

**NATIONAL INDEPENDENT  
AUTOMOBILE DEALERS ASSOCIATION**

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## **NIADA Dealership Internal Control Manual**

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Welcome to NIADA's *Dealership Internal Control Manual!*

**Workbook Goals:**

The *Dealership Internal Control Manual* is intended to help dealers institute and improve their dealership internal control systems. Each chapter contains both overview of the topic and specific suggestions to look for possible fraud and embezzlement. **Therefore, the authors recommend that dealers read this manual first before passing it on to other dealership employees. This manual has specific illustrations of embezzlement that dealers may not wish their employees to read.**



The *NIADA Dealership Internal Control Manual* is one of NIADA's many new and ongoing efforts to serve our dealer members with the best possible training materials. For NIADA and Page Publications, our developer-partner, we welcome your comments and suggestions for future revisions and improvements. Send written, FAX or phone comments to:

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**Reminder:** Dealers will need to obtain a copy of the *NIADA Dealer Chart of Accounts* as a reference tool for this workbook. This workbook is also available from NIADA.

**Acknowledgements:** The authors would like to acknowledge the many suggestions and sample documents from NIADA member dealerships. Text, spreadsheets and clip-art graphics have been provided by ©Microsoft Office 97 - Small Business Edition.

Dear NIADA Dealer,

NIADA's Dealership Internal Control Manual is considered a continually in-process project and we welcome your comments and suggestions for future revisions and improvements. Please take a moment to complete the questions below.



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Put a check mark (✓) in the column indicating your rating of each section of the workbook.

Workbook Chapters	Excellent	Good	Average	Needs Work
Chapter 1. Introduction to Internal Control				
Chapter 2. Accountable Documents				
Chapter 3. Cash Receipts				
Chapter 4. Credit and Accounts Receivable				
Chapter 5. Purchasing and Receiving				
Chapter 6. Accounts Payable and Cash Disbursements				
Chapter 7. Petty Cash				
Chapter 8. Vehicle Purchasing and Inventory				
Chapter 9. Vehicle Sales				
Chapter 10. Parts and Service Sales				
Chapter 11. Warranty and Internal Sales				
Chapter 12. Rental and Leasing Sales				
Chapter 13. Other Assets and Liabilities				
Chapter 14. Personnel and Payroll				
Chapter 15. Other Income and Expense				
Chapter 16. Financial Statement Analysis				
Chapter 17. Job Responsibilities				
Chapter 18. Internal Audit Checklists				

