

OBLIGATIONS AND DUTIES OF A CONTROLLER

By: John J. Pico, JD

***“Oh, what a tangled web we weave, When first we practice to deceive.”
– Walter Scott***

The Obligations and Duties of a Controller

In the good times, everybody feels good. The store is “humming,” money is flowing and everyone thinks that **they** are the ones making it all happen.

Those are the times when the factories say: “Dealers don’t sell cars, our name brand does.” “Let’s cut out the dealers and we will make a lot more money.”

Dealers, on the other hand, also get lulled into a “false sense of security.” Their IQs fluctuate with their balance sheets and, after a few months of record profits, they feel bulletproof.

Then they start spending money on elaborate facilities and they don’t pay as much attention to cost controls.

All of a sudden, either the franchise, or the economy, or both get cold.

Cash flow shrinks and the dealership is in trouble. It’s like running down the street at 50 miles per hour and stepping on a rake.

Floor-checks and flooring expenses increase, banks want business plans, inventory builds. Then, like a junkie, they need a “quick fix.” The pressure is on.

How should the controller respond?

The short answer is that the controller must refuse—and, if the dealer or owner insists, quit; but before we can begin that discussion we need a solid foundation upon which to build.

A good anything (dealer, controller, lawyer, accountant) is a student of the industry. He or she is grounded and doesn’t get carried away with euphoria when fads and aberrations occur.

CONTROLLERS - DIFFICULT TIMES CREATE DIFFICULT CHOICES

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When I was a young lawyer I found that even the bankers would breathe rare air.

I was doing a deal where the dealer's overdraft at the bank was over \$30,000,000 and at a dinner with the bankers and their lawyers, the dealer and the banker were arguing over who would pay the dinner bill. The guy was \$30,000,000 overdrawn. Who did they think was paying his American Express anyway?

So, before you begin to build a controller's role, you need to progress in a building-block order and create a foundation. You need to define:

- I. Who you are
- II. To whom do you owe your loyalties?
- III. Where are you today?
- IV. How do you survive and prosper?

1. WHAT IS A CONTROLLER?

The book says that a **controller** or **comptroller** is a person who supervises accounting and financial reporting within an organization. In conjunction therewith, the controller oversees the implementation and monitoring of internal controls.

In my experience I have found that a controller is more than that.

The controller is the keel on the ship. The dealer or GM steers the ship and the controller keeps it in trim.

He or she cannot get caught up in fads and inflated markets.

The controller doesn't just amass information.

The controller is the one who should know the health and direction of the organization.

By the direction, I mean that the controller should be aware of the inventory and days' supply. The controller must not only know where the store is, financially and where it has been, but where it is going.

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If you are building a new facility that is projected to have a rent factor of \$1,500 per new unit retail, it is up to the controller to know: “That dog don’t hunt.” The store is going to go broke.”

The controller must then relate that information accurately to the dealer, the general manager and the owner.

Although sometimes they may be the same person, they are often three or more distinct individuals and **the controller cannot forget that.**

“The items controllers monitor” and “How they monitor them” are obvious. Recognizing to whom they owe a duty is sometimes blurred.

CONTROLLERS MUST UNDERSTAND WHERE THEIR LOYALTIES LIE.

It sounds like a simple question, but generally it’s not. The reason it is not simple is because:

- (1) Owners/Investors do not usually take the time to set the foundation for and to emphasize the answer to that question.

Factories are an exception. If one has ever worked for a DD, Motors Holdings, or an MID store, you know that the factory is specific about to whom the controller owes his or her loyalty. Only the factory can hire, fire or give a raise to the controller. The GM has no authority in that regard and must discuss any complaints about the controller with the factory.

Investors (outside the factory) usually ignore the discipline required to define the controller’s responsibilities and authority.

- (2) The daily interaction between the General Manager [GM] and the controller creates a relationship that sometimes taints an open and honest relationship between them and the owner.

This is an important topic – especially in a struggling economy, so let me be clear on the subject.

The dealership is having a bad month and the GM tells the controller to book certain expenses into “prepaid” and to pick them later, in a month when the store is doing better.

So, what do we have and who do we have to tell?

1. We have the makings of a fraudulent financial statement.
 - A. The statement is going to be given to a lender and that statement will portray an **in**accurate net worth, **in**accurate working capital and **in**accurate statement of assets.
 - B. And, the dealership will be asking the lender to lend money, such as flooring or a cap loan, based upon that **in**accurate statement.
 - C. The lenders and the government call that “fraud”, which I will get back to in a moment.
2. We have a problem with the dealer and the owner.
 - A. For all the same reasons we stated about the bank, because if the controller goes along with the program, he/she is knowingly supplying them with an inaccurate financial statement concerning their investment; and
 - B. If he/she goes along with the program, they are denying the dealer and the owner the opportunity to correct problems before they exacerbate to a degree that they cannot be corrected.

