UHY LLP
Certified Public Accountants

MANUFACTURING INSIDER

VOLUME 6 :: ISSUE 4

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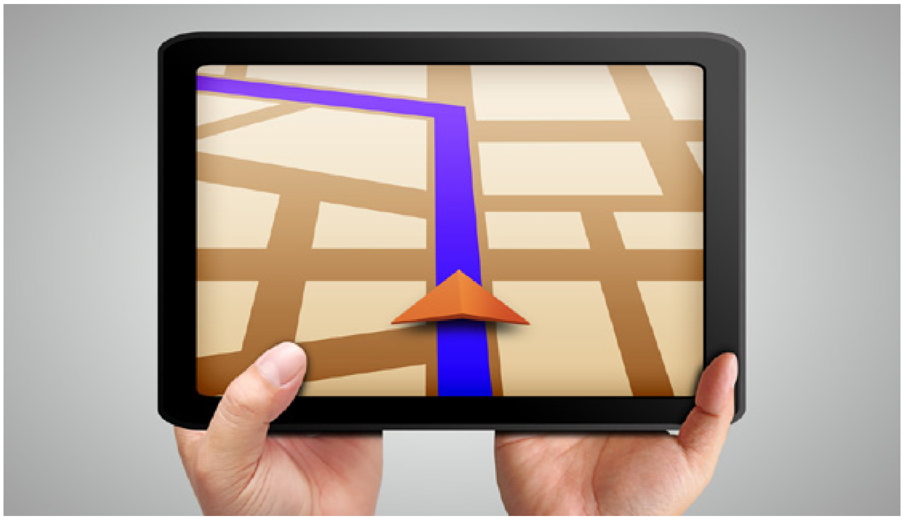

ON THE ROAD AGAIN: USING PROJECT MANAGEMENT AS A GPS IN MANUFACTURING

What happens when you have a big project to complete and you decide to jump in without a plan? Sometimes it can work out, but usually it becomes a big mess very quickly. So how do you make sure a project is heading down the right road? How do you make sure all of the intricate moving pieces are in the right place at the right time? The answer is simple; you develop a project management office ("PMO") and project management plan ("PMP") to guide your every move. You use a GPS.

WHAT'S YOUR DESTINATION?

A supplier to a large Tier 1 automotive manufacturer ("Company") had a facility that could not sustain its profitability because it was built to produce more inventory on a daily basis than the market currently demanded. The Company needed to save money, but knew there were many factors to consider including the magnitude of a potential move, pre-negotiated production agreements with the Tier 1 automotive manufacturer and the staff employed at the current facility.

To complete a full move, each piece of equipment has to be labeled, dismantled, boxed, labeled again, rigged, shipped, received, unpacked and reassembled correctly. It's no small feat. Business also doesn't stop during a plant move for a supplier. People are still buying vehicles, and the Tier 1 manufacturer still has to produce enough vehicles to meet market demand while also meeting stringent quality standards. Adding to the challenge, the plant was located in a very small town, and 140 people would become unemployed when the plant shutdown occurred. Due to this, the risk of poor quality products being produced because of disappointed and disgruntled workers had to be mitigated.

So how do you handle a huge move, manage 140 soon to be unemployed workers, and still produce your daily quota while also creating extra inventory to cover demand during the shutdown period? You develop a very detailed project management plan that incorporates every possible scenario and mitigates risk that is overseen by a project management office. The PMO/PMP will serve as your GPS to ensure you get where you need to go, when you need to get there.

GETTING FROM 'POINT A' TO 'POINT B'

In order to save money, the Company decided to consolidate this facility's operations with existing operations in another state. Once the decision was made, there was a lot to take into consideration. With all of these different

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roads to travel down, how do you ensure you take the right one at the right time? A good PMP provides the map, but also takes into account that throughout a project there will be "recalculating" and the plan will mitigate any potential risks and help prepare for the "what if" scenarios.

The PMP, guided by the PMO, for this plant move involved the following:

- The shipping plant plan
    - o Human resources management plan
        - ■ Severance planning
        - ■ Relocation setup
        - ■ State regulatory management
    - o Building an inventory bank
    - o Managing IT and finance shutdown procedures
    - o Technical vendor management
    - o Complete factory dismantling
    - o Rigging and specialty transportation
- The receiving plant plan
    - o Construction plan
    - o Production cell readiness plan
    - o New employee training
    - o IT and finance setup
    - o PPAP plan

While moving the plant was a daunting task by itself, everything was contingent upon the human resources management plan. During the plant shutdown and all of the time leading up to it, the Company still had to produce inventory to meet contract deliverables and there was no way to do that without the current staff as they had specialized knowledge and training. Because of this, a very lucrative human resources management plan was put in place to ensure production and quality, and to sustain the workforce though the shutdown period.

