

## **gvo3 and Associates**

by : Gil Van Over

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Readers probably recognize the name Gil Van Over. Since 2004 he has been a monthly contributor to *Dealer magazine's* F&I section, where he shares news, insight and advice designed to help dealers navigate the often complex world of F&I and dealership compliance. Given the rash of news of late reporting dealer principals, managers and employees caught up in illegal activities, we decided to ask Van Over to help us understand what is going on.

### **Gil, what service does gvo3 provide to new-car dealers?**

We deliver compliance auditing and training in the areas of sales and finance and insurance. We also do a lot of expert witness work.

### **How should we define “dealership compliance” here?**

We more broadly define dealership compliance to be everything that regulates and potentially attacks the sales and F&I processes in dealerships. We also work with a consortium of attorneys, accountants, human resource professionals and OSHA experts as well to cover all areas of compliance that impact car dealerships.

### **What specific compliance regulations must dealers be aware of and heed?**

Where do I start? From a federal level, dealers must comply with the Equal Credit Opportunity Act, Truth in Lending and Leasing, the Fair and Accurate Credit Transactions Act, the Safeguards and Privacy Rules, the Do Not Call Rule, OFAC, the Used Car Rule, and the Monroney Act, to name a few. And the feds are expected to implement the Red Flags Rule by the end of this year. Moreover, in both federal and state courts the areas where dealers are being attacked in sales and F&I fall under Unfair and Deceptive Trade Practices, another way of saying fraud. Each state has its own Unfair and Deceptive Trade Practices statutes.

State regulations and federal Unfair and Deceptive Trade Practices statutes are so vaguely written that it's difficult to define what it is, which give the plaintiff attorneys and the state attorneys general the opportunity to define it however they see fit. That's what puts forth a lot of the issues that you hear in the industry, such as “payment packing.” Payment packing is only against the law, now, in one state, but it started out as an Unfair and Deceptive Trade Practices claim.

### **This lack of specificity puts dealers in a defensive mode.**

It does. The Truth in Lending Act is a disclosure law that was meant to help consumers understand credit definitions, to be able to compare a true rate, called an “annual percentage rate” when shopping for credit. For example, the plaintiff's attorneys have been able to take that statute and have the courts define what “consummation of a contract” is, which isn't defined in TILA. Then from there, they've been able to sue dealers when they backdate contracts because according to TILA they didn't properly disclose the annual percentage rate.

A hot topic today is what is called Adverse Action Notification. It is required of creditors under the Equal Opportunity Act (EOA) and under the Fair Credit Reporting Act (FCRA) when a consumer is declined credit. And neither one of those laws say that dealers have taken an adverse action when third-

party lenders deny credit on applications submitted by dealers, but the plaintiffs' attorneys have been able to convince the judges that dealers are participating creditors and, therefore, have a requirement to do it, even though the consumer has never been damaged by not giving them notice.

### **What grade would you give to dealership compliance?**

A "B" overall. Compliance is improving through awareness, but it's also becoming more and more confusing at the same time. When you ask dealers what compliance means to them you never get the same answer. I firmly believe the vast majority of dealers want to do the right thing. They just have trouble understanding what the right thing is. Because of their integrity, because of their awareness of what's becoming required of them and because more and more of them are recognizing that they have to manage this risk, the compliance quotient in the industry is improving.

### **What compliance themes repeat among your clients?**

We focus on the areas talked about already, but especially those where dealers are most at risk – Unfair and Deceptive Trade Practices, plus safeguarding consumer information and identity theft. There are definite compliance processes that can be put into place and there are also definitive requirements on how you do that.

### **We are seeing more headlines about dealership management embezzlement, thefts and more; how can dealers protect themselves from such bad things happening to them?**

A common process can help a dealer protect him or herself from all types of compliance concerns. We focus on internal controls of the type of issues that seem to be cropping up more and more frequently. I don't know if it's because these events are now getting more exposure by the media or if more people are engaged in these crimes. That said, dealers wanting to prevent this from happening to them should begin by conducting a risk assessment in whichever area of the business they want to focus.

Dealers need to understand where their risks are and then they need to develop policies and processes and procedures for how they will conduct business and then document what those policies and procedures are. Good training of everyone on those policies and procedures is the next step. After that, but certainly integrated with the process – whether you're focused on sales and F&I compliance, accounting compliance or sexual harassment policy compliance – the only way to confirm what you have is through an independent audit of those processes.

The auditor or auditors must be an individual or individuals who have no stake in the game, no turf to protect. They should be free to walk through the dealership and audit every employee to determine how they are conducting business and whether it is being conducted according to the compliance policies and procedures the dealer has put into place.

