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Overdrive

Somerset CPAs Dealership Team
Consultants to Dealers and Their Dealerships

Winter 2007/2008

Wow! How One Dealership Dropped Its Break-Even Point By 52%

Yes! Members of our Dealership Team worked with a domestic dealer who was able to **reduce the dealership's break-even point from 165 units to 80 units** in less than 18 months. How was this done and how can you achieve similar results? While space will simply not allow us to detail each of the numerous small and large changes that it took to accomplish this, we will feature some of the strategies in this and future issues of *Overdrive*.

We will also discuss some of these items in detail at our Dealership RPM (Roundtable Professional Meeting) scheduled for February 20, 2008 (see insert).

We were able to assist the dealer mentioned above in establishing processes and obtaining buy-in from management and staff to abide by these new procedures and increase variable gross profit...**average new and used retail gross including F&I (net of chargebacks) increased by roughly \$1,400** in a relatively short period of time. Some of these changes in procedure were quick and easy (e.g., training the salespeople to ask for more money down on every deal), while others took a little more time and training (e.g., the use of a menu with every customer in the F&I office). Vehicle packs that had not been reviewed in decades were increased too.

Inventory management may have been **the biggest factor** in increasing variable profitability. Enforcing a strict days supply policy and a reasonable wholesale policy once a unit becomes aged resulted in significant increases in variable gross. The dealership's salespeople, sales management and the dealership all realized **increases in their "paychecks"** as a result of these changes and, importantly, customer satisfaction scores did not suffer.

Service and parts profitability also increased. We were able to put in place service advisor training and incentives that

led the advisors down the path to becoming more than just "order-takers" as evidenced by the **decrease in the number of one-line item repair orders**. We also changed the labor pricing structure, thereby increasing the dealership's effective labor rate. As more service work was performed in the shop, more parts business was generated, thereby further increasing fixed profits. Minor changes to the parts pricing matrix also led to increased profits.

(Continued on page 2)

Here We Go Again: The "Red-Flag" Rules Require Dealers to Increase Identity Theft Procedures

Pursuant to the regulations under the Fair and Accurate Credit Transaction Act of 2003 (FACT Act), dealers must adopt procedures designed to detect the warning signs of fraud and prevent identity theft from occurring. Certain events—such as a change of address, an unusual number of recently established credit arrangements or a recent and significant increase in the volume of inquiries—are "red flags" that may signal potential fraud. **The federal government requires that dealers adopt security guidelines and procedures for dealing with these and numerous other "red flags" listed in the regulations.**

(Continued on page 2)

**Somerset
Dealership Team**



**Helping drive
your business.**

In This Issue...

How One Dealership Dropped

Its Break-Even Point By 52% 1 & 2

Reducing Administrative Costs of Retirement Plans . . . 3

The "Red-Flag" Rules 1 & 2

Audits...Audits...Audits: Large Assessments 3 & 4

How One Dealership Dropped Its Break-Even Point By 52%

(Continued from page 1)

Expense control was another key to this dramatic reduction in break-even. Before getting too far into this topic, it is important to state that the Somerset Dealership Team members clearly understand that **a dealer needs to spend money to make money**. However, a dealer will generally not see a return on investment for expense dollars that are wasted and not spent wisely.

Obviously, the “Big 5” expenses (advertising, data processing, insurance, interest and personnel) were reviewed, and changes were made. But, the expense reviews could not and did not stop there. Every line item was investigated, and cuts were made easily where there was no impact on the level of service or the quality of product delivered by the vendor. Other cuts were more difficult and required the input from all levels of the staff. Please see “*Reducing the Administrative Costs of Your Dealership’s Retirement Plan*” in this issue for some ideas on controlling one significant dealership expense.

It takes some effort and buy-in by the dealership staff to realize a 52 percent decrease in your break-even point; however, I think every dealer would agree that the results are certainly worth the effort.

