FIVE WAYS TO STAY CLEAR OF A FACTORY AUDIT

Dealerships across the country are striving to make 2011 a far more profitable year than 2010. Hard-working dealers are keeping their eyes on the market, on sales goals — and on all of their business practices that impact the bottom line.

While the crunch is on, one area that's easy to overlook is the possibility of a factory audit. But remember, a factory audit costs a dealership time and, hence, money. With manufacturers also looking hard to boost profits, you'd be wise to do what you can to avoid an audit by your manufacturer.

1. Fulfill expectations. Being tuned in to what the factory expects is the first, and perhaps most critical, step in steering clear of an audit. Make sure you and your staff understand the requirements and the potential exposure for failing to live up to these contractual obligations.

Once everyone knows the rules, check that employees are documenting every transaction in a way that clearly shows they've been followed. If you're unsure of what may be required in a specific situation, contact your factory representative.

Advise your staff that there can be no shortcuts when it comes to documentation. A simple purchase order with a final new vehicle price probably won't suffice. Tell employees to start with the MSRP and itemize every discount offered to the customer.

2. Get your key people involved. No dealer can monitor every transaction for compliance, of course. That's why relying on sales and service managers is critical.

These key players must stay up to date on factory requirements. And be sure they realize that failure to live up to their responsibilities could cost the dealership significant sums of money. In some cases, dealers have been forced to liquidate their businesses because of factory chargebacks.

3. Review your records. On a regular basis, and as part of your general internal controls, review the paperwork a factory audit team would examine in a random or targeted audit. Look for discrepancies, errors, incomplete information, missing documentation and any other problem that could prompt further investigation. Then make sure the records are kept for the audit exposure period — usually two years.

If you uncover any problem, dig deeper. Don't assume you've stumbled over a single lapse in recordkeeping or a solitary misapplication of the rules. That could be the case, but you may have tripped over the tip of an iceberg.

A pattern of abuse could be going on right under your nose by employees who have found that breaking the rules helps them work less or even commit fraud. In any case, the consequences could be costly for you.

4. Stay on the beaten path. Although some audits are random, others are generated by dealerships whose operations vary too much from the regional norms. In this respect, the factories share a targeting technique with the IRS: They both look for the unusual. One of the most common triggers related to unusual activity is the apparent misuse of discount programs, such as offering discounts to ineligible buyers.

5. Inspect your service department. Manufacturers don't look for just unusual sales activities; they also scrutinize service department activities. For example, multiple warranty replacements of the same parts on the same vehicle or incorrect mileage readings on vehicles receiving warranty work can trigger audits. So can labor hours that are out of line with factory allowances or a high number of certain service procedures or repairs.

Contact your local Auto Team America member for additional information.

FRAUD PROTECTION ON CASH

Did you know that most fraud is performed by employees who have worked for either a very short time (several months) or a very long time (10+ years)? This means that even though you have a trusted bookkeeper who has been with the company for many years, you still should take some precautions to reduce the risk of fraud.

Reviewing supporting documentation with each check can reduce the likelihood of unauthorized payments being made before they happen. Your accounting staff should be trained to attach the invoices to the checks when presenting them for signing. This way, you can review why the payment is being made, especially for non-routine items.

One simple but effective control is to pick a month and review the cleared checks in the bank records. This month should not be at year-end, as a smart bookkeeper would know that the accountants tend to look at the year-end months more closely. For the chosen month, go through the cleared checks and make sure that the proper signatures are present. Also, verify you recognize the supplier name and if it is to Amex, Mastercard or Visa, that it relates to an approved credit card. Be sure to look at support for electronic transfers of funds as well.

Ideally, this would be done every month as a control, but doing it at random once a year can still be very useful in identifying a bookkeeper who may be taking cash from the company.

Contact your local Auto Team America member for additional information.

TOOL PLANS ON THE IRS HIT LIST

The IRS has repeatedly attacked the use of tool plans as a means of avoiding taxes. The IRS recently blessed a taxpayer's reimbursement plan, but the ruling provides little practical guidance for taxpayers. The plan at issue addressed the IRS's previous concerns and followed the existing requirements exactly.

