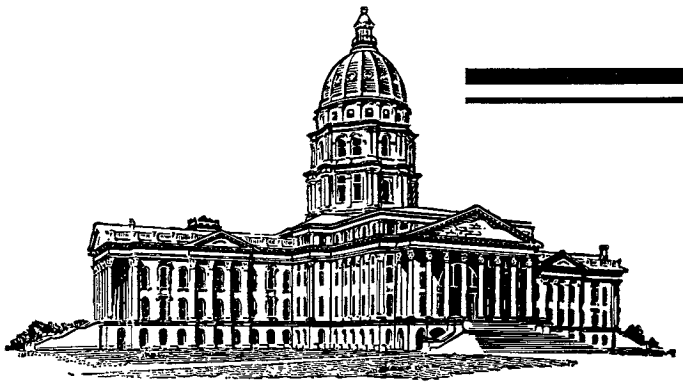

PERFORMANCE AUDIT REPORT

Misuse of Dealer License Plates By Kansas Vehicle Dealers

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
September 1983

83-12

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By Kansas Vehicle Dealers

OBTAINING AUDIT INFORMATION

This audit was conducted by three members of the Division's staff: Leo Hafner, senior auditor, Tom Vittitow, auditor, and Linda Saiger, associate auditor. If you need any additional information about the audit findings, please contact Mr. Hafner at the Division's offices.

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SUMMARY OF LEGISLATIVE POST AUDIT'S FINDINGS

1. **Who is authorized to use dealer license plates when operating a vehicle?** Under State statutes, dealer license plates may be used by licensed manufacturers or vehicle dealers for the purpose of demonstrating, exhibiting or displaying vehicles held in inventory. The persons specifically authorized by law to use dealer plates are:

- --The licensed vehicle dealer
- --The licensed vehicle dealer's spouse
- --Corporate officers of the dealership who are also full-time employees
- --The sales manager and all other sales personnel who are full-time employees
- --Any employee of the dealer when the use is directly connected to a particular business transaction
- --A customer during a vehicle demonstration or when negotiating the purchase of a vehicle

2. **How effective is the Department of Revenue's Dealer Licensing Bureau in ensuring that the use of dealer license plates conforms to the requirements of law?** In reviewing the use of more than 1,500 dealer license plates at 94 dealerships in six counties, the auditors found 69 instances of what appeared to be clear cases of dealer plate abuse. The abuses included dealer plates being used by children of dealers, friends of dealers, a coach at a State university, and wives of various employees at dealerships.

To determine what means are available for curbing such abuse, the auditors reviewed the methods for issuing dealer plates in Kansas and in 15 other states. The auditors concluded that Kansas' guidelines for issuing dealer plates need to be improved and consistently applied to ensure that dealers receive no more plates than necessary to conduct business.

Improvements in the system for inspecting dealers may be another way of helping to curb abuse of dealer plates and other violations of law. The audit found that some dealerships are seldom inspected, and those that are may receive no follow-up visit to determine whether problems have been corrected. However, the benefits of such a system would have to be weighed against its increased costs.

Finally, the auditors concluded that clarification of certain requirements for being a licensed vehicle dealer may make it easier for the Department to carry out its dealer inspection duties. The requirements needing clarification are for lot space, signs, and minimum number of sales.

MISUSE OF DEALER LICENSE PLATES BY KANSAS VEHICLE DEALERS

At its meeting on June 2, 1983, the Legislative Post Audit Committee directed the Legislative Division of Post Audit to conduct a performance audit examining possible abuse of dealer license plates in Kansas. The audit addresses two questions: Who is authorized to use dealer license plates when operating a motor vehicle? How effective is the Department of Revenue's Dealer Licensing Bureau in ensuring that the use of dealer plates conforms to the requirements of law? Each of those questions is addressed below.

Who Is Authorized to Use Dealer License Plates When Operating a Motor Vehicle?

