|Asset|Services|

Whitepaper

Fixed Asset & Equipment Inventories, Ledger Reconciliations & Asset Valuations for

Manufacturing Organizations

|Asset|Services|

| Fixed Asset Inventories | Ledger Reconciliations | Asset Valuations |

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1. Purpose

The purpose of this whitepaper is to illustrate to manufacturing organizations the importance of having professional fixed asset/equipment inventories performed. This information will assist companies in determining if their current method of tracking and reporting assets is satisfactory, or if it is necessary to perform a professional asset inventory. This document also provides information on Asset Services fixed asset inventory solution.

This document will provide financial personnel with the following information:

- Leading questions pertaining to current inventory practices.
- The importance of having a professional fixed asset inventory completed.
- The implications of not performing a professional inventory completed annually.
- An overview of the inventory, asset reconciliation, and valuation processes.

2. Definition of a Fixed Asset Inventory

A fixed asset inventory should be performed on an annual basis to assist businesses in maintaining accurate financial records pertaining to fixed and moveable assets within its facilities. Fixed assets usually pertain to items with a cost more than $1,000 with a life expectancy greater than one year. The items are non-consumable and typically fall under the following asset classes:

- Manufacturing Equipment
- Furniture
- Information Technology
- Audio Visual Equipment
- Office Equipment
- Health & Fitness Equipment
- Kitchen Equipment

In addition to the fixed asset classes listed, controlled items that cost less than the determined threshold, are typically inventoried as well. Those controlled assets include, but are not limited to, serialized items such as:

- Monitors
- Laptops
- Personal Computers
- Cameras
- DVD Players

3. Leading Questions

Leading questions pertaining to the current inventory practices are necessary to gain an understanding of your organization's current inventory process. It also identifies where this process can be improved by having a professional inventory performed, and identifies the scope of such a project. Review these questions and take a self-evaluation of your organization's current process.

Questions

- Do you currently perform fixed asset inventories?
    - If not, how does your finance department prepare annual reports, accounting for fixed assets?
    - If you do perform annual fixed asset inventories, how are the inventories performed?
        - Is the "paper & pen" method being used? This is a method where a listing of all assets for a particular department is printed and distributed to each department. Then a representative of the department "checks off" each asset identified on the list.
        - Are untagged assets added to the inventory? In other words, if you run across an item that does not have a tag, or is not on the inventory list, are they added or ignored?
- If you do perform annual fixed asset inventories, who performs the inventory? Are you using manufacturing or administrative personnel to inventory their respective departments, or are you using professional inventory personnel? If you are using manufacturing or administrative personnel, what is the true cost of having them perform inventory functions? There is the tangible loss of professional salaries to perform an inventory, but there is also the intangible loss; is manufacturing processes or customer service being compromised during the inventory process?
- If you do perform annual fixed asset inventories, what equipment is included? Is it just manufacturing and IT equipment, or all fixed assets above the $1,000 cost threshold?
- If you do perform annual fixed asset inventories, how confident are you that the inventory is as close to 100% as possible? If manufacturing or administrative personnel are performing the inventories, we have found that they are not usually enthralled with the idea and tend to perform a less than accurate inventory. They also tend to be interrupted frequently to assist with more urgent tasks.

4. The Importance of a Professional Inventory

The following are justifications why an organization should perform an annual fixed asset inventory:

- **Financial Reporting Accuracy** – Businesses are required to provide accurate financial reports on an annual basis. An accurate fixed asset ledger is an integral part of that financial report, as it identifies current assets and determines the worth.

- **Financial Reporting Compliance** – Businesses, whether publicly or privately owned, still have financial requirements that need to be met. An accurate accounting of all assets owned by the organization assists in ensuring compliance with accounting regulations such as FASB and Sarbanes-Oxley (SOX).

- **Capital Budgeting** – Accurate knowledge of current assets is critical in planning for purchasing requirements. An annual inventory may identify equipment that has been lost or stolen, and therefore require replacements be purchased. An inventory may also uncover equipment believed to have been disposed of, stored in an undisclosed location, therefore nullifying the need to purchase replacements.

