

Fixed Asset Management and Property Insurance Appraisal: Benefits of Combined Services

Typically, the biggest question for an organization's finance team is:

Are you confident that your fixed assets are accurately represented in the year-end financial statements?

Similarly, insurance teams are expected to address the following question:

Where do your property's reported insurable values come from?

While fixed asset management and property insurance appraisal are not the most interesting of subjects, both are essential for meeting audit requirements, capital budgeting, financial management and informed decision-making in the risk management process. Fixed assets can represent the largest item on an organization's balance sheet as well as in its property insurance budget—especially in capital-intensive industries such as manufacturing, telecommunications, power generation, oil & gas and healthcare. Thus, finance and risk management teams rely on accurate fixed asset accounting records. This reliance raises additional questions: when the finance team considers fixed asset management services, should it coordinate with the risk management team to determine the need for a property insurance appraisal, and vice versa?

The cost of inaccurate records

Inaccuracies in fixed assets can arise over time for a number of reasons:

- Acquisitions, mergers, consolidation and rationalization of operations
- Inadequate asset descriptions including missing manufacturer, model and serial number data
- Little or no use of property identification tags
- Bulk purchases and inconsistent application of the accounting capitalization threshold

- Construction-in-progress projects not properly segregated into building and/or equipment accounts
- Poor documentation of asset movement including disposal activity and transfers
- Infrequent or no periodic physical inventory/reconciliation process

Poor fixed asset accounting records can lead to inaccurate financial reporting. . . and inaccurate financial reporting can lead to audit issues and possibly a qualified audit opinion, which can damage management's credibility with shareholders, lenders and suppliers.

From an insurance perspective, underwriters are demanding increased data integrity – precise building and equipment values as well as building construction, occupancy, protection and exposure (COPE) data in catastrophe-prone regions. In addition, fixed asset accounting records are used to determine the replacement cost of personal property for insurance placement purposes. When it comes to insurable values, accuracy is vital – no one wants to be paying higher rates or excess premiums because of poor data or insuring ghost assets.

Similarly, depending on jurisdiction, an organization may be subject to personal property tax, and tax assessments are typically based on fixed asset accounting records, with rates being applied to the assessed value. Unfortunately, organizations can end up overpaying taxes by 20% to 30% due to ghost assets.

The benefits of combining services

Our clients often ask, "While you're completing a property insurance appraisal, can you also assist us in cleaning up our fixed asset accounting records?" We find that there are many similarities between fixed asset management and property insurance appraisal services. Primarily, both require a physical inspection and inventory of the fixed assets - this alone makes it a worthwhile joint exercise.

Duff & Phelps starts by gaining a thorough understanding of the finance and insurance teams' needs and how they might be met effectively. A diagnostic review of the fixed asset accounting records and the current Statement of Insurable Values helps determine the scope of each service. Typically, an insurance appraisal will consider a total replacement cost of all the entity's assets (except land), buildings, property in the open and personal property. This would also include expensed assets below the capitalization threshold, whereas a fixed asset inventory for financial reporting is typically restricted to fixed assets that have been capitalized.

Other scope differences for a fixed asset inventory for accounting and financial reporting purposes would include:

- Inventory of the personal property at the accounting capitalization threshold.
- Reconciliation or comparison of the inventory file to current fixed asset accounting records (in brief, the reconciliation process will identify matched assets, unrecorded additions and unrecorded retirements). Varying levels of diligence can be applied to this process, from simple tag number matching to a line-by-line reconciliation.
- Bulk entries and grouped purchases allocated to the individual assets.
- Conclusion of historic cost where necessary.

On the other hand, an insurance appraisal might include:

- COPE data elements for buildings.
- A personal property inventory listing cut-off significantly higher than the accounting capitalization threshold. Assets below this threshold are still valued; however, they are grouped with like-kind assets, not individually listed (with the goal being to track addition and retirement of major assets only).
- The location of personal property assets is identified, typically by building and floor to facilitate underwriting analysis, whereas fixed asset inventories tend to record additional information, such as room and cost center.
- The conclusion of insurable value/cost of reproduction new versus historical cost.

The benefits of the combined services include:

- Eliminating ghost assets: why insure or pay property tax on something that's long gone?
- Identifying individual assets in bulk entries for maintenance of future disposals
- Truing up transferred assets
- Eliminating negative management letter comments from external and internal auditors and meeting GAAP and IFRS expectations

- Accounting for, managing and controlling assets
- Eliminating the possibility of excess premiums/insufficient coverage
- Negotiating better insurance rates and underwriting terms and conditions

Once the services have been completed, committing to annual updating will maintain the integrity of the fixed asset accounting records and insurable values.

Can we do this ourselves?

Many organizations attempt to perform fixed asset inventory services in house, which poses challenges - lack of experience, inadequate descriptions on the fixed asset accounting records, lack of a reconciliation process or experience, and not being able to allocate enough time, among others. This type of inventory is conducted by the actual custodians of the equipment, who may be reluctant to report discrepancies – especially if concerned that their department may be the reason for ghost assets and a personal property tax overstatement. Independence and objectivity can be lost during an in-house inventory and reconciliation.

In addition, a structured property insurance appraisal program provides the following benefits:

- An independent third-party opinion of value will be readily accepted by underwriters, due to a lack of self-interest influencing value or cost.
- The same consistent approach and methodology, as well as pricing sources, will be used for all insured locations.
- Site inspections and value analyses are efficient and cost effective, with minimal involvement and disruption of local staff, and conclusions will be delivered by the contracted date.
- The report will be recognized and approved by brokers and insurance companies.

Duff & Phelps provides fixed asset inventory solutions and insurance valuation for clients on a global basis. We serve clients in virtually every industry, with particular expertise in serving capital-intensive industries, technology companies, higher education, healthcare and government, among others. Our use of leading-edge technology benefits our clients through data collection, software conversions and web-based reporting.

Mark Bobber
Managing Director, Fixed Asset
Management and Insurance Solutions
T +1 414 225 1288
E mark.bobber@duffandphelps.com

Nigel Wilson, ASA, CEng, MIMMM
Director, Fixed Asset Management
and Insurance Solutions
T +1 617 378 9485
E nigel.wilson@duffandphelps.com