



## In this Issue:

Feature Article .....	1, 7, 9
President's Message .....	5
New Members .....	6
Advertising Opportunity .....	12
Board of Directors.....	14

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## Et Tu, Brute?

# Top 10 Best Practices for Preventing Internal Fraud in Dealerships

By John Buelow, *CliftonLarsonAllen*

Fraud is rampant these days. Good, honest people find that so hard to believe, but that is part of the problem: good, honest people have faith in others' better nature. In the automotive industry, dealership owners tend to place trust in those they should not, including the credentialed controller or high-performing sales manager they hired to help run their dealerships. In their belief in common decency, they fail to remove all temptation from their financial and operational protocols. This makes it just a little too easy and all too irresistible for less honest employees to rob them from right under their noses.

As a dealership consultant, I have had clients and known non-client dealers who have been victims of internal fraud, sometimes to devastating effect. Though the patterns of theft and the results were all different, they all shared four distinct preventive shortcomings:

- They were caught completely off guard.
- They were part-time or absentee owners who trusted their fraudulent employees completely.
- They did not have internal controls in place that were regularly followed.
- The perpetrator was caught by chance, not through systematic fraud controls.

Attorneys who counsel dealerships and their owners should be aware of this growing problem and what can be done to stem the

tide of internal fraud. In my consulting practice, I advise dealers on financial, operational, and leadership issues that make them high-performing, profitable businesses. I have often joined forces with other professionals in my work, including lawyers, who have dealers' best interests at heart, too. Over the years, I have found that these ten best practices are the most effective at both preventing and unearthing employee fraud:

1. **Segregation of the performance of all accounting duties — but with shared knowledge of them:** Dealers would be unwise to give one individual control of all functions in the finance department. There should be clear and distinct separations of assignments for accounts payable and receivable, cash and bank reconciliations, receivables write-offs, customer credit card refunds, titling, etc. These lines of separation act as hurdles to fraud, encumbering a perpetrator's route to theft.



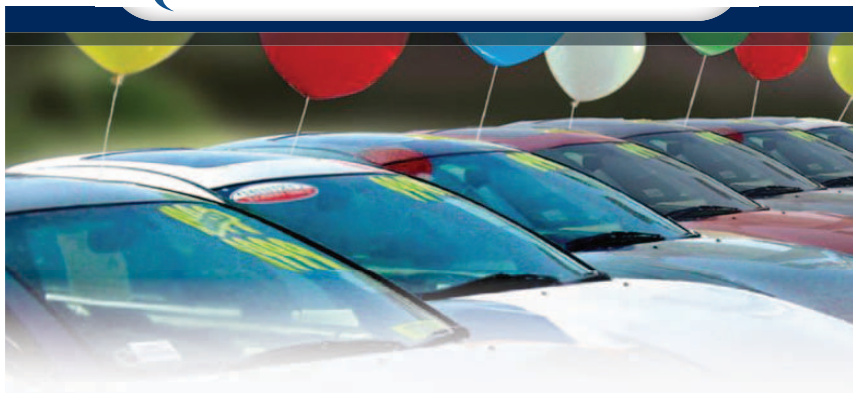
Once dealers have cordoned off these various internal functions, they should make sure that all finance personnel are cross-trained in each of them, including (and especially) those that fall in the controller's realm. Hoarding knowledge can cloak a fraudster's misdeeds.

2. **Monthly cash reconciliation — to the penny:** Dealers should train multiple people in the finance department to perform this essential chore. It is a good idea to change up the individual who performs this task from time to time.
3. **Mandatory controller vacation:** When finance personnel are cross-trained and can cover for the when the controller is away, dealers should require the controller's absence on an annual basis.

Mandatory vacation means several consecutive days out of the office so other staff have to get their hands and eyes on the controller's business — feel and see their world. This can serve to keep the controller honest or to root out any fraud, should it be there.

