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# WHITEPAPER

Fixed Asset Inventory Best Practices

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Successfully implementing asset tracking into an organization, by necessity, requires a considerable change in policies, processes and responsibilities. The stark difference between asset tracking (or management) and fixed asset accounting is often under-appreciated despite today's regulatory environment which mandates significantly enhanced controls. Systems operating based simply on momentum often breed weaknesses.

Prior to the shift to a service oriented economy, most organizations formally accounted for the financial presence of the assets, but only casually for their physical presence. The accounting department maintained asset information, both non-financial and financial. Eventually, weighed down by paper based systems and exploding asset volumes, accountants began to employ expedients like high and ever-increasing capitalization limits and basket purchases to achieve a minimum balance in their workload. However, these practices had the effect of creating un-auditable records, driving up property taxes and assuring that fixed asset ledgers were usually out of date.

The nature of assets has changed. Traditional approaches to asset control were designed to address a relatively few, high value assets that were often physically large and immobile, such as are found in a manufacturing environment. As the economy has shifted towards services where assets are more numerous, have lower individual cost, are often physically smaller and may be reused in a variety of configurations, these approaches have become strained, if not completely obsolete.

Correcting this weakness requires a fresh look at the contemporary fixed asset environment coupled with an organization-wide mandate. Simply put, asset management cannot be successfully implemented by the accounting department alone (or any other single department). What follows is a dispassionate look at today's asset management climate and the tools available to improve controls. We will examine approaches and techniques that are achieving the desired results in the field. And, we will review what does not work and why. Lastly, we will identify those best practices which have proven effective and durable.

## What is an asset?

An irreducible requirement for successful asset management is the proper definition of an asset. This definition must be consistently applied, easily and widely understood and meaningful both in the field and in the accounting department. Ideally, an asset is the lowest level item that is commonly *managed*. It will, generally, have a useful life greater than a year and will be used, directly or indirectly, in the production of income. In practice, it is best to track and manage assets within categories – all computers and monitors, for example – rather than adding arbitrary parameters such as cost or make/model.

Once defined, each asset must be physically labeled with a unique number that is entered into the asset database as its identifier. This unique asset identity allows robust descriptions and *the means to update asset records electronically*. The current accepted standard is to label assets with bar coded numbered tags except in extremely harsh environments where materials and adhesives will not withstand the abuse. It is likely that radio frequency identification (RFID) will become more established and many users will take advantage of its benefits. However, it is presently a large increase in cost.

Notice that this definition of an asset gives scant consideration to cost because cost has little influence on which items are *managed* and those which are not. In fact, asset solutions relying on a capitalization limit to define an asset will compromise rather than enhance internal controls. When assets are defined based on an arbitrary dollar amount, line management has only a vague idea which are assets and which are not. Compound the problem by distinguishing assets based on the purchase event (invoice total) and it quickly leads to the confusing situation where two identical items may be classified differently. Defining individual assets categorically based on the manner in which they are used will create a detailed, meaningful database used by line management. Capitalization limits may then be applied to transactions relating to assets based on historical cost to address the accountant's desire to avoid the cost of accounting for small value assets where expensing the asset is not material. *However, automating asset management transactions achieves much the same goal while providing greater granularity of data, reliable audit trails and lower operating costs.*

### Best Practice: Asset Definition

- Asset is defined as the lowest level of individual item commonly managed.
- All assets are identified with a machine-readable asset label.
- All items within a category are identified regardless of cost.
- Capitalization limits are applied to transaction flow rather than asset recording.
- Assets are identified individually, not by groups.

## Asset Management Responsibilities

Once agreement has been reached on the organization's definition of an asset, daily activities needed to maintain the currency of asset data need to be modified. Best practices require a segregation of responsibilities between line management and the accounting department. Managing and safeguarding assets is performed by those who use or are assigned the custodial responsibility for assets rather than the accounting department. Therefore, responsibility for identifying and entering additions, updates and retirements must be assigned to those individuals. Obviously, they must be held accountable for the accuracy of the data. Once this data is recorded, the fixed asset accountant enters and maintains financial information about each asset.

While integration with the fixed asset depreciation system will be discussed later in greater depth, it is important to segregate duties related to capital assets and the larger pool of managed assets. A useful exercise is to identify the activities and data capture requirements which are to be assigned to the asset inventory system and those assigned to the fixed asset accounting system.

## Typical Asset Management Duties

### Asset Inventory System

- Receive and label new assets capturing asset number, description, location, serial number, and PO number.
- Relocate assets as movements occur.
- Update non-financial data regarding asset use and condition.
- Provide data to line management for life cycle asset management.
- Retire assets capturing the type of retirement.
- Audit accuracy of asset database.
- Maintain supplemental information, such as maintenance, photos and non financial activities.

