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LENDING ARRANGEMENTS

All dealers have borrowing arrangements with lenders, including new floor plan, used floor plan and capital loans. The following are some observations regarding dealers and lenders.

Some lenders want dealers to sign many documents that had the dealers realized what they were signing, they probably would not. It is common for larger banks, not factory finance companies, to have dealers meet some financial metrics, also called financial covenants, which can include profit ratios, etc.

One problem is that the dealership could be well above factory working capital guidelines or vehicle equity guidelines (cash plus vehicle receivable plus new inventory and used inventory less new and used floor plan minus trade-in payoffs), but if the dealership is not profitable enough, it could be in violation of a loan covenant. This could allow the lender to call in the loans, which is more likely to occur when the dealership is not that profitable. While these lower profits could be due to actually having less profits,

other factors can affect profits, such as more compensation being given to the dealer or substantial money being diverted outside of the dealership as “side” income, such as service contract income.

At times, some lenders do not allow for special financial items or special income tax deductions when computing financial covenants, to the detriment of the dealership. Also at times, the lender’s covenants may restrict the dealership from making distributions to the dealer. This is unreasonable if the dealer is well above factory working capital guidelines and has a solid amount of vehicle equity for their dealership size.

Make sure you understand your lender’s requirements for this issue. If you are in violation of the lender’s covenants, you should require them to give you reasonable notice—120 days, for

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example—before they can terminate the lending relationship.

Understandably, some dealers prefer not to sign personal guarantees. This is understandable, but not “real” world valid. Why? In most of these cases, the dealer agrees to keep its dealership(s), which guarantees all loans at such a level of capital, working capital and vehicle equity, so that if the dealer individually allows these metrics to go below lender guidelines, the individual dealer has to put needed funds back into the dealership—in effect a “personal guarantee.” In all the lender arrangements I have seen, if there is no “personal guarantee,” the dealerships and the dealer in effect have a “personal guarantee” without realizing it.

I currently see new-vehicle floor plan rates of 3% to 5%, sometimes more. Most dealers’ real rate should be less than 4%. Some lenders that charge the higher rate try to present to the dealer credits to the high interest rate, which is often misleading. The lender might automatically give a credit to the high 5%+ rate so they can claim to always charge the same prime rate.

Sometimes these lenders give a credit on the high floor plan rate if the dealer sells enough retail installment contracts to that lender. However, when we have reviewed these arrangements, we

find at times the “buy rate” of this lender is not competitive. We also hear that the lender buys “deep” on retail paper. This is doubtful, and if it matters to your dealership, you need to have someone analyze these “doubtful” deals to see if the lender is really buying deep. I do find factory finance company rates being higher at times, but the lower insurance cost allows for a portion of the higher rate.

We have seen that some lenders have the dealer sign an agreement, specifying that if the dealer passes away, the lender can call in the loan(s). I have asked lenders about this, and they say “trust us.” You can’t allow this. In such instances, you might ask the lender to give your estate a 120-day notice if they plan to “pull” the loans.

Summary: Based on the size of your dealership and/or the working capital and/or tangible net worth of the dealership, make sure your floor plan rate is reasonable. Have a qualified advisor—typically an attorney or automotive accountant—review all documents to make sure they are reasonable and you understand what you are signing. Most dealers do not read all these legal documents or understand what they really mean; make sure you understand what happens with the lender if you pass away. Consult your **AutoCPAGroup** member to assist with this lending process. ✍️

WHAT DOES IT COST TO GENERATE YOUR PAYROLL?

**Gerry Green
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I have walked into many dealerships that run payroll over multiple periods. Some apply as many as eight payrolls a month: four weekly, two biweekly and two semi-monthly. When factoring in personnel costs and software charges, the cost of generating these payrolls adds up. Whether you use an outside source or company



personnel to process and file returns, it still requires a large amount of office time to gather the information, calculate commissions and submit the payroll. Consolidating payroll for multiple companies can help reduce some costs.

The cost of generating a payroll check or electronic payment can range from \$0.80 to \$5.00. Reducing the number

of pay periods becomes more important when considering that the larger the organization, the greater the impact of streamlining process and pay periods.

