



## Ensure Sarbanes-Oxley Compliance Of Fixed Assets on the Balance Sheet

### Sarbanes-Oxley Act

The Sarbanes-Oxley Act (SOX) is intended to ensure accurate financial reporting for publicly traded companies. This added fiduciary responsibility and burden on senior management and their auditing firms has created the need to redefine the Best Practices used to manage the business. SOX has made its presence felt and this SEC requirement has cost companies thousands, even millions of dollars to comply. The SOX 404 internal control assessment requirement is the primary reason corporations are incurring these additional costs.

### Section 404(b) of the Sarbanes-Oxley Act states:

With respect to the internal control assessment required by subsection 404(a), each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this subsection shall be made in accordance with standards for attestation engagements issued or adopted by the Board. Any such attestation shall not be the subject of a separate engagement.

It is recognized that compliance is more than revenue recognition policies, accurate statement of earnings, stockholder equity and SEC filings. While these are critical to SOX compliance requirements; the Balance Sheet, specifically Fixed Assets, is material for companies and should not be ignored.

### The Problem

For many companies, fixed assets are a significant part of the balance sheet. This makes fixed assets one of the material items for SOX 404 internal control validation. The balance sheet needs to fairly reflect the assets of the company. Unfortunately, it is common for assets to be misclassified, unrecorded or retired. This occurrence presents challenges in tax, capital budgeting, insurance and other areas. Most importantly, this represents a potential disclosure risk for executives now responsible for certifying the accuracy of financial data. Today, organizations are reporting "**material weaknesses**," and others have identified "**significant deficiencies**"; primarily due to major data validation/quality concerns and failure to enforce internal controls.

In recent studies, it is estimated that data management is costing businesses billions of dollars each year. SOX 404's compliance adds to this cost. Many organizations hoped that a technology solution would satisfy the SOX compliance

requirements only to discover that poor data quality forced delays or abandonment of these new system implementations. Other research published by the not-for-profit Information Integrity Coalition, an organization that promotes the awareness and understanding of information integrity, has estimated that the pervasive lack of information integrity "costs the economy hundreds of billions of dollars." Studies at MIT and other notable institutions of higher learning echo similar estimates about the impact of poor data quality on the cost structures of corporate organizations. These studies focused on the overall impact of poor data quality in general but the same issue applies to fixed asset data.

To identify the contributors to the fixed asset data quality issue, one need only review the related accounting transactions. For example: when an organization acquires a complex asset, e.g., an asset composed of dozens of smaller independent assets, it is common to see a "bulk" asset entry. Such an entry would record the asset as a particular machine with a value of \$5 million and a depreciable life of seventeen (17) years. While this entry is not inaccurate, per se, it can lead to misrepresentation later.

Taking it a step further; a financially sound decision is made to upgrade a portion of the original machine investment to improve production quality or manufacturing efficiency. The corresponding accounting transaction is entered as a \$250,000 equipment upgrade. Presumably, this upgrade replaces a portion of the original equipment. Since this is a partial retirement with no corresponding detail record to debit, the retirement transaction never gets recorded. The net effect is an asset with an overstated gross book value (GBV) of \$5,250,000, an unbooked asset retirement and inaccurate depreciation.

Other contributors include the complete replacement of an asset with no corresponding retirement, unrecorded equipment transfers from one corporate entity to another or incomplete consolidation of assets from a newly acquired company.

AMR has repeatedly found that up to 30% of assets are not properly reflected in the financial records. Without proper validation, the fixed asset financial data is probably misstated. If the financial information is used by purchasing, finance, tax or other departments, strategic decisions may be suspect due to the poor quality of the data used in the decision making process.





### The Solution

Most companies already have policies and procedures in place for fixed asset management. Still others have established controls and audit procedures required by SOX as vital to mitigating management risk. Regardless, policies and controls do not address the historical nature of past practices and circumstances. Moreover, the ever changing landscape of Corporate America, with the commonality of acquisitions, reorganizations and divestitures, points to the need to establish a new baseline if any certainty is to be realized for SOX compliance for Fixed Assets.

The good news is that fixed asset data validation is not an extraordinary exercise costing millions of dollars. In fact, the resulting reduction in operating costs, tax savings and other efficiencies far outweigh the fractional cost of fixed asset verification and reconciliation. It delivers confidence for SOX compliance and data quality for better strategic decisions.

The Best Practice for data validation is an independently conducted wall-to-wall physical inventory and reconciliation of all fixed assets. This comprehensive approach can minimize uncertainty in the financial accuracy of fixed assets. This method establishes the baseline for business process improvements and the management of fixed assets throughout the life cycle. In short, this approach is the definitive method for attestation required for SOX compliance.

### The AMR Approach

Review and analyze the fixed asset management process, focusing on the fixed asset life cycle.

- Address systemic issues by devising, documenting and implementing an overall fixed asset management strategy, involving all stakeholders in the process.
  - Document current state.
  - Define the desired/future state.
  - Document plan to bridge the gap between current and future practices.
    - Identify technology resources to support the future state.
    - Define metrics to measure results.
    - Implement strategy.
    - Measure results.
    - Modify and improve
- Select a department that will be responsible for ensuring that data is collected, captured and stored.
- License or develop a fixed asset management system to enable the collection and use of data to manage fixed assets from acquisition to retirement.
- Complement the documentation and testing of internal controls with a comprehensive fixed asset inventory and reconciliation of fixed asset balance sheet accounts. This should be completed using an "independent" company, allowing the corporation's external auditor to issue an unqualified opinion on the results.

### About Asset Management Resources

Since 1990 AMR has inventoried millions of fixed assets with GBV in excess of \$150 billion dollars. Our expertise encompasses project management and technological competencies necessary to collect information within a corporate operating environment with limited disruption and maximum efficiency. The process incorporates a variety of quality control mechanisms to ensure completeness, accuracy, and uniformity of data. Additionally, many companies enjoy personal property tax relief with confidence.

### AMR's core competencies include:

#### Wall-to-Wall Fixed Asset Inventory & Reconciliation (FAIR)

- Barcode Tagging, Data Collection and Physical Inventory ensure identification and tracking of all assets.
- Floor-to-Book; Book-to-Floor Reconciliation – Your physical inventory exactly matches the assets reported on your financial statements.
- Extensive Audit Trail facilitates SOX compliance.
- Accurate independent validation of Fixed Assets.
- Reduction in operating costs, e.g., taxes.
- Superior Expertise in Large and Complex Environments – Our professional inventory team has expertise with a wide variety of machinery, equipment, and computer hardware to ensure assets are accurately categorized for SOX compliance and maximum tax benefits.

#### Personal Property Tax Management Consulting (PPT)

- Classification Analysis supports reduced tax liability.
- Cost Segregation maximizes exemption allowances.
- Pollution Control Review can achieve additional tax exemptions.

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To learn more about how AMR can assist your inventory reconciliation, please contact:

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