



THERE ARE SEVERAL METHODS, WITH EACH HAVING ITS ADVANTAGES AND DISADVANTAGES

Contractors should allocate administrative overhead wisely or their profitability will diminish

JEFFERSON, NY According to Michael Ceschini, CPA, CCFP, managing partner of Ceschini Williams, CPAs,



Michael Ceschini

PLLC, the method contractors use to allocate administrative overhead costs unrelated to jobs can affect their bid amounts, and ultimately the profitability of their businesses.

"Sometimes the selected method's effect may be advanta-

geous to the customer, and sometimes it may be advantageous to the contractor. Successful contractors will allocate overhead in the manner that best suits their particular businesses," said Ceschini.

A certified public accounting and profitability consulting firm with a construction industry niche, Ceschini Williams works closely with its contractor clients and their operational challenges. Allocating overhead wisely is one of those challenges. "One popular method of allocating overhead costs is to divide the anticipated administrative overhead by the number of hours to be worked in a period. Then the result is multiplied by the

number of hours the particular project is estimated to take," said Ceschini.

"Sometimes the selected method's effect may be advantageous to the customer, and sometimes it may be advantageous to the contractor. Successful contractors will allocate overhead in the manner that best suits their particular businesses."

Fixed overhead is made up of those costs that do not vary substantively with sales. This might include the rent on the central office or other costs that are not directly related to contracts. They are incurred even if there are no

sales.

Sometimes these expenses are called general and administrative

expenses. These are different from indirect job costs, which might be allocated to jobs using another technique.

This method will result in overhead costs being allocated slightly disproportionately. The disproportion is acceptable within the historic range of bids, but it becomes larger the more the contract at hand varies from the historic range.

If the job is bigger than the historic range, the disproportion favors the customer. Over a period of time, the job mix may shift to larger jobs with a disproportionately smaller allocated overhead. Unchecked, this may lead to lower profitability. Perhaps the simplest way to allocate general fixed costs is to take all the overhead and divide it equally among the number of contracts. If a contractor completes an average of ten contracts each year, and the annual overhead is \$2 million, each bid would have \$200,000 added as allocated overhead. Again, this method works best in situations in

"One popular method of allocating overhead costs is to divide the anticipated administrative overhead by the number of hours to be worked in a period. Then the result is multiplied by the number of hours the particular project is estimated to take."

which the values of all of the contracts are in a relatively narrow range, with no big jobs and no little ones.

But within this simplicity, cautions Ceschini, lies inefficiency, "With straight-line relationships between cost and revenue, economies of scale will go unexploited."

Although there are several methods of allocating overhead, each method has different advantages and disadvantages for particular business situations. Software programs, from general application software such as MS Project to more sophisticated and complex software such as Opus, can help with overhead allocation. But selecting the right software tools can be a daunting task, fraught with jeopardy. Not only do contractors risk the disadvantageous allocation of overhead, they also may waste the time and expense of converting to new software more than once.

Ceschini recommends that contractors seek out professional profitability consultants in order for them to have their overhead allocation methods properly evaluated. "This way," said Ceschini, "contractors will be furnished with recommended avenues for increasing their competitiveness while enhancing their profitability."

BDG CONSTRUCTION CORP

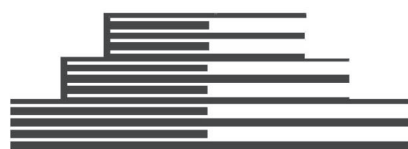
=

CREATIVITY

IMAGINATION

REINVENTION

INNOVATION



BDG

300 Robbins Lane

Syosset, NY 11791

516 921-0800