2. What topics, subjects or examples should be added or changed? Attach extra sheets as desired.

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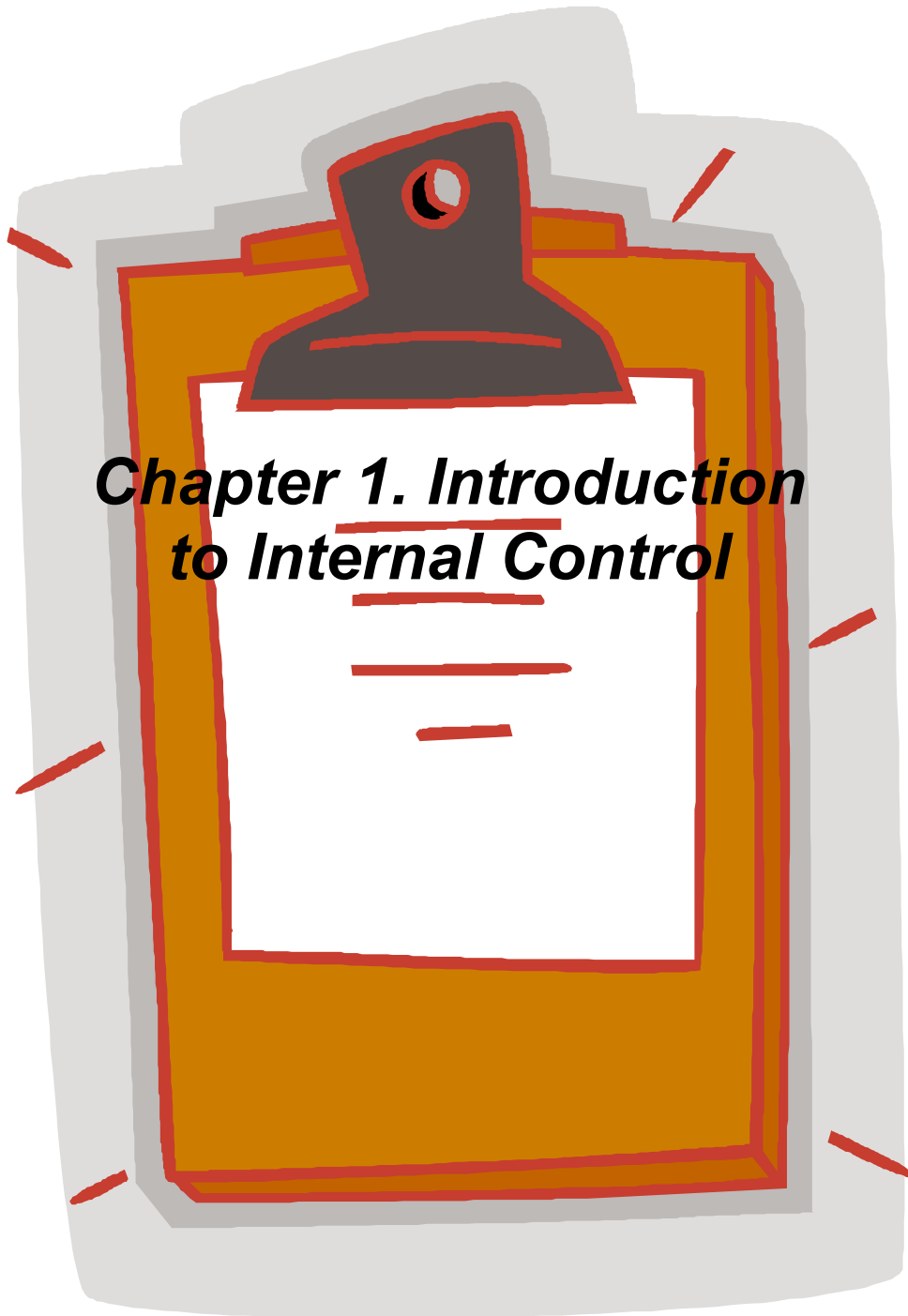
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***Chapter 1. Introduction  
to Internal Control***

**Dealership Internal Control Manual**



**Topics and Objectives for this chapter.**

This chapter should provide the dealer, internal auditor (and office manager if desired) with an introduction to internal control concepts and procedures.

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## Chapter 1. Introduction to Internal Control

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### 1.0 Introduction to Internal Control.

A successful NIADA dealership, like any business, needs standard procedures and controls to protect company assets and profits from theft and fraud. This chapter is designed as a starting point for NIADA dealers and their office managers to review some basic IC concepts used by thousands of new and used car dealerships in preventing losses in the dealership through theft, embezzlement and larceny. *Another way of stating this is instituting procedures to help honest people stay honest and stop the crooks from taking everything that isn't nailed down.*



You may see that your dealership already uses many of the ideas presented. However, you should be aware that even dealerships with well-documented controls still suffer losses through customer or employee theft. Therefore, the authors encourage you to read these ideas and procedures as if these procedures were just being implemented in your dealership. You may find new insights and aspects of these procedures that you had not considered before.

A well-designed internal control system contains several elements:

1. Accurate, detailed and current financial records.

NIADA dealerships deal in significant amounts of cash, receivables and various inventories. If accounting and management records are not current, theft or embezzlement activities may not be found for days or months after it has occurred. Once problems are found, poorly documented records may be inadequate to reconstruct exactly when and how the theft or embezzlement occurred.

2. Segregation of duties throughout the dealership.

One basic tenet of strong internal control is the segregation of duties, specifically requiring that employees involved in the recording of dealership transactions should not be responsible for, or have custody of the assets of the dealership. Obviously, factors such as staffing, sales volume, and facility layout have to be considered when assigning duties and establishing controls

3. Being pro-active in limiting opportunities for loss.

No system has been devised which will absolutely prevent embezzlement. Often, dealership losses can be traced to a lack of security or to inefficiency. Certain precautions can be taken to keep inherently honest employees from misusing dealership money or materials. When signs of employee dishonesty show up, one or more of the following situations generally exists:

1. The dealership was unwilling to implement and require ongoing basic security and auditing procedures.
2. The dealership did not routinely talk about security and internal control issues with their employees.
3. The dealership did not take necessary steps to adequately document losses, the reasons for the losses and take as strong corrective action as necessary.
4. The dealership had poor personnel pre-employment screening and training.
5. The dealership had dishonest management.



