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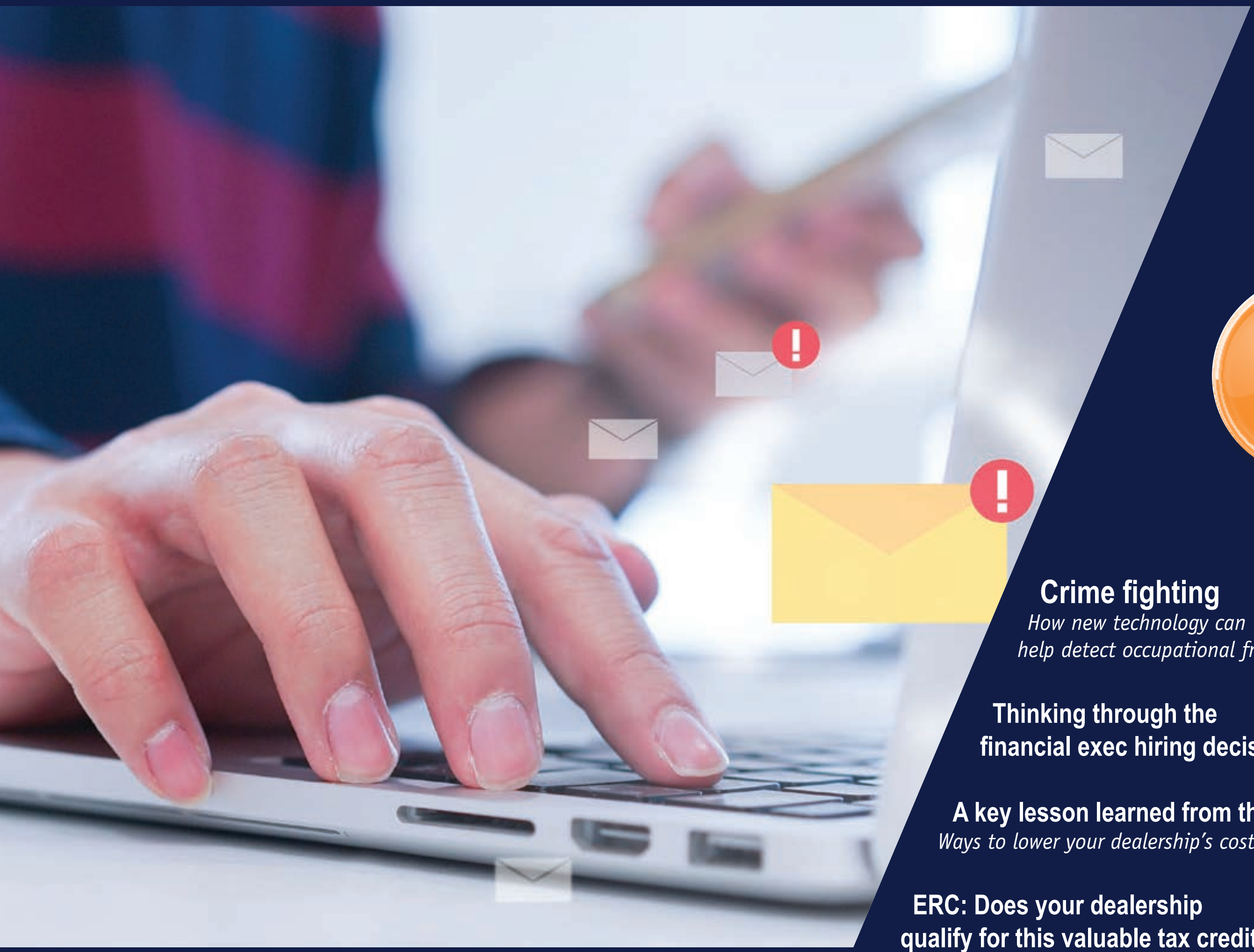

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ERC: Does your dealership qualify for this valuable tax credit?

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Crime fighting

How new technology can help detect occupational fraud

Occupational fraud remains a growing problem for many businesses, including dealerships. According to the Association of Certified Fraud Examiners' *2020 Report to the Nations*, organizations lose 5% of their revenue on average to fraud each year.

