

General Overhead & Profitability: Construction Company

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STUDENT & COURSE LEARNING OUTCOMES

ACCE (American Council for Construction Education) Student Learning Outcomes covered in this course:

- ▶ SLO 11 - Understand construction accounting and cost control.
- ▶ SLO 13 - Understand construction project control processes.

Course Learning Outcome for this lecture:

- ▶ CLO 3 -Understands the significance of general overhead for a company and its impacts on the company's profitability. Correlation with taxes to manage and control costs.

CLO 3 - GOAL

- ▶ Identify and categorize the components of a construction company's general overhead costs
- ▶ Relay the significance of general overhead: analyze, manage, and control costs -the company's profitability.

WHAT IS GENERAL OVERHEAD?

Expenses to operate a business

- ▶ Main office costs
- ▶ Supervisory costs not billed to a specific construction project.
- ▶ Company-wide
- ▶ Typically, construction companies GOH: 10% - 25%
- ▶ Typically, construction companies' net profit: 5% or less

GENERAL OVERHEAD RATIO

Proportion of
revenue to run
company

3/18/04	DEMO Construction Co., Inc. INCOME STATEMENT March 2004				Page 1
Completed Job Basis	-----This Year-----		-----Prior Year-----		
	Month	Year-to-Date	Month	Year-to-Date	
INCOME					
Interest Income	485.12	1,943.60	45.67	246.77	
Discounts Earned	78.00	78.00			
Closed Job Revenue	24,382.00	131,964.69	21,890.00	39,578.00	
TOTAL INCOME	24,945.12	133,986.29	21,935.67	39,824.77	
COST OF CONSTRUCTION					
Closed Job Labor	4,819.56	18,234.27	3,266.50	4,838.50	
Closed Job Material	4,249.45	24,004.77	3,623.25	5,759.05	
Closed Job SubContract	5,190.25	40,820.75	8,710.50	11,752.80	
Closed Job Miscellaneous	3,382.74	10,805.96	489.75	503.65	
Closed Job Burden		8,145.13	910.00	1,266.00	
TOTAL COST OF CONSTRUCTION	17,642.00	102,010.88	17,000.00	24,120.00	
Gross Profit	7,303.12	31,975.41	4,935.67	15,704.77	
GENERAL & ADMINISTRATIVE					
Contributions		150.00			
Dues & Subscriptions				58.25	
Estimating Expense				45.00	
Insurance - General	281.50	844.50	281.50	563.00	
Insurance - Medical	35.02	147.47	158.00	316.00	
Office Expense		220.23		57.00	
PR Taxes & Ins	694.47	911.11	1,144.85	1,746.56	
Rent	1,800.00	5,000.00	2,000.00	4,000.00	
Salaries - Office	1,440.00	4,440.00	800.00	3,900.00	
Telephone		25.96		312.50	
Utilities		128.25		665.00	
TOTAL GENERAL & ADMINISTRATIVE	4,250.99	11,867.52	4,384.35	11,663.31	
Operating Profit	3,052.13	20,107.89	551.32	4,041.46	
Net Income Before Taxes	3,052.13	20,107.89	551.32	4,041.46	
Net Income	3,052.13	20,107.89	551.32	4,041.46	

Source: DEMO Construction Co., Inc., Sample Income Statement, March 2004.
Used for educational purposes.

GO H ratio =
17.04%

GO H ratio
= 8.8%

GO H ratio =
19.9%

GO H ratio
= 29.3%

COMPARE: PROJECT OVERHEAD & GENERAL OVERHEAD

Project Overhead	General Overhead
Project cost	Company cost
Billed to the project	Included in gross profit of a company
Line item before the Gross Profit	Line item after the gross profit. Reduces the profit of a company <ul style="list-style-type: none">• $\text{Gross profit} = \text{net profit} + \text{general overhead}$. The higher the general overhead, the lower the net profit.

