

PART 1 OF A TWO-PART CED-EXCLUSIVE SERIES

Theft Schemes in Dealerships – Is It Happening to You?

They're expensive and often undetected – and you may be surprised by which companies are the most vulnerable.

BY REX COLLINS



Internal theft is big business.

It is estimated that the cost to each employer is \$9 per day per employee. For a dealership employing 100 people this amounts to over \$234,000 each year. Furthermore, dealerships with fewer than 100 employees are most vulnerable to theft.

The Association of Certified Fraud

Examiners' *Report to the Nation*, states that five percent of a company's revenues are lost to internal fraud. This amounts to over \$600 billion dollars for the U.S. economy. Additionally, this report states that the median time it takes to discover a fraud is 18 months. Another study completed in 2007 concluded that 19 percent of

all dealers reported employee theft. Finally, another survey indicated that between 25 and 35 percent of dealers are the victims of a significant employee theft every year – and those are just the dealers who discovered it.

A few more numbers of interest:

- In 1964, 12 percent of employees admitted stealing.
- By 1985, 32 percent admitted employee theft.
- For the five-year period ending in 1993, 50 percent of all dealerships experienced theft, and this was increasing at a 5 percent rate.
- 80 percent of all dealership employees stole something in the last five years.
- Experts say that 95 percent of all corporations have experienced or are experiencing employee perpetrated theft, and that less than 10 percent of this fraud is detected.
- Certified fraud examiners state that fraud is worse today than five years ago; and even though fraud detection is better, fraud detection resources still are not adequate.

The bottom line here is that theft is happening. It is not a matter of *if* your employees are stealing from you; it is a matter of *how much* they are stealing from you.

You may have heard, "crime is 10 percent motivation and 90 percent opportunity," and the fact is, there is plenty of opportunity in dealerships.

The Victim

The most costly abuses occur in organizations with fewer than 100 employees. Because small companies

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do not have sophisticated systems of internal control, the smaller the company the higher the risk of fraud. Another common attribute of the victim is that they are very trusting of their employees.

Often, the victim can be his own worst enemy by creating negative top down influences. Many times, when the employees see the dealer principals or the managers doing such things as cheating on their taxes or cheating on their spouses, they rationalize that if it is okay for the boss to cheat it’s okay for the employee to steal.