Under State statutes, dealer license plates may be used by manufacturers or vehicle dealers provided these manufacturers or dealers have met certain licensing requirements, and provided that they adhere to certain restrictions on the use of the plates. Once a dealer has been validly licensed by the State, he or she may obtain dealer license plates by paying an annual fee of $10.50 for each plate requested. Those plates enable the dealer to operate a vehicle without going through the regular registration process. Also, the plates may be transferred from one vehicle to another for the purposes of demonstrating, displaying, or exhibiting vehicles held in the inventory of a dealer or manufacturer. The persons authorized to use dealer plates are specified in K.S.A. 8-2406 as follows:

--The licensed vehicle dealer
--The licensed vehicle dealer's spouse
--Corporate officers of the dealership who are also full-time employees
--The sales manager and all other sales personnel who are full-time employees
--Any employee of the dealer when the use is directly connected to a particular business transaction
--A customer during a vehicle demonstration or when negotiating the purchase of a vehicle

How Effective Is the Department of Revenue's Dealer Licensing Bureau in Ensuring that the Use of Dealer License Plates Conforms to the Requirements of Law?

To answer this question, the auditors reviewed the Dealer Licensing Bureau's procedures for licensing automobile dealers and for issuing and controlling dealer license plates. They also reviewed data on the number of vehicle sales, the number of licensed salesmen, and the number of dealer license plates assigned to all new, used, and salvage vehicle dealers in eight counties: Cloud, Cowley, Johnson, Phillips, Sedgwick, Shawnee, Sumner, and Wyandotte. In all, they reviewed records for more than 800 dealers in these counties. This represented about 34 percent of the 2,358 dealers listed in these three categories in the April 1983 edition of the Department's vehicle dealer

directory. The auditors visited 94 of those dealers to verify that the dealers met the criteria to be licensed and to determine how dealer license plates were used. Finally, the auditors surveyed 15 other states to gather comparative information regarding the issuance and use of dealer license plates. In brief, the auditors' review indicated the following:

--The Department of Revenue's guideline for determining the number of dealer plates to issue may need to be improved to ensure that dealers do not receive more plates than necessary.

--Some recent improvements have been made in documenting inspections of vehicle dealerships. However, a regular schedule of comprehensive dealer inspections and follow-up is not in place. Such regular inspections and follow-up could help ensure that problems are uncovered and corrected.

--Certain requirements for being a licensed dealer may need to be clarified in order to provide employees of the Department of Revenue clearer guidelines for the execution of their duties.

The Guideline for Issuing Dealer License Plates May Need to Be Improved

The Dealer Licensing Bureau issues dealer license plates to active vehicle dealers each year as part of renewing their licenses. Prior to renewal, the Bureau reviews each dealer's sales for the preceeding 12-month period and indicates on the renewal form the number of dealer license plates each dealer is qualified to receive. The decision is based on several factors such as inventory size, the number of licensed salesmen employed by the dealer, and the sales history of the dealership. However, the primary criterion for allocating dealer plates is an unwritten guideline allowing one dealer plate for every five vehicles sold in the preceding 12 months. New dealers with no previous sales history are generally allocated up to three license plates until they can demonstrate a need for more.

In order to assess whether this method for allocating dealer license plates is reasonable, the auditors conducted three kinds of examinations. The first was a survey of 15 other states to determine what methods they use to allocate dealer license plates. Second, the auditors reviewed the records of all new, used, and salvage vehicle dealers in eight counties to determine if the guideline used by the Dealer Licensing Bureau was consistently applied. Finally, the auditors visited 94 vehicle dealers in six counties to determine if the Department of Revenue's guideline appeared to provide more dealer plates than necessary to operate a dealership, thereby allowing for abuse.

Other states contacted by the auditors offer few examples of more restrictive formulas for issuing dealer license plates. The auditors found that 11 of 15 states they contacted had no set formula for allocating dealer license plates. However, three of the four states which did have some type of formula appeared to be somewhat more restrictive than Kansas' ratio of one dealer plate for every five sales. Those states and their allocation methods are summarized on the next page.

Colorado	Louisiana	Nebraska
3 plates per dealership + 1 plate per salesperson + 2 plates for service vehicles + 1 plate per 50 vehicle sales	1 plate per salesperson	1 plate per 20 vehicle sales

The fourth state with a formula (Indiana) allows two dealer plates per employee. Whether this approach is more restrictive than the one used in Kansas depends on how many employees a dealer has.

