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NADA MANAGEMENT SERIES

SP14

A DEALER GUIDE TO

# Preparing For A Warranty Audit



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The National Automobile Dealers Association (NADA) has prepared this management guide to assist its dealer members in being as efficient as possible in the operation of their dealerships. The presentation of this information is not intended to encourage concerted action among competitors or any other action on the part of dealers that would in any manner fix or stabilize the price or any element of the price of any good or service.

# Preparing For A Warranty Audit

It's increasingly important that dealers evaluate their warranty-claim administration and record keeping procedures. They should do so first to bring them into conformance with manufacturers' policies and second to ensure that they are requesting reimbursement on authorized repairs in a timely manner. With the proliferation of extended warranty programs, manufacturers and distributors will be taking even closer looks at warranty claims to ensure that the work was done correctly and properly charged. Although the prospect of a warranty audit is not a pleasant one, it can be less stressful and less expensive than you might previously have thought possible. Getting your warranty records and repair procedures in shape now may help you avoid an audit altogether or at least prepare your dealership for the auditors when they visit.

This bulletin will address the topic of warranty audits from three perspectives—(1) preparing yourself against the prospect of an audit, and (2) conducting yourself during an audit and (3) recognizing your rights after it is completed.

As a basic approach to either the likelihood or the reality of an audit, you should conduct your own in-house version of an audit. Make sure that your dealership has accurate record keeping practices, that warranty work is done in accordance with the factory policy and procedures manual, that claims are filed as soon as possible (daily in many cases), and that all personnel recognize the potential costs of careless performance. Most dealers think they won't be targets of warranty audits or, if they are audited, the results will not be costly since they don't deliberately *cheat* the factory. Dealers who think this way, however, may be surprised when the final audit report is issued. It's not sufficient just to think or assume that your operation meets factory requirements. You must be certain that your records do substantiate the warranty claims you have submitted.

To help guide your thinking and preparation for a warranty audit, answer the following questions and then read through the rest of the material. Keep in mind how your dealership compares with the recommended procedures outlined in this bulletin.

	<u>Yes</u>	<u>No</u>
Do your employees make frequent reference to the warranty policy and procedures manual?	<input type="checkbox"/>	<input type="checkbox"/>
Does one individual have overall responsibility for warranty claims administration?	<input type="checkbox"/>	<input type="checkbox"/>
As the dealer, do you periodically review warranty repair orders?	<input type="checkbox"/>	<input type="checkbox"/>
Are your warranty repair orders always cross-referenced to the complaint and to the work performed?	<input type="checkbox"/>	<input type="checkbox"/>
Are customer complaints and technician corrections specifically explained on the repair order?	<input type="checkbox"/>	<input type="checkbox"/>
Are operation and failure codes listed and referenced to the complaint and to the work performed?	<input type="checkbox"/>	<input type="checkbox"/>
Is additional labor time explained and authorized by service management?	<input type="checkbox"/>	<input type="checkbox"/>
Are all replaced parts tagged and stored in one location?	<input type="checkbox"/>	<input type="checkbox"/>
Do your parts-purchase and disbursement records correspond to your warranty claims?	<input type="checkbox"/>	<input type="checkbox"/>
Are you doing all you can to substantiate your warranty claims?	<input type="checkbox"/>	<input type="checkbox"/>
In view of your answers to the previous questions, is your dealership prepared right now for a warranty audit?	<input type="checkbox"/>	<input type="checkbox"/>

## Are you a likely candidate for a warranty audit?

In some respects, a warranty audit is like an IRS audit. The main reason for such a review of financial recordkeeping is to determine why a dealership's performance deviates consistently from that of the average dealership. Deviations may occur in one specific area, such as a high incidence of a certain type of repair, or they may be a general feature of a dealership's warranty claim history.

Although you may have excellent reasons for why your dealership does something that does not comply with the factory's policy on warranty claims—for example, a specific policy may not be efficient on a day-to-day basis—remember that most auditors are not concerned with daily expediencies. Their focus will be limited to the written agreement between the manufacturer and the dealership and how well the dealership lives up to its provisions.

In general, your dealership may be audited if your warranty expense is consistently above the regional average, if your dealership is about to be sold or closed, or if your warranty-claim procedures vary significantly from manufacturer's procedures.

Your approach to an audit should vary with your situation. If you're not currently the focus of an audit, take a critical view of your procedures and recordkeeping to ensure that you can properly substantiate all warranty repairs for which you have been compensated. You cannot impress your staff with the importance of *following the rules* on a daily basis if you are not convinced the importance of doing so yourself. If you are currently undergoing a warranty audit or are in the post-audit negotiation phase, you should be concerned with providing evidence showing that the repairs for which you have received credit were actually *warranty covered* repairs and that your repair procedure in a given situation was the correct one.

