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DEALER INSIGHTS

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Things can go easy-breezy if you think like an auditor

Dealer Digest

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Now is the time for a year end financial snapshot

As year end approaches, your store is no doubt busy with myriad administrative tasks. One job that should be at the top of your priority list is conducting a recap of your dealership's 2014 financial performance with your accountant.

Your review will provide you with a comprehensive snapshot of your dealership's financial position as you wrap up the year. Just as important, it will lay the groundwork for your financial forecast and budget for 2015.

Focusing on particulars

As you conduct the recap, you'll want to pay especially close attention to a handful of financial indicators and ratios, including the following:

Gross profit margin. This should be broken out by the different areas of your dealership — primarily vehicles (both new and used), service and parts. While the numbers will vary depending on vehicle types (domestic vs. import, luxury vs. nonluxury), some dealership consultants suggest that a healthy dealership today is seeing gross profits as high as 6% to 9% on new vehicle sales, 10% on used vehicle sales,

30% to 35% in the parts department and 70% to 75% in the service department. You also can view your new-vehicle gross margin in more detail by breaking it out by trucks vs. cars or individual vehicle models.

Net profit margin. This will tell you how much money your dealership — or each department — made after subtracting all the "overhead" expenses involved in running your business. These expenses typically include dealership sales, general and administrative (or SG&A) expenses, including sales commissions. Bonuses for general managers and other executives are often based on the dealership's net profit.

Fixed costs. Controlling fixed costs is one way to boost net profit margins. Expenses like rent, utilities, office supplies, data (for example, Internet access), dues and subscriptions should be fairly constant and easy to control. Factor any significant variances into your 2015 budget — or take corrective action to get them under control.

Inventory turnover. How many days of supply are currently sitting on your lot? If you're carrying too much inventory, you're paying excess interest and other carrying costs. If you're carrying too little, you might lack the vehicles your customers want. In general, about 45 days of new car inventory and 60 days of used car inventory are good goals for many dealerships, according to some dealership consultants. If vehicles move slower than this, studies show that the gross profit per vehicle sold starts to fall off precipitously.

Current ratio. This ratio will give you insight into the short-term financial health of your dealership. It measures your current level of liquidity — or in other words, your ability to pay

Meaningful benchmarks require a basis of comparison

Financial ratios and indicators are of little value when viewed in isolation. To give these numbers meaning and context, they should be compared to prior periods, competitors and industry peers — a process that's referred to as benchmarking.

By comparing your numbers to your historical results, you can look for indications that the dealership's financial performance is improving, diminishing or staying the same. It can be even more helpful to compare your results to those of similar dealerships in your region. The best way to obtain these benchmark financial indicators is to ask your CPA or join an automotive dealer "20 Group."

The 20 Groups bring together similar, noncompeting dealers from a broad cross-section of the country. Members share ideas, strategies and best practices with one another, as well as monthly financial composites that members can use for comparative purposes.

current obligations — and is figured by dividing current assets by current liabilities. Aside from the current ratio, many manufacturers prescribe minimum working capital requirements for their dealerships that are stated as a minimum dollar amount. Working capital calculations can vary by manufacturer, so understand your manufacturer's specific methodology.

The *current ratio* measures your current level of liquidity — or in other words, your ability to pay current obligations — and is figured by dividing current assets by current liabilities.

F&I penetration. Finance and insurance (F&I) presents an opportunity for dealerships to earn extra revenue by offering vehicle financing and selling extended warranties, gap insurance and other extras. Penetration tends to be higher with high-end vehicle sales, but selling an F&I product on every other vehicle sold is a solid goal for any dealership.

Interest coverage ratio. This ratio provides a snapshot of a dealership's ability to pay interest charges. It's calculated by dividing earnings before interest and taxes by the dealership's interest expense. The higher the interest coverage ratio, the better positioned a dealership will be to weather financial storms.

Forecasting and budgeting

With a 2014 financial snapshot in hand, you'll be ready to set financial goals for next year and create your 2015 forecast and budget. Use this year's numbers as the starting point and, of course, strive to improve each of these financial indicators and ratios.

Keep your goals and projections realistic, basing them on current and anticipated conditions in the broad automotive market and your local market. If your data is inaccurate, your budget numbers could be off as early as the first month or quarter of the year, which will, in turn, negatively impact your financial planning for the rest of 2015. ■

Choosing the right vehicle sales model

Transparency is a hot topic in automobile retailing today, but the concept isn't new. It actually goes back to the original no-haggle, one-price sales model introduced by Saturn in the mid-1980s and extended to pre-owned vehicles by CarMax and AutoNation a decade later. And TrueCar has now brought no-haggle pricing to the Internet.

But what exactly does "transparency" mean? And is the one-price model a better way to sell vehicles than the traditional sales model of negotiating the vehicle price with your customers?

What's transparency?

First, let's define what we mean by transparency. True transparency happens when the buyer and seller both have access to the same information and equal abilities to interpret that information.

