

Volume No. 1—Policies and Procedures	TOPIC NO	30505 – Cardinal
Section No. 30500—Asset Control and Management	TOPIC	Physical Inventory
	DATE	August 2015

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Overview

Introduction

The purpose of this topic is to provide guidance in the administration of a capital asset physical inventory. The objectives of a physical inventory are to ensure that the capital assets recorded in the Fixed Asset Accounting and Control System (FAACS) physically exist, determine if unrecorded or improperly recorded transactions have occurred, and identify any excess, defective or obsolete assets on hand. An effective inventory results in an accurate accounting of capital assets, and indicates the reliability of the system of accountability for the acquisition, use, and disposal of those assets.

The frequency of taking an inventory depends on the nature, quantity, and value of the capital assets, and the cost and effort required to perform the procedures. This topic provides the policy, procedures, and suggested forms to utilize in conducting capital asset physical inventories.

Policy

General

A physical inventory of capital assets is required at least *once every two years* in order to properly safeguard assets and maintain fiscal accountability. The methods an agency may use are as follows:

- Conduct a wall-to-wall physical inventory of all assets recorded on FAACS.
- Conduct a physical inventory based on a generally accepted method of statistical sampling of assets recorded on FAACS (see Subtopic “Statistical Sampling.”)

Either of the above methods is acceptable by the Comptroller's Office for certification of correctness of data within FAACS. Inventories of assets which are susceptible to errors or irregularities should be conducted on a more frequent basis.

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Procedures

Guidelines

The following general guidelines have been established to ensure that the inventory will be effectively implemented and performed by the agency:

- Individuals responsible for the property management function of the agency should establish a timetable and coordinate the effort necessary to conduct the inventory.
- Responsible persons should assist in conducting physical inventories in their area.
- Discrepancies between recorded and actual inventories must be resolved in a timely manner through the submission of revised input forms and tagging, if necessary.
- Each item recorded is physically inspected for changes in condition and availability codes.
- Additions, deletions, and changes to FAACS inventory records must be transmitted to the individual responsible for agency property management on a timely basis.
- Inventories may be conducted on a cyclical basis (i.e., all capital assets do not have to be inventoried at the same time as long as the entire inventory is done within the required two-year timeframe). Cyclical inventories enable property managers to schedule inventory activities over a long period of time, and thus conserving staff resources.

The physical inventory must verify the asset's existence, and should provide a reference to lists and/or other documents evidencing the existence and cost of the asset examined. Procedures must include verification from the list to ensure the physical existence of listed assets and from the physical assets back to the list to ensure all assets physically in existence are recorded in the inventory records.

Although a physical inventory is only required once every two years, it is recommended that equipment inventories be conducted annually, if practical. This is due to equipment assets being more subject to change, therefore, necessitating tighter control.

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The following detailed guidelines are provided for conducting the inventory, and apply primarily to items in the equipment category:

- The individual performing the agency property management function will be permitted access to every room being inventoried.
- Either all the equipment (or the equipment sampled) located in the room will be checked for tag number and traced back to the inventory listing with the following physical attribute fields rechecked; location, responsible person, equipment condition, and equipment availability. Tagged items in the room which are reported on the agency inventory report as located elsewhere will require a revision to record the change of location.
- If tagged items are missing from the inventory listing, or if untagged items are identified as meeting the FAACS definition of either a capitalized or controlled asset, inventory information must be completed at that time for subsequent entry into the on-line system. The information which must be completed is contained in CAPP Topic No. 70325, *Data Entry*.
- A sampling of items with tags should be made and traced to the inventory listing to ensure it is recorded. Also, a sampling of items from the listing should be made to ensure the physical existence of the item.
- Any items found to be unrecorded or not physically existing should be listed as a discrepancy, subsequently researched, and then either entered or removed by disposal from the system, as appropriate.
- Once all the agency locations have been checked for tagged, untagged, recorded or unrecorded items, the required changes will be processed by property management.

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To assist agencies in taking these physical inventories, FAACS report FAC30080, *Assets by Location*, should be used. This is a detailed report that lists an agency's capital assets by location in terms of FIPS code, building, etc. The report comes in three options.

- **Option 1** lists the agency's assets grouped according to organization, location within organization, nomenclature codes within location with the associated FAACS ID number for each item.
- **Option 2** lists the agency's assets grouped according to location and then in numerical order code by FAACS ID number within location with the associated nomenclature code for each item.
- **Option 3** lists the agency's assets grouped according to organization, location within organization, and then in numerical order by FAACS ID number within location, with the associated nomenclature code for each item.