The human resources management plan motivated the employees to continue their daily production and incentivized them to produce more than double the current production volume with fewer people while not sacrificing quality. In addition to severance based on years of service, the plan included bonuses for production, quality, minimized scrap and attendance. The following programs were also put in place to further help the employees:

- Education plan to ensure all employees were fully informed on "what's in it for me" including information on severance and bonus plans
- Education vouchers for local vocational schools and colleges to help the employees receive training for new jobs
- Communication with other companies in the area informing them that 140 good employees would soon need employment
- Workshops on interview techniques, how to fill out applications, and what to wear to interviews
- Job fairs coordinated with other companies and the state

This huge endeavor was completed in a very tight timeframe. The shutdown was announced on February 21 and production was shut down on May 15. A subset of 15 people continued working after the shutdown to help with the next stage of the process: packing and shipping 40,000 square feet of manufacturing equipment.

Seven key employees, one from each production cell, were retained to work at the new facility in order to preserve the specialized knowledge. These key employees helped dismantle, pack, ship, receive and reassemble all of the equipment. Because of the transfer of their expertise, the move was completed by August and the new facility was already producing test runs. Every detail of the project was managed and tracked by the PMO and PMP. The PMO provided a comprehensive view of the Company's activities which was essential in managing all of the project areas, leading to success in a very short timeframe.

YOU HAVE ARRIVED

While a move of this size is no easy task, if you follow the GPS you can arrive at your destination with very few detours. By combining facilities and following the GPS, the Company was able to:

- Save over $3 million per year and achieve profitability
- Consolidate human capital and reduce the number of workers needed to produce the same output (from 140 at the previous facility to only 36 at the new location)
- Aid 90% of the 140 employees in finding new jobs within three months of the facility closing
- Start realizing financial and production benefits in less than eight months after the initiation of the PMP
- Retain specialized knowledge by transferring a subset of seven experts from the original plant to the new facility
- Manage thousands of interrelated tasks for seven different work streams situated under one PMO

"The PMO/PMP will serve as your GPS to ensure you get where you need to go, when you need to get there."

IT'S ABOUT THE JOURNEY AND THE DESTINATION

From a large plant move to a facility redesign to smaller internal projects, a good PMO and PMP can guide any company to their destination. Specifically, manufacturing companies can benefit from a PMO and PMP in that they:

- Provide central and coordinated management and oversight
- Develop a requirements management plan to ensure delivery of the appropriate objectives
- Manage complexities and interdependencies between various work streams
- Develop a communication strategy to foster positive acceptance to any changed business processes and systems
- Align project demands to resource capacity and capabilities
- Foster cooperation and organizational alignment between work stream teams
- Develop an acceptance plan to ensure successful achievement of deliverables and milestones periodically throughout the project
- Monitor and control the multiple work streams to ensure delivery in scope, on time and within budget
- Save time and money
- Mitigate risk
- Allow better project execution efficiency
- Provide a competitive edge
- Produce increased quality