The overall number of dealer plates issued in eight counties reviewed by the auditors exceeds the informal guideline of one plate for every five sales. The auditors' review of the records of all new, used, and salvage vehicle dealers in eight counties showed that on the average, 1983 dealer license plates were issued at the rate of about one plate for every 4.1 sales in the previous year. The table below summarizes this information for all eight counties combined and for each individual county examined. The ratios on an individual county basis ranged from one plate for each 5.4 sales in Cloud County to one plate for each 2.7 sales in Wyandotte county.

County	Countywide Ratio of 1983 Dealer Plates to 1982 Sales
Cloud	1 per 5.4
Cowley	1 per 5.1
Johnson	1 per 3.9
Phillips	1 per 3.6
Sedgwick	1 per 4.5
Shawnee	1 per 5.0
Sumner	1 per 3.9
Wyandotte	1 per 2.7
All Counties Combined	**1 per 4.1**

There does not appear to be a single dominant reason that would explain the variances between counties. The variances probably are the result of many reasons that affect individual dealerships. For example, the Department will generally allow a new dealership up to three dealer plates until its sales will justify more. These new dealerships will obviously have no sales for the preceding year. A county with a large number of new dealerships may therefore have a higher number of plates to sales than a county with fewer new dealerships. Other factors such as the number of salespeople or the number of corporate officers may also cause dealerships to vary from the guideline.

Another factor which may result in a high ratio of plates to sales for dealership is an unusual drop in sales due to a mishap, such as an owner's illness. Such an illness may cause a small dealership to close operations for several

months, resulting in lower sales. In these cases the Department weighs the factors which caused the drop in sales and may decide not to reduce the number of dealer plates issued to the dealer.

According to officials of the Dealer Licensing Bureau, special requests from outside persons on behalf of the dealer can also cause the number of dealer plates to increase. One such example was brought to the auditors' attention. In this case, the dealer sold three cars in each of the last two years and was authorized one dealer plate by the Dealer Licensing Bureau. However, when an outside person requested that additional plates be given, the dealer received a total of five plates in 1983.

Especially in larger dealerships, there are wide differences in the number of dealer plates issued. The auditors also noted that there were wide variations in the number of plates issued to dealers with similar numbers of vehicle sales. This was especially true with larger dealers. The table below illustrates those variances for three categories of dealers in the eight counties examined. These three categories showed some of the widest variances between dealers.

Range of Sales per Year		Licensed Salesmen	Vehicles Sold	Dealer Plates Issued	Ratio of Plates to Sales
1,600-1,800	Dealer #1	31	1,627	60	1 to 27
	Dealer #2	26	1,710	121	1 to 14
	Dealer #3	13	1,715	50	1 to 34
	Dealer #4	14	1,745	45	1 to 39
2,000-2,200	Dealer #1	40	2,086	190	1 to 11
	Dealer #2	29	2,115	60	1 to 35
	Dealer #3	34	2,177	100	1 to 22
	Dealer #4	11	2,180	35	1 to 62
4,000-5,000	Dealer #1	67	4,185	350	1 to 12
	Dealer #2	55	4,562	194	1 to 24
	Dealer #3	73	4,998	168	1 to 30

As shown in the table, dealers who sell only a few vehicles more or less than another dealer can have two to five times as many plates as that dealer. Especially interesting is the fact that in the largest category (4,000-5,000 sales per year), the dealer with the highest number of vehicle sales has less than one-half the number of plates available to the smallest dealer in that category. Also, it can be noted that in each of the categories, the dealer with the highest sales has the lowest number of dealer plates. Although some of the variance can be explained by differences in the number of licensed salesmen, this would not account for some of the larger variances in the number of plates issued.

Visits to dealers showed that some appear to have more dealer plates than necessary to carry on their business, and that apparent abuse does occur. The auditors visited 94 dealers in six counties to determine how their dealer plates were being used. The dealers were selected based on several criteria such as being an existing dealer with no sales in the previous year, having a high ratio

of dealer plates to sales when compared with other dealers, or being one of the largest dealers in a county. The auditors' testwork was limited to discussions with dealers or their employees regarding who was using each dealer plate assigned to the dealership. The auditors did not physically verify that each plate was actually used as described by the dealer. During these visits the auditors noted a number of uses of dealer plates that do not appear to be authorized by statute. In all, the auditors reviewed the use of 1,538 plates at these 94 dealers and found 69 examples of what appeared to be clear cases of abuse. Examples of these apparent abuses included assigning dealer plates to:

