Physical Counts & Your Parts Department

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Parts inventory can be overlooked as among the more substantial investments of the dealer because it's owned, unlike vehicle inventory that's financed --there aren't any flooring checks of parts by the bank. Unfortunately, benign neglect with internal controls over parts can be this department's Achilles heel. On reflection, management's scrutiny over parts would likely be different if the parts bins held cash instead. It may not be realistic to manage and store parts like you secure cash in a safe, but there are steps that can significantly improve the accountability of those charged with protecting your parts investment.

Count Your Parts!

Banks count its cash daily and it is unthinkable they would do it any less frequent. Parts should be counted by an outside service at least once every twelve months. I suppose using employees of the dealership for the count is better than none at all, but the inherent conflict of interest should give one pause. Whenever the jury and the advocate are the same person, the chances of a contrived result in the parts variance is a risk. Trust goes a long way inside dealerships, but my experience with inventory counts is that management is apt to learn more about the condition and value of this investment when an outside service is used. In lieu of this, have your CPA supervise any in-house count.

Regular Bin Counts

In addition to annual physicals, management should test count parts bins randomly during the year. On a periodic basis, the office should run count sheets (preferably high value items) by bin location for independent counts by the dealer or management (again, it's best that it be by someone outside the parts department). Differences should be investigated. This practice also signals to the parts department that, as custodian of a high-value asset, it warrants management oversight.

Parts Variances

At the conclusion of a physical count, the overall variance (i.e. shortage or overage) shouldn't exceed a widely quoted 2% of total inventory value. Unfortunately, there are parts managers who operate with the idea that a shortage of any amount will punch their own pink slip. They may also believe that a $10,000 overage merits a favorable performance review, if not a raise.

Among the many worthy goals of the parts manager, when it comes to a parts count, the goal should be precision. A $500 shortage on a $100,000 inventory is an excellent ½%. On the other hand, a $10,000 overage represents a 10% variance, well outside our benchmark. A 10% variance, even an overage, simply raises more questions than it answers about your parts investment: there's a credibility gap with it. And the owner is right to wonder if that $10,000 overage should, in fact, be something more. Or more likely, in the process of identifying the source of the overage, the actual variance should have been a shortage. Evaluating your count results should be done with care and with an understanding of the factors that create it. Unfortunately, it's all too common that only a cursory review of the variance is performed.

Because there may be motivation by parts managers to report an overage, they have been known to artificially create an overage. In their mind, shortages of any amount are to be avoided. Consequently, the goal of running a tight inventory may shift from accuracy to "creative parts management." In the stock market, it's the pressure management feels from Wall Street to report expected earnings. In your parts department, ownership needs to communicate to parts managers that expectations are for an accurate count and that any chicanery compromising it will not be tolerated.

Parts Appreciation and Overages

One method by which an overage can occur is the failure to properly record factory pricing practices. In a period of rising prices, a factory price tape effectively "writes-up" the parts inventory value. Again, the significance of these "artificial overages" is that they can possibly conceal a shortage.

An example is that of a part costing $100, reported for this amount by both the parts department and the office at the time of purchase. If the factory subsequently increases the cost by $2, the parts department will report $2 more than the office if certain steps aren't followed. The office needs to record the price change by using the parts appreciation report (parts decreases should be recorded as well). At a minimum, verify this parts department report is received by your office on a regular basis for posting in the accounting records. This is only one example among others to engineer a parts overage. My purpose here isn't to provide a roadmap to your parts managers, but to alert you to the fact they exist. Is a parts overage ever acceptable, or reasonable? I'm not convinced, unless the parts department learns how to manufacture its own parts, or if the factory stops charging for parts. If parts management practices are creating additional profit (which can be a recipe for an overage), they should be recorded to the period in which they occur and not deferred to the date of the next parts physical.

Role of the Accounting Office & Monthly Reconciliations

An accurate variance depends as much on the completeness of the reconciling items as it does on the absence of errors with the quantities of the parts counted. And make sure the office reconciles the parts statement prior to the count.

Finally, the best chance to minimize the threat of a large variance at the time of the annual count is to monitor differences between the parts department and the office each month. This is accomplished by a reconciliation of the parts pad total with the parts amount reported in the general ledger. This does not require a physical count of the inventory: it is a clerical procedure, taking into account the normal reconciling items (e.g. packing slips, credits, work in process, etc.) that occur with any full count. Below is a suggested format, excluding additional reconciling items not contemplated here:

Parts Reconciliation

Parts inventory, per books	Amount	
Inventory parts and accessories, per general ledger	_____	
Add:		
Open packing slips (parts on pad, not in books)	_____	
Less:		
Pending credits (e.g. parts returned for credit, not on pad)	_____	
Parts tickets issued, not in accounting	_____	
Parts inventory per books, as adjusted	_____	**A**
Parts inventory per physical count		
Inventory parts and accessories, per inventory pad	_____	
Add:		
Used cores on hand (not on pad)	_____	
Miscellaneous parts not on pad	_____	
Work in process (Customer Pay/Warranty/Internal)	_____	
Parts inventory per physical inventory, as adjusted	_____	**B**
	_____	
Parts inventory per physical inventory, as adjusted	_____	**B**
Parts inventory per books, as adjusted	_____	**A**
Inventory overage (shortage)	_____	**(B-A)**