Forecasting Costs and Managing Capital Expenditure Programs

Powerful Insights

Issue
In recent years, numerous companies, including many household names, have realized record losses and have been forced to lay off thousands of workers due to poor financial markets and conditions, even filing bankruptcy in some cases. Often times, the inability of organizations to forecast and control costs effectively has led to these events.

Surprisingly, within a large number of these companies there is not a clearly defined owner of forecasting and budgeting costs and managing major capital expenditure programs. As a result, key stakeholder questions can go unanswered: What tools/technologies is the company employing to meet its forecasts and expectations? Is the organization monitoring its costs with the scrutiny that stakeholders expect? What are the potential risks in the company's level of costs and capital expenditures? How are these risks being assessed, managed and monitored? These are among many questions that company leaders face from investors, stakeholders and employees.

How and why do companies experience budget overruns? There are a variety of reasons and drivers, some of which are beyond a company's direct control:

- Lack of ability to accurately forecast supply and demand
- Insurance, litigation and regulatory costs
- Commodity prices
- Environmental protection costs
- Natural disasters
- Inadequate capacity
- Reliance on third-party contractors and consultants
- Internal cost misallocations or erroneous vendor charges

Challenges and Opportunities
In a time and business environment where access to capital is becoming tougher to obtain and management must control costs to sustain a competitive advantage, companies are realizing that every dollar counts. Organizations across the globe are becoming smarter about how they utilize their capital by focusing on cutting costs and spending money in areas where the return on investment (ROI) is the greatest. These companies can benefit from deploying best practices to forecast cost and manage capital expenditures. Such practices include, but are not limited to, the following:

- Ensure centralized reporting (all business units/entities are monitored in one location).
- Project work capacity (set high/low achievement projections by month/year).
- Ensure all capital-intensive projects are captured in the forecast.
- Re-forecast at least quarterly based on level of completion (percentage/dollar), schedule updates or cost adjustments.
- Track authorization for expenditure (AFE) drawdown (gross/net) and any supplemental requirements/impacts.
- Monitor AFE spend at least monthly and ensure AFEs are being closed in a timely manner to mitigate the risk of expense items being charged to capital accounts as a result of improper coding.
- Ensure proper accruals are being made each month/quarter so that spend is captured accurately, thus enabling more accurate forecasting of remaining costs.
About Protiviti

Protiviti (www.protiviti.com) is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit, and has served more than 40 percent of FORTUNE 1000® and FORTUNE Global 500® companies. Protiviti and its independently owned Member Firms serve clients through a network of more than 70 locations in over 20 countries. The firm also works with smaller, growing companies, including those looking to go public, as well as with government agencies.

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Our Point of View

Companies are constantly striving to meet production and revenue goals. In the process, they often lose sight of the cost of doing business when just a small improvement in the cost basis can have a significant positive impact. Alternatively, not having defined capital expenditure processes in place to monitor these risks can have a major effect on a company’s ability to meet its profitability goals and remain competitive in the marketplace. By undertaking best practices and appropriate technologies to manage capital expenditures and forecast costs more accurately, organizations will improve their bottom lines and gain significant competitive advantage.

PROVEN DELIVERY

How We Help Companies Succeed

Protiviti partners with companies to build and implement best-in-class processes, procedures and systems that ensure better forecasting and control of capital expenditures. We conduct independent assessments of processes and controls associated with the initiation, planning, execution, monitoring and completion of contract and capital project-related activities. We have a methodology to analyze and document processes, risks and controls; identify and document control gaps; and recommend remediation plans to improve contract and capital project management processes. We also identify process linkages to key technology enablers such as contract management, accounting and procurement systems, while training resources with our clients to ensure effective implementation and full adoption of the processes.

Example

An independent exploration and production company engaged Protiviti to perform an assessment of its capital expenditure program as it related to drilling and completion activity, on which it spent an estimated $2 billion annually. As part of this assessment, we reviewed processes for conducting specific drilling and completion projects, analyzed data at a detailed transaction level, and performed a summary-level analysis of the company’s entire capital project portfolio, inclusive of five years of historical activity.

From the results of this assessment, we were able to work with both the accounting and operations groups to identify and link the root causes of cost overruns on projects to a specific transaction or event, develop custom reporting that linked data from disparate systems to provide more transparency into capital expenditures for senior management, and implement best-practice project management processes to measure and monitor expenditures going forward. In addition, we performed an exercise with management to close more than 75 percent of the active budgets in the company’s portfolio that were no longer needed, which significantly reduced the risk of future cost misallocation.

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