In addition to FAC30080 report, agencies may also choose the FAC316 report, *Inventory by Responsible Position*, FAC30010 report, *Agency Inventory Report*, FAC308 report, *Master Inventory by Organization and Nomenclature* (for automated data processing (ADP) equipment), and FAC332 report, *Asset Inventory Report*, to assist with the taking of physical inventories.

Timing of Inventory Activities

FAACS is maintained on a perpetual inventory basis. Changes are made to the master file records as soon as practicable after such changes occur in asset status. Information concerning new acquisitions is recorded once the item has been delivered to the agency.

All assets are assigned to a position in the department or unit where the asset is located or controlled. Assets belonging to the agency as a whole, such as land and buildings, are assigned to the agency head or fiscal officer. Consequently, all assets are assigned to a position responsible for safekeeping.

Although the system permits rapid notification of changes to agency inventories, physical inspection is necessary to ensure that changes are correctly processed. Therefore, various inventory activities must be conducted during the year, in the following sequence:

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Daily

Departments or other organizational units must submit revisions to the individual charged with the property management function whenever permanent changes to the below listed information fields occur:

- Change of ownership (organization code)
- Change of location (space identifier code)
- Change of responsible position
- Change of asset status (availability code)
- Change of asset operability (condition code)
- Direct receipt of new asset

Quarterly

Many organizations receive inventory reports at the end of each fiscal quarter. These must be specifically requested from the Department of Accounts (DOA). Reports received for the quarters ending in September, December, and March may be reviewed by organizational managers to verify the accuracy of recorded information. Reviewed reports should be signed and returned to property management personnel, indicating any discrepancies. Required corrections must be processed by keying revisions into the on-line system.

Inventory Staffing

A responsible position/person must be assigned to each asset item recorded in FAACS in the data field provided. This is to ensure that an individual within the agency has responsibility for maintaining and safeguarding the asset. The responsible person may or may not be directly involved in using the asset.

The responsible person for equipment would usually be an individual in charge of a specific section of the agency (e.g., cost center manager). Assets assigned to the agency as a whole yet utilized by more than one division or cost center (e.g., assets such as land) would usually have the agency head as the responsible person. At a minimum, the responsible person should be directly involved in the acquisition and disposition of assets assigned to his/her position.

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Individuals responsible for the property management function within the agency should assist in conducting the physical inventory of capital assets.

Inventory count activities should be conducted by count teams made up of a team supervisor and agency personnel. If necessary, part-time employees may be utilized. Agencies are encouraged to utilize work study students as a manpower resource for conducting the physical inventory. Use of part-time employees enables the agency to keep from disrupting the functions of full-time employees during the year and to quickly increase the inventory count staff on a temporary basis when physical inventories are required. However, the agency must determine the method of staffing the inventory count team that best utilizes its available resources.

Tagging

Tagging provides a method of assigning a unique identification number to each capital asset equipment item, so that the item can be accounted for and identified within FAACS. The tag should provide a unique number and the property owner's name (agency name). It is important that the format of the tag used should serve the primary purposes of identification; therefore, the number should be the predominant feature on the tag. The numbering sequence utilized should be a simple, consecutive series of numbers. Numbers should be assigned in consecutive order without regard to asset type or location.

The consecutive numbering allows each asset item within FAACS to carry a unique number throughout its entire life regardless of change in location, responsible person, or other data elements assigned to the asset item, until such asset is retired or disposed of. Once disposition has occurred, the number is retired. FAACS will maintain a history file of the retired identification number for three years after disposition for audit trail control purposes.

Assets to be entered into FAACS should be tagged at the time of physical receipt, or as soon thereafter as possible.

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Items incapable of receiving a physical tag will nevertheless be coded a unique tag identification number for FAACS input purposes. These types of untaggable assets include heat-sensitive or finely-tuned equipment items for which physical tagging would be impractical or would otherwise alter the item's usefulness. The tag indicator field on the asset control specification screen must be completed with a **Y** if the item was tagged, or an **N** if the item was not physically tagged. The unused tags should be stored in an agency log book or otherwise controlled to avoid duplicate use of tag numbers.

It is emphasized that no single, Statewide identification tag is mandated for inventory purposes. Agencies may continue to use current tag formats as long as the above tagging procedures are met.

Although the use of serial numbers as a unique identification number is not disallowed, it is not recommended.

Statistical Sampling

The use of statistical sampling is recognized as an acceptable technique in conducting physical inventories. This section describes the objectives, plans, and design criteria to be used in developing valid statistical sampling techniques.

