



Improve Your Bottom Line With Burden Rate Accuracy

By Jack Ganley, CPA

The recent economic landscape has yielded rough terrain for the construction industry, and while the climate has started to shift to a more positive direction, the need to maximize profitability remains vital. Tight competition and subsequent tighter profit margins equals no allowance for costly mistakes; billing rates must be “right on the money.”

Employee compensation is perhaps the largest expense a business owner faces; as such, the need for accuracy in determining labor costs cannot be overemphasized.

ESTABLISHING BURDEN RATE

In order for a construction company to properly determine its billing rate for each class of employees, it must first establish its burden rate, followed by the fully-burdened cost per hour worked by employees and the overall average for each class of employees. But in the absence of a thorough understanding as to all the elements that comprise burden rate, this essential component to profitability cannot be properly calculated.

Most business owners know—or have access to—each of their employee’s salary or hourly wage, and likely also have a fair idea of their outlay for payroll taxes. However, many have never taken the time to calculate total expenses linked to each employee. These “hidden” costs can add up to significantly impact employee burden rate ... and a company’s profits.

CALCULATING BURDEN RATE

So what exactly is burden rate? Simply put, it’s defined as the total indirect contract costs, calculated as a percentage of the construction company’s direct labor. In other words, for every dollar of direct labor allocated to a contract, burden is applied as a percentage of the direct labor. But before a contractor can accurately calculate burden rate, all contract costs assumed by the company must be fully accounted for and factored into the final burden rate equation.

Contract costs are broken into two classifications—direct and indirect. Direct, or prime contract costs, are all known expenditures directly associated with the project. Examples of prime costs include subcontractors, direct labor, materials and supplies, equipment rentals, bonds, and permits.

Indirect contract costs include workmen’s compensation, general liability and automobile insurances, motor vehicle and equipment repairs and maintenance, depreciation, motor vehicle expenses, field communications expenses, employee benefits such as health, life, disability, profit sharing, bonuses, and 401(k) match, and of course, payroll taxes. In fact, all costs associated with paying employees, including FICA, unemployment, and Social Security should be calculated as part of labor.

The lengthy and varied list of indirect contract costs continues with vacation time, holidays, sick days, drivers and warehouse personnel, training, safety seminars, and special work clothes—and office or floor space costs. Also

ABOUT THE AUTHOR

Jack Ganley, CPA, shareholder and director of construction services of Kirkland, Albrecht & Fredrickson, LLC, has over 30 years experience providing audit and business advisory services to the construction and other related industries. Jack has written articles and presented seminars on topics such as burden rate analysis, working capital analysis, financial statements for contractors, modern financial ratios for contractors, the contractor’s business model, and systems of internal controls for contractors. The company, located in Braintree, Massachusetts, is one of the leading CPA firms in the Boston area, offering expertise and insight needed to develop innovative solutions to all of their client’s financial needs. For more information, visit www.kafgroup.com or call 781.356.2000.

factor in meetings and time spent on problem solving ... and employer-paid meals, parties, and snacks.

OTHER EXPENSES IN THE MIX

Other expenses that are regularly ignored when calculating labor costs include small tools that are often lost, stolen, or abandoned during or after a job. Variable overhead should also play into the overall mix. This category includes all costs directly related to employees that cannot be divided accurately between jobs, such as fuel and cell phones.

All too often, these overhead expenses are overlooked by contractors and therefore not included when calculating a project's burden rate—a true disservice to the bottom line since, depending on the benefit package involved, employee related costs will typically account for 24-33%, for a non-union contractor. For a union contractor, the burden rate for employee related costs will range from 60-70%. It should also be noted that the rule of thumb is to use a 1.0 workmen's compensation modification rate if the contractor's rate is more than 1.0.

Companies that are equipment intensive—such as small paving contractors—should include all equipment and related operational costs as part of its labor burden rate since the same equipment is used consistently by the paving crew. Larger paving contractors that primarily fulfill public contracts typically utilize the services of a separate equipment company. The burden rate for these companies should be based on a calculation of the estimated average

cost per hour for each pool of equipment based on the estimated and known costs, divided by the estimated annual hours the equipment will be used.

ROUTINELY REVIEW FOR ACCURACY

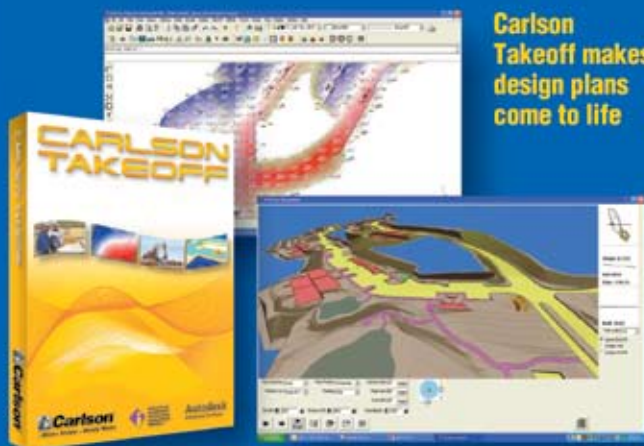
It's wise to review labor burden calculations roughly every 6 months—regular assessments will open eyes to costs that might otherwise be forgotten. After a complete list of full burdened labor costs have been added up, simple mathematics take over by dividing that number by the number of hours that an employee works on projects. Most business owners will be surprised to learn that employees can often cost a company from 50% to as much as 150% above their gross hourly labor rate.

In order to maintain a proper accounting of all burden rate components, construction companies should meet the imperative of maintaining separate accounts for all direct and indirect contract costs. A company's software package can calculate and affix indirect contract costs to the total job cost as each labor dollar is applied. Accounting software can display labor burden "budgeted" for actual field and office payroll in addition to "actual" accumulated expenses.

Having the burden delineated on job management reports can help to accurately bill a job, gauge future estimates, and keep management informed of a job's true costs. Only then can a genuine measurement of the operation's burden rate be taken, leaving no aspect underestimated or much worse, overlooked. ■

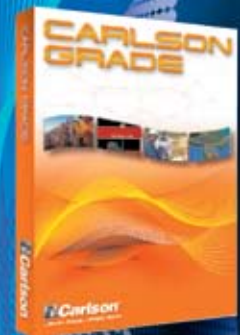
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