The “Red-Flag” Rules Require Dealers to Increase Their Identity Theft Procedures

(Continued from page 1)

It is important to note that existing guidelines under and compliance with the Gramm-Leach-Bliley Act (GLBA) are no substitute for a dealer’s responsibility under these “red flag” rules. You should start planning now for how you are going to implement these regulations when they become effective in the coming months. In order to comply with the FACT Act, a dealer must at least:

- **Adopt an Identity Theft Prevention Program** to detect, prevent and mitigate the possible risks of identity theft. Some of the steps in this program must include:

- Identifying “red flags” that may indicate the occurrence of identity theft
- Verifying the identity of every customer who buys or services a vehicle on credit
- Carrying out the process of actually detecting the “red flags”
- Reacting to any “red flags” discovered while conducting business
- Taking steps to mitigate the risks of identity theft
- Training staff regarding your Identity Theft Prevention Program
- Overseeing the dealership’s vendors in light of these requirements
- Reporting to the Board of Directors no less than annually

- **Monitor the Identity Theft Prevention Program** to

ensure that the program is up-to-date with the current risks and methods of identity theft. This would include:

- Being aware of the ever-changing methods of identity theft and new ways to spot identity theft
- Taking into account your own experiences with identity theft and changes in your own business practices that may impact identity theft opportunities
- Being aware of new techniques for preventing identity theft and techniques for mitigating the damages from identity theft

- **Revise the Identity Theft Prevention Program** to address any items identified during the monitoring phase (or that otherwise come to the attention of the dealer).

It is clear that the steps that you have taken under the GLBA-Safeguards Rule, while important, are not sufficient to comply with these regulations.

Furthermore, with identity theft on the rise, it is prudent for any dealer to have well-documented procedures in place for protecting and detecting the theft of its customer’s identity. If you would like a list of some of the “red flags” that you should address or if you would like assistance in implementing an Identity Theft Prevention Program, please contact us at 317-472-2200, 800-469-7206 or info@somersetcpas.com.



Reducing the Administrative Costs of Your Dealership's Retirement Plan

Do you have any idea of the total cost of your dealership's retirement plan? You may be thinking about the portion of each employee's retirement deferral that the dealership pays (the "company match"), but don't forget about the costs associated with administering the plan. These costs are either paid directly by the plan, which reduces the employees' account balances, or are paid by the dealership...and they can be substantial.

The chart below compares some of these typical costs and shows how a simple move to a plan that utilizes a third-party administrator (TPA) and family of mutual funds can dramatically reduce these costs.

	Insurance Company or Bank Plan	Direct with TPA and Mutual Fund Family
Administration Fees	\$1,000 - \$6,000	\$2,000 - \$3,000
Corporate Trustee Fee	\$750	\$750
5500 and Filing Fees	\$1,000	N/A
Risk and Mortality Charges	1.25% - 1.50%	0%
Asset Management Fees	0.50% - 1.50%	0%
Monthly Charge Per Employee	Varies	0%
Money Management Fees	0.50% - 2.50%	1.00% - 1.75%
Web Site Access	Varies	Yes
Broker of Record	Varies	Yes
On-Site Consulting	Varies	Yes

The chart below is an example of a dealership retirement plan with \$1,000,000 in assets. **As you can see, the administrative expenses could be reduced by almost 50%.** Our Wealth Management Team can review your plan at no charge and then help implement changes to reduce your administrative fees where possible. Please contact Steve Dum, CLU, ChFC, CFP at 317-472-2105.

	Insurance Company or Bank Plan	Direct with TPA and Mutual Fund Family
Administration Fees	\$1,000	\$2,000
Corporate Trustee Fee	\$750	\$750
Risk and Mortality Charges	\$12,500	0
Asset Management Fees	\$5,000	0
Monthly Charge Per Employee	Varies	0
Money Management Fees	\$5,000	\$10,000
Web Site Access	Varies	Yes
Broker of Record	Varies	Yes
On-Site Consulting	Varies	Yes
Total Annual Fees	\$25,250	\$12,750
Cost Savings	\$12,500	

Audits...Audits...Audits: Large Assessments from the IRS, the State of Indiana and Your Manufacturer

The Internal Revenue Service (IRS) has issued guidance with regards to Section 263A, also known as UNICAP or Cost Capitalization, as it applies to dealerships. This guidance is extremely controversial and, if implemented, would lead to enormous tax assessments for nearly all dealers. In essence, the IRS is treating dealerships as if they were producers instead of retailers. (*Exactly how much manufacturing do you think you perform? None, right?*) This change, along with other interpretive changes in the application of Section 263A, results in a **significant tax burden** to dealers. The National Automobile Dealers Association is working with the IRS in an attempt to resolve this issue. The Dealership Team at Somerset CPAs has been specifically asked by the IRS to assist in helping them understand the true impact on dealers should this guidance be implemented. The IRS has informally agreed to **not** apply this new interpretation until sometime during 2008. We will keep you informed as this matter develops further.

