

HEADLIGHTS

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CONVERTING CONTROLS TO TOOLS

Managing the books, operations and employees can be burdensome. To help keep up with your responsibilities, here are some suggestions to turn already established internal controls into management tools.

Reconciliations

The control: Reconciliations of cash, floor plans, finance reserves, accounts receivable, accounts payable and other high-risk accounts should be performed monthly. Once complete, any outstanding items should be dated and described on the reconciliation. The accounting staff should perform research on reconciling items in order to understand the nature of any errors and ensure timely clearance, or to warn management of an impending charge-off.

The tool: Hold monthly meetings with the accounting staff to understand the nature and age of outstanding items on reconciliations. Through discussions, assess whether internal problems, vendor errors or other issues caused these errors. For recurring internal errors, report outstanding items to the appropriate department manager to ensure

prompt resolution. To prevent future reconciliation problems, team up with managers to develop corrective action plans.

During these meetings, understand the expected charge-off amount for the month and assess the their causes. For example, determine whether losses relate to policy violations such as employee check cashing (returned not sufficient funds [NSF] checks) or delinquent hold notes. Develop a method of reporting such incidents to department managers so that losses are minimized.



**Gerry Green,
CPA
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Segregation of Duties

The control: Throughout the accounting department, duties should be adequately segregated to prevent one individual from having two or more of the following responsibilities: authorization, custody

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and recording. For example, the same individual responsible for bank reconciliations should not process cash receipts and bank deposits.

The tool: Based on your existing segregation of duties, develop an organization chart that allows for quick assessment of how responsibilities are allocated among the staff. On a periodic basis, ask employees to indicate the time spent on assigned accounts, schedules or other duties. Evaluate with the accounting department whether (1) responsibilities are equitably distributed, (2) currently as-

signed employees possess the appropriate skills and (3) duties are divided or combined in the most efficient or effective manner.

Some other controls that may help you to stay up on operations include mandatory reviews of general journal entries (perhaps, over a specific dollar amount), evaluation of accrual calculations and methodology as well as reviewing vehicle inventory counts. As you know, it also doesn't hurt to keep an eye on controls, just to make sure they are operating as designed. *☞*

SELLING THE FAMILY BUSINESS Barton Haag, CPA Albin, Randall & Bennett, CPAs

Many dealers were introduced to the automobile dealership industry because one of their parents owned a dealership that had been in the family for generations. This is an incredible opportunity for those children interested in continuing the family legacy. But what do you do if your children are not interested in continuing your business? Do you sell the family business to your local competition or a publicly traded company? Many dealers do not find these options appealing. Another alternative is selling the dealership through an Employee Stock Ownership Plan (ESOP).

An ESOP is a qualified defined contribution plan similar to a 401(k) or profit-sharing plan. However, a big difference between ESOPs and other contribution plans is that ESOPs invest primarily in the stock of the sponsoring company—your dealership. This makes an ESOP an excellent tool for selling a profitable dealership when the next generation is not interested in inheriting the family business and the dealership has long-term employees and a core management team that are interested in and capable of running the dealership.

ESOPs pack some potentially significant income tax savings for the dealership. The dealership is able to deduct employer contributions made to the ESOP, just like in a profit-sharing plan. The deduction limits for ESOPs, however, are higher (25%) than other traditional defined contribution plans (15%). In addition to the employer's contributions, the dealer can

generally deduct interest and principal payments on loans the ESOP uses to buy company stock.

The opportunities for dealership owners to implement an ESOP are equally exciting. They not only get to sell the company (organized as a C corporation) at a premium value, but they also get to defer the gain on the transaction. Usually, the deferral period is stretched up to 50 years through the purchase of long-term corporate bonds. Dealers can then access the cash from the deal through margin loans against these bonds. Often, the margin interest and interest income earned on the bonds offset each other, allowing dealers to use the funds as they wish. With a little up-front planning, a dealer can pass significant assets to his or her children and grandchildren free of income taxes and estate taxes.

ESOPs and the income tax and estate-planning techniques that go along with them are extremely technical. Therefore, you should work very closely with your **AutoCPAGroup** representative and a qualified attorney before, during and after implementation of one of these plans. ESOPs are an excellent tool for families struggling with the question of whom to pass the family business to when the children are not interested. The dealer is able to reward long-term employees and a core management team, get the cash out of the business without paying capital gains taxes and potentially transfer significant amounts of wealth free of any taxes. *☞*




FACTORY RELATIONS

At times, the factory requests (demands) site control of the dealership's real estate and the dealer gives it up because he or she doesn't know any better. There is rarely justification to give the factory site control of dealership real estate.

In most states, the factory cannot prevail on demanding site control. If, however, the factory is paying for site control, the dealer needs to decide whether or not the amount of money is worth giving up control. If the factory is offering, for example, \$50,000 for 25 years of site control, this amounts to little more than \$2,000 per year.

Another thing to remember is that when you sell the dealership, the factory might request or require the new buyer to agree with the continuance of site control. This will hurt negotiations. Carefully review

the terms whenever considering giving up site control to the factory.

The same is true regarding a "right of first refusal" to someone on the sale of your dealership. If the buyer knows that you have given a right of first refusal to someone else, it will slow down the buying process and very likely reduce the price you can obtain for your dealership. Willing buyers could very likely think that all they might be doing is setting the purchase price for the person with the right of first refusal to buy the dealership. 

IRS OPENS DOOR FOR PARTS LIFO

Craig D. Nelson, CPA, ABV
Virchow, Krause & Co.

In March, the IRS issued Revenue Procedure (Rev. Proc.) 2002-17, which allows dealerships in the business of selling cars and light-duty, medium and heavy-duty trucks to use replacement cost in the calculation of parts LIFO. This ended years of speculation following a court ruling that left the viability of using parts LIFO in the industry up in the air.

Background: In 1999, the IRS scored a victory in *Mountain State Ford v. Commissioner* (112 T.C. 58-1999). The court ruled that replacement cost did not accurately reflect income in determining the value of the cost of the parts inventory. The taxpayer was kicked off LIFO and the entire reserve was added into income as a result.

Since essentially all dealership computer systems calculate the cost of

parts inventory using replacement cost from parts price tapes, any dealer using LIFO to value parts inventory was in jeopardy of having its LIFO election terminated.

The National Automobile Dealers Association (NADA) was quick to discuss this case with the IRS in an attempt to preserve the LIFO reserves of the dealerships using this method. The resulting settlement was a self-audit procedure that each dealership needed to do.

Current: Now, the IRS has acquiesced on the issue entirely and has issued a revenue procedure that allows the use of replacement cost to value the parts inventory.

If you are on parts LIFO already, you should review your original parts LIFO election and consider whether you need to file IRS Form 3115, Change in Accounting Method. On this form, you would indicate that you are now going to use replacement cost to determine the cost of your parts inventory. Taxpayers must compute LIFO under the procedures outlined in their elections filed with the IRS.



IRS OPENS DOOR FOR PARTS LIFO

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The IRS has made this Change in Accounting Method an automatic change under Rev. Proc. 2002-9, meaning the \$1,200 filing fee has been waived. The only cost to make the change is the cost of having someone prepare the form on your behalf.

You should evaluate whether making a parts LIFO election is right for you. The safe-harbor provisions of Rev. Proc. 2002-17 provide a simple, virtually risk-free way to enjoy the benefits of LIFO. Remember, the cost to perform the LIFO calculations must be weighed against the potential benefits each year.

Your **AutoCPA Group** specialist can assist you with determining the next step. 

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