- **Accurate Asset Listing** – Some organizations never inventory. Instead, they receive assets through the materials management department, where the assets may be tagged, and then the asset information is sent to the financial department. The financial department then enters the assets in the FA ledger and sets up the depreciation of the item. Then, on an annual basis, depreciation is calculated, and the item is <u>assumed</u> to still be owned and in use by the organization, when in fact it may have been lost or stolen. If an organization assumes, from year-to-year that all items are still accounted for and in-use, the FA ledger becomes more and more inaccurate as each year passes. This is known as the snowball effect.

- **Locate Missing Assets** – An annual inventory will assist a business in locating assets that are assumed missing, or may verify that the assets are in fact, lost.

- **Identify Surplus Equipment** – After a thorough inventory has been completed and a review of the fixed asset ledger is performed, surplus equipment may be identified that can be sold on the open market.

- **Decreased Tax Payments** – An accurate inventory ensures the organization is only paying taxes on equipment that it actually owns. If an organization is still carrying equipment on its books, that may have been lost, stolen, or inadvertently disposed, it would be paying unneeded taxes on that equipment.

- **Accurate Insurance Premiums** – A business insures the equipment that it currently owns. An accurate inventory ensures the organization is only paying insurance premiums on equipment that it has in its possession, yet is adequately insured.

- **Disaster Preparedness** – If a disaster were to occur, does the business have an accurate picture of what it owns? This is critical on two accounts: a) insurance claims, and b) the ability to recover. Being able to provide insurance carriers with an accurate listing and value of items lost in a disaster ensures faster and more accurate reimbursement.

  Just as critical, if not more, is the ability to recover from the disaster and rebuild. An accurate inventory identifies not only what assets were lost, but where the assets were located in the facility. This provides the organization with a virtual plan for rebuilding the damaged area.

- **Standardized Inventory Across Departments** – The standardization of data ensures a more accurate FA Ledger. If there are numerous people across several departments performing the inventory, the data will lack standardized results, and require more time being spent "cleaning" the data.

- **Return on Investment (ROI) and Cost Savings** – The return on investment realized by a company may be enormous based on the low cost of having an inventory completed and the savings the organization may realize through reduced taxes and insurance premiums. The cost of an inventory is far less expensive than what organizations may believe.

- **Inventory Professionals Prevent Lost Man-Hours by Company Personnel** – If administrative or engineering personnel are performing the inventories, they are being taken away from their primary responsibilities.

5. Ramifications of Not Having a Professional Inventory

The following are possible implications an organization could face if annual inventories are not completed:

- **Noncompliance of Annual Financial Reporting** – Often times, organizations are required to submit accurate annual financial reports in order to comply with financial accounting requirements. An important part of this financial report is to properly account for all equipment owned by the company and to report the value of those assets. Without performing an inventory, the report is based on the assumed accuracy of the fixed asset ledger and the possibility of inaccurate financial reports is greatly enhanced.

- **Inaccurate Tax Payments & Insurance Premiums** – Organizations pay taxes and insurance premiums based on actual asset value. If the company does not have an accurate account of its equipment, it may be inaccurately paying taxes and insurance premiums.

- **Snowball Effect of an Inaccurate Fixed Asset Ledger** – After performing inventories for clients who have not regularly inventoried their facilities, we have seen fixed asset ledgers that are less than 40% accurate. Meaning 60% or more of the items on the asset ledger cannot be located, or there are items identified during the inventory that are not on the asset ledger prior to the inventory. Once an organization decides not to validate their asset ledger on an annual basis, the inaccuracy of the ledger multiplies each year.

- **Items that may be Lost or Stolen** – When equipment is needed in the routine activity of the organization, and it gets lost, stolen, or wrongly disposed of, the non-availability of that equipment may not be realized until it is too late. It then takes time to replace the item. Annual inventories may identify missing items as well as identifying items that may be misplaced in another location in the facility.