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Many dealerships that have been ripped off thought their internal controls system was adequate. Often what had happened was that controls broke down at some point because of differences between theory and actual practice. The dealer and/or office manager should make checking some part of the internal control system part of his/her daily procedure.

### **1.1 Fifty Ways to Steal from the Dealership.**

Dealers and office managers who have been in the automobile business for only a short time may be amazed at the number of ways employees and customers find to steal from the dealership. Before moving into the specifics of implementing a strong internal control systems, take a moment to review these 50 common examples of dealership theft or embezzlement.



1. Using dealership stamps or postage machine for personal correspondence.
2. Stealing office supplies and office equipment.
3. Stealing shop tools, by claiming they are personal tools or were broken while in use.
4. Stealing shop or body shop supplies such as paint, tape and chemicals for off-site repairs for cash.
5. Stealing or "arranging" theft of shop equipment.
6. Stealing aftermarket merchandise such as caps, jackets and other accessories.
7. Stealing small amounts from cash funds and register and explaining the losses as routine shortages.
8. Not recording repair orders or other sales and pocketing the cash.
9. Creating overages (slush funds) in cash funds and registers by under-recording sales.
10. Cheating on expense reports by reporting non-existent expenses.
11. Misusing dealership cash for personal use.
12. Taking payments on customer's accounts without issuing a receipt and then pocketing the money with or without updating the customer's account balance.
13. Collecting an account, pocketing the money, and writing off the money as a bad debt.
14. Collecting payments from written-off accounts and not reporting the payment.
15. Charging customer's accounts with cash stolen.
16. Issuing credits for false customer claims and returns.
17. Not making bank deposits daily, or depositing only part of the money.
18. Altering dates on deposit slips to cover stealing.
19. Making round sum deposits, attempting to catch up by month-end.
20. Carrying fictitious extra help on payrolls, or increasing rates/hours.
21. Carrying employees on payrolls beyond actual severance dates.
22. Falsifying additions on payrolls withholding unclaimed wages.
23. Destroying, altering, or voiding cash sales tickets and pocketing cash.
24. Withholding cash sales monies by using false charge accounts.
25. Recording cash receipts with unwarranted cash discounts and pocketing the bogus discount amount.
26. Increasing amounts of petty-cash vouchers and/or totals in accounting for disbursements.
27. Using personal expenditure receipts to support false paid-out items.
28. Using copies of previously used original vouchers, or using a properly approved voucher of the prior year by changing the date.
29. Paying inflated invoices in collusion with suppliers.
30. Paying fake (self-prepared) invoices with dealership funds and pocketing the money.
31. Completing repairs for cash without preparing a repair order.
32. Selling parts for cash without preparing a parts invoice.
33. Buying or selling vehicles at an unfavorable-to-dealer price and collecting a kickback or payoff from the other party to the transaction.

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34. Increasing amounts of suppliers' invoices through collusion.
35. Charging personal purchases to dealership through misuse of purchase orders.
36. Billing stolen merchandise to fictitious accounts.
37. Shipping stolen merchandise to an employee's or relative's home.
38. Falsifying inventories to cover thefts or delinquencies.
39. Taking checks payable to the dealership or to suppliers and forging endorsements.
40. Increasing canceled bank checks to agree with fictitious entries.
41. Inserting fictitious (no basis in fact) journal entries into dealership records.
42. Making incorrect entries in cash receipts and disbursements journals.
43. Deliberately mis-posting expenditures to try to hide theft in large dollar accounts.
44. Selling waste and scrap materials with no sales invoice and pocketing proceeds.
45. "Selling" door keys or combination to safe or vault.
46. "Selling" customer names and credit card numbers.
47. "Accidentally" being occupied while a theft occurs.
48. Falsifying bills of lading and splitting with carrier.
49. Stealing blank checks (unprotected) and forging signature.
50. Permitting special prices or privileges to customers, or granting business to favored suppliers, for "kickbacks".



As you can see from these examples, virtually everything the dealership owns is subject to theft. As you read through the remaining chapters, you will see that for each instance of theft above, a defense or internal control procedure has been devised to attempt to limit that theft.