GENERAL OVERHEAD BUDGET

General overhead budgets serve two primary strategic functions for a company:

- ▶ Cashflow projections and management
 - ▶ Profit projections and management
-
- The difference between cash flow and profit will influence how the company handles costs and loans.
 - It is possible for a company to be "profitable" on paper but "bankrupt" in reality.

GENERAL OVERHEAD BUDGET CONT.

- ▶ The categories included in a general overhead budget will vary from company to company.
- ▶ Small companies generally track fewer items than larger companies.

TYPICAL GENERAL OVERHEAD EXPENSES

- ▶ Advertising & Marketing
- ▶ Bad debts
- ▶ Bank fees/interest/credit card fees
- ▶ Vehicle expenses
- ▶ Charitable contributions
- ▶ Technology/ equipment
- ▶ Head office
- ▶ Depreciation
- ▶ Professional / organizational memberships
- ▶ Office employee expenses
- ▶ Insurance

[Reference for detailed reading](#)

MORE GENERAL OVERHEAD EXPENSES

- ▶ Publications and subscriptions
- ▶ Repairs and Maintenance
- ▶ Taxes and Licenses
- ▶ Telephone
- ▶ Travel
- ▶ Delivery and postage
- ▶ Meals
- ▶ Entertainment
- ▶ Unallocated Labor
- ▶ Unallocated Materials
- ▶ Miscellaneous
- ▶ Legal/professional services

Reference for detailed reading

UNALLOCATED LABOR

- ▶ Refers to wages paid to employees typically assigned to projects.
- ▶ These costs aren't billed to any specific construction job.
- ▶ Examples include downtime between projects or administrative support from field staff.
- ▶ Still part of the company's overall labor expense and must be budgeted under general overhead.

[Reference for detailed reading](#)

UNALLOCATED MATERIAL

- ▶ Materials bought for construction use but not charged to a specific project.
- ▶ Often includes wasted, damaged, or stolen materials.
- ▶ These costs must be tracked under general overhead, not project costs.
- ▶ Examples: excess inventory loss, jobsite damage, or theft.

INSURANCE

- ▶ Covers general liability, workers' compensation, and key person life insurance.
- ▶ Applies to policies where the company is the beneficiary.
- ▶ **Excludes:**
 - Vehicle insurance → listed under Car & Truck Expenses.
 - Employee benefit insurance → listed under Employee Benefits.

UNDERSTANDING NET PROFIT

- ▶ Is the company profitable?

Hypothetically, if the company has one project:

Revenue = Project bid

- ▶ Project bid = Direct costs + Indirect costs

As the project bid equals revenue, then

Bid amount(revenue) - Direct costs = Indirect costs

General Overhead

Net Profit

- ▶ Revenue – Direct costs – General Overhead = **Net Profit**

NET PROFIT BEFORE TAXES

Revenue - Direct costs (of construction/manufacturing/service) = Gross profit

Gross profit – General overhead = **Net profit before taxes**

- ▶ Is Net Profit Before Taxes, company's taxable income?

Not necessarily, as it depends on the specific general overhead expenses incurred.

Key Considerations

Asset purchase → Not tax deductible

Business meals → Only 50% tax deductible

Depreciation of Assets → 100% tax deductible

- ▶ Taking the above into consideration,

Net taxable income = (Net Profit Before Taxes) + (50% of Business Meals)
+ (Asset cost) - (Allowed depreciation)

DEPRECIATION OVERVIEW

- ▶ Depreciation: The loss in the book value of asset (books referring to accounting records)
- ▶ The method used to calculate depreciation affects how the asset's value declines over time:
- ▶ For tax purposes, only the MACRS (Modified Accelerated Cost Recovery System) method is allowed.
- ▶ MACRS enables businesses to:
 1. Deduct more depreciation early in the asset's life (accelerated depreciation).
 2. Recover the asset's cost over a defined recovery period based on its class life.
- ▶ Class Life is the IRS-determined number of years an asset is can be depreciated for tax purposes.