Dealers too need to be alert to red flags. A CFO who refuses to take time off, works 18-hour days and refuses any help to get his or her job done is such a warning. If you lack internal controls and every duty in the office is not segregated, a dealership like that is going to run into issues, and it doesn't matter whether it's compliance with Truth-in-Lending or a sexual harassment lawsuit or someone taking money.

## **How can such events happen without someone noticing?**

The cases cited involve large chunks of money to be sure, but from those I have read about it seems the money was taken over time. And without any noticeable spikes in expenses for one particular month, for instance, such a red flag may not appear. A red flag did pop up in the case of the Ohio dealership CFO who was allegedly in cahoots with a vendor who allowed him to over bill. The dealer there was astute enough to pick up on that and initiated an investigation.

And often, people simply ignore the red flags. Especially in many dealerships, which are family operated and staffed, where management thinks of staff as family, it's natural to want to be trusting.

Many red flags are just "gut." I can't define it and I don't know anybody that really can, but you know when something's not right. I call it the Clue-O-Meter. Certainly CFOs should be audited; dealers can insist on criminal background checks before anyone is hired. The IT system should be monitored for how it is being used; in some of the recent embezzlement cases, the gambling the alleged perpetrators committed that lead to the embezzlement was online gambling.

Dealers who look only at the financial statement bottom line can miss the flags. For instance, for a dealership making six figures a month as income, if \$5,000 went somewhere that's not well-documented, that may not be noticed readily.

We encourage all dealers to embrace the approach that Mr. Reagan took with the Russians. He said, "You've got to trust that they're going to do things right, but you also have to verify that they are."

## **Is it easy to categorize which dealers will embrace compliance?**

The compliance message at dealerships does start at the top. A dealer who embraces compliance has these thoughts in mind: "I want to sleep better at night. I don't want to have to worry about the lawsuits, I don't want to worry about the regulators coming in, I don't have to worry about getting a message that the state attorney general wants to talk to me." They embrace it and implement a compliance process throughout their dealership.

The fear has been, "OK, if I do things right, I'm not going to make as much money." That fear is subsiding, but it's still out there. These dealers say, "This is the way I've always done things. Yeah, I might not be totally compliant, but you know what? I'm making an awful lot of money and if I fully disclose everything that I sell to customers, I'm not going to make as much money anymore. And I'm just a small guy and nobody's going to bother me." Our experience has shown that profitability normally increases after a dealer embraces a compliance program. At the least, profits do not diminish.

So, these dealers continue to go about it: packing payments, not disclosing to consumers, not worrying about checking OFAC, and not necessarily safeguarding customer information. They are setting themselves up.

Thankfully, it is a small minority of dealers not actively embracing compliance. Most dealers either have other constituents, like shareholders, to be concerned about, or they are larger dealerships having partners in those stores who have a stake in the game.

One way we consultants can help dealers better implement compliance programs is to understand first how the dealer's process works: How cars are sold and financed, number one. Number two, understand that the employee that you're dealing with has an overriding desire to make money. The individual who gets in the way of those two components of working within a dealership is going to have difficulty in implementing a compliance process.

The consultant's mindset has to be, "I'm not going to tell you how to sell cars. I'm not going to tell you how to sell F&I products. My job is to understand how you sell them and if there are regulatory or legal concerns, I've got to make you aware of that, but my job is to help you disclose and document that you did things in an upright fashion."

### **Why isn't compliance more air tight, given the downside risks?**

For many privately owned dealerships and the individual who owns one or two stores, the staff person responsible for compliance may also be responsible for financing inventory as well as getting monthly statements to lenders. They have other obligations and this whole thing called "compliance" can be so overwhelming. Any such compliance initiatives often get no more than halfway done because nobody in the store focuses on it either.

Like the earlier question about grading dealers on compliance, from an overall perspective, the industry has come from a "C+" grade five years ago to "B" today, heading toward a "B+". Does anybody earn an "A+"? You have to balance the risk versus the reward. Quite frankly, I think if you're "A+" in compliance, you're probably not selling any cars.

To be an "A+" in compliance is like putting up a brick wall around the dealership and taking every customer down to the DMV to confirm that they are who they say they are before they can even come through the door. So you certainly can't go overboard with compliance, but an "A-" or a "B+" is where you want to be.

### **What are the top processes dealers should put in place, at a minimum?**

First, determine whether they have anyone on staff that truly understands what the compliance requirements are. The comparison should be to a doctor or accountant. These professionals are educated, trained, their training documented and then they are trained again to establish and maintain their knowledge and credibility. Dealership compliance to regulations and the law is the same thing; there's a requirement upon dealerships from various bodies. There are either best practices on how to avoid being accused of fraud through the Unfair and Deceptive Trade Practices or FTC regulations or other state and federal laws the dealership must comply with.