Background
Under an acceptable tool plan, an employer may reimburse an employee for the cost of his tools tax-free, if the plan requires that (1) the tools be used for the employer's business and be deductible as a business expense, (2) the employee maintains adequate substantiation of the expense, and (3) any excess reimbursements be returned to the employer.

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The plan in question had the following features:

Business connection – The Tool Plan only covered expenses incurred during the current plan year and on job assignments while employed with the current employer. Tools and equipment must be maintained at the employer's place of business and must be considered necessary for the industry.

Substantiation – Employees must submit a claim form that certifies that the purchased item meets the requirements listed above and identifies the job assignments requiring the expenses. The employee must submit acceptable proof of purchase that includes the item description, date of purchase, and cost within 30 days of purchase.

Repayment – The plan does not allow cash advances, so there should not be excess reimbursements. However, it states that erroneous reimbursements must be returned within 30 days.

Other – The Tool Plan required the employer to determine a maximum reimbursement limit per employee at the beginning of the year. The employer stated that reimbursements are not made as part or instead of compensation. The plan did not provide adjustments to compensation on account of reimbursements.

Although it is encouraging that the IRS did not dispute the plan above, it is hardly informative for taxpayers seeking guidance for terms not falling squarely under the rule. To use the Tool Plan as a guide would likely require employers and employees to change the terms of their current agreements.

TAX TIP

IRS AUDIT RED FLAGS

Ever wonder why some tax returns are audited by the IRS while most are ignored? The chances of you being audited or otherwise hearing from the IRS can increase depending upon various factors, including whether you omitted income, the types of deductions or losses claimed, certain credits taken, foreign asset holdings and math errors, just to name a few. Although there's no sure way to avoid an IRS audit, you should be aware of red flags that could increase your chance of drawing some unwanted attention from the IRS. Here are the 12 most important ones:

Failure to report all taxable income.
The IRS receives copies of all 1099s and W-2s that you receive during a year, so make sure that you report all required income on your tax return.

Returns claiming the home-buyer credit.
First-time homebuyers and longtime homeowners who claimed the homebuyer credit should be prepared for IRS scrutiny. Make sure you submit proper documentation when taking this credit.

Claiming large charitable deductions.
This comes up again and again because the IRS has found abuse on audit, especially with those taking larger deductions.

Home office deduction.
The IRS is always very interested in this deduction, primarily because it has a pretty high adjustment rate on audit. Don't be afraid to take the home-office deduction if you're otherwise entitled to it.

Business meals, travel and entertainment.
Schedule C is a treasure trove of tax deductions for self-employed individuals. But it's also a gold mine for IRS agents, who know from past experience that self-employed individuals tend to claim excessive deductions.

Claiming 100% business use of vehicle.
Another area that is ripe for IRS review is use of a business vehicle. When you depreciate a car, you have to list on Form 4562 what percentage of its use during the year was for business. Claiming 100% business use for an automobile on Schedule C is red flag for IRS agents.

Claiming a loss for a hobby activity.
Your chances of "winning" the audit lottery increase if you have wage income and file a Schedule C with large losses. And, if your Schedule C loss-generating activity sounds like a hobby, the IRS pays even more attention.

Cash businesses.
Small business owners, especially those in cash-intensive businesses…taxi drivers, car washes, bars, hair salons, restaurants and the like…are an easy target for IRS auditors.

Failure to report a foreign bank account.
The IRS is intensely interested in people with offshore accounts, especially those in tax havens. U.S. tax authorities have had some recent success in trying to get foreign banks (such as UBS in Switzerland) to disclose information on U.S. account holders.

Engaging in currency transactions.
The IRS gets many reports of cash transactions in excess of $10,000 involving banks, casinos, car dealers and other businesses, plus suspicious activity reports from banks and disclosures of foreign accounts. Also, beware that banks and other institutions file reports on suspicious activities which appear to avoid the currency transaction rules (such as persons depositing $9,500 cash one day and an additional $9,500 cash two days later).

Math errors.
One of the biggest reasons that people receive a letter from the IRS is because of mathematical mistakes they make on their tax returns

Taking higher-than-average deductions.
If deductions on your return are disproportionately large compared to your income, the IRS audit formulas take this into account when selecting returns for examination.