs to resolve the complaint, and going the extra mile can make all the difference. Consider providing transportation to those who need it. Or, if the vehicle problem arose from a manufacturer mistake, counsel the vehicle owner on how to raise the issue with a factory rep.

Feeling better?

Satisfied customers are a dealership's lifeblood, and staying on top of the complaint process can help you keep this precious liquid healthy. Review how your staff handles complaints and look for ways they could improve. 🚗

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