Sample Objectives:

The overall objective of the sample inventory is to ensure that the information recorded in FAACS is correct.

The sampling methodology must provide assurance of correctness of the information by:

- A statistically valid sampling plan, whose results can be projected to the entire population;
- Procedures for periodically checking the accuracy of the information in the system and maintaining an approved level of accuracy;
- Mechanisms to periodically collect updated information on a group of items in the system; and,
- Procedures for periodically checking assets and verifying that they are tagged and properly included in the system. This is to ensure that assets do not go unrecorded in the system.

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Sampling Plan:

The sampling plan is used for selecting a group of capital assets from the total population, from which estimates of population characteristics will be made.

The sampling plan must address the following issues:

- sample design
- sample sizes and accuracy levels
- sample selection, and
- method of measurement.

Sample Design - The basis for the sample design is the list of items produced by FAACS. The proposed design is to stratify the sampling units by type of asset (nomenclature code) to provide groups of items with similar characteristics.

Asset Stratification - may be useful in identifying potential groups of items for which data is inaccurate, and may reduce the number of items to be inventoried.

Sampling Methodology - The purpose of taking a physical inventory of capital assets can be summarized into two main categories:

Substantive testing Does the item exist, and are its characteristics, such as usability and condition, shown in the records?

Compliance testing Are the data elements shown on the record correct? This would include tag number accuracy, location, description, and other elements which relate to the asset.

After clearly defining the population to be surveyed, clarifying the goals of the survey, and defining the accuracy and confidence needed from the survey by management, there are several scientific sampling techniques which could be used to develop the sample. These techniques include simple random sampling, systematic random sampling, cluster sampling, proportional and nonproportional stratified sampling, and more.

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Since FAACS will be generating capital asset financial information for inclusion in the Commonwealth's financial statements, a principal qualifier is the dollar amount represented by the asset grouping when considering the methodology to use for developing the sample size, and selecting the specific items which will comprise the sample for testing in the physical inventory process. A technique which gives greater consideration to the higher dollar amounts recorded and which is reasonably easy to apply is the Dollar Unit Sampling method, described in the following paragraphs.

Sample Size - The Dollar Unit Sampling Method may be used in establishing the size of the sample to be tested. In addition to knowing the total recorded amount of the asset category (i.e., equipment), the two remaining criteria to be considered are confidence and precision:

- Confidence, in qualitative terms, represents a risk or a chance that an event will occur. Expressed in quantitative terms, it is usually shown as "95 in 100," or "10 to 1," and the like. For statistical sampling purposes, it is management's expression of the level of risk that the results of the sample inventory can be extended to the total inventory with reasonable accuracy. It is a qualitative judgement, in part, which may be based upon tests of adequate input controls to FAACS, procedures for tagging and controlling items, etc. A manager may feel that since the system's controls are strong and that the property management function is well organized, a lower level of confidence is required. Conversely, if weaknesses exist, the manager may desire a higher level of confidence to offset these.
- Precision is the degree to which the amount of inventory value expressed from the sample will vary, and is shown as a "plus or minus" amount. It also is a management judgement which will impact the sample size. The sample size has a substantial bearing on the precision of the results.

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The following formula for developing a sample based on the **Dollar Unit Sampling** method applies:

$$n = \frac{(V) \times (CF)}{P}$$

Where

- **n** is the number of items in the sample size.
- **V** is the total book value of the asset category.
- **CF** is the confidence factor* required.
- **P** is the precision required.

* The confidence factor is a mathematical function of the percent of confidence desired and is shown below for several levels which may be used.

<u>Confidence Level</u>	<u>Confidence Factor</u>
95%	3.0
90	2.3
85	1.9
70	1.2
50	1.0

Example

The total equipment value for an agency shown on the agency's inventory report (FAACS report 30010) which is to be inventoried is \$13,450,500. Management desires a confidence level of 90% and wants the result to represent a precision, or tolerance of + or - \$100,000. In other words, management wants to be "90% confident that the book value represents the total dollar value of the asset category, plus or minus \$100,000

$$\begin{aligned}
 V &= \$13,450,000 \\
 CF &= 2.3 \\
 P &= \$100,000 \\
 n &= \frac{(13,450,000) \times 2.3}{\$100,000}
 \end{aligned}$$

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Selecting the Sample

The next step requires developing a dollar amount sampling interval, determined by dividing the total asset inventory value by the sample size:

$$\frac{\$13,450,000}{309} = \$43,527$$

Although a reasonably simple computer program would help select the sample from the listing of items, a manual calculator will suffice for this purpose.

