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DEALER INSIGHTS

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Dealer Digest

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3 ways to beat the cash flow blues

A dropoff in sales volume. Lower profit margins. Tighter credit for both customers and auto dealerships. Circumstances such as these can easily lead to a cash flow problem. Fortunately, there are ways to beat the cash flow blues — and here are three in particular.

1. Keep separate cash accounts

Maintaining an organized system for managing cash accounts is the first step in strong cash-flow management. Make it a policy to maintain at least two bank accounts — one for general funds and one for payroll — which you reconcile regularly. Require your accounting department to complete monthly bank reconciliations promptly upon receipt of the bank statement.

Small daily overages and shortages aren't uncommon. To maintain an organized system for managing and reconciling cash, set aside any discovered variances in cash deposits each day in a separate general ledger account. Review and reconcile this account monthly.

A dealership's inventory can play a major role in a cash flow slowdown.

Depending on your dealership, a large percentage of cash can come in through contracts-in-transit. Thus, you should maintain only one general ledger account for these transactions. Any division of this account allows for additional, unnecessary entries and greater room for error. Collect all contract balances within five days and investigate all credit balances.

2. Loosen up funds

To free up cash, process a sale as soon as possible after its completion. Lags in time can cause an unnecessary tie-up of a large amount of cash. One idea for assuring that money from contracts-in-transit is collected promptly is to hold a portion of commission checks (representing the uncollected amount) from sales staff until proceeds from their contracts are collected. Implement this idea only if the entire sales force understands this policy.

You also can determine the average time it takes for funds to be received and when floor plans are due to be paid. To convert paper to cash sooner: 1) submit rejected contracts more quickly, and 2) submit paper to financing companies several times daily.

Maintaining a tight collection policy also can help free up cash and save you money in the long run. Your computer system likely lets you print summary receivable reports so you can thoroughly review account aging. According to a study by the U.S. Department of Commerce, the "true worth" of accounts receivable decreases significantly as aging increases. For example, receivables:

- ❏ Legitimately considered current are worth 100 cents per dollar,
- ❏ More than 60 days old are worth 90 cents per dollar,
- ❏ More than 90 days old are worth only 67 cents per dollar, and

- ❑ More than 12 months old are worth less than half of their original value — 43 cents per dollar.

Exception reports can print out all receivables more than 30 or 60 days old. Generate these reports monthly for department managers to review and clear. Each dealership should maintain an updated list of the 20 oldest receivable balances, indicating the customers' names, amounts owed and current collection status.

Additionally, you should institute a credit policy that 1) authorizes a maximum of two or three people to approve credit limits for commercial accounts, 2) establishes clear credit restrictions, and 3) sets up an aggressive collection program.

Last, hire a top-notch warranty administrator. Aim for a three- to five-day time span between submitting a claim and getting paid.

3. Tighten inventory

A dealership's inventory can play a major role in a cash flow slowdown. Specific areas to tighten include:

Parts inventory. Dispose of inventory older than three years. Computer software programs can help reduce obsolescence.

New vehicle inventory. Assign someone to reconcile and verify the monthly floor-plan statement. Pay attention to discrepancies between the date that vehicles are delivered and the date interest starts to accrue. Verify that payoff dates are accurate. Limit the number of managers who order inventory. Target vehicles more than 90 days old for speedy sales.

Used vehicle inventory. If you have determined that your used vehicle inventory is too large based on current demand, take action to convert the excess to cash. You could reduce the selling price, provide extra incentives to salespeople to sell the used vehicles, provide promotional items to potential buyers (such as gas cards) and send the no-sellers to the auction house for rapid disposal.

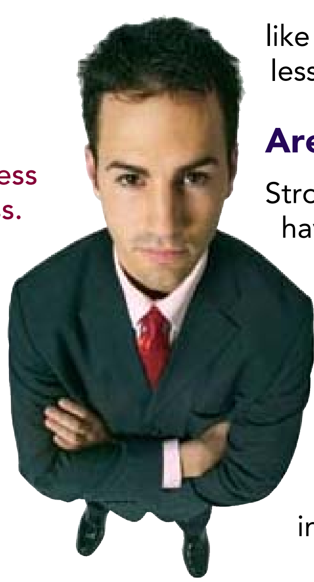
A 24/7 job

Managing cash effectively for your dealership is a 24/7 job requiring oversight of all aspects of your operation. Your accounting professional would be glad to provide assistance in setting up and reviewing accounts and procedures — and developing an overall cash management policy. ■

Internal controls

How to detect and deter employee fraud

Internal controls have always been important for dealerships. They help protect you from losing money to mistakes, faulty procedures or theft, and an evaluation of their effectiveness is now a big part of the audit process.



