Facilities Finance 101

- ## Operating budgets

  - Annual budget for operations, repairs, minor construction /alterations and overhead
  - Money budgeted but not spent in a given year does not roll over until the next year

  - Preparation of budget:
    - Important to know how company derives and manages the budget
    - Starting point is revenue plan which drives affordability levels

  - Top down vs bottoms up
    - Top down – budget number is determined by total affordable spend; usually set by upper management.
    - Bottoms up – budget number is determined by organization by building up required spend.
    - Facilities should quantify their required spend even if top down approach is followed in order to highlight disconnects
    - Requests should be prioritized. Items necessary for keeping production running or environmental / safety requirements should be highlighted. Upper management does not like surprises.

  - Controllable vs non-controllable
    - Controllable costs are those costs that a department has authority and responsibility for
    - Uncontrollable costs are those costs that a department doesn't have authority over and can't change
    - Cost allocations are uncontrollable costs.

- Operating budgets

  - Fixed vs variable costs
    - Fixed expenses or costs are those that do not fluctuate with changes in production level or sales volume. They include such expenses as rent, insurance, dues and subscriptions, equipment leases, payments on loans, depreciation, management salaries, and advertising.
    - Variable costs are those that respond directly and proportionately to changes in activity level or volume, such as raw materials, hourly production wages, sales commissions, inventory, packaging supplies, and shipping costs.
  - Support groups or cost centers do not generate revenue or profit.
  - Facilities cost centers are usually charged out to occupying departments as a "rent" or building services charge.

Journals, Reports and Cost Allocation

- Understanding them
  - Large companies use systems such as Oracle or SAP;
  - Most accounting entries are automated
  - Journals (JE) are accounting entries, either automated or done manually
  - Two sides of the entry made: debit and credit
  - Entries can be balance sheet to balance sheet, income statement to income statement, or balance sheet to income statement and vice versa

- Reports
  - Systems and data warehouses contain reporting available for budget to actual comparisons, department expense detail, open purchase orders, balance sheets and income statements (profit and loss)

- Cost allocations
  - Costs from departments or cost centers are allocated to income statements (profit and loss) thru use of allocation bases maintained by Finance
  - Facilities cost centers usually allocated on square footage, utilities usage, etc.

- ## Invoicing and Contracts

  - Understanding the process
    - Who is authorized to approve contracts? Supply Management, Procurement, Legal?
    - Invoices should be reviewed and approved only when work is completed.
    - Are bids required? Best practice minimum - 3 Bid Process.
      - Go to bid – every 3-5 years

  - US GAAP requires matching of expenses with benefit received
    - Is it okay to ask a vendor to submit an invoice before work is performed in order to have expenses recognized in the current year?
    - Is it okay to ask Finance to accrue for work to be performed next year in the current month because the department is running under budget this y
    - Can a hotel bill be paid in advance of travel so it goes against the current month budget?

- ## Capital Budget

  – Capital budget is used for managing large one-time projects involving purchase or construction of assets with funding potentially over multiple years.

  – Capital budget approved by top management in capital review process.
  – Review process looks at ROI (return on investment) and other metrics.
  – Manufacturing expansion (revenue growth) versus facilities projects (safety/environmental, cost reduction)
  – Budget and actual spend usually managed by capital project.

- ## Capital spending
  - What is capital?
    - Property, plant, equipment and natural resources that are tangible assets of a permanent nature not held for sale.
      - Examples are:
        - » Land
        - » Land improvements – paving, sewers, fences, landscaping, roads, parking lots, etc.
        - » Buildings – all structures used for manufacturing, storage, offices, etc.
        - » Building improvements
        - » Machinery and equipment – stationary or movable items used in production, transportation, and other business uses.
        - » Furniture and fixtures (bulk purchases)
        - » Computer equipment and software (bulk purchases)
  - Life of asset and dollar value criteria for capitalization; Life of asset greater than 1 yr and $5k.