## Anatomy of an audit

A warranty audit usually has three main components: (1) a systems compliance review, which includes a technician control/compliance evaluation and which has as its focus the records that substantiate warranty claims, (2) a parts-scraping inspection, and (3) a vehicle inspection, which is usually done only when warranty fraud is suspected. An auditor may perform all or only some of these steps in a particular dealership.

Although individual auditors, even if they work for the same manufacturer, use a variety of methods, they usually look for the same thing—proof that the warranty repairs for which the factory reimbursed a dealer were made properly and that the charges were reasonable and inline with factory policy.

## Step 1—Systems compliance review

Each manufacturer has established a period for which you must maintain records to support your warranty claims credits. Refer to specific policy manuals for the exact duration for which you must maintain records. Pay attention to the *starting day*. Some records are to be kept for a certain number of years from the *repair order date*, whereas others are kept from the *payment date*.

Exemplary record keeping is the key to a successful audit. The key characteristics of a sound record keeping system are accuracy, consistency, verifiability, and accessibility. All records should be cross-referenced so that the history of a given warranty repair can be traced. Among those documents auditors will scrutinize are the following:

1. All copies of repair orders for warranty work and work paid for by the customer and internally charged repairs
2. Technician time and payroll records
3. Credit memos, claim registers, or other payment information
4. Previous warranty and transportation claims
5. Parts purchase and disbursement records
6. Invoices for towing, sublet repairs, and other services provided by outside suppliers
7. Records for other materials charged to warranty repairs, and other services provided by outside suppliers
8. Copies of all factory- and/or dealership-issued claims authorizations

The repair order is the most important document; from it all other records can be located and the history of a warranty repair can be traced. All supporting documents should be cross-referenced to the repair-order number. For a repair order to be complete, its heading should be filled out completely. It should contain the vehicle identification number; the car's delivery date and mileage; the customer's name, address, phone number, and signature; and

the date on which the car was brought in for service. The customer's *complaint* should be explained in detail—diagnostic information (e.g., “car stalls when cold”) should be listed and space left so that any additional work needed can be noted and authorized by service management.

In addition to the complaint, its cause, once identified by technicians, should be specified, along with the *correction*, or steps taken to fix it. Since these three important statements—complaint, cause and correction—are used to determine labor charges, auditors will check all repair explanations to see if the charges were fair and properly assigned to the factory. Additional labor time must also be explained and authorized by service management on the repair order. Operation numbers and failure orders given in the factory manual should be assigned by the service manager and referenced to the complaint and correction comments.

Technicians' time records should be consistent with a given technician's abilities and attendance records. Auditors will check to see if the technician listed on the repair order was actually able to perform the work on the given day. They will also determine whether dealer policy work and shop comebacks were improperly added to warranty claims.

The flat-rate system for technician compensation requires that dealership managers maintain control of labor charges. A good rule for ensuring that technicians report their time accurately is to state that for each customer complaint listed on the repair order, a technician may perform one *fix*. Any additional work needed to correct the complaint (either additional straight time or additional operations) should be approved by the service manager on the hard copy of the repair order. Most potential chargebacks will be eliminated if you do this.

Invoices for sublet repairs will be scrutinized to make sure charges were proper and if the dealership diagnosed the problem and maintained control over the repair. Accounts payable and vendors' monthly statements will be checked to determine if any discount was given to the dealer that was not passed on to the factory. Towing bills will be examined to make sure that charges and distances are accurate and consistent with other documentation.

In going over a dealership's records, an auditor will investigate unusual patterns in the way re-

pairs are listed or excessive occurrences of the same type of repair (e.g., electrical shorts or water leaks). The possibility of *pyramiding*, or repeated charging of a large but fixed number of suboperations to a major repair job, may also be a target of auditors.

Other features of repair orders may be examined, including reasons for voiding an order, unusual or obscure notations, unreasonable material charges, or shop comebacks.

Many audit chargebacks can be traced to a lack of proper management of technicians and how they are paid on a particular repair order. If auditors find evidence that the technician has “too much say” about how the warranty time is allocated on the repair order, a chargeback will usually be the result. Most policy manuals require that any work added to the repair order must have the approval of the service management. The same is true for *straight time* or *actual time* repairs.

An auditor may also question claims when it's clear that the work was not controlled by service management; often these debits will be described as *ineffective* or *unnecessary* repairs.