BUSINESS MEALS

- ▶ Must be tracked separately due to limited tax deductibility.
- ▶ Not all meals costs are tax-deductible.
- ▶ It's helpful to separate this into two categories:
 - **Partially deductible:** Business-related meals consumed in the presence of employees.
 - **Non-deductible:** Expenses that don't meet IRS criteria.
- ▶ Accurate tracking ensures better tax reporting and budgeting

MARGINAL TAXABLE INCOME

- ▶ Marginal Taxable Income: income to the last dollar earned.
- ▶ To find the Marginal taxable income, add all taxable income from all businesses and subtract expenses.
- ▶ **Marginal Taxable Income = Net Taxable Income**
+ Dividends or other earnings
- Interest or other expenses
- ▶ Estimate the taxes to be paid on Marginal Taxable Income;
Estimated Taxes = Marginal Tax rate (%) x Marginal Taxable Income

NET INCOME AFTER TAXES

- ▶ How much business keeps after paying taxes

$$\begin{aligned}\text{Net Income after Taxes} = & \text{Net Profit Before Taxes} \\ & + \text{Dividends or other earnings} \\ & - \text{Interest or other expenses} \\ & - \text{Taxes}\end{aligned}$$

PRACTICE PROBLEM - DISCLAIMER

This exercise is designed to simulate real-world financial messy data scenarios. It contains **intentionally erroneous and extraneous data points, as well as made-up scenarios**. The objective is to identify and filter out “fluff/noise” that is irrelevant to calculating the company's net income and achieve consistent results across participants. All values are for illustration purposes only.

PRACTICE PROBLEM

A construction company's revenue is \$2,500,000 for the year 2018. The direct construction costs totaled \$1,650,000. The total general overhead of the company for the year is \$106,000, which includes the following expenses, along with many others:

- ▶ The company purchased a water treatment plant for \$38,000. The allowed depreciation for the plant is \$13,000.
- ▶ The company spent \$7,500 on business meals during the year.
- ▶ The company spent \$4,000 in office supplies for which the allowed depreciation is \$2,225.
- ▶ The company spent \$10,500 in advertising and marketing and took the depreciation of \$1,576

PRACTICE PROBLEM CONT. 1

- ▶ The company spent \$3,500 on office utilities for which the allowed depreciation is \$1,125.
- ▶ The company spent \$5,000 on professional dues and memberships for which the allowed depreciation is \$2,115
- ▶ The company purchased office furniture for \$12,000. The allowed depreciation for the furniture is \$8,000.
- ▶ The company purchased an office laptop and software for \$25,000. The allowed depreciation for the laptop is \$4,800.
- ▶ The company had bad debt equaling \$1,500 for which the allowed depreciation is \$600.
- ▶ Allowed depreciation on past assets for the year is \$8,035.

PRACTICE PROBLEM CONT. 2

The company's tax rate for the year is 16%. The company also receives \$25,000 in dividends and \$1,200 in savings interest and pays \$2,500 in interest. Determine the following for this company:

- ▶ a) Gross Profit from the construction business
- ▶ b) Net Profit before taxes from the construction business
- ▶ c) Marginal (total) taxable income
- ▶ d) Net profit after taxes for the company

SOLUTION

Company's Profitability	Solution
Revenue	\$2,500,000.00
Direct costs	(\$1,650,000.00)
Gross Profit	\$850,000.00
General overhead	(\$106,000.00)
Net Profit before taxes	\$744,000.00
(add the below line items as they are not tax deductible)	
50% Business Meals	\$3,750.00
Water treatment plant	\$38,000.00
Furniture	\$12,000.00
Laptop & software	\$25,000.00

SOLUTION CONT. 1

Solution: Net Profit of company	
(subtract the following as they are tax deductible)	
Deprecation - water treatment plant	(\$13,000.00)
Depreciation - furniture	(\$8,000.00)
Depreciation – laptop & software	(\$4,800.00)
Past allowed depreciation	(\$8,035.00)
Net taxable income from construction business	\$788,915.00
Income from dividends	\$25,000.00
Income from interest	\$1,200.00
Paid interest	(\$2,500.00)
Marginal taxable income	\$811,415.00
Estimated Taxes @16%	\$129,826.40
Net profit	\$637,873.60