--a company car at a company condominium in Colorado
--a coach at a State university
--dealer's children, who are not full-time salespersons
--wives of general managers and sales managers
--a purchasing agent for a major customer of a dealer
--the wife of a factory representative
--the wife of an attorney for a dealership
--a friend of a dealer living in another city

An example of a dealer who has exhibited some clear cases of abuse, and who appears to have a large number of dealer plates allocated for certain purposes appears in the profile at the right. This particular dealer sold 4,185 vehicles in 1982 and received 350 dealer plates in 1983. This compares with two other dealers selling 4,562 and 4,998 vehicles in 1982 and receiving 194 and 168 dealer plates respectively. This raises a question as to why dealers with even larger sales volume are able to operate with significantly fewer dealer plates.

APPARENT ABUSE OF DEALER PLATES: AN EXAMPLE

One dealer was issued 350 dealer plates for 1983. The auditors' visit disclosed that 83 of those plates were issued to the service and body shop departments of the dealer. The auditors were told that a large number of those plates (69 out of 83) were used on "loaner" vehicles which are leased to customers having service work done on their vehicles. The dealer also had numerous "floater plates" (plates which are used as needed but not assigned to any particular employee or for any particular purpose). In addition, the dealer had plates on a car at a condominium in Colorado and on another car at a lake in Arkansas. Plates were also assigned to the dealer's children and wives of various employees. In addition, the dealer had 14 plates which could not be located during the auditors' visit.

Other cases which were suspicious but less clear cut were not counted as abuse by the auditors. For example, one dealer who received five dealer plates for 1983 sold only one car in the previous year and two cars in the first five months of the current year. On the day of the auditors' visit, two of the five plates were said to be out on test drives. The auditors were unable to make return visits to verify that this was true. The types of abuses found by the auditors indicate that the dealers may be obtaining more plates than are necessary to operate their businesses. These excess plates, in turn, increase the likelihood that plates will be misused.

Dealer plate abuse has a financial impact on the State and its counties. The misuse of dealer plates allows persons to forego registering vehicles and

paying the applicable personal property taxes and registration fees. The registration fee the State collects on automobiles in 1983 ranges from $13.50 to $26.50. A county's loss in taxes from a non-registered new vehicle can be hundreds of dollars, depending on the type of vehicle. In Shawnee County, for instance, the appraiser's office indicated that the property tax on a new luxury vehicle such as a Mercedes Benz can run as high as $900, whereas the tax on a new economy model may be closer to $200. A dealer, on the other hand, only pays tax in the form of a tax stamp which is affixed to the manufacturer's statement of origin or the title when the vehicle is sold. These stamps cost from $1 to $33 depending on the weight of the vehicle. As a result, the benefit to a person misusing dealer plates can be substantial. However, there are other impacts as well. For example, one dealer visited by the auditors provided a dealer plate to the purchasing agent for a major fleet account. Such misuse allows the dealer an unfair competitive advantage over dealers who comply with the law.

Revising the method for determining the number of dealer tags may be one step to correct abuses. The fact that these abuses are able to occur indicates that dealer license plates need to be more carefully controlled. The wide variances in the number of dealer plates issued to dealerships with similar sales volume suggests that one way to control licenses more carefully is to develop a more uniform and equitable way to determine how many plates a dealer shall receive. If the Legislature thinks this matter should be addressed, it could consider directing the Department to develop more stringent guidelines. Such guidelines could be incorporated into administrative regulations in order to provide the Department with a stronger position when working with the dealers.