- **Efficient Capital Budgeting**– Without an accurate inventory and fixed asset ledger, capital budgeting is more difficult. Having an accurate fixed asset ledger identifies equipment that needs to be purchased.

- **Unable to Recover from a Disaster** – It is said that an organization that does not recover from a disaster within a few months, will never reopen. Having an accurate fixed asset ledger that identifies the equipment owned by the company, and ensures that insurance claims are recouped quickly and for the correct amount. It also acts as a virtual floor plan for identifying equipment (by room) for recovering from a disaster.

6. The Inventory Process

Asset Services works with each client to develop a project scope that meets the organization's needs and project goals. Once the scope is determined, Asset Services will create an inventory data base and conduct a physical field inventory based on the project requirements.

The following is an overview of the inventory process used by Asset Services for a typical business:

Asset Tagging

Asset Services will apply a property tag to each item inventoried and capture descriptive data pertaining to the asset. Standard data collected for each item includes:

- Asset Number
- Asset Description
- Facility/Location
- Department
- Room (if applicable)
- Manufacturer
- Model or Product Number
- Serial Number

Asset Services also provides digital photos of larger items such as manufacturing equipment. These digital photos are linked to the asset listing.

Deliverables

Upon completion of the project, the client is provided with the following:

- Inventory data in electronic spreadsheet format that can be easily uploaded into your current asset management system.
- Printed inventory report of assets by location.
- Electronic copy of inventory report.

The following reconciliation reports derived from a data reconciliation of physical inventory to current asset ledgers and databases:

- Assets Unable to be Inventoried: Items on the current asset ledger which do not fall under the scope of inventoried items (i.e. buildings, infrastructure, leasehold improvements, software, etc.).
- Matched Items: Inventoried assets that match directly to items on the current asset ledger.
- Unmatched Ledger Items: Items on the current asset ledger that were not located during the physical inventory.
- Unmatched Physical Items: Items identified during the physical inventory that are not identified on the current asset ledger.

7. Data Reconciliation

Asset Services performs data reconciliations, where the physical inventory data is reconciled against the client's current asset inventory listing. Asset Services performs data reconciliations using the following two-tier method:

Tier 1 Reconciliation

Tier 1 Reconciliation is an automated process where items are matched by a unique identifier. The first step is to match items by an existing asset tag number (if applicable), and the second matching criteria used, is the item's serial number.

Tier 2 Reconciliation

If additional reconciliation of assets is necessary after completion of Tier 1, Tier 2 Reconciliation can be performed. This process involves a line-by-line comparison of the current asset list to the physical inventory results in an attempt to identify assets as unique items. Tier 2 Reconciliation consists of the following steps:

- An analysis of the current asset ledger is performed where each asset (line item) is assigned a designation code, such as:

    a. out of scope item
    b. item is not a physical asset
    c. items with incomplete data
    d. inventoriable and unique item

- Ledger is searched for matches using model numbers.
- Ledger is searched for matches using manufacturer.
- Ledger is searched for matches using product descriptions.

Tier 2 Reconciliation is considered an iterative process, where Asset Services will be in contact with client personnel to insure any assumptions made are satisfactory. Once Asset Services has reached a point in the reconciliation where assumptions will need to be made on Asset Services' part that may not be accurate, the data is delivered to the client and the Tier 2 Reconciliation is complete.

8. Asset Valuation

Asset Services performs asset valuations based on the list of assets created from the physical inventory, including physical condition code. To determine replacement and market values, a number of sources are utilized including equipment distributors, IT distributors, furniture distributors, manufacturers, and used equipment dealers across the U.S. Also, a number of other sources are researched including equipment catalogs, internet sources, and data gathered from previous clients. With all of these sources, a comprehensive database of values has been compiled and is updated continuously.

Market value is largely determined by a number of factors including condition, type, and age of the items. One of the most important elements in determining market value is what comparable items are selling for in the open market place.

9. Contact Asset Services

Please feel free to contact us with any questions pertaining to our asset management solution, or if you would like an estimate for completing an inventory for your organization.

For additional information, please visit our website at: www.AssetServices.com

Or contact us at:
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