One fraud prevention strategy is to analyze internal data for red flags indicating potential fraud. But with so much business data now in an unstructured format — think emails, instant messages and social media posts — this task has become increasingly difficult.

Is there a solution?

The good news is that new technologies now exist that can help analyze your dealership's unstructured data more efficiently as it seeks to uncover occupational fraud. These include graph search algorithms, advanced data analytics, predictive analysis and natural language processing (NLP). It's a form of artificial intelligence and machine learning that combines computational linguistics with statistical models to analyze large volumes of unstructured data.

Without tools such as NLP, forensic accounting specialists typically conduct manual analysis on random samples of unstructured data to search for abnormalities and inconsistencies that could indicate fraud. Random samples can be inefficient because they require forensic accountants to develop representative sampling methodologies, a time-consuming task. Sampling also can lead to missed red flags and failure to uncover fraudulent activities before it's too late.

How does it work?

NLP enables text mining (also known as text analytics) that can process patterns and assertions from large blocks of unstructured data in search of potential fraud. This helps explain why a growing number of forensic accountants now use NLP to analyze millions of data points, as opposed to relying on representative sampling techniques. The result is greater efficiency and effectiveness in occupational fraud detection.

NLP uses algorithms that break down (or diagram) sentences contained in employee emails, instant messages and other unstructured data. It defines words within the context of sentences, which helps analyze data for signs that an employee has committed, or plans to commit, fraud.

For example, NLP could analyze instant messages between employees to find out that an individual is unhappy at work or facing severe financial stress at home. Such employees can sometimes be tempted to commit fraud or embezzlement. You might want to keep a close eye on these at-risk employees or limit their access to your dealership's sensitive financial areas.

How else is it used?

NLP also can help identify collusion that might take place between employees and outside vendors and suppliers. For example, a dishonest purchasing manager might steer business to a supplier in exchange for a kickback. Or a sales manager might purchase or sell used vehicles at inflated or deflated prices in exchange for a kick-back from the wholesaler. NLP could help uncover these types of fraudulent activities before they lead to big losses.

In addition, NLP could help protect your dealer-ship's intellectual property. For example, suppose an employee is planning to leave your dealership to work for a competitor and take sensitive corpo-rate information (such as your dealership's finan-cials or customer lists) with him. If this employee were to discuss his plans with others via company email or instant messaging, NLP will bring it to your attention.

What about legalities?

Federal and state laws tend to give employers a lot of leeway when it comes to using NLP and other technology to monitor employee communications contained in unstructured data. The laws generally allow businesses to monitor almost any data that comes in or out of a company-owned device or across a company-owned network, including:

- Emails,
- Keystrokes,
- Internet browsing history,
- Social media activity, and
- Screen content initiated from computers, tablets, cellphones and other digital devices issued by the company.

However, employers don't have as much flexibility to monitor employee communications initiated from their personal devices. Under certain conditions, you might be allowed to monitor data on an employee's personal device if you have a written workplace policy that permits this while the device is on your dealership's premises. As a general rule, though, employees are protected from unauthorized moni-toring of their devices by their employers.

Occupational fraud: By the numbers

Every other year, the Association of Certified Fraud Examiners produces its *Report to the Nations*, a detailed analysis of the costs, schemes, victims and perpetrators of occu-pational fraud. Here are a few takeaways from the 2020 report:

- The typical fraud case lasts 14 months before it's detected with a monthly cost of $8,300.
- Asset misappropriation (theft) is the most common, but least expensive, type of fraud ($100,000 median loss). Financial statement fraud is the least common, but most expensive, scheme ($954,000 median loss).
- Fraud committed by business owners and executives resulted in the largest corporate losses, with a median loss of $600,000. Meanwhile, fraud committed by managers resulted in a median loss of $150,000. Fraud committed by other employees resulted in a median loss of $60,000.

Minimizing fraud risks

Occupational fraud is a risk of doing business, but it doesn't mean your dealership should be a sitting duck. You can lower this risk by taking proactive measures — including hiring a forensic accountant to conduct an investigation using NLP and other technology tools — to help detect and prevent fraud at your dealership.