Dealer License Plate Abuse Might Also Be Better Controlled Through Improved Inspections

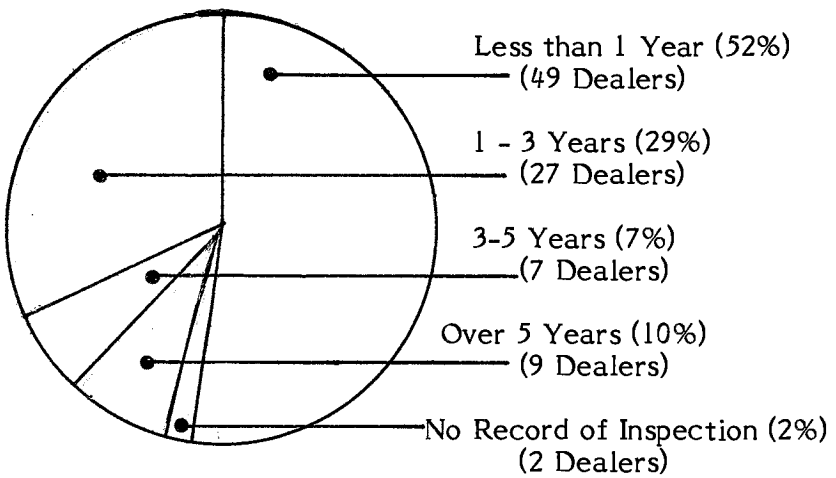
In addition to controlling the number of dealer plates issued, another method available to the Department for limiting abuse is to verify that dealer plates are properly used. The Department of Revenue's Field Services Bureau performs this function as part of its inspections of vehicle dealers. Verifying that dealer plates are properly used, however is just one of many functions served by the Department's dealer inspections. Inspections are also designed to verify that the dealer has complied with a number of other statutory licensing requirements.

Because the auditors wished to determine how well inspections limited dealer plate abuse, and because the auditors noted a number of significant dealer license plate abuses during their visits to 94 dealers, they reviewed inspection reports to determine how recently those dealers had been inspected and how thorough the inspection had been in checking on dealer plates. Two problems were noted during this review. First, the inspection reports reviewed by the auditors did not always indicate if a check on the use of dealer plates had been included as part of the inspection. Second, it appeared that some dealerships had not been recently inspected, or had not been reinspected to ensure that violations noted in earlier inspections had been corrected. The first problem noted by the auditors has recently been addressed by the Dealer Licensing Bureau. The need for regularly scheduled inspections and follow-up, however, still may warrant some consideration. These items are discussed on the next page.

Inspection reports have been improved. The auditors' review of inspection reports for the 94 dealerships showed that in most cases, the narrative description on the inspection form was insufficient to determine if dealer plates had been reviewed. There was no indication on the form as to what items were inspected. This problem was previously noted in 1982, when Legislative Post Audit conducted a sunset review of a number of aspects of the Dealer Licensing program. That review indicated a need for formal inspection procedures and instructions as well as a revised inspection form to ensure that dealer inspections were conducted on a uniform basis. In response to the earlier audit, the Department of Revenue revised the inspection form to provide the reason for each inspection as well as a checklist of the items that were inspected. This checklist included an accountability of dealer plates. In addition, the inspection report still contains a narrative section for comments by the investigator. This new form was adopted in March of 1983 and should substantially improve the documentation of the vehicle dealer inspection process. Because this form is so new, only one or two of them were included within the files of the 94 dealers examined by the auditors. However, on the new forms the auditors did encounter, they noted that even though a space is provided to indicate that dealer plates had been checked, the investigator had not indicated that such a review took place. It appears that if abuse is to be controlled, such a review should be a required part of every dealer inspection.

Some dealers had not been recently inspected. The auditors' review of inspection reports for the 94 dealers visited during this audit revealed that about 12 percent of those dealers had not been inspected in the last five years. Two of those dealers had no record in their file of ever being inspected. At the same time, several of the dealers examined by the auditors were visited by inspectors more than once in a given year. The data on the most recent inspection for the dealers reviewed by Legislative Post Audit appears below.

Time Elapsed Since
Most Recent Inspection of Dealership



The auditors discussed inspection schedules with Department of Revenue officials to determine if there was a regular schedule to ensure that all dealers

