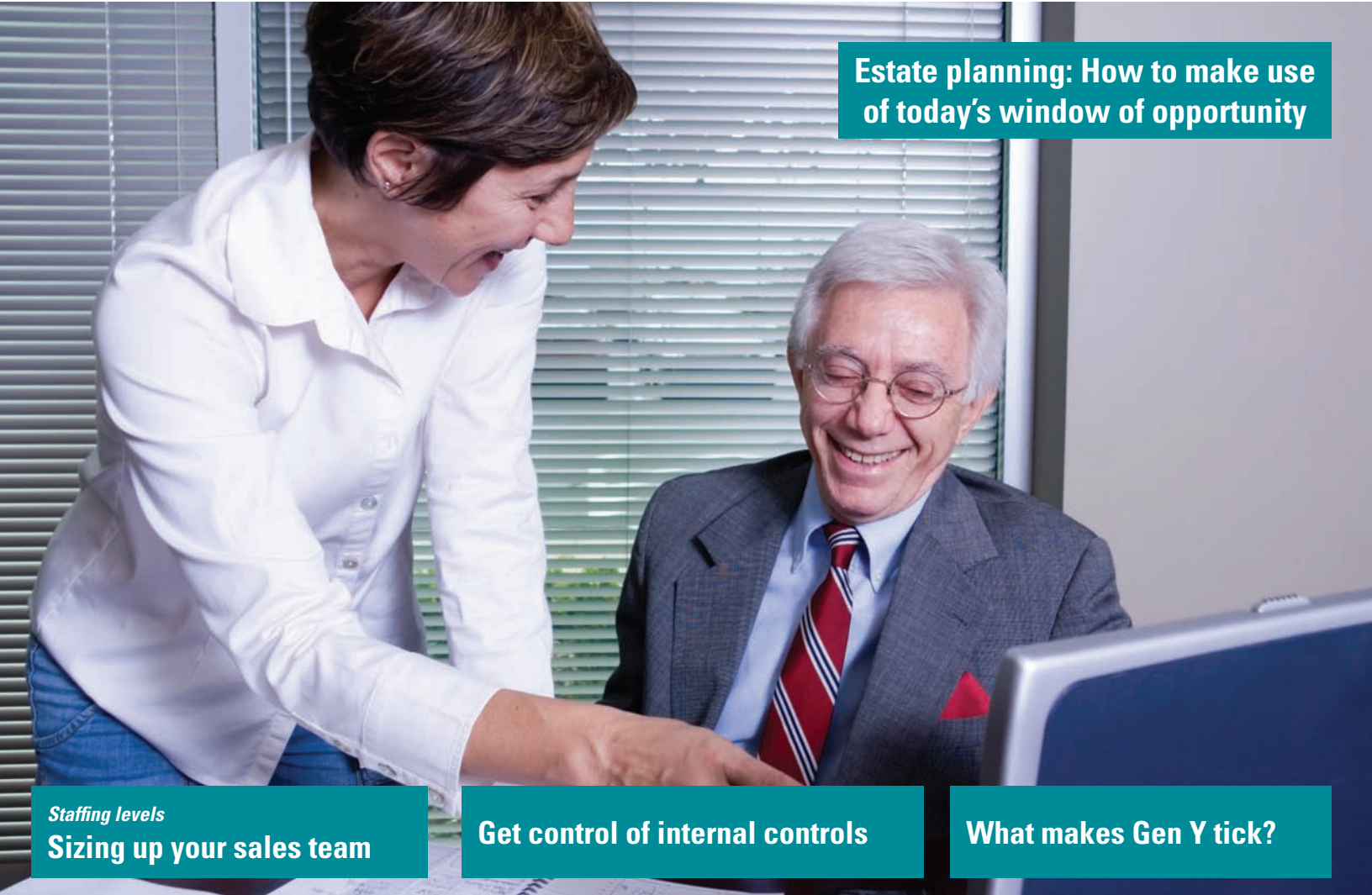


# Steering Column

Spring 2011



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## KB Parrish & Co. LLP

CONSULTANTS TO AUTO DEALERS ACROSS THE COUNTRY

"At KB Parrish, excellence is never an accident. It is always the result of high intention, sincere effort, intelligent direction, skillful execution and the vision to see obstacles as opportunities."



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### Meet the Dealership Team



Ned R. Van Emon  
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Check the back cover for accounting news and tips your dealership can use!

# Estate planning: How to make use of today's window of opportunity

**F**or an auto dealer, estate planning is especially complicated. The bulk of your estate is likely made up of one large, illiquid asset: your dealership. This means that your estate planning needs to be tied closely to both succession planning for your dealership and retirement planning for yourself.

Still, minimizing estate tax is an important objective. The good news is that the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 creates a significant window of opportunity this year and next.