Thinking through the financial exec hiring decision

Despite the pandemic, many dealership businesses have seen strong financial results amid bumped-up consumer demand and restored supply chain efficiency. Perhaps you've even grown to the size where you're considering stepping up the financial management of your operation by hiring a controller or a CFO. If so, here are some things you should know.

Revenue thresholds

Dealerships usually need to reach a minimum size before it's financially feasible to hire a financial executive. Generally, two thresholds come into play: 1) Revenues of around $75 million, or operating multiple smaller stores, could mean you're ready to hire a controller, and 2) revenues of around $300 million, while running multiple locations, could indicate it's time to hire a CFO.

If your dealership has met one of these thresholds, or soon will, it's time to look at the potential benefits of adding a financial executive to your staff. The biggest benefit is bringing a higher level of strategic and analytical skills to the financial management of your dealership and its locations — expertise that exceeds number-crunching. A CFO or controller can provide strategic financial direction.

Typically, these individuals look beyond day-to-day financial management to holistic, big-picture financial-operational planning. They'll take a seat at the executive table and serve as your go-to for all matters financial and operational.

Responsibilities

A financial executive can go beyond *compiling* financial data to *interpreting* it. This individual should be able to demonstrate how financial decisions will impact all aspects of your dealership. A CFO or controller also can show how improved

data interpretation can help lead to better management decisions.

Their responsibilities also generally include:

- Ensuring adequate internal controls are in place to help safeguard the dealership from internal fraud and embezzlement,
- Performing ratio analysis and comparing the dealership's financial performance to benchmarks established by similar-size dealerships in the same geographic area,
- Determining whether it would be beneficial for the dealership to perform a cost segregation study and, if so, spearheading this effort,
- Combining the financial operations of multiple franchise locations and finding ways the dealership can benefit from economies of scale,
- Implementing cash management practices that will boost your dealership's cash flow and improve budgeting and cash forecasting, and
- Analyzing the tax and cash flow implications of different capital acquisition strategies, for example, leasing vs. buying equipment and real estate.

In addition, this individual may evaluate possible expansion opportunities, such as a merger or an acquisition. And, of course, your financial executive will be the primary liaison between your dealership and its lenders to ensure your financial statements meet the bank's requirements and loan requests are granted.

Compensation package

Hiring a full-time CFO or controller represents a major commitment in money and time. This executive will likely command a six-figure salary and an attractive benefits package, so make sure your dealership has the financial resources to support this level of compensation.

Bringing in a financial executive also will require a time commitment from ownership and the management team. You'll need to bring the controller or CFO up to speed on all aspects of your dealership's finances and operations. If the training doesn't go well, or the new executive isn't granted enough decision-making authority, he or she could become discontent and leave — wasting your efforts and disrupting the business.

On the cusp

Your dealership might find itself stuck in the middle. That is, you're not quite large enough to afford a full-time CFO or controller, but you're too big for your office manager or bookkeeper to continue managing the finances.

In this situation, your CPA may be able to work with your financial staff to provide outsourced oversight of financial and accounting functions as well as strategic expertise. This option may provide the best of both worlds for smaller dealerships: You'll receive high-level financial and operational know-how without having to pay the high salary and other overhead required for an executive position.

Think it over

Hiring a controller or CFO is an important move that can help take your dealership to the next level. But evaluate the decision carefully to make sure it's worth its proverbial weight in gold.

A key lesson learned from the pandemic

Ways to lower your dealership's cost structure

The COVID-19 pandemic turned the dealership world upside down last spring, and the ramifications are still being felt. With over a year's experience behind us, it's a good time to discuss a pivotal lesson learned during this precarious time.

Lower your cost structure

Lowering costs should always be a key goal for dealerships but, during the pandemic, it's taken on greater urgency. Here are three areas to examine.

1. Staff. Payroll is one of the largest expenses for most dealerships so it's one of the first places to look when cutting costs. Perform a top-to-bottom analysis of your dealership's staffing expenses to get a handle on how much money you're spending. Then start looking for areas you can trim.

This doesn't necessarily mean you have to lay off employees. Some dealerships have shaved fringe benefits — for example, by suspending matching contributions to employees' retirement accounts or requiring that employees contribute more to their health insurance. Or perhaps you can reduce work hours across the board for most or all employees instead of laying anyone off. These may not be popular solutions, but drastic times call for drastic measures.

