



Work With Accounting

Why Are Some of My Asset Fixed?

One of the on-going points of confusion in the ITAM world, especially if you are not an accountant and are new to ITAM, is the overlap between Fixed Assets (F/A) and IT assets. In general, as IT asset managers, some of the assets that we are concerned with are fixed (in the accounting definition) and some of our company's fixed assets are of interest to IT asset management. This article is a primer for the non-accountant on what is considered a fixed asset and what we, as IT asset managers, need to be concerned about.

A brief diversion into accounting:

Accounting at its simplest form (with apologies to all accountants) is the recording of money coming into and going out of the company. If I own Acme Widget Company and I sell a widget, I record income or revenue. But what about the money I spent in the making of that widget? That, I record as outflow or expense. As long as I have more revenue than expense, I make money. In theory that is as easy as it gets. But due to the nature of tax laws and other rules, regulations and policies it gets a little more complicated.

One of the primary functions of accounting is to make sure that both revenues and expenses are recorded, or recognized, in the appropriate time period. And in most cases, the appropriate time period is the time closest to the event in question. In other words, revenue is recognized when the company has sold something and expenses are recognized when a company has bought something. Simple. Well, not really. What about things we pay for over time? Or what about things we buy that we will use for years?

Governing Bodies:

While accounting has a myriad of purposes in a company, at a basic level, accounting practice is governed by the tax laws and the financial reporting requirements of the country you are in. We need to track our money because at some point we need to file a tax report, an annual report or other financial disclosure.

To help with the ins and outs of this, there are organizations that provide guidelines. In the US, the major source of information is the Financial

Accounting Standards Board (FASB – pronounced 'faz be'). FASB is a private, non-profit organization whose sole purpose is to develop and publish generally accepted accounting principles, known throughout the accounting world as GAAP.

So what does this have to do with me?

GAAP outlines the principles and practices that your company's accountants, auditors and CPAs use to record the various transactions. This goes to the heart of recognizing revenue and expense. Remember that all of the assets you manage have a counterpart transaction on the books of your company (i.e. at a minimum all the assets were purchased and all will eventually be disposed of). So it behooves us to have a general knowledge of the language accountants speak so we can better optimize the assets we manage.

So what is a fixed asset anyway?

OK, diversion over, and back to the subject at hand. How do we account for money that leaves the company?

If Acme Widgets buys a ream of paper, chances are it will be used up fairly quickly. In that instance the cost of the paper would be expensed and recorded in the current period (say the current month). The theory is that this paper would be used to contribute to the income earned in the same period and the entire expense would be counted against the month's income.

But what if Acme buys a new widget machine? This new machine will create widgets for years and as such, the benefit of the machine goes beyond the current period. In this case, it would seem that it makes sense to spread the expense out and record it against the income that will be realized over the coming years. And so we can.

The expense for an asset (anything of benefit to the company) can be recognized over time to better align the expense of the asset to the expected benefit (income) derived by the asset. This is known as depreciating the asset and an asset so recorded is referred to as a fixed asset. There are several ways to account for this, but for our purposes we will assume that you divide the cost by the expected life of the assets and apply the expense evenly. This is known as straight-line depreciation.



Incidentally – FASB is financed from fees imposed by Sarbanes-Oxley. Internal cost allocation and chargeback issues are purposely left for another discussion. Other methods include: declining balance, activity, sum of years and MACRS. All of which are discussed much better in basic accounting texts than we can do here.

So, if we assume our widget machine will last 5 years, we would divide the cost of the widget machine by 60 and apply 1/60th of the amount to our expenses every month (5 years x 12 months = 60).

The bottom line is ‘fixed asset’ is an accounting designation for those assets whose expense is recognized over time and not all at once. Of course there is more detail here, but for our purposes this definition will suit.

Implications for ITAM:

In ITAM, by definition, we are concerned with our organization’s IT assets. Based on the discussion above it stands to reason that some of the assets we are concerned with are ‘fixed’ in the accounting definition. And what we have here is the overlap of two worlds.

On the one hand, accounting is concerned with all fixed assets and some of those assets belong to IT. On the other hand, ITAM is concerned with all IT assets and some of those are in the fixed asset registry. So whose responsibility is this? Actually it is everyone’s responsibility.

