

Organizational Risk — Is it Feast or Famine? (Part 1)

By Wayne A. Fortier, CPA

Dealerships traditionally suffer from insurance claims that result in losses from Sales, Service, Parts, Accounting, F&I, Body Shop - basically from all over the dealership. These losses can be comprised of personal injury claims, losses from stolen or lost inventory/merchandise as well as litigation. Of these, the last one, litigation, is the one that scares folks the most. Part of the reason for litigation concerns stems from court fees, attorney fees, and the fines and penalties that can be levied by the courts can all add up to be substantial. So substantial, these costs could easily exceed the insurance coverage the dealership organization has in place which could force the dealer out of business. The potential losses that can be levied by the courts can be difficult to quantify and define. It may also be difficult for the organization to identify what business practices are failing that could end up putting the organization in a situation where court proceedings are on the horizon in the first place. So what drives if its feast or famine by the courts? Well, that depends on whether the organization has taken some steps to put in proper controls to do the right thing.

What makes litigation cost containment management so scary is that it is an area that may prove difficult to get your arms around. It is also an area that does not normally receive a lot of attention from a dealer. It's after all, not about selling cars or handling a customer complaint. These activities typically consume a lot of a dealer's time. So, what happens is out of sight out of mind. Most dealer organizations are flying blind. The organization has done nothing or at best put minimal effort into looking at and managing these risks. The results from this neglect are however predictable. When the shoe drops so to speak, the horse is out of the barn and the dealer is scrambling into a cost/recovery mode. In other words, how much trouble are we in and what can I do to minimize the damage? We call this type of reaction "crisis management." To manage these risks in a proactive versus a reactive manner first involves looking at the lay of the land and determining where the exposures exist.

Organizations, just like individuals can be found guilty of criminal, as well as civil misconduct. While I am not an attorney and am the first to admit you should consult your legal counsel, I am told the courts do look at Federal Sentencing Guidelines when determining what the fines or punishments should be when considering resolution of court cases. The most common occurring "crime" cases involve fraud, environmental waste discharge, tax offenses and anti-trust to name a few.

The Federal Sentencing Guidelines are designed to further two key concepts:

1. Just Punishment
2. Deterrence

Under the just punishment model, the punishment is associated with the blameworthiness of the offender. The deterrence model looks at rewarding or offering incentives for the organization to detect and prevent crime.

Organizations can find themselves in trouble as a direct result of the actions of their employees who may have acted in an inappropriate manner while in their capacity as an employee of the organization. This is true even if the employee knew better or was trained by the organization to act appropriately. In other words, the act committed was in direct violation or contrary to company policy. This is what drives folks crazy! We attempt to teach, train and communicate to our employees what is expected of them and how they are supposed to conduct themselves. Yet, when they veer off course, the organization still finds themselves in the “hot” seat. This can be frustrating to say the least. But wait, there is relief! When the guidelines were established, the guidelines allow for mitigating the fines that could be assessed by up to 95 percent. To get relief the organization should be able to demonstrate that it had put in place an “effective compliance program.” This potential lowering of fines assumes prompt reporting to authorities and the non-involvement of high level personnel in the actual offense.

So what constitutes an “effective compliance program?” Here are some key areas mentioned in the guidelines. Compliance standards and procedures reasonably capable of reducing the prospect of criminal activity should include:

1. Oversight by high level personnel
2. Due Care in delegating substantial discretionary authority
3. Effective communication to all levels of employees
4. Reasonable steps to achieve compliance, which include systems for monitoring, auditing and reporting suspected wrongdoing without fear of reprisal
5. Consistent enforcement of compliance
6. Reasonable steps to respond to and prevent further similar offenses upon detection of a violation

Embodied in the language of the guidelines are references to an “effective compliance and ethics program.” Ethics and the culture within the organization permeate from the top echelons of the organization. The tone and culture of an organization cannot be over emphasized. The Sarbanes-Oxley Act is legislation that has affected a wide range of companies. While it was intended to place responsibility and accountability upon organizations that were publicly traded, the act has also had and continues to have an impact on smaller private companies. The law currently requires all public companies to have their internal controls validated each year by an auditor to ensure that they are providing reliable financial reports and complying with regulations. As awareness begins to take hold, organizations are creating oversight boards and committees to design, implement and monitor these areas.

Ask yourself a few simple questions. Are you comfortable with how your organization manages and monitors your business practices? Are you comfortable with the risks associated with your current business practices? What would happen to you and your organization if you were to have your day in court? Would you be ready? If you do not like your answers to these questions, consider gathering your management team to start putting your program in place.

Part 2 in this series of articles on organizational risk will define the goals and objectives of an effective compliance program and how you can begin to implement this program at your dealership. The series will be continued in the next edition of Compli's *ComplianceCast: Dealer Edition*.

Dixon Hughes can also assist you through our Compliance Risk Assessment program. If you would like further information on this program, contact kange@dixon-hughes.com or call 877.DLR.CPAS (877.357.2727).

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