4. **Mail control:** It is smart for the dealer-owner to open all invoices and payments sent to the business. These should never be delivered directly to the AR and AP departments still sealed. If this duty is parceled out to another employee who is considered trustworthy, dealers can test their instincts by mailing themselves \$100 cash (with a disguised return address). If the cash does not end up on their desks, it is a safe bet a sticky-fingered employee is in their midst.

5. **Annual vendor audit:** Savvy internal thieves often create sham vendors who bill for small amounts, effectively paying themselves significant figures over several years' time. Every single year, dealers should pull a list of all vendors and corroborate each one's corporate name, assumed name, physical address (P.O. box is insufficient), owner's name, and phone number. Dealers should then call the numbers and speak with live people to verify the vendors' authenticity. Dealers should also review contract terms and pricing and make sure they align with the payment history.
6. **Journal-entry and general ledger-reclassification reviews:** Fraudsters are wily, agile people. An eagle-eyed review of the journal and general ledger can detect some of their financial acrobatics,



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such as controllers cutting themselves a check but reclassifying it to another account. They also could charge a big employee receivable and then move it to customer receivables and write it off as aged. Dealers should scour the books for these kinds of tricky maneuvers.

**7. CPA spot checks:** Bring in hired guns on occasion. Dealers are wise to engage a certified public accountant to drop in with a day's notice (or no notice at all) to inspect the books onsite. The inspection itself will be valuable, but the dealer can also monitor the controller's reaction to the announcement and behavior during this event. Panic is a tell-tale sign of wrongdoing. Composure and confidence are reassuring.

**8. Parts department controls:** Fraud is not limited to the pilfering of cash. Unscrupulous employees can steal equipment from a dealer as well, of course, but also they can compromise the business's best interests for personal gain. "Schmoozy" vendors tempt bad behavior with kickbacks and perks, rewarding certain purchase thresholds with trips, game tickets, big-screen TVs, and the like. For example, a dealership that only needs to hold 100 tires in inventory may find itself with several hundred more on hand because the purchasing manager over-bought to get that personal kickback.

Dealers can prevent equipment theft and kickbacks with a few internal controls. They should monitor purchasing behavior and look for excesses and imbalances in vendor patterns. Inventories of physical parts are best managed by an outside party that supervises internal staff in the process. Parts rooms should be locked and accessed in pairs with strict, written check-out protocols.

**9. Used and rental/loaner vehicle controls:** There is plenty of opportunity for fraud in the movement of a dealership's used vehicles and rental or loaner cars if it is not watched closely. A good practice is regular spot checks of the vehicles themselves and their management protocols. Dealers should physically see and touch their used cars to be sure they are actually on the lot and not already sold, for sale somewhere else, or altogether fictitious. The same goes for rentals and loaners, which can disappear without proper, enforced agreements.

Sales managers can be lured into fraudulent behavior just as easily as controllers and purchasers or parts-room employees. Dealers are wise to avoid used-car wholesalers because they tend to peddle their wares with personal kickbacks and rewards to managers, who may sell vehicles for less than market value to chock up more perks. This principle also holds true for auction transactions. Dealers should spot-check prices paid for auction and wholesale vehicles. They should also spot-check the appraisals of customer trade-in vehicles and make sure their customers are getting fair market value.

**10. Welcome and encourage whistleblowers:** Employees who suspect or witness fraud often keep their suspicions or knowledge to themselves because they are timid or fear retribution. Dealers can assure their confidentiality—and show they are serious about preventing and prosecuting fraud—by establishing and posting anonymous fraud-tip hotlines. They should set up a confidential 800 number and post it in internal-only areas of the dealership.

These ten practices can help honest dealers think like perpetrators and put themselves into a more defensive frame of mind. When these controls are established, communicated, and adhered to, fraud declines considerably. It can be difficult for trusting business owners to enforce such wary measures, so your advisory role in helping to instill the value of these controls cannot be overstated. Dealers who understand the power of prevention may not have to suffer losses, prosecute employees, and incur other reactive costs. ■

*John Buelow is the leader of the national dealerships consulting practice for CliftonLarsonAllen (CLA). His experience includes working with dealers on mergers and acquisitions, operations, strategic consulting and organizational development. John serves single point and top 20 national dealer clients throughout the country with revenues ranging from \$20 million to over \$3 billion. CLA is a professional services firm delivering integrated advisory, outsourcing, and public accounting capabilities to help clients succeed professionally and personally. For more information visit [CLAconnect.com/dealerships](http://CLAconnect.com/dealerships).*

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## NADC Job Board

Please remember to check the NADC Job Board in the members only section of the website if you are seeking employment.