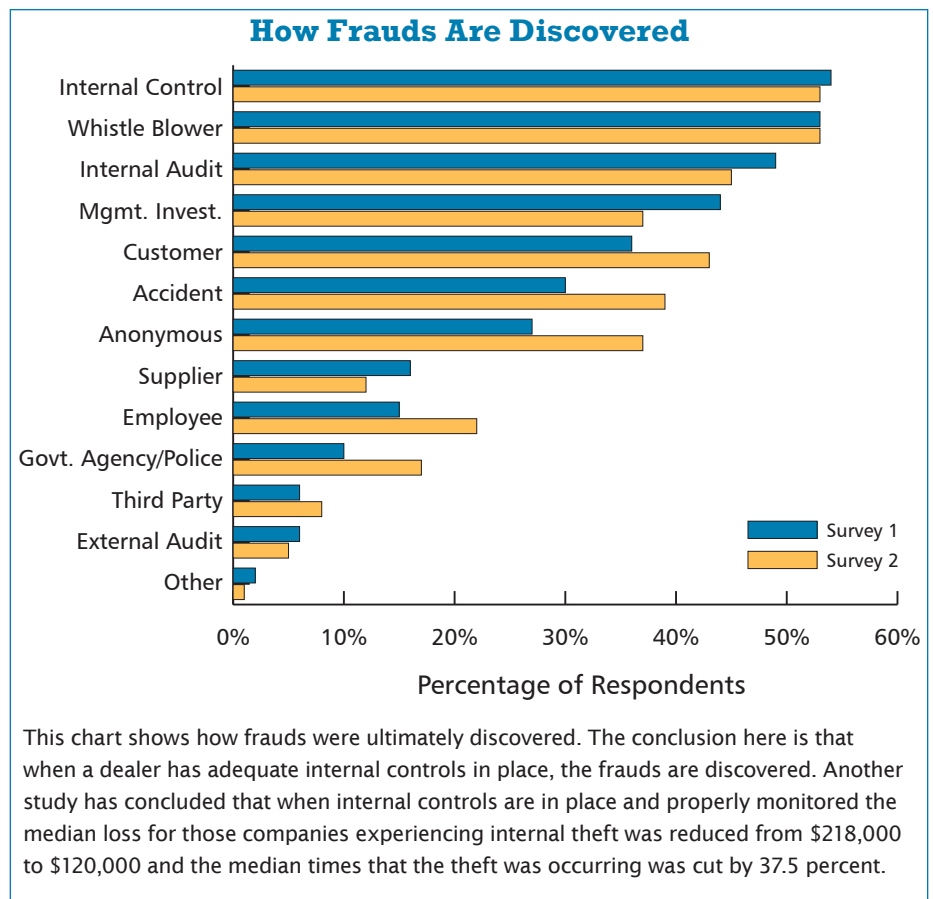
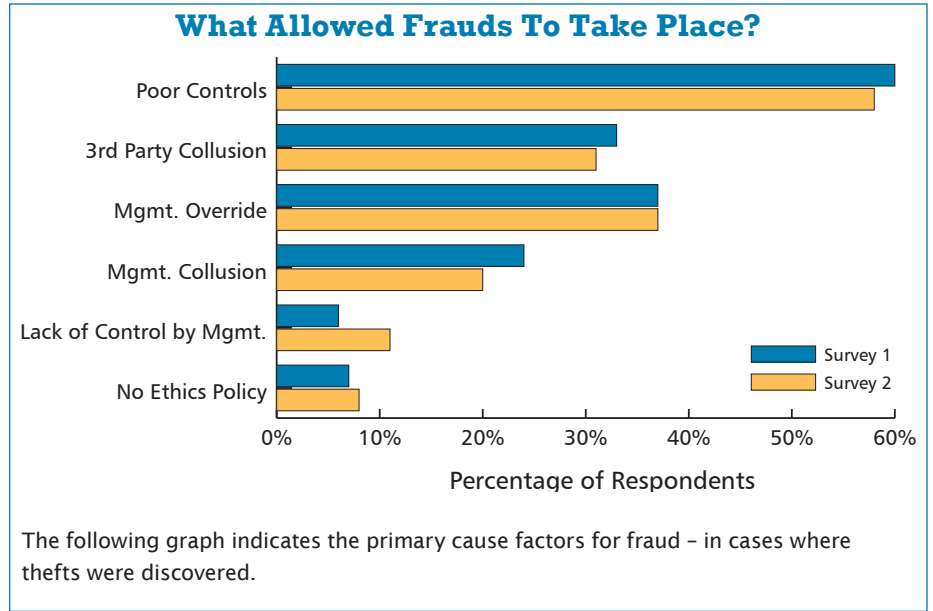
In a survey conducted of 2,300 workers, three out of four of these employees saw blatant violations of law or company standards. Sixty-one percent did not think the company would discipline the individuals who violated these laws or standards. Finally 55 percent of the employees said the boss was unapproachable if they had to deliver bad news. This is great news for a thief. In essence, if an employee knows that another employee is stealing, that employee feels that the boss will shoot the messenger rather than deal with the offending employee.

The Thief

For a long time, the image of the white-collar criminal has been a mature, white, college-educated, married, male employee; but in reality, workplace thieves crisscross boundaries of gender, color, marital status and education. A more accurate picture of the thief includes these traits:

- Usually works alone
- Compulsive
- Works long and hard hours
- Rationalizes the theft
- Repeats the crime
- Has access to cash, parts or other liquid assets
- Intelligent
- Long-term employee

Let’s think about these attributes. The individual usually works alone and



is working long and hard hours – in order to cover up the crime! The thief usually has access to cash (which would include the ability to authorize, sign or generate checks) and the

employee has had a long tenure at the dealership; if the dealer is paying the employee an honest and fair wage plus that employee is also stealing
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from the dealership, he or she has no reason to change jobs.

There are some warning signs of when a dealer should be concerned that internal theft may be occurring. The initial warning sign concerns the general economic conditions of your industry and your company specifically. Another warning sign is when the dealer has to make the difficult decisions relating to downsizing departments or cutting payroll and/or benefits. Other warning signs specific to the thief are that the individual is experiencing personal stresses such as divorce, illness, drugs, gambling, etc. A relatively new warning sign relates to what is now called the “tweener generation.”

People in the “tweener generation” are old enough to have children who have been married and moved away from home and are now going through divorce and moving back home (possibly with children).

This same generation is also being burdened with the care of parents as they age. Not too long ago a dealer in Ohio experienced a \$35,000 theft loss from an employee in just these circumstances. This long-term employee wrote checks payable to herself and even transferred a company vehicle to her name.

Several studies have demonstrated that 5 to 25 percent of a dealer’s employees would never steal. The same studies concluded that 5 percent to 25 percent of dealer’s employees would always steal. This leaves 50 to 90 percent of a dealer’s employees who would steal if the opportunity presents itself. These facts simply reinforce the importance of having a proper system of controls in place at your dealership.