## The new law

The Tax Relief act increases the lifetime gift and estate tax exemptions to \$5 million. And it sets the top marginal gift and estate tax rates at 35%. Also, a new portability provision allows the unused estate tax exemption of a spouse who dies to be transferred to the surviving spouse.

But the higher exemptions, lower rates and exemption portability apply only through 2012, unless Congress extends them. If no action is taken, in 2013 the exemptions will fall to \$1 million, the maximum rates will jump to 55% and exemption portability will disappear.

## Maximizing your gift tax exemption

The combination of a high gift tax exemption and probably a lower-than-usual dealership value due



to the recession provides a unique opportunity this year and next: You may be able to transfer a substantial portion of your estate to your loved ones without incurring gift or estate taxes.

If you haven't already used any of your lifetime exemption, you can gift up to \$5 million worth of assets tax-free over this year and next — \$10 million if your spouse agrees to "split" the gift. If you used up your lifetime exemption when it was \$1 million (2002–2010), you can still make an additional \$4 million in gifts during 2011 and 2012 — again, more if your spouse splits the gift.

You may be able to transfer even more than that tax-free if the dealership interests qualify for minority-interest and lack-of-marketability discounts.

An independent appraiser can help you determine the fair market value of your dealership and any applicable discounts. An explanation giving the factual basis for the claimed discounts and the amount of the discount taken — typically a copy of the appraisal — must be included with your gift tax returns.

Like an FLP, a grantor-retained annuity trust (GRAT) allows you to transfer dealership interests and other assets to your children while retaining some control over them.

### Alternatives to outright gifts

What if you want to take advantage of the \$5 million gift tax exemption while it's available but you're concerned about giving up control of your dealership? Or you have substantial assets other than your dealership interests? Consider these alternatives to outright gifts:

**FLP.** A family limited partnership (FLP) allows you to transfer dealership interests and other assets to your children (or other loved ones) while retaining some control over them. Plus, you can benefit from valuation discounts — even if you're transferring assets other than, or in addition to, dealership interests.

How does an FLP work? You transfer dealership interests and other assets to the FLP and then gift *limited* partnership interests to your children, removing their underlying value from your taxable estate. Because you retain the *general* partnership interest, you can continue to manage the dealership, as well as any other assets the FLP holds.

Because the limited partnership interests lack control and marketability, valuation discounts can be applied to

them for gift tax purposes. This helps you to make the most of your gift tax exemption. (See "An FLP in action" below.)

However, be aware that the IRS frequently challenges FLPs. To maintain favorable tax treatment, your FLP must have a bona fide, nontax business purpose and meet a variety of other requirements.

**GRAT.** Like an FLP, a grantor-retained annuity trust (GRAT) allows you to transfer dealership interests and other assets to your children while retaining some control over them. In addition, a GRAT provides you an income stream and allows you to leverage your gift tax exemption.

A GRAT works similarly to an FLP in that you transfer dealership interests and other assets to it. But instead of consisting of general and limited partnership interests, a GRAT consists of an annuity interest and a remainder interest. You retain the annuity interest and receive payments over the trust's term. You can serve as trustee and continue to manage the trust's assets, including the dealership.

You name your children as remainder beneficiaries. The value of the remainder interest for gift tax purposes is calculated using an assumed

### An FLP in action

Suppose you set up a family limited partnership (FLP) and contribute stock in your dealership to it. An appraiser decides that gifts of limited partner units in this FLP are subject to a 40% discount. You and your spouse together have \$8 million of lifetime exemption available. Under the exemption, you can jointly give interests valued at \$13,333,333 before the discounts ( $\$13,333,333 \times 40\% = \$5,333,333$  discount;  $\$13,333,333 - \$5,333,333 = \$8$  million).

So, by making the resulting \$8 million gift, you'd essentially remove \$13,333,333 from your estate tax-free. On top of that, you'd remove any future appreciation on those interests from your taxable estate.

growth rate prescribed by the IRS. If the GRAT assets outperform that rate — which is easier to do in a low-interest-rate environment — the GRAT can transfer substantial wealth to your beneficiaries gift-tax-free.

The downside of a GRAT is that, if you die during the trust term, the assets will be included in your taxable estate, erasing the GRAT's benefits. But you'll be no worse off tax-wise than if you hadn't established the GRAT.

## Customized solutions

The strategies mentioned here are by no means the only ones available, and a one-size-fits-all estate plan doesn't exist. Important factors to consider include your charitable goals and family situation, the dealership's value and real estate holdings, and the value of the rest of your estate. But one thing's certain: You can't afford to put estate planning on the back burner — especially in light of the temporary tax-saving opportunities in 2011 and 2012. ■

## Staffing levels

# Sizing up your sales team

**T**he economy is better for auto dealerships now than it was a year ago. NADA, for example, predicts double-digit percentage gains for new vehicle sales in the United States in 2011. Is your dealership prepared to handle the 11% or more additional business that is expected to walk through your doors or make online inquiries?