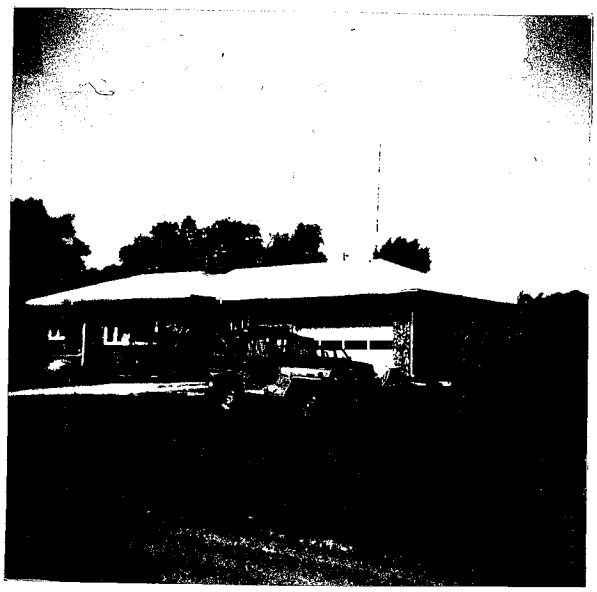
are periodically inspected. The Department indicated that currently no such schedule exists. Dealers are inspected at the request of the Dealer Licensing Bureau, as a result of a direct complaint to a field agent, or on the field agent's own initiative. According to the Department, a regular schedule of inspections is not feasible because manpower is limited and because the cost of traveling to all dealerships would be prohibitive. While it may not be cost-effective to regularly inspect all dealerships, inspections are one of the primary ways of verifying that dealer plates are properly used. Therefore, it is important to inspect as many dealerships as possible. Even more important are follow-up inspections of dealerships who have exhibited violations in the past, to ensure that those violations do not recur. The Legislature would need to consider both the cost and the abuses in determining if an expanded system of inspections and follow-up is an appropriate step.

Some dealers did not appear to be reinspected to ensure that violations were corrected. The auditors noted that three of the dealers they visited had been previously inspected by the Department and were found to have rather serious violations relating to dealer plates or to licensing requirements. Although the Dealer Licensing Bureau took administrative action in each of these cases, including such steps as hearings and fines, the auditors found no evidence in the dealers' files of sufficient follow-up inspections to verify that the problems were corrected and did not recur.

For example, a field agent's inspection report showed that a large dealership was misusing dealer license plates by providing them to coaches at a State university in 1978. However, during Legislative Post Audit's visit in 1983, the dealer again has a dealer license plate assigned to a university coach as well as several other individuals not authorized to use them.

Another dealership was found to have numerous dealer plate violations during an inspection in 1981. However, during Legislative Post Audit's recent visit to this dealer, many of the same abuses were still found at the dealership.

Finally, a field inspection report filed in 1977 indicated that the vehicle dealer in the photograph on the left was making sales from a residence--a violation of law. However, Legislative Post Audit's recent visit to the same dealer, some six years later, shows that sales are still being made from the residence. Although this is not a direct misuse of dealer plates, it appears to be an indirect abuse because the dealer is not fulfilling a statutory requirement that he have a permanent place of business (not a residence). As a result, it appears that this dealer should not be licensed and should not be eligible to receive dealer plates. The situation with this dealer, as well as others noted by the auditors during visits to licensed dealerships,



raised some question as to whether some of the dealers included in their sample should actually be licensed as dealers by the State. This issue is discussed in the following section.

Enforcement Efforts Could Be Helped if Licensing Requirements Were Clarified

One problem encountered by Legislative Post Audit during its review of vehicle dealers for use of dealer license plates was determining whether some dealers qualify to be licensed and to receive dealer license plates. This problem meant that the auditors had to examine some of the other aspects of dealer regulations besides use of dealer plates. The auditors found that some provisions for licensing are vague and perhaps need to be clarified.

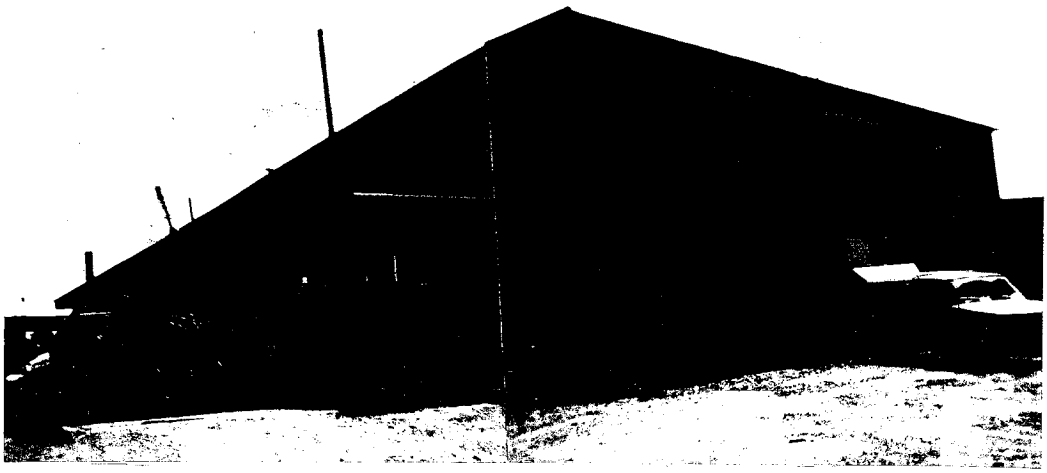
The statutes place certain requirements on vehicle dealers before they can qualify for a license and obtain dealer plates. Some of the major requirements include:

