Each capital project involves multiple types of financial outlay. Those expenses can fall into one of several classifications, with some of the more common ones being capital expenditures (CAPEX), sustaining capital projects (SUSCAP), and operating expenditures (OPEX).

Because of the immense size and sophistication of many of today's capital projects, how you address and manage these expenses in the near and long term can have consequences that affect a company's financial health.

Let's look at each expense classification and how to approach them.

CAPEX

Capital expenditures consist of costs for — or investments in — tangible, fixed assets that are primarily new. So naturally, these will have a higher price tag than other expenditure types.

This can be a broad category. Here, you'll find more permanent things like a plant or a facility (whether a purchase or new construction) and land property. It's also where you'd classify necessary upgrades or complete renovations, such as outfitting a structure with current energy-efficient technologies or

SUSCAP is a form of capital expenditure that includes costs of bringing equipment and facilities up to regulatory standards or replacing or fixing outdated, worn, or damaged structures or equipment to maintain capacity and functionality. They're not considered additional capabilities or functionalities, nor are they meant to improve them. Instead, they're intended to keep these at current levels, preserving the value of the depreciable asset while keeping downtime to a minimum.

OPEX

What is built must be maintained. Operating expenses keep the capital asset, in whatever form, going each day. As such, these expenses are considered intangible. Think trailer and office rentals, wages, administrative costs, taxes, fees, and utilities. These shorter-term overhead expenses — typically having a usable lifespan of less than a year — are incurred and paid within a payment cycle rather than depreciating over time, like CAPEX costs.

Individually, the dollar value of these expenses is often far less than CAPEX; however, they can add up. For project owners, OPEX will likely represent the bulk of the costs needed to maintain the built structure throughout its functional life.

Expenditure Classification Decisions: Confusion or Strategy?

Sounds pretty cut and dried. Until it's not. Things can get fuzzy, or at least interesting, in how expenses are classified and reported when you realize some can straddle CAPEX and OPEX categories. But what may look at first glance as a conundrum could actually be strategic in some cases. How so? Look at the short-term and long-term implications and how they align with your project's financial goals.

Let's say you need a major asset such as a vehicle, machinery, or computer equipment. If you want to limit your capital expenditures over time, then leasing it (OPEX) may be preferable to buying it (CAPEX). Or, if you prefer to hold onto your operating cash reserves, purchasing the asset through external financing (CAPEX) may make more sense than paying for it out of your operating budget.

Another scenario to consider, if industry rules allow, involves both capital and operating expenditures. Let's say you have equipment past its prime at an existing facility and want to replace it. You could classify the equipment's removal as OPEX and its replacement installation as CAPEX. It's a creative way of deciding how to classify expenditures.

About the Article

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