Yet, in these prickly economic times, effective internal controls are now more essential than ever for another reason: With a growing number of employees potentially facing financial problems, it's more likely they may attempt to commit fraud. And, like most dealers, you probably can't afford *any* less income.

Are you protecting your assets?

Strong internal controls for dealerships begin with having the right restrictions to assets in place. Employees should have access to only those assets — cash, vehicles, parts, equipment — necessary to perform their job.

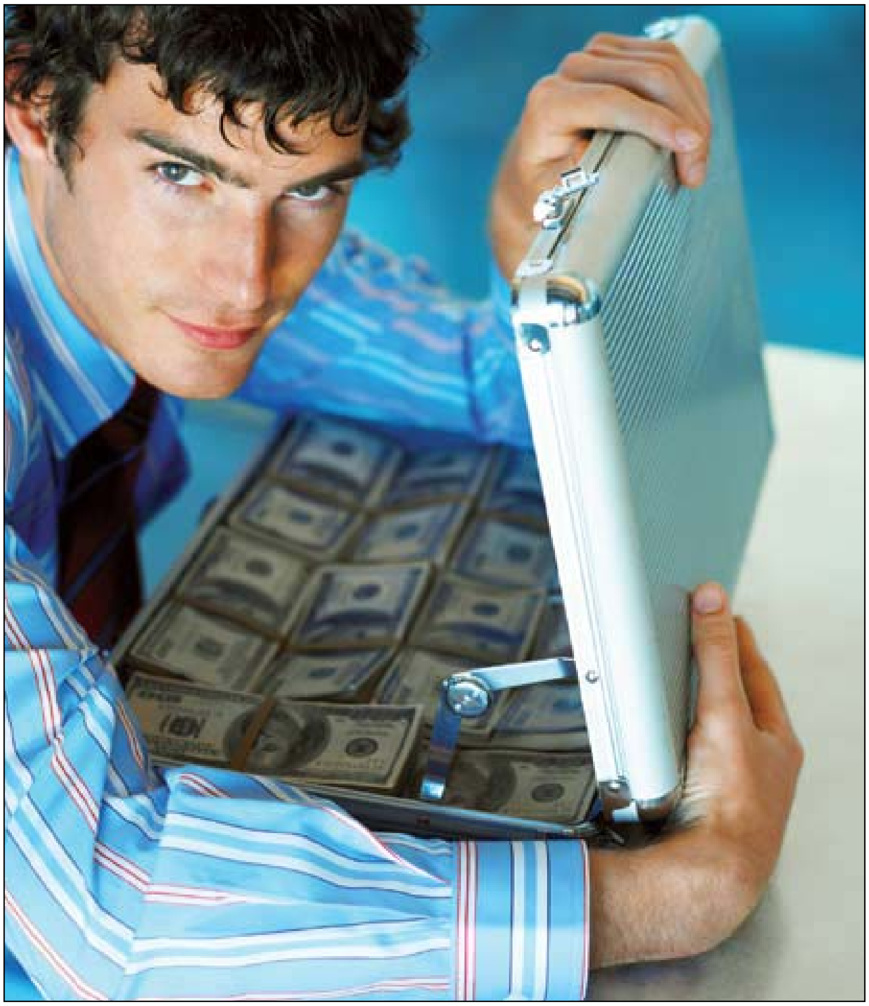
Adequate controls should include a system of checks and balances — for example, the segregation of check-writing duties from disbursement approvals — and frequent physical inventories of parts and used vehicles together with comparisons to book records. On a higher technical level, controls could include electronic surveillance and voice-recognition security systems.

To help define who has access to various assets at your business, put employee job descriptions in writing. Outline the scope of individuals' responsibilities and address the separation — and duplication — of sensitive duties.

For example, the employee who collects customer payments shouldn't be the same person who makes bank deposits. And checks above a certain amount should require your signature or that of another trusted, high-ranking employee.

Is management paying attention?

Lax management oversight and subpar supervision are other potential concerns. Management can be so focused on core operations, such as meeting sales and profit goals, that internal controls end up on the back burner. Too often, busy supervisors give subordinates' work a perfunctory signoff, thereby providing an opportunity for fraudulent activity.



Strong internal control systems, on the other hand, require management to follow certain basic business principles, such as the segregation of duties. Always try to assign different individuals to handle the primary duties of authorization, custody, and recordkeeping and reconciliation.