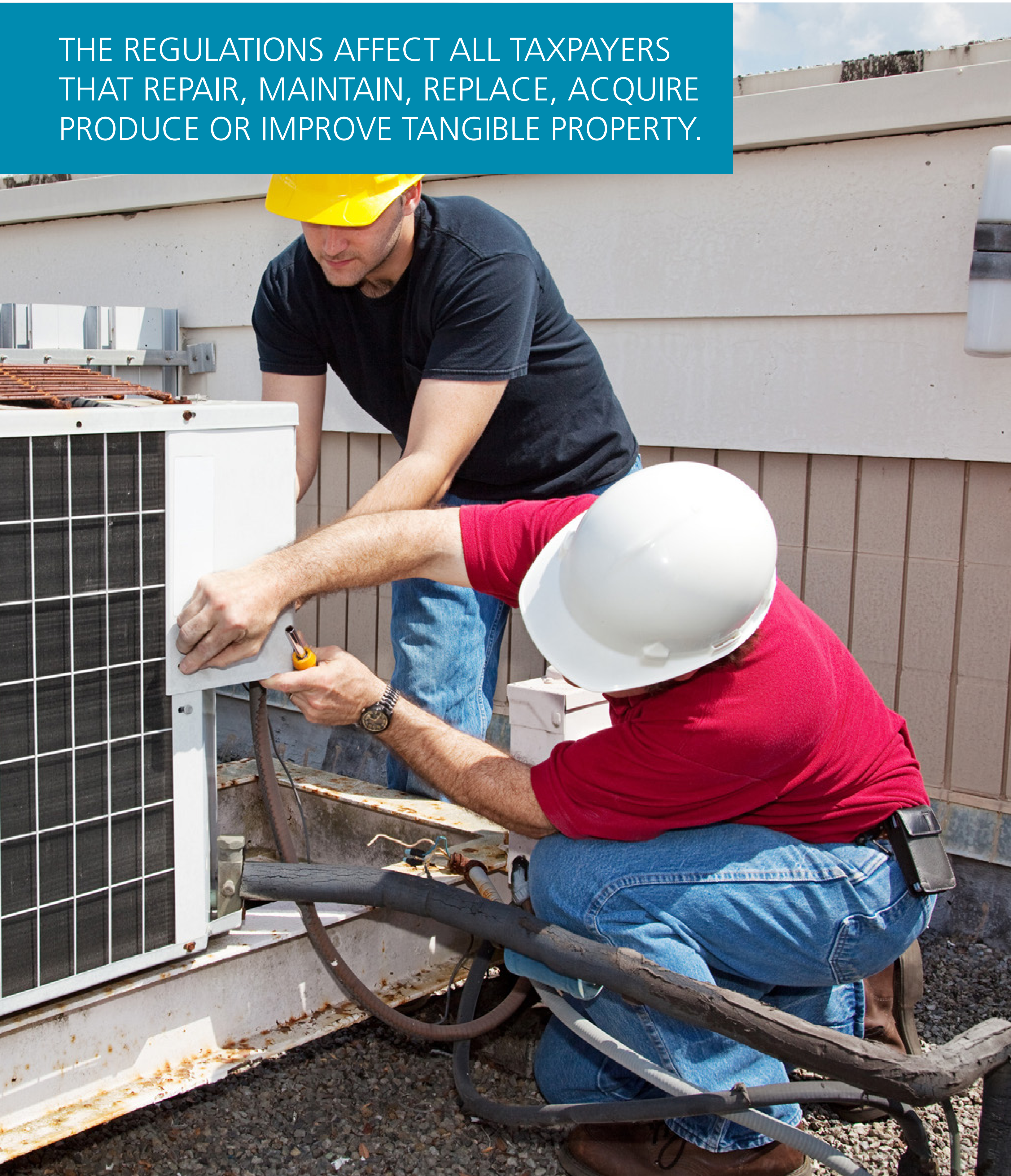
For this Company, the PMO served as a powerful bridge in creating and managing the link between strategy and results. Without the PMO to oversee the multiple work streams included in the PMP, this huge endeavor could have turned out very differently. PM Solutions' The State of the PMO 2010 Research Report indicated that PMOs:

- Decreased failed projects by 31 percent
- Delivered 30 percent of projects under budget
- Demonstrated a 21 percent improvement in productivity
- Delivered 19 percent of projects ahead of schedule
- Saved companies an average of $567,000 per project

For any manufacturing company, the benefits of creating a project management office and project management plan before embarking on a journey of any size can ensure that the journey is smooth and that you reach your destination.

By Cynthia Hannafey, Principal (Atlanta, GA)

THE REGULATIONS AFFECT ALL TAXPAYERS THAT REPAIR, MAINTAIN, REPLACE, ACQUIRE PRODUCE OR IMPROVE TANGIBLE PROPERTY.



FINAL IRC REGULATIONS ON DEDUCTING MANUFACTURING EXPENSES: HOW WILL THEY AFFECT YOUR BUSINESS?

On September 13, 2013, the IRS issued Treasury Decision 9636 which contained long awaited regulations under Section 162(a) of the Internal Revenue Code ("IRC") and IRC Section 263(a) (collectively referred to throughout as the "Regulations"). The Regulations under IRC Section 162(a) address when certain expenses related to the repair, maintenance and replacement of tangible property are deductible for federal income tax purposes. The Regulations under IRC Section 263(a) address when expenses incurred in acquiring, producing or improving tangible assets can be deducted for federal income tax purposes. If not deductible under the Regulations, then such expenses are required to be capitalized. The Regulations affect all taxpayers that repair, maintain, replace, acquire produce or improve tangible property and apply to tax years beginning on or after January 1, 2014. The following article summarizes the specific application of these new regulations to manufacturers.