--having a permanent place of business which cannot be a residence
--having a sign easily visible from the street identifying the established place of business
--conspicuously displaying the dealer license in the established place of business
--owning or leasing sufficient lot space to display a number of cars at least equal to the number of dealer plates issued to the dealership
--complying with local zoning requirements
--maintaining adequate and continuous liability insurance coverage
--filing monthly sales reports with the Dealer Licensing Bureau.

The auditors reviewed compliance with the last three requirements listed by reviewing the files of 810 dealers in eight sample counties. This review showed that the Dealer Licensing Bureau was doing a good job of ensuring that dealers file monthly reports and document compliance with zoning and insurance requirements.

The auditors also checked for compliance with the other major requirements such as an adequate sign and adequate lot space during site visits to 94 selected dealers. Compliance with some of these requirements, such as whether or not a dealer has displayed his license, are relatively easy to determine. During their visits to dealerships, the auditors noted 16 instances in which dealers failed to meet statutory requirements for a sign, and 23 instances in which dealers violated requirements to display their licenses. Other requirements, such as whether lot space is suitable, are less well defined and leave much to the judgment of the inspector.

For instance, several dealerships visited by the auditors were housed at the same location as a body shop or a salvage yard. Such an example is shown in the photograph on the following page. For these types of business combinations, the law provides that a place of business otherwise meeting the requirements for licensing may be used by a dealer to conduct more than one business, provided that suitable space and facilities exist to conduct the business of a vehicle dealer. It is the term "suitable space and facilities" which provided the auditors with the most difficulty.



In most of these cases, the lot space consists of the parking area around the salvage or body shop operation. Technically, this fulfills the requirement of suitable space. However, the auditors question whether this fulfills the intent of the law, especially in light of the fact that many of these types of dealers sold no vehicles in 1982, and have no indication on their sign that vehicles are sold at the location. Currently, it appears that the owner of any of these types of operations could obtain a dealer's license and dealer plates for use on personal vehicles with no intent of ever selling them. Therefore, it would appear to be helpful if the Department of Revenue would implement some specific lot space, sign, and minimum sales requirements for being a licensed vehicle dealer.

The Department of Revenue currently has only one regulation addressing vehicle dealer licensing. That regulation requires persons selling five or more motor vehicles in one year to obtain a vehicle dealer's license. Other previously existing regulations governing vehicle dealers were revoked in May of 1982 and have not yet been replaced. In a January 10, 1983 memo from the Kansas Dealer Licensing Board to the Secretary of Revenue, the Board endorsed regulations requiring dealers to have a sign with printed letters at least six inches high which identify the business as a vehicle dealer. Likewise, the proposed regulations call for requiring all dealers licensed in the state, with the exception of new dealers, to sell a minimum of five vehicles during a calendar year to qualify for dealer license plates.

When questioned about the status of the proposed regulations, Department officials told the auditors that the regulations were currently in the Department's Legal Services Bureau and have received no action due to staff turnover. The auditors were told that the regulations may be ready to be forwarded to the Attorney General for review by the fall of 1983.

These new regulations, when adopted, will address several of the auditors' major concerns regarding qualifications for being a licensed vehicle dealer. The auditors' concern regarding what constitutes sufficient lot space should, however, still be addressed by the Dealer Review Board and the Department of Revenue. Such improved guidelines will provide a better tool for investigators to use in executing their official duties.