Maybe it's time to replace some of those sales jobs that were eliminated during the worst of the recession. Or is your sales staffing just fine the way it is? Here are some steps you can take to make sure your staffing level is on the money.

### Where do you start?

To reach your optimal sales staffing level, there are a number of steps you can take. A simple place to start is your monthly gross profit per employee.

A rule of thumb is that each sales employee should generate profit of at least \$6,500 per

month. To determine your average, take your December year-to-date gross profit and divide by 12. Then divide the result by your current number of sales employees. Does the average fall above \$6,500? If so, you may be able to afford to hire more sales staff.

Reaching your optimal sales staffing level isn't a black-and-white matter. You'll need to think about your operation's changing shades of gray.

Be aware that, depending on your circumstances, a \$6,500 average may not be right for your business. Always compare your dealership to the market in which you're operating. And consider checking with manufacturer or group composites to see how your average stacks up.

## What else should you consider?

Reaching your optimal sales staffing level isn't a black-and-white matter. You'll need to think about your operation's changing shades of gray to customize your approach. Consider how you handle staffing when sales employees take vacations, request a day off — for example, on a weekend — or call in sick.

Also think about the staffing levels you need for key weekday and weekend hours and for special sales and promotions. Will your staff on the floor be too thin to handle lunch hours and breaks if traffic picks up? What if traffic starts to decline again? Answering these questions will help ensure you have the staffing necessary to handle all your peaks and valleys.

## Do you need a crystal ball?

Even in good or better times, you should have your nose to the future. A question to always keep in the back of your mind is, "Would our dealership survive a decrease in traffic?"

Dealers must continue to work at keeping the number of sales employees in line with sales so that, if the market turns down, they'll be better able to stay on an even keel. If you

already monitor your traffic and keep tabs on trends, you're ahead of the game.

Problems that arise from carrying too few or too many sales employees can creep up on you. Be careful not to hire at a rate faster than your gross is increasing. Continually adjust your headcount to match your sales, and you'll have a better chance of maintaining your dealership's profits during challenging periods.

## Are you ready?

Hopefully all the market factors — lower interest rates, old cars that demand replacement, higher gas prices and plenty of new cars and trucks to choose from that include hybrid vehicles, smaller cars and diesels — will lead to the anticipated boost in new vehicle sales. Make sure that your sales team is staffed to handle it. ■



# Get control of internal controls

**Y**ou can't control external factors that affect your dealership, such as the economy and industry trends. But internal controls are well within your reach. Internal controls are the policies and procedures dealers employ to protect assets, improve operating efficiency and ensure reliable financial reporting. They also are your first line of defense against theft and fraud.

## Don't give "family" free rein

It's common for dealers to adopt a not-in-my-backyard attitude toward internal controls. They presume resources are spread too thin and employees are too closely knit to justify a formal control system.

"We were like a family," recounts Bob, a dealer-owner who filed for bankruptcy last winter. He

and his former best friend, Rob, jointly owned six dealerships in a large metropolitan market.

For more than a decade, Bob overlooked his partner's lavish spending habits, which included season tickets to the local NFL team and country club dues. Rob also wrote off a home remodel, including it as part of the company's new showroom. His over-the-top spending didn't stop when the market softened, precipitating the bankruptcy claim.

But tighter controls might have curbed Rob's spending. For instance, the partners could have reviewed each other's expense reports. Or the checking account could have required two signatures for checks over, say, \$10,000.

The control environment starts at the top. When employees see that management is overriding internal controls and "borrowing" dealership assets for their personal use, they're more likely to view fraud as acceptable and attempt it themselves.

### Protect your assets

Internal controls needn't be time-consuming, expensive or offensive to trusted employees. Start by brainstorming potential fraud risk areas and potential fixes, including:

**Inventory.** Inventory is a dealer's biggest, most desirable asset. Set a good example by refraining from keeping dealership vehicles in your home garage. Lock the parts and accessories inventory and keep it tidy. Conduct monthly or quarterly inventory counts to compare what the computer says vs. your personal observations. Identify slow-moving items; discount them for a quicker turnover or return them to the manufacturer, if possible. Frequently reconcile your physical inventory of vehicles to your floor plan documents.

**Customer lists.** These belong to the dealership, not your salespeople. Protect electronic databases with passwords that change on a monthly basis. When salespeople leave, don't allow them to take valuable customer data with them.



It could come back to haunt you if they join one of your competitors.

**Cash.** The majority of fraud schemes involve cash. So, keep petty cash in a safe, not the receptionist's desk drawer. Ask your CFO for the *original* copy of the bank statement and review the bank statement every month. And don't forget *segregation of duties* — the key principle of internal control. For example, don't allow one person to handle both the cash receipts and the accounting records.

