

BODY SHOP FRAUD– IS YOUR OPERATION AT RISK?

In the current environment dealers are all looking for ways to provide services to customers and diversify their income streams. Many have built body shop departments to provide this income diversification. In an automobile dealership, having a body shop department adds more complexity to an already complex operation. Operating a body shop involves managing the flow of vehicles and parts of manufacturers other than the franchise. However, the volume of activities and various moving parts in the body shop department present a unique challenge for management and certainly opens doors for possible fraudulent activities if proper controls are not implemented.

One scheme discovered by an auto dealer was where a body shop employee was found misappropriating parts and moonlighting. In the scheme, the employee would order extra parts under a legitimate repair order (RO) but were not on the insurance company estimate and then reduced the cost of other items on the RO (i.e. reduce labor costs, provide unauthorized discounts) to approximate the cost of the RO to the insurance estimate. As an example the employee would order a new bumper for the front of the car when the real fix was to the rear of the car. The employee would then alter the labor charges to allow the RO to still be the same as the estimate. The employee went as far as putting Honda parts on a Mercedes vehicle RO. The employee then walked away with the extra parts and conducted side business. The side business was sometimes done at the shop and

other times it was done offsite. The drop in profit margin from reduced RO costs was not significant enough to draw management's attention due to the high sales volume. Furthermore, the insurance company did not perform independent reviews to notice the difference in the breakdown among labor, parts, and material/supplies between the RO and the insurance estimate. They were only focused on the total amount of the RO as compared to the original estimate. In most instances the RO and the estimate would agree to the dollar.

Management needs to also pay attention to what is going on within the department. Additional analytical metrics could have also identified this fraud. Management needs to continue to challenge the key performance indicators for each department and continually monitor them versus benchmarks. When management looks back and reflects on the employee there were indicators that were present which could put this employee at risk. The person was on their cell phone constantly. This would not be normal company business; something else must be going on. The employee was always on the internet. The employee had marital issues and owed child support. When they look back at all these indicators they believe it should have clued them into looking closer at this part of the operation.

What parts of your business do you have an uneasy feeling about?

Below are a few controls to consider strengthening the body shop department:

Segregation of Duties

- Parts purchases and sublet repairs should be reviewed and approved by the parts department or designated personnel outside the body shop department.
- Accounts payable should review authorization for purchase before making the payment and have receiving records to evidence the physical receipt of the good.
- Discounts over certain dollar thresholds should be authorized by the general manager. The general manager should review discount records on a periodic basis.

System Controls

- Limit access to edit/remove parts from RO and to move parts from one RO to another
- Limit access to edit labor rates/part costs.
- Limit access to enter discount over certain dollar threshold.

Physical Observation

- Perform parts inventory observation on a unannounced basis in the parts department.
- Inspect parts orders and inventory for vehicles currently under repair in the body shop department; compare number of vehicles in the shop against active RO.
- Observe any unusual activity such as increase in traffic or people in the body shop department.

Vendor Control

- Establish and maintain an authorized vendor list.
- Understand the vendors' policy on discounts such as volume discounts.
- Review vendor purchases periodically for abnormalities.

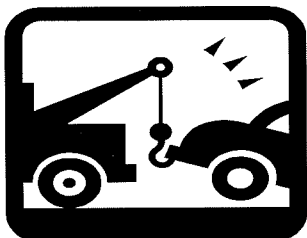
Identify pressure/opportunity/rationalization for employees to commit fraud

- Watch for employees living beyond his/her means.
- Consider external factors such as mounting credit card debt, alimony/child support payments, personal bankruptcy, etc.
- Consider job rotation.
- Observe employees to see if they are constantly on their cell phones conducting personal business and try to understand more about their personal financial situation. Desperate employees will do the wrong thing if given the opportunity.

Other Controls

- Periodic review of ROs and compare them to the insurance quotes. If Honda parts are on a Mercedes RO something could be wrong. Does the part make sense compared to the fix?
- Strong background checks including calling previous employers to get a better understanding of why they left those jobs.
- Margins review monthly to ensure they are in line with expectations. Meeting with department management to ensure they know executive management is monitoring their department. Don't allow departments to be out on their own. All departments need to be accountable.
- Consider having an outside party review the department, instill more fear into people and add a level of deterrence.

If you have questions on the above matter please contact your ATA representative.



**TAX
TIP**

VOW TO HIRE HEROES ACT

The VOW to Hire Heroes Act of 2011 made changes to the Work Opportunity Tax Credit (WOTC). The Act added two new categories to the existing qualified veteran targeted group and made the WOTC available to certain tax-exempt employers who hire qualified veterans as a credit against the employer's share of social security tax. The Act allows employers to claim the WOTC for veterans certified as qualified veterans and who begin work before January 1, 2013.

To be considered a veteran, the individual must, have served on active duty (not including training) in the U.S. Armed Forces for more than 180 days or have been discharged or released from active duty for a service-connected disability, and not have a period of active duty (not including training) of more than 90 days that ended during the 60-day period ending on the hiring date.

In addition to the above the veteran is considered qualified for purposes of the credit if he or she is certified as:

1. A member of a family receiving assistance under a food stamps program for at least a 3-month period during the 12-month period ending on the hiring date.
2. Unemployed for a period or periods totaling at least 4 weeks (whether or not consecutive) but less than 6 months in the 1-year period ending on the hiring date.
3. Unemployed for a period or period totaling at least 6 months (whether or not consecutive) in the 1-year period ending on the hiring date.
4. Entitled to compensation for a service-connected disability and hired not more than 1 year after being discharged or released from active duty in the U.S. Armed Forces.
5. Entitled to compensation for a service-connected disability and unemployed for a period or periods totaling at least 6 months (whether or not consecutive) in the 1-year period ending on the hiring date.

The VOW to Hire Heroes Act of 2011 made the Work Opportunity Tax Credit available to qualified tax-exempt organizations who hire qualified veterans who begin work on or after November 22, 2011, and before January 1, 2013. The credit for qualified tax-exempt organizations is claimed as a credit against the employer's share of social security tax on wages paid to all employees of the organization during the 1-year period beginning with the day the qualified veteran begins employment.

For-profit organizations will claim the tax credit as a general business credit on Form 3800 against their income tax.

Qualified tax-exempt organizations will claim the credit on new Form 5884-C, Work Opportunity Credit for Qualified Tax-Exempt Organizations Hiring Qualified Veterans, as a credit against the employer's share of Social Security tax. The credit will not affect the employer's Social Security tax liability reported on the organization's employment tax return. In addition, a qualified veteran must work at least 120 hours for any credit to apply.

An employer must obtain certification that an individual is a qualified veteran in order to claim the credit. To obtain certification, an employer must Complete Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity Credit, to pre-screen and to make a written request to their State Workforce Agency to certify an individual as a member of a targeted group for purposes of qualifying for the work opportunity credit. This form is not filed with the Internal Revenue Service; it is filed with the appropriate State Workforce Agency.

After the veteran is certified by the appropriate State Workforce Agency, the for-profit employer will use Form 5884 and Form 3800 to claim the credit when filing its business income tax return.

The credit can be as high as \$9,600 per qualified veteran for for-profit employers or up to \$6,240 for qualified tax-exempt organizations, but the amount of the credit will depend on a number of factors, including the length of the veteran's unemployment before hire, the number of hours the veteran works, the hire date of the veteran, and the veteran's first-year wages.

If you have any questions you should consult with your ATA representative.