There are three components of fraudulent transactions:

- 1.) The employee’s pressure or incentives to commit a fraud
- 2.) The employee’s justification or

rationalization of the fraud
3.) The perceived opportunity to commit the fraud

Of these three components, only one is controllable by the dealer, and that is the *opportunity* to commit a fraud. Again, with the proper systems of checks and balances in place the perceived opportunity to commit a fraud is greatly diminished.

Could This Happen to You?

A dealer in the Southeast recently experienced a \$95,000 theft loss as the result of the following scheme. The perpetrator of this theft, we’ll call her Betty, made entries to the cash clearing account via the purchase journal. The cash clearing account is used to process each day’s parts and service sales, and should balance to zero at the end of every day. Betty’s entry allowed her to short the daily deposit by the amount of her entry without the books being out of balance.

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THE NEW GENERATION

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The entry made via the purchase journal “represented” a bogus credit memo from a vendor. Instead of reducing the cash sales account, a real credit memo would have reduced the parts inventory. In order to reconcile the vendor statement to the dealership’s books, Betty showed this bogus credit memo as open at the end of the month. The following month she recorded the entry to eliminate that credit memo and set up another credit memo for the same amount. This second entry’s purpose was to give the appearance that the open credit memo was from the current month and therefore looked appropriate on the outstanding list.

Ultimately, a vendor (not necessarily the same vendor) actually issued a valid credit memo. Betty then relieved some of her bogus credit memos and plugged the balance as a reduction to the parts inventory (where the entire credit should actually have been posted anyway). In essence, she covered her theft by applying the valid credit memo to various vendors instead of the parts inventory.

Eventually, Betty no longer went through the laborious process of posting items through accounts payable and falsifying the monthly vendor reconciliation. She simply reduced the cash sales account and increased the parts inventory balance. In this way she was still able to reduce the daily deposit amount and pocket the cash.

**How Can They Steal?
Let Me Count the Ways**

There are many other ways that dealership employees have been stealing from their companies. Some other examples of theft schemes we have uncovered may illustrate the dangers present in your dealership.

Fraud through Dealership Income

■ **Case 1:** A dealer in the Midwest suffered a theft of \$200,000 perpetrated by its general manager (GM). The GM opened the incoming mail

and pulled out miscellaneous checks (vendor refund checks, finance reserve payments, etc.). This GM was also responsible for taking the deposit to the bank each day. After he was given the daily deposit by the office he would pocket some of the cash, and replace it with the checks he pulled from the incoming mail. He went so far as to prepare a new deposit slip listing all of the checks, including the ones he added to the deposits, and the new cash amounts. This was done so that the deposit slip the bank processed would match the actual cash and checks received. The deposit receipt provided by the bank thus reflected the original amount of the deposit even though the GM had stolen funds from the dealership.

■ **Case 2:** Another dealer located in the Southeast had a rental operation and was victimized by its rental manager who stole at least \$98,000 over a three-year period. The manager encouraged the customers to pay cash for their rental transactions by giving them unauthorized discounts if they paid in cash. She then destroyed the rental tickets and pocketed the cash. This dealership had no system in place for detecting the missing rental agreements and did not fully understand the rental business. Furthermore, it should be noted that the dealer’s theft insurance limit was only \$25,000.

■ **Case 3:** A dealer in the Louisville area experienced an \$80,000 theft loss perpetrated by the office manager. This theft occurred while the dealership was going through computer system changes. These changes created an element of confusion and chaos in the dealership, and the office manager took advantage of the opportunity. In this case the office manager took money out of sales deals and deposited the funds into her own account. She was in charge of all accounting functions and was able to easily cover her tracks.

A concern in today’s dealership environment relates to controlling collections of previously written-off accounts receivable. Since these balances are no longer on the company books there is generally no system of checks and balances to ensure that partial payments or full payments, relative to these once bad debts, are truly deposited in the dealership’s bank account. We have also worked with many dealers who have suffered at the hands of their vendors. Often vendors will provide prizes, awards or other benefits to the dealership’s employees and many times these prizes and awards are not known to the dealer. A relatively simple way to address this problem is through a letter that has been counter-signed by the vendor. This letter states that all prizes, awards and other gifts will be sent to the attention of the dealer principal at the dealership’s address. Any violation of this by the vendor will result in monetary damages of, say, \$50,000. ■

**Please look for Part 2 of
Rex Collins’ “Theft Schemes
in Dealerships” in CED’s
September issue.**



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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 gained dealer industry experience as the CFO of a multiline dealer group for three years and as the GM and CFO of a dealership group.