Also double-check your invoices against contract prices. One dealer discovered that a third-party installer of aftermarket leather seats and sunroofs had been overcharging for parts and labor. The dealership's service manager and the vendor's CFO split the difference between actual and invoice prices using phony return memos.

### Let auditors do the legwork

Reinforcing your internal controls may seem like a daunting task. You may wonder where to begin and how to achieve the biggest bang for your buck. Your CPA can help guide you through the process of implementing cost-effective internal controls. He or she also can identify accounts at risk for "material misstatement" through the audit process. ■

# What makes Gen Y tick?

**G**eneration Y — adults born after 1979 — is 77 million people strong, according to the U.S. Census Bureau. But they're wound a little differently than the rest of us. Dealers who understand Gen Y and customize their marketing and sales strategies accordingly stand to profit.

## Understanding preferences

Gen Y is buying vehicles just as much as Gen X and baby boomers, according to a Deloitte-sponsored study of university students. But Gen Y has less disposable income and doesn't see cars as a status symbol as much as its predecessors do.

So, many Gen Y buyers select used over new cars. This is good news for not only used car sales but also for service departments — if you can convince Gen Yers to return to your dealership for repairs and maintenance.



Gen Y also wants technology and connectivity. Vehicles equipped with mobile messaging, MP3/WMA playback capability, and hands-free cell phone options win over Gen Y.

The first generation to grow up with home computers, music downloads and cell phones, Gen Y has been inundated with technology their entire lives.

Finally, Gen Y wants a vehicle that stands out. For example, MINI and Toyota's Scion allow buyers to customize a base vehicle with, say, decals, stylized mirrors and stereo equipment. Customization represents a huge opportunity for selling parts and accessories.

## Marketing and sales — the right way

The first generation to grow up with home computers, music downloads and cell phones, Gen Y has been inundated with technology their entire lives.

If you want to catch a Gen Y shopper's attention, your website needs a searchable online inventory listing, and you should advertise at sites like Cars.com and Facebook. Texts and e-mail blasts are the ideal way to reach this segment about sales and service promotions. Some manufacturers even offer smart phone apps for online bill payment.

Once you get Gen Yers into your showroom, remember that, because they're often significantly younger than their salespeople, they worry they won't be taken seriously. Dealers who create a positive showroom experience with a friendly, low-pressure sales approach build brand loyalty. ■

# News tips you can use from K.B. Parrish

## Systems review can protect your dealership ... and you

A periodic Systems Review is more than just a perfunctory audit of your dealership. It's actually a safety check to be sure that everything is being run properly. This kind of review can not only make sure your dealership's controls are in place but also can identify areas where they are not working properly, such as problems with your employees.

"The importance of a thorough Systems Review cannot be underestimated," says Tim Cookerly, a Partner at K.B. Parrish. "We perform these reviews every year for many of our more than 250 dealership clients across the country to assist managers in assessing the effectiveness and reliability of their controls. Many times, a Systems Review will identify areas where internal controls are lacking ... or simply non-existent."

"The Systems Review process also helps us assess the accuracy, reliability and completeness of dealership records," adds Ned Van Emon, also a Partner. "This helps us identify problems with personnel performance or particular job functions." After fieldwork is completed, K.B. Parrish documents its findings and makes recommendations to management. If desired, the report can be structured on a departmental basis and can be used as a tool for personnel training.

## What *are* Accountants looking for?

A Systems Review can be tailored to your dealership. The process can involve testing a broad range of procedures and records or it can target only those areas of concern to dealership management. Following are just a few of the things accountants will be looking at in a comprehensive Systems Review:

- Cash on hand – review controls & procedures
- Bank Reconciliations – in depth review; EFTs
- Check Sequencing/Inspection
- Payroll – verify pay, review bonus plans
- Cash Disbursements – review procedures
- Cash Receipts – test deposits for accuracy
- Employee Files – review (I-9s, licenses, etc.)
- Repair Orders and Parts Tickets – review transactions, open ROs, etc.
- Parts Department – analyze management reports, annual physical inventory, etc.
- Account/Schedule Analysis – review all schedules, accounts, etc.
- Brief Compliance Assessment – review information security, customer privacy policy
- Deals and Finance – review process, customer signatures, title delivery, trade-in payoff, etc.

## Test, test, test

Systems Review is all about testing a dealership's internal controls in a variety of ways to be sure that they are working properly. These controls provide the dealership accurate data (critical for decision-making), safeguard assets (particularly important in the computer era), and encourage employees to follow proper procedures.



Overall, internal controls should help the dealership operate efficiently by preventing duplication and waste and by using resources wisely.

There are two basic types of internal controls: accounting (capturing financial transactions and preventing embezzlement) and administrative (safeguarding assets and regulating activities).