In no case should any one person be responsible for all duties. The more susceptible the asset is to theft — for example, cash — the more critical the segregation of duties and control structure. Where limited staff makes the segregation of duties difficult, supervision — and checks and balances — are particularly important.

In addition, enforce mandatory vacations of at least one week per year. Doing so allows another worker to perform the job duties of the absent person, possibly uncovering undesirable activity. Also train managers to be aware of warning signs, such as unusual journal entries or the overriding of internal controls.

After putting a strong internal control system in place, management must continually monitor controls to ensure that they remain adequate. Moreover, you need to communicate them on an ongoing basis. Describing the system at employee and manager meetings and publishing articles in an online newsletter, for example, lets employees know that internal controls are a priority and serious consequences await perpetrators. Be sure to publicize fraud-reporting mechanisms, such as anonymous hotlines, as well.

Is there ample financial oversight?

Taking a close look at key accounts and reconciling them regularly is one sign of strong internal controls. Dealerships should never wait until year end to confirm account balances. Schedules should be reconciled and independently reviewed monthly.

Regular internal and external audits also can help catch problems early. Your own staff may be unable to evaluate internal controls with the same level of objective assessment that an auditor could. For example, auditors might ask employees to explain why they perform a particular step in an operation. Employees, however, may believe they already know the answer and therefore never bother to ask.

Safer by the dozen: 12 essential internal controls

For any auto dealership, no matter how large or small, the importance of effective internal controls cannot be overstated. Here are 12 essential ones to consider:

1. Restrict access to cash and cash equivalents to as few people as possible, and ask your cashiers to count the money before and after their shifts. Limit access to computer data via passwords.
2. Assign *two* people to make cash deposits.
3. Periodically rotate accounting personnel.
4. In dealing with receivables, make sure no single person can approve a sale, post it *and* apply the cash. A fraudster could record a legitimate receivable, collect the receivable from the customer in cash and keep it, and then apply a fictitious credit to eliminate the receivable.
5. For payables, no one person should be able to set up a new vendor; post invoices; and then cut, sign and mail the checks. Establish a strict approval process for new vendors and limit access to vendor files. Scan the outgoing mail for anything sent to an anonymous name.
6. Regularly review your dealership's vendor list to see whether new providers have materialized.
7. In the parts department, limit access to your inventory system — especially in terms of receipts, sales and adjustments.
8. Hold cycle test counts of parts, complete physical inventories annually and reconcile figures to accounting records. Then decide which discrepancies are explainable and which warrant further investigation.
9. In the service department, mandate that only managers (infrequently) authorize policy and goodwill adjustments.
10. Have your bank statement delivered, unopened, directly to you for your examination.
11. From time to time, open the checks that arrive in the mail, total them and then compare that amount to what's later deposited.
12. Look for employees whose standard of living suddenly seems to increase or who openly show they feel underpaid or undervalued. Also be aware of those who request payroll advances and retirement plan loans.

For these and other reasons, internal control reviews by an external auditor may provide a more effective way to identify weaknesses in internal controls and procedures. There is, after all, something to be said for independence.

New auditing standards for privately held companies, established since 2006 by the American Institute of Certified Public Accountants (AICPA) and still evolving, require a risk-based approach. (See AICPA's Statement on Auditing Standards Nos. 104 to 114.) Outside auditors are more focused than ever on identifying control weaknesses and potential loopholes that fraudsters can exploit.

Is honesty your policy?

All of these measures will help ensure that you have an effective system of internal controls, which is crucial even if you aren't audited. But perhaps the most important "big picture" move you can take to thwart theft is to create a dealership culture that encourages employee honesty and discourages resentment and disconnectedness.

Such a climate will help not only curtail fraud — and its inherent costs — but also may make your workplace more productive and agreeable. ■

Take it to HEART

Federal law boosts employee benefits of reservists

Dealerships with employees in the military reserves have some new rules of engagement when it comes to their benefits. The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART), signed by the president in June 2008, gives breaks on a number of employee benefits to men and women called to active military duty.

FSA balance forfeitures

Employees no longer need to forfeit unused balances in their health care Flexible Spending Accounts (FSAs). Instead, you may amend your FSA to permit reservists with at least six months of active duty to take balances as a taxable cash distribution.