### **1.2 Fifty Dealer Directives for Stronger Internal Controls.**

Here are some typical dealership procedures and controls to minimize or prevent theft. These are actions that must be initiated and required on an on-going basis by the dealer/owners. As a NIADA dealer, it is your business and your internal controls. These procedures will only be followed

on a consistent basis under your leadership and example.

1. Bond all employees.
2. Check references and past employers before hiring.
3. Have company mail addressed to a post office box.
4. All incoming mail is opened by the dealer and then distributed to addressee.
5. Periodically check daily deposit slips versus bank statements.
6. Insist on document accountability (control log) and review personally.
7. Periodically review reconciliation of bank statements.
8. Periodically examine canceled checks and endorsements.
9. Challenge all unusual discounts and write-offs.
10. Personally cancel all invoices at the time you sign checks.
11. Inspect pre-numbered checkbooks periodically for missing checks.
12. Have the business audited by an outside agency at least annually.
13. Have physical inventories done by an outside agency annually.
14. Do not allow employees to work on own cars on premises after hours.
15. Require authorization of overtime; make sure employees are supervised.
16. Separate responsibilities so no one employee handles a complete money transaction.
17. Insist on employees taking vacations.
18. Let your people know you are control conscious.

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19. Enforce dealership rules, regulations, and systems.
20. Provide a policy manual which spells out what those policies are.
21. Hold periodic manager meetings to review and update internal controls as necessary.
22. Stamp keys "do not duplicate".
23. Change all locks semi-annually.
24. Have your parts and service departments shopped periodically.
25. Detail (spread) and analyze at least 3 expense accounts each month.
26. Spot check repair orders, counter tickets and deal paperwork.
27. Review and initial all general and standard entry journals quarterly.
28. Sign all extended service warranty claims.
29. Personally meet all vendors.
30. Personally meet all vehicle wholesalers.
31. Require bids and purchase orders on all vendor jobs, and review them.
32. Personally distribute payroll checks periodically.
33. Require aging of all overdue receivables.
34. Question all voided documents.
35. Check on unusual cash register over-rings.
36. Personally inspect demonstrators and lot cars from time to time.
37. Install alarm system (at point of entry or in area of safe.)
38. Keep a checklist of locks, alarm systems, etc. which need to be activated at night.
39. Assign a key employee with responsibility to open and close dealership.
40. Post warning notice that building is protected by alarms.
41. Locate safe in full view of street and keep lighted.
42. Centralize cashier (so thieves must go through building to rob.)
43. Consider fences, guards or guard dogs for vehicle storage lots.
44. Keep lots well lighted.
45. Park cars close together to make stripping difficult.
46. Mark hot theft items, such as spare tires and radios, to make identification easier.
47. Disable units which might be driven away; block driveways.
48. Keep titles and vehicle keys under lock.
49. Review all gas tickets for dealership vehicles.
50. Lock parts department and tool storage area; limit access.



**Summary: The more ways that a dealer knows how they can be ripped off, the more ways they can devise to protect their assets.**

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### 1.3 The Dealer as Internal Auditor.

No one wants the business to succeed more than the dealer does. Therefore, learning how to think like an internal auditor or your dealership's CPA will help protect the assets and improve the efficiency of the business. *You should know that all audit programs begin with the dealership's chart of accounts (general ledger).* Outside auditors want to determine the answer to two basic questions.



- 1. Is the dealership's Balance Sheet correct and stated fairly in accordance with generally accepted accounting procedures (GAAP)?**
- 2. Is the dealership's Profit and Loss Report correct and stated fairly in accordance with generally accepted accounting procedures (GAAP)?**

The dealership's internal auditor adds two more questions to the questions asked by the outside CPA.

- 3. Is there anything missing from either the Balance Sheet or Profit and Loss Report that should have been included in these financial reports (*i.e. Is fraud occurring in the dealership*)?**
- 4. Are the dealership's internal procedures and controls operating efficiently and can they be improved, while still allowing the business to function smoothly?**

The NIADA Chart of Accounts is shown on the next two pages. As you look over the account names and numbers, note the following:

- Asset account numbers range from 1000 to 1999.
- Liability and Net Worth account numbers range from 2000 to 2999.
- Sales and Cost of Sales accounts are divided into departments, similar to new car franchisees' account numbers. This is necessary in order to prepare departmental sales, expense and profit reports.
- Expense accounts are more comprehensive than some dealerships may be used to working with. These additional accounts allow expenses to be better allocated to different departments.