Please send any job postings to:  
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## President's Message



Steve Linzer  
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Wow! That was my immediate reaction when told that our Chicago Fall Conference was a virtual sellout. The final attendance tally—a remarkable 182! That number of attendees far exceeds the turnout for past years' Fall Conferences and comes close to matching our Spring Annual Member Conferences (that usually have the most attendance). Thanks to the planning committee, our executive director and staff, our sponsors, the presenters, and our members. In addition, comments and evaluations from the attendees, reflect a most successful meeting. If you have not sent in your evaluation responses, please do as they are a valuable tool in the planning process. At the same time, please update your profile at the NADC website ([www.dealer counsel.com](http://www.dealer counsel.com)) as that information will be used for the NADC Attorney Directory, which will come out next year.

The meeting standards bar has now been set high, so we have already begun to plan for our next meeting—the 12th Annual Member Conference which will be held from May 15-17 in Palm Beach, Florida at the Four Seasons Resort. You should start making reservations as soon as possible. Please plan on attending and consider being a presenter. Presenters get not only recognition at the event, they get free registration!

For those of you who like to plan ahead, the 2016 Fall Conference will be held from October 23-25 in Chicago at the Radisson Blu Aqua Hotel. The reason for this decision was that the meeting for the first time will be “piggy-backing” with the ATAE conference, which will occur at the same hotel during the days immediately following NADC's event. Our 2017 Annual Member Conference will be held at the Ritz-Carlton, Laguna Niguel in Dana Point, California from April 23- 25. This is another hotel change mandated by room cost and capacity. The Ritz-Carlton is another outstanding ocean view hotel located just down the coast from The Montage (our former venue).

Here is an update on “happenings” at NADC. We held our Board Meeting on Sunday, just before the start of the Fall Conference. Several items that were decided and/or discussed are noteworthy. One is the federal registration of the NADC trade name and trademark and then the adoption of a policy to allow members to use these protected marks in their online biographies and resumes. The Board approved the first step, *i.e.*, the federal registration of the current mark and indicted its willingness to create, in the future, a policy for members' use.

The Board received a report on the status of the NADC Database Project. During the August Board meeting, members with an interest and expertise in databases were recruited for input on the project. An initial meeting was held to discuss the unification of all of NADC's data into one system and to integrate the website with this database. The Board received the committee's report and instructed the Executive Director to proceed with evaluation of a vendor to further this project.

The Board also considered and approved a trial period for an NADC News Alert Project. The Board previously had considered the problems our members have in keeping abreast of industry legal matters. Larger firms and specialized areas of practice have access to a great deal of industry materials and information while those who practice in smaller firms may not have access to as many resources on a regular basis. This News Alert would have a narrow focus on relevant legal issues and focused articles. This would be an added benefit to our membership. The Board approved the implementation of a pilot project to send this News Alert on a weekly basis. A vendor has been chosen to assist in the aggregating of pertinent articles as well as a template for distribution. Look for this News Alert in the future.

Another topic that was discussed was the formation of a NADC Regional Speakers Bureau to create a list of members available to speak to auto industry groups, local non-profits and social groups on auto

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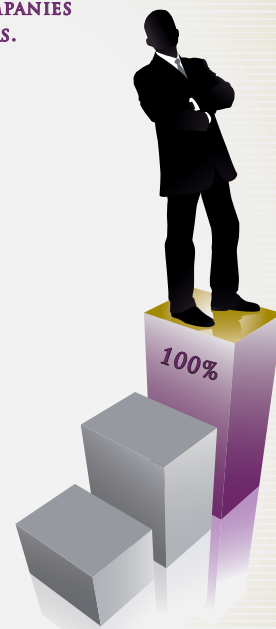
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related topics. The notion is NADC would maintain and publicize such a list and coordinate the program. The Board will further explore this concept.