Ideally one payroll a month is preferable, but this may not be feasible in the real world in which the auto dealer operates. The greatest obstacle to consolidation I hear when discussing this with dealers is the employees, particularly shop mechanics who live paycheck to paycheck. Many dealers have moved these people and other hourly personnel to a biweekly payroll, thus eliminating two payrolls a month. It may take some transitional assistance from the dealer for employees to defer their pay periods, but the time and cost savings to the dealer will more than pay for it.

The timing of commission payments should also be considered. Because most commissions are calculated on a monthly basis, paying them on a semi-monthly payroll in the middle of the next month rather than at the beginning of the next month will allow the office time to properly calculate the payroll and make sure all employee receivables have cleared and deductions have been paid out.

Streamlining payroll processing can have multiple benefits: saving employees' time allocated to processing payroll and saving the "hard costs" of generating checks or electronic payments. Dealers should consider working with their **AutoCPAGroup** member to discuss reducing the number of payroll periods and associated costs. ✍️

THEFT PROTECTION

Does your dealership have guidelines in place to prevent employee theft and catch embezzlement? Many cases of embezzlement have been uncovered in dealerships, resulting in theft of millions of dollars. When implemented at your dealership, these suggested guidelines could help prevent and catch embezzlement.

Are your employees bonded? One of the first steps in preventing embezzlement is to determine which employees are bonded and which ones should be. The controller, business manager, cashiers and all others who handle the dealership's funds in large amounts should have a bond.

Do you have an outside accounting firm? It is very important that your outside accounting firm has real knowledge of the automotive industry and experience in working with dealerships. The accounting firm can assist you in ensuring that the necessary steps to catch embezzlers are in place and safeguards are being used to prevent embezzlements from occurring.

Who handles the cash in the dealership? Does more than one individual handle the same funds during a period from the same register? Is the collection area safe and not near windows,

doors, etc.? All cash collected must be deposited daily in full. The person who collects the funds should not make the deposit, post cash receipts or prepare journal entries related to cash. Petty cash should not be paid from the daily receipts.

Who is authorized to sign the dealership checks? For control purposes, the dealer and as few individuals as possible should be authorized to sign checks. All pertinent information should be attached to the checks for signature and reviewed before signing. If this control is not in place, signing checks could be expensive and possibly dangerous. Never should company checks

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be cashed in the dealership. At least quarterly, the dealer should pick up the bank statement and cancelled checks and review who signed the checks, what the checks were for and who endorsed the checks.

Who in the dealership pays the mechanics? The person who pays the mechanics must be firm but fair. Many times, service management does not realize that packing labor onto time tickets is theft. In most cases, this has been found on the internal repair orders. Also, the work-in-process balance should be reviewed to ensure that it does not continue to increase. This could be a sign of an out-of-line condition in labor earned vs. paid labor.

Do you have controls for the accounts receivable at the dealership? Most dealerships have one accounts receivable for parts and service and one for vehicles receivable. Without proper controls in place, this is a prime area for embezzlement. Any vehicles receivable accounts should be reviewed every month, and the balance should have only end-of-month carryover deals. Parts and service receivables should be negligible as customers pay by cash or credit card at point of sale.

Are journal entries for the dealership being reviewed? Journal entries have been used by clever embezzlers to steal from dealerships. Particular attention should be paid to journal entries that debit expense accounts, cost of sales accounts, other deduction accounts, etc. The offset to these journal entries is usually to the accounts receivable account, bank accounts or other balance sheet accounts. Entries to these accounts for write-offs are often monies that have been stolen.

Are schedules and general ledger accounts current and in balance? Sloppy record keeping in dealerships accounts for a large percentage of the embezzlements uncovered. The dealership should maintain complete and accurate records at ALL times. Poor controls can help embezzlers cover up stolen funds, not to mention that it hurts the operations of the dealership.

Implementing guidelines and controls is imperative to prevent theft at your dealership. Your

AutoCPAGroup member can assist you with implementing these guidelines and answer any questions you may have relating to theft prevention. ✍

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