We will be working our way through these accounts in this workbook.

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CONTINUE TO THE NEXT PAGE.





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### 1.4 Are the books current?

A key element in understanding the accounting system is the question of *how current is the accounting data available to the dealer?* For example, if the dealer wants to see a Balance Sheet and Profit and Loss Report for the current month, do they have to wait and see it on the 20<sup>th</sup> of the following month when the outside accountant completes it? Alternatively, with internal accounting functions, can the dealer see a month-to-date report (Daily Operation Control or D.O.C.) by 1:00 PM today that is current through yesterday at 5:00 PM?



Tuesday's DOC is due on Wednesday by 1:00.

#### The daily accounting goal at City Auto Sales.

*All accounting transactions are posted on a daily basis to the extent possible, using all available interface functions to automate as many of the transactions (entries) as possible.*

Our fictional dealership referred to in the NIADA Dealership Accounting Training Manual has a stated accounting goal for its office staff. What does this goal mean in day-to-day terms at City Auto Sales?

1. All vehicle sales for yesterday posted this morning.
2. All repair orders for yesterday posted this morning.
3. All checks written yesterday (computerized or handwritten) are posted yesterday or today at the latest.
4. All invoices received from vendors (including sublet repairs) yesterday are posted this morning.
5. All payroll checks are posted into accounting on the day written or the morning after at the latest.
6. All cash receipts and cash deposits are posted on a daily basis.
7. All other routine accounting entries (ex. posting the month-end bank or credit card statements) are handled on a systematic (scheduled) basis.

What will accomplishing this daily accounting goal achieve for City Auto Sales?

1. Up-to-date profit and loss information for the dealer.
2. Current checkbook balance for both the operations and payroll bank accounts.
3. Improved information for decision making.

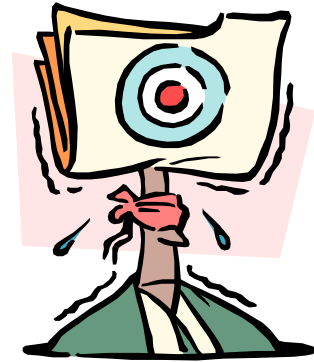
**Are your books as current as City Auto Sales?** As NIADA dealerships become more professional, progressive dealers are adapting the same daily accounting procedures that have been in place at new franchise dealerships for decades. Additionally, with the great improvements (and accompanying cost reductions) in used dealership computer applications, this accounting goal should be within the reach of virtually any NIADA dealer.

Additionally, with the implementation of standardized account numbers, a standardized financial statement, and other standardized procedures, dealers will be better able to share best ideas, trends and accounting data with their bankers and with other dealers at their NIADA Twenty Group meetings.

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### 1.5 The quality of your accounting system will impact the quality of your internal control systems.

NIADA dealers and office managers need to understand their own dealership's accounting systems inside out. If a dealer does not fully understand how their accounting system works, or the process by which documents are accounted for, they will have difficulty in instituting and overseeing ongoing internal control procedures. While most NIADA dealership office managers are trustworthy individuals looking out for the interests of the dealership, *there are also dishonest managers who take advantage of dealer's ignorance and lack of interest in supervising internal controls.*



The dealer is ultimately responsible for what happens to their business, regardless of who is employed as the office manager. Therefore, the dealer, as well as their CPA should have a thorough understanding of the accounting procedures of the dealership. The CPA's special function is as a trusted outside adviser and consultant who can help the dealer verify that adequate accounting and business internal controls are being maintained.

### 1.6 Four Questions for the Dealer.

Another way to think of the internal control process is for the dealer to ask themselves four questions.

1. What are the key account numbers in this area?
2. Who is in charge of producing the original source documents, calculating the entries and posting the transactions for this department?
3. Who is checking to make sure that departmental entries are correct and that no transactions have been left out?
4. As the dealer, what should I do to double check that everything that should be done on a daily, weekly and monthly basis is being done?



Our examination of the internal control process and the answers to these four questions continues in the next chapter.

This concludes the materials for this chapter.