I have seen this movie hundreds of times and only the names, franchises and towns are different. The script and the theme are the same.

The assets are overstated and the liabilities are understated.

It begins with “packing” Prepaid Expenses
Progresses to inflating Contracts-in-Transit
Then, Vehicle Receivables are “packed”
Soon thereafter, all payables are not reported
Subsequently, the Accrued Vacations are not accurate
And the tangled web continues.

Then one day the bank finds the dealership out of trust and when they ask what happened, the GM says: “We had a bad weekend.”

It wasn’t a bad weekend. It was bad management – and a bad controller.

In the Enron case they called them co-conspirators.

Beware. I have said this a thousand times:

'A car dealership is like a dinosaur. You put a bullet in its brain and it walks 5 miles before it falls over dead.' - John Pico

There is so much cash flow in a dealership that I have seen dealerships that went for over five years before anyone figured out they were broke.

So where do your duties lie as a controller?

First, "Be true to thyself."

Your first duty is to you and your family, if you have one.

In Tampa Bay the controller got off easy. He pled guilty to the felony of **"conspiracy to commit bank fraud"** and agreed to testify against the dealer.

The charge of "conspiracy to commit bank fraud" carries a maximum penalty of five years in prison, a \$250,000 fine, three years' probation and a special assessment of \$100.

In Texas, two controllers were sentenced to prison and ordered to pay restitution of over a million dollars for a scheme a dealer concocted to keep the dealerships afloat until they sold.

The controllers argued to the 5th Circuit Court of Appeals that they were just following the orders of the dealer and had no specific intent to deceive or cheat the bank and that they thought the dealer, who was a wealthy man, could cover the float.

The dealer even testified on their behalf and accepted personal responsibility for the scheme.

The court held that the controllers knew their activities would have the effect of artificially inflating the bank balances. The court held:

To find a conspiracy violation under 18 U.S.C. §371, [conspiracy to commit bank fraud] a jury need only find an agreement between two or more persons to violate the law and an overt act by one member of the conspiracy in furtherance of the conspiracy. A specific agreement need not be shown, but may be inferred from concert of action.

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Your second duty is to be true to the owners that put up the money. They are the people who trusted you to monitor the finances and to tell them how they were doing.

If you lie to them by fudging the books and not disclosing to them what the GM asked you to do, you are then putting their families at risk because the bank will look to them for any short-fall.

If you lie to them by fudging the books then you deprive them of the opportunity to accurately evaluate their investment and decide whether they want to stay in, or get out and you also deprive them of the opportunity to correct a situation before it gets out of hand.

If you tell them the truth and they also tell you to fudge the books – it's "show and tell" time for your character.

WHAT DO YOU NEED TO DO?

First of all, you need to keep the books correctly. If someone tells you differently, you need to explain to them the ramifications both with respect to losing control of their own "horizon indicator" and with respect to the potential liability.



For those of you who don't fly, a horizon indicator is an instrument used in an aircraft to inform the pilot of the orientation of the aircraft relative to earth.

It indicates pitch (fore and aft tilt), bank (side to side tilt) and yaw (left to right and right to left.) It is displayed like a ball, colored blue on top, dark on the bottom – with a centering line going across it. If the centering line is in the blue, you are climbing. If it is in the dark, you are descending.

You can pray. You can tilt your body like some people do when they go bowling. But, the fact is: if the indicator indicates descent, you will eventually hit the ground unless you correct the plane.

A dealership financial statement is the business' horizon indicator. It tells you if you are climbing, falling, tilting, or about to take a turn.

Put inaccurate information in, and you will get inaccurate information back.

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The company's accountant should be able to tell if prepaid expenses are overstated, if contracts in transit are high, and if you are properly accounting for accrued vacations and other liabilities.

There are also factory accounting websites to help you properly categorize your expenses, pro-rate your rent and calculate your working capital.

What the CPA cannot know is:

Were the aftermarket items added to the vehicles legitimate? I have seen phony RO's and phony aftermarket invoices adding value to vehicles in stock.

Were the add-ons all booked timely? I have seen aftermarket items added to vehicles, but not booked before the vehicle was sold, thus causing the sales department to appear to make a big gross selling the vehicle when in fact the vehicle was sold for a loss.

Were the contracts properly cashed at the bank? I have seen misrepresentations made ranging from misstated income to non-existent sunroofs in order to get a vehicle financed.

It is the controller's job to know those things and to report them to the owners, regardless of loyalty, or sympathy toward any other person, and if the owner tells you to hide them, you should quit.

As Troy Aikman said after a Dallas loss to St. Louis:

**Tough times don't build character,
they emphasize the character (or lack of it) already built into you.**

John Pico is a retired attorney and founder of Advising Automobile Dealers, LLC and has been consulting with automobile dealers for over fifty years. For more articles about the dealerships and dealers, visit our new website at www.advisingdealers.com

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