Some argue that true transparency might not be entirely possible when it comes to automobile retailing.

Of course, the Internet now makes it possible for car buyers to access a wide range of dealership cost information. In fact, this has been one of the driving factors behind the move toward one-price selling. When customers walk in the door knowing what you paid wholesale for a vehicle, this changes the rules of negotiation.

But determining your true cost of a vehicle on your lot, not to mention your eventual profit, isn't always so simple. There's usually more involved than just the invoice price you pay the manufacturer. For example, *holdback* represents a portion of your cost (frequently 2% to 3% of the invoice price) that you eventually recoup as profit. But buyers often don't have access to data about holdbacks or rebates offered by the manufacturer for reaching monthly quotas.

Given this, some argue that true transparency might not be entirely possible when it comes to automobile retailing. As one industry consultant recently put it, "The information provided these days to consumers is vast. There is so much cost information available, even dealers and their staffs have a difficult time interpreting it. Dealers often don't know their true cost per vehicle until a particular program ends."

Creating a positive experience

It might be debatable whether or not true transparency in auto retailing is possible, but almost everyone would agree that customers want to have a positive car-buying experience. This is true whether they conduct significant research to arm themselves to negotiate the lowest price, or they prefer the simplicity of the one-price, no-haggle pricing model.

There will always be some buyers who enjoy the thrill of negotiating the price of a vehicle. They'll never be satisfied simply paying the sticker price, because they'll feel like they didn't get the best deal. Similarly, many buyers dread the "negotiation game" and welcome the no-haggle vehicle sales approach.

Whether they like to haggle or not, most car buyers accept that dealerships need to make a profit. Many are less concerned about negotiating the lowest possible price than they are about being treated with honesty and respect. In other words, they want to do business with a dealership that's upfront about the total price of the vehicle from the get-go, with no extra charges and hidden fees revealed when they sign the paperwork.

Which sales model is best?

There are pros and cons to both sales approaches. In deciding which sales model is best for you, consider such factors as the types of vehicles you sell — for example, new or used cars and economy, midrange or luxury cars — and the demographics of your target customers. ■

Are you ready for your audit?

Things can go easy-breezy if you think like an auditor

Do you flinch each year before your annual audit? Do you think of the process as something that will significantly interfere with your work for days at a time? If so, think again. An audit doesn't have to be a time-draining or stressful experience if you're prepared.

Anticipate requests

You'll be at an advantage if you anticipate your auditors' workpaper requests. Auditors typically ask dealerships to provide documents, such as monthly manufacturers' statements, a trial balance and bank reconciliations. Auditors will accept copies for some items. For others, such as vehicle titles, floor plan statements and vendor invoices, they'll want to see originals.

These requests change little from year to year. So a review of last year's workpapers can help prepare you the next time around. Additionally, most auditors will provide you with a list of items that they'll want to examine.

What *does* change annually is the sample of transactions that auditors randomly select to test your account balances. For example, they may look at November cash transactions in 2015 and at July transactions the following year. The element of surprise is important to auditors because it keeps bookkeepers honest.

It's also likely that your auditors will ask you questions about footnote disclosures in your financial statements. In preparation, examine the footnote disclosures in your *prior year* financial statements for any changes the auditors will need to know about, such as changes in debt servicing companies or banks, 401(k) or pension plans, accounting policies and procedures, warranty programs and credit policies. Alert them in advance so that the footnotes can be changed early in the audit process. Plus, changes that affect the footnotes may require new or different audit procedures.

Take stock of inventory

At your year end, an audit team member will schedule a time to physically inspect your inventory. Be sure to have at least two of your experienced personnel available to assist the auditors with their test counts.

The auditors will randomly count items from your parts inventory and compare test counts to your inventory records. Misstatements may require more testing or extrapolation over your entire inventory balance.

Auditors also will compare each new and used vehicle's VIN to your inventory listing. Expect to provide explanations for any missing vehicles, including demos and loaners.

Learn a lesson or two

Good auditors will present a list of management points when they deliver your financial statements. These are ideas gathered throughout the audit process to help improve your operations.

Auditors also may share their financial analysis tools. Here, your auditor benchmarks your store's performance over time and against industry averages. Auditors use analytics to boost audit efficiency. In turn, you can use this information to explore your store's strengths and weaknesses.

Revisit your inventory method

Finally, your auditor can help you determine whether a change in inventory accounting methods would be appropriate to help lower your taxes. Accounting options for new-vehicle inventory include the *specific identification* method, which expenses the factory invoice price of the specific vehicle sold. Most dealers currently use this method, because it's based on the actual flow of units sold.

The *last-in, first-out (LIFO)* method is a more complicated inventory accounting alternative. LIFO places the last costs incurred into cost of sales and retains the earliest costs as the ending inventory. Essentially, this method removes inflation from your ending inventory and expenses it in the current accounting period.