### Fixed Asset Accounting System

- Harvest transaction activity for capital asset additions, changes and retirement.
- Create entries for non-moveable fixed assets.
- Augment or update asset value based on actual purchase information.
- Reconcile supporting entries from other accounting systems (general ledger, accounts payable).
- Apply harvested transactions with each accounting cycle.
- Calculate depreciation for book and tax.
- Augment or update asset value based on actual retirement information.

The underlying concept is to assign to line management the responsibility for managing the physical receipt, movement, reuse, maintenance and disposal of all assets. Accounting responsibility is focused specifically on capital assets and their financial impact on the organization. The approach mirrors how assets are actually handled in practice. Each area targets the information needed to perform their respective duties and is uniquely qualified to perform the duties timely and accurately.

However, caution is indicated in designing adequate security into the system. Line management should not be able to access depreciation information or change any data related to the financial aspect of the asset. Concurrently, it is futile to expect the accounting department to accurately initiate receiving, updating and retirement transactions about assets for which they have no visibility. As an added safeguard, many organizations will create databases for each application and transfer transactions rather update a single database. Others will create well-defined profiles for all users so that adequate security is provided. Either can work if properly implemented.

An underlying assumption is that transactions will be recorded in the database when they occur in the field. For example, when an item is received, the core information (asset number, serial number, location, condition, serial number, etc) is recorded. Subsequent movements are recorded so that the asset's location is continuously visible and accurate. Often, accounting information will not be available upon the item's physical receipt requiring the transaction be placed in a pending status until proper data can be applied.

Once the day-to-day duties have been assigned, it is important to examine auditing requirements. Asset labeling provides a foundation for rapid, accurate inventories either complete or of selected areas. Because the bar code label is simply scanned, the person conducting the inventory does not need extensive product knowledge to create reliable results. With this in mind, the frequency and scope of the audit requirements may be easily established.

### **Best Practice: Asset Management Responsibilities**

- Responsibility for non-financial transaction activity is assigned to line management; financial data remains in the accounting department.
- Segregate data between finance and non-finance protected by adequate security.
- Define and document process, duties and segregation for both systems.
- Record transactions upon their occurrence in the field.
- Create audit program to assure that systems operate properly.

## **System Interfacing**

An important benefit of establishing an asset management system is interfacing transaction data into the fixed asset accounting system. The goal is to eliminate a dependency on maintenance forms, documents and aggregated entries from other systems. These traditional approaches are not only obsolete but can cause significant inaccuracies and weaknesses in internal controls.

How the interface actually occurs varies based on system architecture. If both asset management and fixed asset accounting share a common database there is no need to perform physical export of the transaction data. Similarly, if the two systems are linked at the database level, a portion of the transaction flow will occur automatically. Only if the two systems are separate will a physical export be required.

Recalling that the asset database will contain entries for all assets that are managed regardless of cost, a necessary first step for interfacing is to identify those assets which are considered capital assets. This is best accomplished by capitalizing assets based on a common description or similar identifier so that the assignment can be automatic as new assets are added. Doing so will assure consistency across all data and can be controlled by the accounting department with a minimum of effort. Most contemporary databases that are relational in design will perform this task with ease. Non-relational databases will require each line item to be properly classified.

As assets are classified, cost becomes a factor rather than an absolute determinate in segregating capital and expensed assets. For integrated systems, asset cost is invariably assigned at the individual asset level. Because the asset database is developed based on an asset's category, capitalization policy becomes a blend of type of asset and the underlying cost.

### **Once capital assets are defined, the steps below occur during each closing cycle.**

1. Identify transactions to be interfaced based on common type of activity. Any transaction having financial impact requires specific review by the accounting department to assure accuracy.
2. Augment information to complete the transaction for entry into the fixed asset accounting system. Timing differences may dictate that the physical receipt and determination of the cost basis occur in different accounting periods.
3. Apply completed transactions to fixed asset accounting ledgers as information becomes available.

Each implementation and organization will define the detailed steps necessary to complete the integration based on the system design and their unique processes.

### **Best Practice: System Integration**

- Define asset capitalization policy based on category and unit cost considerations.
- Define data capture requirements based on timing and availability of data.
- Create closing procedure to identify transactions of common type and augment each with appropriate financial data.
- Design process to resolve timing differences between actual transaction dates and availability of complete data.

### **Conclusion**

Best practices for asset inventory require those implementing to rethink past practices and understand the tools presently available. Implicit is an organization-wide approach that assigns responsibility and accountability to those individuals best equipped to perform a given task. As systems are brought live, allowances must be made for the clean up of existing records in terms of staff hours and potential financial adjustments. Budgets must provide sufficient resources to support the cost of software, hardware, asset tagging and training.

Clearly, the implementation of an asset inventory system is a serious undertaking however, present regulatory environment provides little choice.