REASONS WHY THE REGULATIONS WERE DRAFTED

The IRS stated that it was issuing the Regulations in order to reduce controversies with taxpayers over what expenses can be deducted as opposed to being capitalized in connection with the repair, maintenance, replacement, acquisition or production of tangible assets. Prior to the issuance of the Regulations, such issues were determined by the facts and circumstances of a taxpayer that often involved the consideration of subjective factors. The Regulations attempt to provide more bright line objective tests for making the deduction vs. capitalization determination in the areas addressed by the Regulations.

MAIN DEDUCTION VS. CAPITALIZATION AREAS COVERED BY THE REGULATIONS

- Materials and supplies (Treas. Reg. Section 1.162-3)
- Repairs and maintenance (Treas. Reg. Section 1.162-4)
- Capital expenditures in general (Treas. Reg. Section 1.263(a)-1)
- Amounts paid for the acquisition or production of tangible property (Treas. Reg. Section 1.263(a)-2)
- Amounts paid for the improvement of tangible property (Treas. Reg. Section 1.263(a)-3)

AREAS OF SPECIAL CONCERN TO MANUFACTURERS

Potentially, all of these areas can affect the federal income tax liability of a manufacturer.

HOW REG. SECTION 1.162-3 (MATERIALS AND SUPPLIES) APPLIES TO MANUFACTURERS

The general rule for "materials and supplies" is that amounts paid to acquire or produce materials and supplies are deductible in the tax year in which the materials and supplies are first used or consumed in the taxpayer's manufacturing operations.

For this purpose, the term materials and supplies means tangible property used or consumed in the taxpayer's business operations that is not otherwise treated as part of the taxpayer's inventory and is either:

- A component part that is acquired to maintain, repair, or improve a "unit of [tangible] property" (as that term is defined in Treas. Reg. Section 1.263(a)-3(e)), owned or leased by the taxpayer, or
- Fuel, lubricants, water, and similar items that are reasonably expected to be consumed in 12 months or less, beginning when first used in the taxpayer's operations, or
- A unit of tangible property that has an economic useful life of 12 months or less, beginning when first used or consumed in the taxpayer's operations, or
- A unit of tangible property with an acquisition or production cost that is less than $200, or
- A unit of tangible property that is identified as such in later IRS guidance.

The term "unit of [tangible] property", as defined in Treas. Reg. Section 1.263(a)-3(e), includes, as a single unit of [tangible] property, not only the building and its structural components, but each of the building's systems (i.e., HVAC, plumbing, electrical, escalators, elevators, fire protection, security, etc.), and each of the manufacturer's functionally interdependent equipment that has a discrete role in the manufacturing process.

HOW REG. SECTION 1.162-4 (REPAIRS AND MAINTENANCE) APPLIES TO MANUFACTURERS

Regulation Section 1.162-4 is fairly short and direct, albeit not particularly illuminating. This Regulation simply states that a taxpayer may deduct amounts paid for repairs and maintenance to tangible property if the amounts paid are not otherwise required to be capitalized. While this Regulation does not expressly direct the reader to where such capitalization rules can be found, the Preamble to the Regulations specifically reference the rules under Reg. Section 1.263(a)-3 for guidance on when capitalization of repair and maintenance expenses are required and when capitalization is not required.

Under Reg. Section 1.263(a)-3(i), amounts paid for routine maintenance on a unit of tangible property (i.e., the building in which manufacturing occurs, the building's building systems, and the equipment and machines involved in the manufacturing process) is tax deductible.

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Routine maintenance is defined to be any recurring activity that a taxpayer reasonably expects to perform more than once during the useful life (or, in the case of a building or building system, the 10-year period after it is placed in service) of the property to keep the unit of property in its ordinarily efficient operating condition. This Regulation goes on to provide that routine maintenance includes the inspection, cleaning and testing of (1) the building structure and each building system included in the building, and (2) the replacement of damaged or worn parts with comparable and commercially available replacement parts.