LIFO allows an indefinite tax deferral in an inflationary market. When inventory levels or factory base prices drop, however, "LIFO liquidation" may take place — and a LIFO-basis dealer may incur additional taxable income. Such surprises are more common when vehicle prices are decreasing and inventories are low. In today's environment, with higher tax rates, increasing vehicle prices and increasing dealer inventory, it could be a good time to switch to the LIFO method if you aren't already using it.

Stay in touch

Occasionally, dealerships have accounting questions that extend beyond the year end audit. Contact your auditor during the year about major transactions and accounting questions, including if you plan to add (or eliminate) a franchise, move to or add a new location, change banks, or implement a new accounting or tax rule or trade discount. ■

F&I certification — a proactive step

The finance and insurance (F&I) department is an integral part of most car dealerships. It provides a valuable service to car-buying customers and a hefty boost to the dealership's bottom line.

But it can also be the source of costly lawsuits and fines against dealerships due to unethical, illegal and fraudulent practices on the part of F&I employees. These will not only drain profits but also will result in unwelcome media scrutiny and negative publicity.

One way to guard against these risks is to have your F&I employees become certified through the Association of Finance & Insurance Professionals (AFIP). The certification course is divided into three modules: federal regulations, state regulations and ethics.

In order to become AFIP-certified, F&I employees must agree to abide by the AFIP Code of Ethics, a strictly enforced industry-derived code of conduct. They also must have (or have applied for) any state licenses required to work in their current capacity. To learn more about AFIP certification, visit afip.com. ■

Are service advisors underestimating repair times?

Dealership service mechanics say that service department advisors give unrealistically short waiting and repair times to about one-third of all service customers, according to automotive consulting firm Carlisle & Company's *2013 Annual Automotive Technician Survey.* Service advisors disagree, estimating that their turnaround time estimates are accurate 83% of the time.

In addition, mechanics say that 43% of repair orders require additional clarification from the advisor, costing them 30 minutes of follow-up time on average every day. If this is accurate, a dealership with 12 mechanics that bills at $90 an hour is losing $135,000 in service revenue per year. ■

Some ACA issues are clarified

Final Affordable Care Act (ACA) regulations issued earlier this year help clarify some ACA gray areas for employers heading into 2015. These include the following:

Clarification of Small Business Health Options Program (SHOP) plans in 2015. The regulations spell out the conditions under which small employers can limit employees' health care plan choices in the SHOP Marketplace.

Implementation of quality standards. Insurers must submit data to support the calculation of quality ratings available to consumers while they shop for plans in the Health Insurance Marketplaces.

Standardization of consumer notification rules. Insurers must use standardized notices when renewing coverage or discontinuing products to help ensure that consumers understand the changes and choices in the individual and small group markets.

Contact your CPA for more information on how the ACA regulations will affect your dealership. ■

We don't just serve motor vehicle dealers. We help them increase their success.

Running a dealership these days is a tough business. You not only have to aggressively market and sell the vehicles you offer. You also have to deliver great service, manage extensive inventory, juggle tight finances, handle a variety of labor issues and deal with increasingly intense competition in an adverse economic environment.

To meet these challenges, you need the assistance of advisors who know the business and can point out ways to increase revenue, minimize taxes and costs, and maximize your success.

This is where **Bowden & Wood, PLLC** comes in. Our experienced CPAs and other professionals specialize in helping motor vehicle dealers realize their business and individual financial goals. We offer a wide range of services characterized by personal attention, professional excellence and proven effectiveness, including:

- Accounting and auditing
- Tax planning and filing
- Strategic planning
- Performance benchmarking
- Computer consulting
- Business sales and acquisitions
- Succession and estate planning
- LIFO inventory computations
- Accounting software selection
- Business entity selection

Because we realize that the better our clients do, the better we do, we view every client relationship like a partnership. So we are always looking for ways to increase your success. And because we understand that service excellence requires keeping up with the latest trends and techniques, we invest heavily in continuing professional education and participate actively in industry organizations, such as the National Automobile Dealers Association annual convention.

We know that dealerships are greatly affected by frequent changes in taxes at all levels of government, as well as by developments in computer technology and the economy. So we are always on our toes with IRS rulings, updates in computer systems and changes in LIFO, and financial conditions. While we are based in Louisville, we serve you best at your location in Kentucky or surrounding states.

We welcome the opportunity to discuss your needs and put our dealership expertise to work for you. Please call Mark Schaeffer, Managing Partner, at 502-583-0262 or e-mail mschaeffer@bowdenandwood.com and let us know how we can be of assistance. For a complete list of our partners, and more information about our firm and the services we offer, visit www.bowdenandwood.com.

We look forward to hearing from you and helping you take your dealership to the next level of success.

Mark Schaeffer, CPA, Managing Partner, has more than 30 years of experience serving auto dealers throughout the greater Louisville area. He is a charter member of the Driving Force Auto Consulting Group. He is also a member of the Kentucky Auto Dealers Association, Greater Louisville Auto Dealers Association, and other professional groups.