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Sep. 19, 2017

Overhead allocation in construction is a way to share costs across multiple jobs. Why on earth would you do that? Simple: these are the costs your projects share responsibility for *anyway* — they're the costs you're already paying but can't easily charge directly to a single project. Instead, they're "indirect costs." And if indirect costs *aren't* tracked properly, it can give you a false sense of job performance.

How do you assign those costs fairly? That's the goal of overhead allocation.

The more accurately you can measure how overhead impacts each job's bottom line, the more accurate your picture of job performance can be. This can also mean better data for estimating, which in turn can protect your bottom line on future jobs.

What Is Overhead?

In broad strokes, you'll sometimes hear about two kinds of "overhead costs"[*] —

1. indirect costs
2. general and administrative (G&A) costs

One way you can think about the difference is whether the costs are related to the activity of your projects.

Indirect Costs

Indirect costs are expenses that relate to your job activity. Unlike a *direct cost*, though, an indirect cost is either:

- tied to multiple jobs or

We can look at another example. They schedule an engineer for six hours on Job 110 and three hours on Job 210. Again, if Job 110 didn't exist, six hours never go to payroll — they're a direct cost to Job 110. Whichever job the engineer works on, however, Build-It Construction still has to pay health care premiums for that engineer. They might treat those indirect costs as overhead as well.

In short, several projects are responsible for the expense, several projects benefit from it, but not *all* jobs necessarily relate to it equally.

G&A Costs

In contrast, a G&A cost might be one that applies to the general running of the business. All projects probably benefit from it more or less equally. Examples include office rent and utilities, administrative salaries, advertising, general liability insurance, and a lot more.

G&A supports your ability to take on and bill jobs — but in one sense, they're relatively stable, despite fluctuation in your job progress and labor. If you'd still have the expense even if you had *no* active jobs (rent, for example), that's likely G&A cost. In general, showing a connection between one job and its effect on a G&A expense is much harder to make. Imagine making the case that one job resulted in a 3% increase in your copier toner use!

That's why G&A can sometimes be handled differently from allocated overhead. Your jobs might have different levels of responsibility for overhead, but your jobs aren't *really* responsible for G&A. Still, you might choose some fair way to disburse G&A across your jobs just so the reality of those costs are factored in alongside your project revenues.

Your construction CPA will be able to help you figure out which costs are direct,

1. Gather Your Costs

First, know what the costs are that you want to allocate. You can ask simply, "What are the *real* costs of completing this job?" Here's where thinking through both overhead and G&A types of indirect costs might become helpful.

In the example of the dozer above, Build-It Construction already knows several jobs are responsible for those equipment expenses: service costs, fluids, possibly depreciation and maybe even their cloud equipment tracking software. They might also pool these with their other overhead costs like labor burden, or they might keep them in separate cost pools. That way, they can distribute equipment costs more heavily to more equipment-intensive jobs and distribute payroll costs more heavily to more labor-intensive jobs.

You can already see how there's no single right answer for everyone. Our example company and their CPA can make overhead allocation fairly simple or highly nuanced, depending on the level of detail and accuracy they want to achieve.

2. Select Your Method

Establishing a basis. Part of defining *what* cost pools you want to allocate to your jobs is also figuring out *how* you want to distribute them. Here are just a few options contractors might use as a basis for allocating overhead:

- total direct job costs
- direct labor costs
- direct labor hours
- equipment costs

Selecting a basis for allocating indirect costs should make sense for the type of cost and for your type of business. A labor-intensive roofing contractor probably shouldn't allocate their liability insurance based on truck usage. Similarly, imagine a

that your overhead for a job generally represents x% of revenue or y% of its direct labor costs. To allocate overhead, you'd add that amount to your total job costs. While this tends to be a simpler method, it also tends to be less accurate.

Using a proportion among jobs. Alternatively, contractors can track each overhead cost in their G/L and distribute them proportionally across all jobs. A simple example could assign 25% of your total overhead to a job representing 25% of your company's direct job costs. However, you can add finer-grain complexity by allocating only a set portion *from* each overhead G/L account or by allocating a greater or lesser proportion *to* certain G/L accounts.

3. Get the Technology You Need

You hear it all the time: having the right tool is important — because it's true! Depending on the size of your business, spreadsheets simply may not be a realistic, long-term option for tracking and managing your overhead allocation.

On the one hand, there's excellent general-purpose accounting software that can work very well for small contractors. But if it isn't designed to allocate overhead to distinct jobs, you can be stuck doing a lot work outside of the system. That increases the risk of entry error and calculation mistakes. Plus, it means your financial data is stored in more than one place.

Construction-specific accounting software can give you multiple ways to distribute indirect costs. Finding the right fit means, in part, making sure that it's able to facilitate the method you and your CPA determine is most beneficial for you. So flexibility is a factor. When you begin the search for construction accounting software, talk with vendors one-on-one and ask them whether their application can do what you need it to do.

Not every accounting system is going to be a fit for everyone. Finding one that you

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