- Capital spending
  - What are costs included in capital value?
    - All costs directly related to its acquisition and to place asset in usable condition. This includes purchase or construction cost, taxes, freight, customs and duties, architectural fees and installation costs paid.
    - Spare parts or replacement parts (not stand alone capital equipment) are usually expensed upon receipt. Some exceptions for new factory startup depending upon company policy.

- Capital spending
  - Some companies have policies on bulk purchases (chairs, etc.) that are capitalized if following criteria are met:
    - Each item exceeds $500
    - Total aggregate purchase exceeds $200k
    - Items are requested on one purchase requisition
  - Personal computers are not considered as bulk purchases

- Capital spending
  - What about leased facilities?
    - Usually same rules for determining capital apply, but asset depreciates over life of asset or term of lease whichever is less.

- Capital spending

  - What is the difference between capital and expense?
    - “Matching Principle” requires that cost be recognized financially in the same time period that benefit is received.
    - Expense is charged as it is incurred such as travel, payroll, repairs.
    - Cost of capital equipment is recognized over its useful life.
    - Depreciation is apportioning the cost of the asset over its useful life.
    - Depreciation: Total cost of asset divided by useful life.
    - Useful life usually determined by category of asset (i.e, plumbing, carpeting, lab test equipment etc. Different useful lives and depreciation methods for accounting and tax purposes.
      - » Building structure: 30 yrs
      - » Electrical, HVAC: 10 yrs
      - » Roof: 10 yrs

- Capital spending
  - Acquisition cost or book value = original cost to acquire asset
  - Net book value = (Acquisition cost – depreciation inception to date)

- Fixed Asset inventory
  - Done on periodic basis to confirm assets (ON is done every 3 yrs)
  - Un-located assets are retired ("written off – ie., net book value is charged to owning department").
  - Be pro-active when assets are acquired to make sure asset description and other info is correct and understandable so asset can be identified and located during a fixed asset inventory. Make sure asset tags are attached when assets are received / installed.

- Fixed Asset inventory
  - If assets are torn out, sold to external parties or abandoned, the asset should be retired (written off).
  - Equipment pool
  - Where do proceeds of asset sales get recognized financially? Offset asset write-off?
  - ARO – Asset retirement obligation. US GAAP. If laws or contractual obligations exist in the jurisdiction where an asset resides that require clean up efforts, the cost of preparing asset for disposal must be recognized as a liability on the balance sheet. EHS assists in determining clean up cost. Cost added to book value and depreciated.

- Costs incurred during ownership – repairs versus improvements?
  - Repairs – expensed when incurred.
  - Additions, improvements, alterations and refurbishments are capitalized over the life of the asset:
    - » Costs incurred exceed $5k and 25% of acquisition cost or greater than $100k and one of the following must occur:
    - » 1) increase the overall capacity of the asset, or
    - » 2) appreciably extend the life of the asset, or
    - » 3) improve the efficiency or safety of the original asset.

Yearly maintenance contracts:

- One-time payment for yearly maintenance contracts should be expensed to operations over contract time period.
- If you have these types of contacts, let Finance know.

Capital versus Operating Leases:

A lease is defined as an agreement conferring the right to use property, plant or equipment (including software) for a stated amount of time.

The criteria for classifying leases between capital and operating is derived from the viewpoint of substantial transfer of benefits and risks incident to the ownership of the property

To meet the criteria for a capital lease, at least one of the following tests needs to be met, in accordance with ASC 840-10 (formally SFAS No. 13):

1. The lease transfers ownership to the lessee by the end of the lease term.
2. The lease contains a bargain purchase option.
3. The lease term is equal to 75% or more of the estimated economic life of the leased property.
4 The present value of the lease cash flows equals or exceeds 90% of the fair value of the leased property.
5. The leased asset is so specialized that at the end of the lease term it will have no alternative use to the lessor.

If the lease is classified as a capital lease, it is shown as a liability on the balance sheet. Currently, operating leases are not shown on the balance sheet. However, effective Dec 18, operating leases will also be required to be shown on the balance sheet.