HOW REG. SECTION 1.263(A)-1 (CAPITAL EXPENDITURES, IN GENERAL) APPLIES TO MANUFACTURERS

This Regulation does two things. First, it provides a general rule that capitalization is required for amounts paid for buildings, permanent improvements or betterments made to increase the value of any property, or the acquisition or production of a unit of tangible property (such as inventory). Secondly, it provides a de minimus safe harbor exception to such general rule for amounts paid for non-inventory, tangible personal property. Under this safe harbor exception, if the taxpayer issues for the tax year involved a certified audited financial statement (referred to in the Regulations as an Applicable Financial Statement ("AFS") and has in place as of the first day of the tax year a written accounting policy that permits the deduction of these types of expenses, then any amount paid for a unit of property that is not more than $5,000 per invoice for the unit of property can be deducted rather than be capitalized. If, on the other hand, the taxpayer does not issue an AFS for the year in question, but does have an accounting policy in place (presumably a written policy), then it can still take advantage of this de minimus safe harbor, but the $5,000 invoice limitation is reduced to $500 per unit of property.

The following example demonstrates the operation of this de minimus safe harbor:

Facts

- The taxpayer ("TP") has a written accounting policy to expense amounts paid for non-inventory, tangible personal property that do not cost more than $5,000 per unit.
- TP purchases 1,000 printers at $500 each.
- TP also purchases 1,000 computers at $4,900 each.

Results:

- TP has an AFS:
  - TP can expense the cost of all printers and computers
- TP does not have an AFS:
  - TP can expense the cost of all printers
  - TP must, however, capitalize the cost of all computers

HOW REG. SECTION 1.263(A)-2 (AMOUNTS PAID TO ACQUIRE OR PRODUCE TANGIBLE PROPERTY) APPLIES TO MANUFACTURERS

The general rule set forth in Regulation Section 1.263(a)-2 is that, with a couple of notable exceptions (discussed below), a taxpayer must capitalize all amounts paid to acquire or produce a unit of real or personal property. For this purpose, amounts paid to acquire or produce a unit of real or personal property include the invoice costs, transaction costs (as determined under Reg. Section 1.263(a)-2(f)), and costs for work performed prior to the date the unit of property is placed in service by the taxpayer.

Under Reg. Section 1.263(a)-2(f), transaction costs include any amount paid to facilitate the acquisition of real or personal property. These typically include, among other things, the costs of transporting the property, securing appraisals of the property, negotiating the purchase of the property, securing necessary permits and other regulatory approvals, conducting architectural, geological, survey, engineering, and environmental reviews, and paying for legal, accounting, and brokerage fees associated with the acquisition.

The two notable exceptions to this general rule are the special rules that apply to the costs of materials and supplies and the expenses covered by the de minimus safe harbor exception (both as indicated above).

HOW REG. SECTION 1.263(A)-3 (AMOUNTS PAID TO IMPROVE TANGIBLE PROPERTY) APPLIES TO MANUFACTURERS

The general rule of this Regulation is that a taxpayer must capitalize any amounts paid to improve a unit of tangible property. For this purpose, a unit of tangible property is improved if amounts are paid for activities performed by the taxpayer that result in either a betterment of the property, a restoration of the property, or an adaptation of the property to a new or different use.

An amount is paid for the betterment of the property if it either ameliorates a material condition or defect that existed prior to the acquisition of the property or arose during the production of the property; creates a material addition, including enlargement, extension, or addition of a major component, to the property; or materially increases the productivity, strength, quality, or output of the property.

An amount is paid to restore the property if it either (1) replaces a component of the property, the cost for which the taxpayer has either previously deducted, or used as the component's tax basis in a prior sale for federal income tax purposes, or (2) restores property for which a casualty loss was taken, or (3) returns the property to its ordinarily efficient operating condition, or (4) results in the rebuilding of the property to a like-new condition after the end of its class life, or (5) replaces a part or combination of parts that comprise a major component or substantial structural part of the property.

> "Potentially, all of these areas can affect the federal income tax liability of a manufacturer."

By Don Hughes, Tax Manager (Houston, TX)
National Manufacturing Practice Member

MANUFACTURING INDUSTRY INSIGHT

UHY LLP recognizes that manufacturing companies require their auditors, tax specialists and business advisors to add value to financial reporting activities. That is why we combine the strength of business and financial expertise with a hands-on, "shop floor" approach to solving complex business decisions in these key segments:

- Aerospace & Defense
- Distribution
- Automotive Suppliers
- Industrial Manufacturing
- Consumer Products

Our professionals are leaders in the industry and take the steps necessary to ensure our client's future success by identifying and addressing new trends, accounting requirements and regulations.

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