The State of Indiana is performing sales tax audits and assessing significant sales tax bills relating to manufacturer employee discount plans (e.g., A-plan, greenslip, etc.). The Indiana Department of Revenue (IDR) issued Bulletin #28S in October of 2007, which outlines their position on this matter. Furthermore, it is clear that the **IDR is attempting to tax nearly all payments from the manufacturer** relative to the sale of a vehicle, whether these payments relate to "customer cash" or "dealer cash" rebates. The Automobile Dealers Association of Indiana is attempting to resolve this issue before it "gets out of control." Many dealers are changing their policies with regards to employee discounts so that they now collect the tax. If you would like a copy of Bulletin #28S, please contact us at info@somersetcpas.com, and we will send it to you.

Cash is tight for everyone and, evidently, it is tight for the manufacturers as well. We are aware of several dealers who have been subjected to sales incentive and warranty audits by their manufacturer. **These assessments are costing dealers hundreds of thousands of dollars.**

(Continued on page 4)

Audits...Audits...Audits: Large Assessments from the IRS, the State of Indiana and Your Manufacturer

(Continued from page 3)

We strongly suggest that you or your outside CPA perform compliance audits on a regular basis to ensure that all needed documents to support each claim are obtained. Lease Loyalty Claims and claims relating to things like VPA (Chrysler) and SFE (General Motors) seem to be especially problematic. We are also aware of dealers who have incorrectly “brokered” deals from one of their dealerships to a sister dealership, thereby putting all rebates relating to those deals at risk. Please be aware that it is quite alright to shift deals from one store to another—there is simply a right way to accomplish this and many wrong ways—so be sure that you do it the right way. The above items, along with many other dealership-specific topics, will be discussed at our next quarterly Dealership RPM (Roundtable Professional Meeting) set for noon on Wednesday, February 20. The details are on the enclosed flyer.

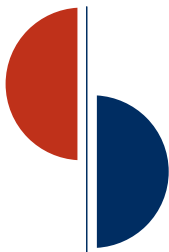
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Somerset CPAs, P.C.

3925 River Crossing Parkway, Third Floor
Indianapolis, Indiana 46240
317.472.2200 • 800.469.7206 • FAX 317.208.1200
www.somersetcpas.com



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3925 River Crossing Parkway, Third Floor
Indianapolis, IN 46240



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3925 River Crossing Parkway, Third Floor
Post Office Box 40368
Indianapolis, Indiana 46240-0368

Tel: 317.472.2200 - 800.469.7206
Fax: 317.208.1200
www.somersetcpas.com

YOU ARE INVITED TO SOMERSET'S DEALERSHIP RPMs

Roundtable Professional Meetings

Somerset's Dealership Team will host lunch meetings each quarter called Dealership RPMs. During these meetings, Rex Collins will lead the group in discussions about **current events and hot topics** impacting the industry. You will have the opportunity to meet with your peers and share your ideas and experiences. Guest speakers will also join the meetings from time to time.

The first meeting will be on **Wednesday, February 20, 2008**, when we will discuss the seemingly endless government regulations dealerships must follow in all departments. Failure to follow these rules and regulations can result in **significant fines and penalties** or the disruption of business altogether, and you are **responsible for ensuring that your dealership is in compliance** with these wide-ranging regulations.

An attorney from the law firm of Stewart & Irwin will join us to discuss **Compliance Problems and Pitfalls in the F & I Department**. Among the topics discussed will be:

- Truth in Lending and Consumer Leasing Acts
- Equal Credit Opportunity Act
- Fair Credit Reporting Act
- FTC Credit Practices Rule
- Gramm-Leach-Bliley Act
- The Red Flag Rules
- Indiana's No-Call Statute
- Numerous Other F & I Related Regulations

We have received numerous calls from dealers requesting help in improving net profitability, so we will also share information relating to **increasing variable grosses, making net profit improvements in the fixed operations and reducing the dealership's expenses**.