Using the listing of equipment items and the value recorded for each, perform the following steps:

Step	Action
1	Choose any number between 0 and the sampling interval. In the preceding example, the interval is \$43,527. This chosen number will be used to establish the random start in the listing.
2	Enter the number in the machine as a negative amount.
3	Begin adding the values of the items in the listing, taking subtotals with each until the subtotal exceeds 0. (Remember, a negative was used in Step 2 which is then being "reduced" as positive amounts are added to it.) The item whose value caused the subtotal to exceed 0 is the random start and the first of the 309 items of the sample, as in the example.
4	Using the subtotal amount derived from step 3 above, enter a negative (subtract) value for the interval amount - \$43,527 in this example - and compute a new subtotal which will be a negative amount.
5	Repeat step 3 until again the subtotal exceeds 0 as a positive amount. The item whose value caused the subtotal to be greater than 0 is, in the example, the second sample item to be tested.

This process is continued until the sample size is reached and the sample items identified. In the case of a single item whose recorded value exceeds the sampling interval, it must be understood that this value may only be utilized once for identifying the items to be included in the sample. For instance, an item whose value is \$130,581 is three times the interval amount in the example, but may only be counted once for purposes of satisfying the sample size requirement.

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An illustration of the sample selection process follows:

		Subtotal Values					
<u>Item</u>	<u>Value</u>		<u>(12,345) *</u>			<u>Interval</u>	
1	\$23,000	<u>add</u>	10,655	+	(43,527)	=	(32,872)
2	40,000	+	(32,872)	=	7,128	+	(43,527) = (36,399)
3	2,000	+	(36,399)	=	(34,399)		
4	19,000	+	(34,399)	=	(15,399)		
5	28,000	+	(15,399)	=	12,601	+	(43,527) = (30,926)
6	35,000	+	(30,926)	=	4,074	+	(43,527) = (39,453)
7	47,000	+	(39,453)	=	7,547	+	(43,527) = (35,980)
8	10,000	+	(35,980)	=	(25,980)	+	
9	17,000	+	(25,980)	=	(8,980)		
10	28,000	+	(8,980)	=	19,020	+	(43,527) = (24,507)
11	22,000	+	(24,507)	=	(2,507)		
12	73,000	+	(2,507)	=	70,493	+	(43,527) = (16,561)
13	31,000	+	(16,561)	=	14,439		

* A random start number of 12,345 was used.

Cardinal Transition Entries

Currently, FAACS interfaces with CARS and there is an interface with Cardinal under development. Each month, FAACS generates an entry to record asset activity in CARS. In order to replicate these fixed asset entries in Cardinal for any adjustments due to completing an inventory, Wave 1 agencies will need to manually create a General Ledger Journal. The GL Journal should be recorded in Cardinal prior to the close of the same accounting period as was used in CARS. This will be an ongoing activity for Wave 1 agencies until the interface from FAACS to Cardinal is implemented in February 2016.

Refer to the “SW GL332 Crosswalk from FAACS Transaction Codes to Cardinal Accounts” Job Aid for further information regarding the recording of FAACS activity in Cardinal. The Job Aid can be found on the Cardinal Project website.

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Internal Control

General

Each agency and institution should implement cost beneficial internal control procedures to ensure that:

- All asset transactions are entered into FAACS in a timely manner.
- All adjustments to FAACS data are approved by a responsible person whose duties encompass property management.
- All FAACS reports are received in a timely manner for accuracy and completeness.
- Discrepancies thoroughly researched and brought to management's attention.
- Inventories are taken at least once every two years, or more frequently, if warranted.

Records Retention

General

Fiscal records related to managing capital assets should be retained for a period of 2 years plus current fiscal year, or until audited, whichever is greater. However, for pending, ongoing, or unresolved litigation, audits or claims, retain documentation until completion, resolution, or negotiation of settlements.

Destruction of records must be in accordance with policies and procedures of the Records Management Section, The Library of Virginia.

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Subject Cross References

References CAPP Topic No. 70325, *Data Entry*

Suggested Job Aid The following can be found on the Cardinal Website, under Statewide Toolbox – Job Aids:

SW GL332 Crosswalk from FAACS Transaction Codes to Cardinal Accounts

Additional job aids and training materials may be available on the Cardinal website.

Please note: The Cardinal job aids, training materials and forms on the Cardinal website are not policy of the Department of Accounts and are not part of the Commonwealth Accounting Policies and Procedures Manual (CAPP).