Finally, the Board considered the adoption of three policies in accordance with prudent business practices: a Document Retention Policy, a Conflict of Interest Policy, and a Whistleblower Policy.

As always, we are looking for articles for *The Defender*. If you have written a brief, motion or memo on a topic that you think would be of interest to our membership, please consider modifying it for our use and submitting it to us. Please contact Editor Jami Farris at [jamifarris@parkerpoe.com](mailto:jamifarris@parkerpoe.com) to submit your articles and ideas.

That is the President's news for now. Have a safe and enjoyable holiday season. We look forward to seeing everyone in Palm Beach in May. ■



#### NADC Member Announcements

Do you have an announcement or an accomplishment that you would like to share with the NADC community?

**Please send any news you would like to share to:**

[emurphy@dealercounsel.com](mailto:emurphy@dealercounsel.com).

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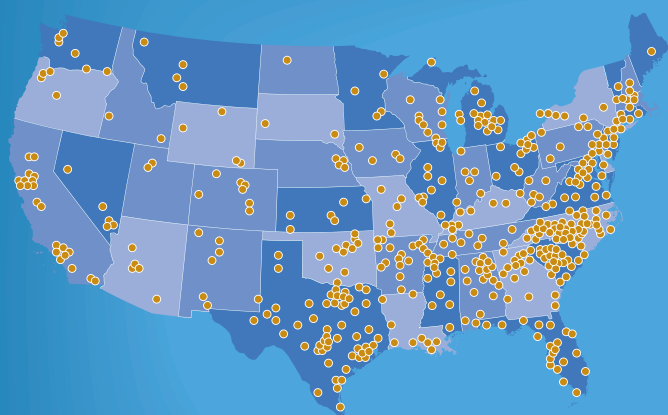
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# Dealership Valuations: Navigating the Powers and Perils in Today's Environment

By Gordon G. Wisbach, Jr., *GW Marketing Services*

Auto dealerships are currently in a bull market, with vehicle sales increasing and profits rising—and those conditions are expected to continue for at least the next three years. As a result, the industry is seeing consolidations across the U.S. The *New York Times* reported that “between 2011 and 2014, the number of dealership groups with revenue of \$1 billion or more doubled, to 43 from 21.” The largest dealer conglomerates, such as AutoNation, Penske Automotive, and Group 1 Automotive, have all increased the number of dealerships in their respective portfolios. This market environment is creating a win-win scenario for both buyers and sellers of dealerships.

However, just because the acquisition market is hot, does not mean that every potential offer is a good one. During the down market, it was very important for dealers looking to sell to come to the correct valuation conclusions. In today's market, it is equally—if not more—important to come to the correct conclusions as well. After all, there is more money involved and we are at or near the top of the market!

Whether your client is buying or selling a dealership, they need to consider three vital factors:

- Have they researched the market and financial data?
- Are there OEM issues that can result in delaying or disrupting the sale?
- Are they aware of red flags that are proven deal-killers?

## Know Your Market Data

Your clients would not put their houses up for sale without obtaining a market report. They would want to see the average listing prices, sale prices, amount of time listings are available, tax data, and more to figure out not just what their house is worth, but also what they should be able to get for their house. And if your client is the buyer, they should be doing the same type of research. As your client thinks about buying or selling a dealership, they must have a similar understanding of the dynamics in their particular market. They need to look at the numbers by region, type and size of dealership, actual and projected sales volumes, location, and other factors. Do they understand the financial impact of manufacturer manipulation in their dealer market? They should have access to market report and financial composites, which are incredibly useful sources of data.

These crucial reports are the OEM's *Business Management Composites*, which provide financial comparisons of like-sized, same-

brand dealerships in similar markets to determine how well the target dealer is doing financially, as compared to a group of their peers, and what potential exists for improvement. Your clients should have available market reports to determine the target's market performance, competition, cross-sell reports, available additional potential, and the size of their market.