Marty Murphy will also be in attendance to bring us up-to-date on his efforts relating to the **Doc Fees** issue and relating to his work on your behalf with the Indiana Department of Revenue relating to the **manufacturer's employee discount sales tax issue**.

Given the nature of these topics, you may want to ask the dealer and other members of management to join us at this quarter's meeting. Below are details for all the 2008 Dealership RPMs:

- Dates: Wednesday, February 20, 2008; Wednesday, May 21, 2008
Wednesday, September 24, 2008; Wednesday, November 19, 2008
- Time: Noon to 4:00 p.m. – Meeting w/Lunch Provided
- Place: Somerset Conference Center
3925 River Crossing Parkway, First Floor
Indianapolis, IN 46240
- Cost: Free

Please register using the form on the other side so we know how many participants to expect.

(over)

Somerset Dealership Team



Helping **drive**
your business.

Accounting
Assurance
Construction & A/E
Dealerships
Dental




Employee Benefits
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Real Estate
Tax
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AN INDEPENDENT MEMBER OF
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ALLIANCE™

SOMERSET'S DEALERSHIP RPMs Roundtable Professional Meetings - RSVP Form

Please mark your calendars for Somerset's 2008 Dealership RPMs. We hope you can join us for each meeting, but you are certainly welcome to attend just the ones that work with your schedule. You may register any of the following ways:

-  Register by calling our RSVP line, 317-472-2501 or 800-469-7206 ext. 2501.
-  Register online at www.somersetcpas.com or by e-mail to seminars@somersetcpas.com.
-  Register by completing the form below and faxing it to 317-208-1237.

Please check the box for each meeting you would like to attend:

- | | |
|---|--|
| <input type="checkbox"/> Wednesday, February 20, 2008 | <input type="checkbox"/> Wednesday, September 24, 2008 |
| <input type="checkbox"/> Wednesday, May 21, 2008 | <input type="checkbox"/> Wednesday, November 19, 2008 |

Attendee Name: _____ Email: _____

Attendee Name: _____ Email: _____

Attendee Name: _____ Email: _____

Attendee Name: _____ Email: _____

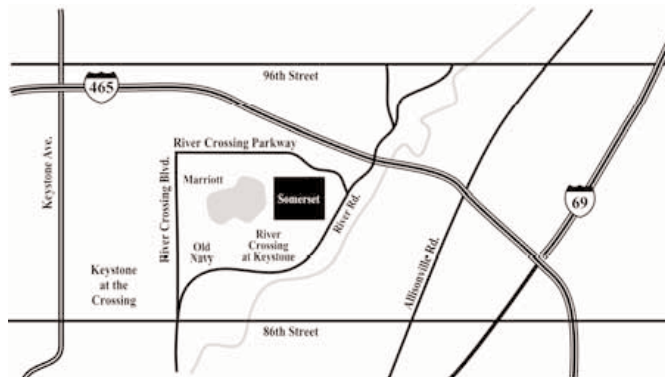
Dealership: _____

Telephone: _____ Fax: _____



About Rex Collins, CPA, CVA

Rex is a senior manager and heads up our Dealership Team. Prior to joining Somerset in 2007, he spent 19 years in public practice as a CPA with several years of focus on serving dealers and their dealerships. Rex's specialty areas include valuations of closely-held businesses; merger and acquisition including negotiating financing and due diligence; litigation support services; forensic accounting; economic, operational and management consulting; estate planning; research and planning taxation; general business and financial consulting; and dealership accounting, operations and management. He also gained dealer industry experience as the CFO of a multi-line dealer group for three years and as the GM and CFO of a dealership group.



Directions to Somerset CPAs:

- I-465 to Keystone Avenue Exit
- Go south on Keystone Avenue to 86th Street/Nora Exit
- Go east on 86th Street to River Crossing Boulevard (Maggiano's Restaurant on corner)
- Turn north onto River Crossing Boulevard
- Continue north on River Crossing Boulevard (through one stop light) to the All Way Stop sign
- Turn right and continue past the Marriott, one office building and the parking garage (all on your right)
- You will see Somerset signage on the outside of our building