The steps therefore are: Know what the regulations are; establish internal processes to be sure your practices and procedures comply with these regulations and laws; compile the processes and procedures in a policy manual; have everyone in the dealership learn it; provide the necessary training so you are confident they know these processes and practices; have them sign off on a document that attests to the fact they have read and understand the contents of the policy manual; continue training on a routine basis; have the processes and employees audited for compliance on a regular basis.

## **What is the return on this type of time and cost?**

The answer starts by trying to understand the risks. The risks aren't only the statutory fines or class-action litigation. If you get named in a lawsuit, you're spending an inordinate amount of time answering depositions, answering interrogatories, going to trial, meeting with your attorneys. One of the lawsuits that I'm involved with this year, being called as an expert witness, is a lawsuit filed in 2004, so it's three years old.

So a dealer has to deal with these lawsuits for two or three years. Their employees get called to testify or to be deposed, their ex-employees are being deposed on how the processes worked or didn't work in dealerships, and so that's the risk.

The rewards, and we found this to be true in our clients, is that if you do things right and you give consumers full disclosure of what products are available to them, your profitability ends up going up and that's for a couple of reasons.

Number one, if you offered every product that you have to every customer that's eligible for that product, they end up surprising you by buying and your penetrations go up. Plus, since they made the decision to buy from an informed position, the likelihood of them coming back three days or four days or five weeks later claiming they didn't know they bought it decrease, so charge backs drop as well.

The second reward is that the owners of companies and the people that have a process in place all report that they're able to sleep better at night. This is one less thing for them to worry about when they put their head on their pillow.

## **OK, but such practices don't address risks like fraud and embezzlement?**

No, not directly. Fortunately, these are rare events. Our firm focuses on auditing deal files and deal jackets. Our goal is to assess for the dealer the risks of those jackets. We might say, "If this were the deal that you were being sued on, this is what the opposing side could allege because you didn't document that you did everything up front," or "That you missed a piece of paper" or "That it wasn't properly completed." The other side is holding the dealer up to a standard that says you're the expert in this business. You've got your computers that you can program. Why is it so hard for you to fill out the paperwork correctly? And that's kind of the standard that dealers are being held up to.

From the perspective of the embezzlement and such, dealers can set up processes to help them prevent such crimes as well. For example, a policy that demands employees take a certain amount of time off each year can help prevent situations like a CFO or other managers working around the clock to cover his or her trail.

Have an independent source come in and audit your books on a periodic basis. This is an audited opinion, not simply a review. A review is nothing more than the bookkeeper telling the accountant, "This is what I have," and the accountant says, "OK, here is your cover letter." A review means nothing.

Also, as a dealer I would absolutely under no circumstances allow my business' bank statement to go anywhere but my house.

## **Why?**

While I trust my accountant or my bookkeeper and I trust the people in the office, I'm going to verify. If I own the dealership, my bank statement is the key thing to be able to check on a monthly basis to see what checks are being written and to see how the monies are flowing, to see if the deposits look right. So the bank statement comes to the house so that it does not, absolutely does not, get interfered with before I review it. And then I take it into the bookkeeper and to the office manager and say, "Here's the bank statement." But the dealer should be reviewing the bank statement every month and looking at every single check that was written.

And as mentioned earlier, gambling habits have created problems in some dealerships that have led to crimes. And we need to be a little careful, too, because as an aside, there are dealer principals who like to gamble as well. That is almost becoming an accepted behavior, but not only is gambling something you have to be concerned about, but also drug use and drug abuse.

## **Should dealerships drug test as a matter of policy?**

Absolutely. The drug test should be an upfront part of the employee hiring process. In certain states you might have to have a separate form or disclosure to be able to do this. Also check job applicant's credit. That certainly seems to be, and in some areas, an indicator of character. If you're trying to hire a CFO that's got a 495 bureau score, there might be motivation for that CFO to steal in order to care of something else.

Also as a matter of policy, dealers should check the OFAC list of when hiring. If someone's a suspected drug dealer, terrorist, or money launderer, you don't want him or her working in your dealership. And have a criminal check done. Have the driving record checked. Do as much calling of references that you can to try to understand who it is that you have in front of you looking for a position. The more that you can do upfront, the less problem that you potentially will have down the road.

Above all though, is that all-important voice from the top. The owner who says on a consistent basis "This is what I believe; this is the way that we operate" sets the right state for compliance. Without such top-down commitment, compliance initiatives are not much more than the program du jour. The dealer who sends a memo to the general sales manager stating "Handle this. We will be compliant" is mistaken.

None of this is going to happen for a dealership overnight. Implementing the processes, communicating to employees what is expected of them and then training them to succeed and verifying their commitment to the policies and procedures and then auditing the entire process is an event that takes nine to 12 months to put into place. And then it needs to be kept current, active and top of mind on an ongoing basis among all employees. In our experience, once dealers and their managers learn the right way to do things they generally do it right most of the time.

**Thanks Gil.**