2. Advertising. Many dealerships rely heavily on traditional advertising like newspapers, television and radio to drive store traffic. But these advertising channels are expensive, which has forced some dealerships to cut back on their ads during the pandemic.

If you haven't shopped your advertising account with other agencies in a while, now would be a good time to do so. Some ad agencies have lost revenue during the pandemic and they might be more willing to work with you on pricing than in the past. Also investigate nontraditional forms of advertising such as social media, online and email marketing — these can be less expensive and more effective than traditional advertising in some circumstances.

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3. Inventory. Improving inventory management can reduce vehicle carrying costs and floor plan interest, two major expenses for most dealerships. Keep a close eye on inventory metrics, including your inventory turnover ratio: your cost of vehicles sold divided by your average vehicle inventory value. Twelve inventory turns per year — or in other words, holding about 30 days of vehicle inventory — is generally considered a good benchmark for most dealerships.

It's also important to manage your inventory of parts and accessories. In some cases, dealers may be able to return some items to the manufacturer for a refund.

Inventory management decisions should be based on data, not hunches or "gut feelings." Your dealership management system should provide you with this kind of information. Examples include which makes and models are selling best, the prices they're selling for (including the percentage of your manufacturer's suggested retail price) and how many days it takes to sell them.

Survive … and thrive

Your dealership can possibly "turn lemons into lemonade" by tapping into these and other lessons from the pandemic. Such cost-saving measures can help position your dealership to prosper in the future.

ERC: Does your dealership qualify for this valuable tax credit?

Dealerships can benefit from a number of COVID-19-related provisions in two laws that have passed in the last six months.

Extended qualification period

One of the most beneficial rule changes is an extension of the period during which wages and health expenses qualify for the ERC. Originally, the tax credit applied only to qualified wages and health expenses from 2020. This had been extended for two more calendar quarters, through June 30, 2021 in the Consolidated Appropriations Act, which was signed into law in December 2020. And the American Rescue Plan Act (ARPA), signed by President Biden on March 11, extended the credit through Dec. 31, 2021. Other changes in the ARPA apply to "recovery startup businesses." Health insurance premiums paid by your dealership count toward qualified wages.

The ERC was initially capped at $5,000 per employee for the 2020 period. The cap has now been increased to $7,000 per employee per quarter for all four quarters of calendar year 2021. Also, the CAA eliminated the 30-day lookback period for determining wages that could be counted when calculating the ERC.

Criteria for the credit

For 2020, your dealership may qualify for the ERC by showing that 1) the jobs of some employees were affected by government shutdown orders, and 2) the dealership had more than 100 full-time employees (FTEs) and paid these employees during times they weren't working in calendar-year 2019. If your dealership had less than 100 FTEs, any wages paid would qualify.

Another scenario: Your dealership also would qualify if it had a decline in gross receipts of more than 50% in any quarter compared to the same quarter the year before.

The gross receipts reduction threshold has been reduced from 50% to 20% for the first two quarters of 2021. This means your dealership may be eligible for the ERC for tax year 2021 if you've had more than a 20% decline in gross receipts in one of these quarters compared to the same quarter in 2019.

More details

If your dealership obtained a Paycheck Protection Program (PPP) loan, you may claim the ERC for tax year 2020 or 2021 as long as the wages used to support the payroll portion of loan forgiveness aren't used to support the ERC. In other words, no double-dipping.

If you obtained your PPP loan in 2020, you may claim the cumulative effect of the ERC in the fourth quarter of 2020 by filing an IRS form. Also, while your dealership may not qualify for the 2020 ERC due to the 50% decline in gross receipts threshold, the reduction in this threshold to 20% for the first two quarters of this year will likely make it easier to qualify for the ERC in 2021.

The changes to the ERC rules are detailed and complex. Speak with your tax advisor for specific guidance in your situation, including the effects of any recent changes with the ERC.

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- Gift and estate planning
- Representation before tax authorities

Paul A. Cerrone, CPA, MST, CVA, managing partner, is an ADP Certified CPA with more than 30 years of experience in serving automotive dealers. He specializes in helping clients minimize taxes, maximize profits and achieve their business and personal financial goals. Paul can be reached at 508-845-7600 or pcerrone@cgscpas.com.

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