To summarize—on the basis of the facts stated on the repair order and on the supporting documents that substantiate those facts, auditors will decide if the work performed should have been paid for by the factory. Owner maintenance, shop comebacks, predelivery items, and soon, are categories of nonwarranty repairs that will result in chargebacks to the dealership.

### ***Step 2—Parts scrapping review***

When scrapped parts are inspected during a warranty audit, the auditor is trying to determine if the dealership should have been reimbursed for the replacement of the part and the corresponding labor charge. If a dealership cannot supply the replaced parts for inspection by the auditor, a chargeback for the parts and labor may result. Review your manufacturer's parts-scrapping policy to make sure that you are in compliance.

All parts necessary to support your warranty claims should be collected from technicians and kept available for the required number of days specified by the manufacturer. A part may be tested by an auditor to make sure it was indeed defective

rather than damaged. Parts noted on repair orders as being re-placed should be tagged and stored in one location in the dealership. Each tag should contain at least the following information:

- a) date of the replacement
- b) repair order number
- c) vehicle identification number
- d) operation codes
- e) failure codes
- f) model and year of vehicle

Service histories may be traced during the parts review to classify responsibility in cases of repeated parts failure or shop comebacks. Materials charges will be reviewed to determine if certain items are routinely charged to warranty (e.g., two gallons of antifreeze added each time a cooling system is repaired).

### **Step 3—Vehicle inspection**

A vehicle inspection is usually not undertaken unless serious discrepancies and problems have been found in the system-compliance, technician-control, or parts-scraping sections of the audit. In extreme cases, owners may be directly contacted by the auditor to determine if the work charged to the factory was actually performed. A vehicle inspection may also be done if a dealership has a high experience rating on specific types of repairs and if the parts scrapping review was inconclusive.

During the inspection, the repairs made to the car will be checked against the work stated on the repair order. In some cases, the repair order will be examined **BEFORE** the work has been done on the car to determine if the repairs are indeed necessary and to make sure that the repair order properly assigns the expense to warranty. Dealer history files may also be examined on any vehicle in the shop to substantiate previous claims. Only one or two cars are usually inspected; demos and rental cars may be inspected instead of contacting customers directly.

### **What to do while an audit is in process**

The important thing to do during a warranty audit is to be cooperative. More harm can be done by an uncooperative attitude than was ever intended when your dealership was chosen for an audit.

Establish guidelines for access to dealership records and employees during the initial meeting with the auditor or auditing team. If necessary, a person can be designated for auditors to call on when records or additional information are required. Appointing such a person will allow you to control the flow of information and access to the auditor. Make sure that you or one of your managers is present when auditors interview employees.

Don't anticipate the results of the audit. Save your rebuttals for the final discussion of the report with factory personnel.

### **The Final Report**

You will receive a complete report from the audit team within a month after the audit was completed. The report is essentially a list of discrepancies the auditors found between how your dealership performed a warranty repair and documented it and how the manufacturer's policy dictated that such a repair should be performed. These discrepancies are expressed in the form of chargebacks, that is, what you have to repay to the factory. Do not agree to any chargeback until you have reviewed the audit report in detail with your managers and key personnel. Such a review should be done for two important reasons:

1. If you have done something wrong, the findings in the report offer you an opportunity to bring about constructive change in your operations. You can work with managers to take steps to avoid similar situations in the future.
2. If the auditor appears to have been over zealous in assessing chargebacks, such a review will often uncover these areas. If you find chargebacks that you are able to counter with additional documentation or explanations, you should detail your case for why you should have been paid for the claim. Although you may be admitting a certain degree of non-compliance, you are also showing why that non-compliance did not result in an overcharge to the factory. Thus, if no overcharge occurred, no chargeback should be made. In all meetings with manufacturers' representatives, be sure to outline what steps you have taken to ensure compliance with their policies and procedures in the future.

### **Learning from a Warranty Audit**

Several lessons can be drawn from a warranty audit aside from how much noncompliance with factory policies costs you. First, you'll discover how well the auditors judged your dealership to be in compliance with those policies. Next, you'll learn the extent to which manufacturers enforce their policies and requirements and what areas they deem to be of the greatest importance in warranty work. Then, you'll be able to identify those areas where you need to exercise tighter control over personnel and record keeping practices. Finally, you'll be able to put the findings of the audit to work for you

by incorporating them into training programs and revised daily operating procedures.

If you have not yet been audited and there is an increasing likelihood that you will be, it's to your advantage to conduct your own audit now. Focus on your record management practices, including the critical cross-referencing of all pertinent documents; increase your control of how technicians allocate labor charges; evaluate the documentation and accessibility of replaced parts; and use the findings from these evaluations to restructure and modify your warranty-claim management.

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