Are you ready for your audit?

Things can go easy-breezy if you think like an auditor

Do you flinch each year before your annual audit? Do you think of the process as something that will significantly interfere with your work for days at a time? If so, think again. An audit doesn’t have to be a time-draining or stressful experience if you’re prepared.

Anticipate requests

You’ll be at an advantage if you anticipate your auditors’ workpaper requests. Auditors typically ask dealerships to provide documents, such as monthly manufacturers’ statements, a trial balance and bank reconciliations. Auditors will accept copies for some items. For others, such as vehicle titles, floor plan statements and vendor invoices, they’ll want to see originals.

These requests change little from year to year. So a review of last year’s workpapers can help prepare you the next time around. Additionally, most auditors will provide you with a list of items that they’ll want to examine.

What does change annually is the sample of transactions that auditors randomly select to test your account balances. For example, they may look at November cash transactions in 2015 and at July transactions the following year. The element of surprise is important to auditors because it keeps bookkeepers honest.

It’s also likely that your auditors will ask you questions about footnote disclosures in your financial statements. In preparation, examine the footnote disclosures in your prior year financial statements for any changes the auditors will need to know about, such as changes in debt servicing companies or banks, 401(k) or pension plans, accounting policies and procedures, warranty programs and credit policies. Alert them in advance so that the footnotes can be changed early in the audit process. Plus, changes that affect the footnotes may require new or different audit procedures.

Take stock of inventory

At your year end, an audit team member will schedule a time to physically inspect your inventory. Be sure to have at least two of your experienced personnel available to assist the auditors with their test counts.

The auditors will randomly count items from your parts inventory and compare test counts to your inventory records. Misstatements may require more testing or extrapolation over your entire inventory balance.

Auditors also will compare each new and used vehicle’s VIN to your inventory listing. Expect to provide explanations for any missing vehicles, including demos and loaners.

Learn a lesson or two

Good auditors will present a list of management points when they deliver your financial statements. These are ideas gathered throughout the audit process to help improve your operations.

Auditors also may share their financial analysis tools. Here, your auditor benchmarks your store’s performance over time and against industry averages. Auditors use analytics to boost audit efficiency. In turn, you can use this information to explore your store’s strengths and weaknesses.
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Revisit your inventory method

Finally, your auditor can help you determine whether a change in inventory accounting methods would be appropriate to help lower your taxes. Accounting options for new-vehicle inventory include the specific identification method, which expenses the factory invoice price of the specific vehicle sold. Most dealers currently use this method, because it's based on the actual flow of units sold.

The last-in, first-out (LIFO) method is a more complicated inventory accounting alternative. LIFO places the last costs incurred into cost of sales and retains the earliest costs as the ending inventory. Essentially, this method removes inflation from your ending inventory and expenses it in the current accounting period.

LIFO allows an indefinite tax deferral in an inflationary market. When inventory levels or factory base prices drop, however, “LIFO liquidation” may take place — and a LIFO-basis dealer may incur additional taxable income. Such surprises are more common when vehicle prices are decreasing and inventories are low. In today’s environment, with higher tax rates, increasing vehicle prices and increasing dealer inventory, it could be a good time to switch to the LIFO method if you aren’t already using it.

Stay in touch

Occasionally, dealerships have accounting questions that extend beyond the year end audit. Contact your auditor during the year about major transactions and accounting questions, including if you plan to add (or eliminate) a franchise, move to or add a new location, change banks, or implement a new accounting or tax rule or trade discount.

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