## Potential OEM Issues

Their next step is to gain an understanding of potential OEM issues that can disrupt or delay the deal. Your clients need to know their OEM's policies, including facility requirements, and sales and services agreements policies. Unfortunately, many deals, especially with outside investment firms like Private Equity Groups, end up disapproved as a result of rights of first refusal or simply because their ownership horizon is not long term.

## Red Flags

With 70% of the dealerships in the U.S. operated by a dealer principal who owns only one or two dealerships, chances are your client has not purchased or sold a dealership in the past. And, just like buying a home, there can be many “gotchas” along the way. Before embarking on this type of transaction, they need to have a solid understanding of common red flags, such as the OEM's “blue print” for representation in the area, is the acquisition properly facilitated and located within its marketplace, how much would it cost to comply, and family and partnership dynamics which could prevent a sale, just to name a few. Knowing them and being able to mitigate them before starting negotiations can have a significant impact on their results.

Today's market dynamics present a great opportunity for your clients to grow their businesses by buying a dealership, or to finally cash out after several years of disappointing economics. It is vital they have an understanding of the market before they make any decisions. Many experts in our industry feel the days of the small “Ma & Pa” dealerships are nearly over, their demise masked by this bull market today! Is your client's dealership still viable as dealership groups (aka platforms) grow in size and the market cools? Should your client buy additional dealerships to insure a proper return on investment? What “succession” plans should be implemented? When you arm your clients with the right information, you will be helping them with an exit or growth strategy and help them get the best deal possible, buyers or sellers.



Today's acquisition market and valuation development has been made much more complicated by onerous OEM's market representation and financial requirements. Qualified dealership mergers & acquisitions specialists are able to assist you and your clients with navigating these issues. ■

### About the Author

*Gordon Wisbach has been in the automotive business for over 47 years, starting out working with Chrysler, and then founding GW Marketing Services in 1980. GW Marketing Services provides auto dealer brokerage services, but also focuses on dealership business valuations, market consolidation, and expert witness services. Gordon is well-known, and highly respected, with a very impressive client loyalty rating.*

*Wisbach has built his expert reputation on repeat and referral business in the very crowded, over-dealered New England market with substantial, complex, market representation issues. He has been involved in over 400 successful buy-sell transactions and hundreds of valuations. This formidable experience has provided him with the expert knowledge needed to deal with more complex issues when making deals or testifying, thus making him very qualified to consummate deals and be an expert in resolving these issues in other parts of the US.*

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# Smartchip Cards: Now at Your Dealership

By Randy Henrick, *Dealertrack Inc.*

When it comes to credit card processing, the U.S. can still be a little old-fashioned. Until recently, the U.S. was one of the only countries in the world that continued to rely on credit cards with magnetic stripe technology on the back. As a result, more than half of the world's credit card fraud takes place in this country. However, in October of this year, that changed, and dealers who accept credit or debit cards for payment in both sales and service need to be prepared for this change.

Similar to the rest of the world, electronic payment associations and regulators have mandated that U.S. card issuers embed smart chips into their cards. Through this new electronic payments industry initiative called EMV (Europay, MasterCard, and Visa), retailers (including automotive dealers) are required to upgrade their card readers to be able to read encrypted information and authorizations communicated from the chip card.

The purpose is to reduce credit card fraud which is rapidly on the rise in the U.S. given the static nature of cards with magnetic stripes and the ease with which to counterfeit them. The new chip card provides a different sequence of credentials (a unique one-time transaction code) for every use. If a hacker steals the chip information from one specific transaction, the stolen transaction number would not be usable again and the card would be denied. This makes chip cards very difficult to counterfeit.

According to the Payments Security Task Force, which represents a group of U.S. electronic payment companies and organizations, they predict that more than 575 million chip-enabled payments cards will be issued by the end of 2015. And some industry experts are estimating that chip card issuance in North America alone could reach a high of one and half billion cards by 2016.