There are two major implications of fixed assets for IT assets managers. They are:

- 1) Location
- 2) Disposal

Asset Location:

Since company assets are property of the company it is very likely that they are subject to property tax (in the US certainly). Property tax rates will depend on the location of the asset. There are many taxing jurisdictions in the US (state, county and/or city) and to accurately determine the property tax owed it is imperative we know where our assets are located. In relation to fixed assets and ITAM we are certainly talking about mainframes and most, if not all, servers. It is also possible, depending on the accounting practices of your company that we are talking about desktops, laptops and larger printers as well.

Note the total amount of the cost of the asset is referred to as ‘book value’, i.e. this is the amount that was entered in to the company’s books. As depreciation expense is applied to the asset over time, the value of the asset decreases. The difference between the original value of the asset and the current value is called remaining book value and will apply to our discussions of asset disposal.

Historically one of the compelling arguments for ITAM is that companies lose sight of their expensed assets as they are not recorded in the accounting system, only the financial transaction is recorded. However, in the case of fixed assets, the assets themselves are recorded (to varying degrees of detail) in the fixed asset register. This recording is an underlying register once a year to determine the location of the assets in the register and to validate the F/A assigned identifier (fixed asset tag) and also the owning department for the asset.

Location information is important is validating property tax bills and owner information is important in determining the appropriate internal allocation of depreciation expense.

F/A systems were designed as accounting systems and not asset tracking systems and as such are not generally designed or used in the daily management of assets. In addition, as accounting systems of record they, are not generally connected to other IT management systems such as help desks or discovery. This makes the location and ownership audits expensive and time consuming. And this is where ITAM can compliment the F/A process.

Let us first recognize that from an accounting (and therefore financial reporting) standpoint F/A is the system of record for the accounting, tax and depreciation aspects of our IT assets. ITAM makes no claims in regard to supplanting F/A systems. It is important that IT asset managers support F/A departments and are not seen as challengers to their domain. Consequently, it is a benefit to ITAM and F/A if ITAM systems are seen as the system of record for asset location and ownership information for all IT assets. ITAM is intimately familiar with various attributes of all IT assets, so we are in a good place to augment traditional F/A systems with location and ownership information increasing the accuracy of an annual audit while decreasing time and expense.

Asset Disposal:

The second major point of overlap between ITAM and F/A is around the disposal process. It is crucial that an ITAM disposal process take F/A into account. The reason for this consideration is that while we may, for performance or obsolescence issues, be interested in disposing of an asset, the financial books of our organization may still have a record of the asset in question and might be carrying a dollar value for that asset.

The consequence of disposing of an asset that has remaining book value can be detrimental to a company’s financial reporting. For example, let’s say that in our company has decided that any asset that costs more than \$1,000.00 is classified as a fixed asset

and depreciated over 2 years. And further for the sake of argument we assume that we bought 500 desktops at the same time. On day one, we are carrying \$500,000.00 of book value for these PCs.

Now let's say that a year later these PCs are obsolete and we need to replace them. Given that half of the expected life has gone by our F/A system has recorded \$250,000.00 of depreciation against our original purchase price. But, these assets still have a collective book value of \$250,000.00 on the books. If we were to dispose of these assets without consulting the F/A group then the company would be forced to recognize all \$250,000.00 of remaining book value as an expense in the current month as opposed to the roughly \$21,000.00 in expense that it was expecting ($\$500,000.00 \div 24$ months, rounded up).

This means that this unexpected expense just negated \$229,000.00 of revenue. If the company had a net profit of \$150,000.00 that month prior to our actions, we just caused the company to lose money in this month. Such unexpected swings in expenses are not a welcome thing. So it is imperative that F/A be included in the asset disposal process.

On the positive side, keeping F/A up to date on disposals of assets that have little or no remaining

book value helps accounting keep the F/A register clean and up to date. This practice may even have a positive impact on the property tax issues by allowing F/A to adjust the property tax bill by removing assets no longer on the books. And just like an unexpected expense reduces net income, a reduced or eliminated expense increases net income.

Conclusion:

There is an overlap in the concerns of F/A departments and ITAM departments concerning a subset of the IT assets in a company. While this overlap has the potential to be a point of contention, it also is an opportunity for accounting and asset management to work together to better manage a company's assets.

While the designator of 'fixed asset' is an accounting definition there are real impacts to a company's financial performance with regard to the treatment of these assets. It behooves IT asset managers to understand their company's policies and definitions surrounding fixed assets and to open a constructive dialog with the F/A group in order to better manage all aspects of IT assets.

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