IRS Notice 2008-83, issued Sept. 30, further addresses FSA cash distribution for active reservists. It includes several important points:

- ❏ If you want to adopt the voluntary feature, you must formally add it to your FSA program.
- ❏ Workers called up for fewer than 180 days of active service can qualify for the cash distribution if subsequent calls bump up their total period of active duty to at least six months.
- ❏ After an employee requests the distribution, you must receive a copy of the order or call to active duty, within a certain time frame, before you can provide the distribution.
- ❏ You generally must provide the distribution within 60 days after the request has been made.

According to U.S. Department of Defense statistics, FSA balance forfeitures are common because activated employees and their families are allowed to enroll in TriCare, a federal health care program that provides generous benefits with no premium contributions. As a result, employees have a vastly reduced need for FSAs, which pay for uncovered health care expenses.

Small business wage credit

A new wage credit for eligible small businesses is now available. According to the law, employers with less than 50 employees are eligible for a credit equal to 20% of up to $20,000, to each qualified employee, of the sum of eligible differential wages paid to active military reservists.

To be eligible, the individual must have been an employee for a minimum of 91 days immediately before the period for which the employer makes the differential wage payment. This credit is effective for amounts paid after June 17, 2008, and before Jan. 1, 2010.

Other important changes

HEART brings other important changes as well. Its provisions also affect:

The Earned Income credit. HEART makes permanent the election to treat combat pay as earned income toward the earned income credit.

Tax-free withdrawals from a 401(k). The law makes permanent the ability of reservists called to active duty for more than 179 days, or for an indefinite period of time, to make tax-free withdrawals from their 401(k) or other defined-contribution plans — avoiding the 10% penalty tax for most distributions taken before age 59½.

Differential pay. When an individual's military pay is less than their civilian pay, you've been able to voluntarily provide the employee with the differential amount. But now, when you pay an employee on active military service, such pay will be included in wages and be subject to federal income tax withholding. Such pay will be treated as compensation when computing the limits on IRA contributions, and for other retirement plan purposes, effective for payments made after Dec. 31, 2008.

Many pertinent details

HEART has many other provisions not covered here, including a modification to the qualified mortgage bond program rules for veterans. Your tax advisor can fill you in on the pertinent details. ■

DEALER DIGEST

EESA gives dealers a marketing tool

If you're located in a no-income-tax or low-income-tax state, the Emergency Economic Stabilization Act of 2008 (EESA) gives you a marketing tool for selling vehicles. Worth publicizing is the law's extension of an individual's choice on his or her federal income tax return to deduct state and local sales taxes in lieu of state and local income taxes — whichever is the greater figure in a given year.

This tax break, which has been extended through 2009, may reduce the after-tax purchase price to the customer of a big-ticket item such as a new or used car. Taxpayers who deduct sales tax as an alternative to state and local income taxes can use either the actual tax paid or the amount from government tables for their "normal" sales tax. They then add to that figure the tax from the large, one-time purchase. A taxpayer must itemize deductions to benefit from this break. ■

Are your employees "actively engaged?"

In the workplace these days, you're likely to hear the term "employee engagement," meaning employees committed or involved in their work. It's a factor that's said to boost productivity, profitability and all things good. Conversely, "actively *disengaged*" employees cost the U.S. economy about $300 billion a year and about 17% of all workers are in that sorry state, according to well-known pollsters Gallup.

Common signs of active disengagement include a lack of spirit or vitality, and frequently offered excuses that portray negative energy and resistance to solutions. Disengaged employees also may try to avoid being held solely responsible for things and sidestep time commitments for getting tasks done — all negative traits you don't want team members to exemplify.

Of course, it's not unusual to see a certain amount of *temporary* disengagement in hard economic times. People are concerned about their own personal finances, their jobs — and even their employers. But you shouldn't tolerate such behavior long term.

So, in a downturn or recession, how do you keep employees actively engaged? Among HR professionals, the words "support," "respect," "encourage" and "reward" often come up. In short, employees want to feel valued and part of the team, and they want their contributions to your dealership to be recognized. Managers hold the key to employee engagement, and are the essential factor in retaining talented people. ■

Health care costs expected to slow

Health care costs remain a top, sometimes unaffordable, expense for many auto dealerships. But the cloud's silver lining in 2009 is that the rise in costs is slowing down, according to a study by HR consultants The Segal Company.

Physician costs are expected to go up 8% this year, compared with a 9.9% increase in 2008. And prescription drug costs are projected to rise 9.9%, a drop from the 10.7% rise last year. The survey results are based on data collected from 70 health-care-related organizations.

On the other side of the equation, price inflation appears to be the biggest element of the overall medical plan forecast, accounting for approximately 60% of overall projected preferred provider organization (PPO) trends in 2008. ■