## Payment Liability Shift

In addition to implementing the latest chip card technology, this initiative includes a payment liability shift for disputed charges between merchants and their customers for point-of-sale transactions. The liability shift means that retailers using non-EMV compliant devices that choose to accept transactions made with EMV-compliant chip cards assume liability for any and all transactions that are found to be fraudulent. MasterCard defines it this way: The party, either the card issuer or the merchant, who does not support EMV, assumes liability for counterfeit card transactions. They will also assume chargeback liability for customers who dispute charges. In effect, the liability will shift to whichever party is the least EMV-compliant.



So, if a dealer is still using the old system, it can still run a transaction with a swipe and a signature. But the dealer will be liable for any fraudulent transactions if the customer has a chip card. The converse also holds true – if the dealer has a new terminal, but the bank has not issued a chip and PIN card to the customer, the bank would be liable.

## Cards-Not-Present and Mobile Payment Liability

The EMV liability shift only relates to face-to-face card-present transactions and not to card numbers you key encrypt where the card is not present such as an Internet or phone sale. So, if a customer disputes the fact or amount of a transaction and paid with a chip card, the dealer will most likely lose that challenge if you swiped the card with an old terminal in lieu of inserting it to read the chip.

Dealers using mobile payment devices such as Square will also have to purchase new equipment to read the chips on EMV cards. Square has designed two EMV-compatible card readers for Android and iOS devices—one for swiping and one for dipping. These will cost approximately \$29 and \$39, respectively, but also require programming changes. Until the dealer upgrades, the new EMV cards will be processed without the additional layer of encryption security the chip provides.

## Transitioning to a Smarter Card

EMV compliance begins with acquiring new point-of-sale card readers. Systems conversions to accept the cards and training is also required but Visa is offering merchants who make the conversion an incentive package that will relieve some of the financial burdens. In effect, you

are changing from swiping a card to “card dipping,” which is inserting the chip card into the new terminal reader and waiting for it to process. The new terminals contain a slot to insert the card on the top or side that looks like a sim card. The new terminal also allows you to swipe the old magnetic stripe cards but also insert the portion of the card with the chip in it into the reader to read the chip data. The new chip cards will have a magnetic stripe on the back to be used with merchants who do not upgrade to EMV.

The card dipping chip verification process takes a little longer than a magnetic stripe card swipe. The card issuer determines whether the customer will use a PIN or a signature although most chip cards use a signature. Like today, the customer will sign on the point-of-sale terminal to take responsibility for the payment.

### What Should I Do Next?

You should contact your merchant acquirer who processes your card transactions and discuss appropriate solutions for implementing EMV at your dealership. There will be a lag time in obtaining the new chip card-reader devices and making software changes to be able to read the chip cards and implement the EMV technology. Your acquirer should be familiar with these processes and work with you for an EMV compliance solution that is cost-effective for your dealership.

Also, the liability shift risk should be weighed against the compliance costs. It does not take many sales or service transactions that are disputed to make the liability shift generate significant losses for your dealership.

What is your chargeback history or experience with counterfeit cards in all aspects of your business—sales, service, and parts? Fraud losses on magnetic stripe cards have doubled over the past seven years and swiping magnetic stripe cards is clearly yesterday’s technology. The time to start planning is now and it should begin with a call to your acquirer to get a sense of costs and timing not to forget to include training of employees as you make this transition. ■

*Randy Henrick is Associate General Counsel and lead Compliance Counsel for Dealertrack, Inc. This article is intended for information purposes only and does not constitute the giving of legal or compliance advice to any person or entity. The information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations from a knowledgeable attorney or compliance professional licensed to practice in your state.*

### NADC Topical Practice Groups

In accordance with the NADC Strategic Plan the Board of Directors has decided to activate the following two topical practice groups:

- \* Regulatory Compliance
- \* Consumer Litigation

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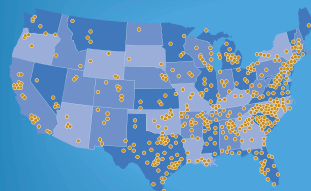


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