FOR FURTHER READING: DIG DEEP

Use the hyperlinks provided below for further reading:

- ▶ [Taxation and Depreciation](#)
- ▶ [Depreciated Methods](#)
- ▶ [Modified Accelerated Cost Recovery Sytem](#)
- ▶ [Taxes](#)

General Overhead and Net Income for Construction Managers

End of Lecture: Concept Review Questions

1. Are income taxes paid on Net Profit before taxes for a business without adjustments? Explain why or why not.
2. What is depreciation, and why is it included in tax calculations?
3. What is MACRS and why is it the only allowable depreciation method for tax purposes in the U.S.?
4. What does "class life" mean in MACRS depreciation?
5. In MACRS system of deprecation, how does the quarter in which an asset is placed into service affect its depreciation?
6. How does the IRS categorize and limit the deductibility of meals and entertainment expenses for tax purposes?
7. Why should general overhead expenses be tracked in separate accounts rather than lumped together? Give at least three specific reasons.
8. Group the general overhead items listed below into three categories: Tax deductible, partially deductible, and not deductible
Salaries (for company office staff), Office rent, Office utilities, Office supplies, Software licensing fees, Telephone and internet, Office insurance (e.g., general liability), Business travel, Business meals, Entertainment, Vehicle expenses (non-jobsite use), Depreciation, Professional memberships, Asset purchases (capital equipment), Marketing and advertising, Legal and accounting fees, Bank fees and interest, Health insurance (employer portion), Training and certification, 401(k) Employer contributions
9. How does the purchase of a capital asset affect Net Taxable Income in the year of acquisition?
10. Define Net Profit Before Taxes and explain why it differs from Net Taxable Income?
11. How dividends and interest income affect taxable income?
12. Define unallocated labor. Illustrate with a specific example.

13. Define unallocated material. Illustrate with a specific example.
14. Define bad debt. Illustrate with a specific example.
15. Explain why specialty contractors typically incur higher general overhead costs relative to general contractors or other construction sectors?
16. Define and distinguish between General (G&A) Overhead and Project Overhead. Detail their key differences and explain how each is represented on a construction company's income statement.

Practice Problem

Disclaimer: This exercise is designed to simulate real-world financial messy data scenarios. It contains intentionally erroneous and extraneous data points as well as made-up scenarios. The objective is to identify and filter out “fluff/noise” that is irrelevant to calculating the company’s net income and achieve consistent results across participants. All values are for illustration purposes only.

INSTRUCTIONS:

1. Write neatly and legibly. Typing is preferred.
2. EXCEL is not allowed.
3. Show all work clearly. Every step must be documented with accurate headers for the step.
 - If you multiply two numbers, show exactly which two numbers were used.

Problem Statement

A construction company’s revenue is \$3,500,000 for the year 2018. Direct costs of construction equal 2,850,000. The total general overhead of the company for the year is \$500,000 that includes the following expense accounts along with many other:

Company purchased railroad tracks for \$58,000. The allowed depreciation for the tracks is \$15,000.

The company spent \$10,500 on Meals and Entertainment during the year.

The company spent \$6,000 in office supplies for which the allowed depreciation is \$2,225.

The company spent \$8,500 in advertising and marketing and took the depreciation of \$1,576

The company spent \$6,500 on office utilities for which the allowed depreciation is \$3,125.

The company spent \$5,000 on professional dues and memberships for which the allowed depreciation is \$3,115

The company purchased office furniture for \$12,000. The allowed depreciation for the furniture is \$4,000.

The company purchased legal and professional services for \$30,000

The company spent \$50,000 on employee’s hair style and depreciated that at \$3,500.

The company purchased office laptop and software for \$25,000. The allowed depreciation for the laptop is \$6,800.

The company had bad debt equaling \$1,500 for which the allowed depreciation is \$600.

Allowed depreciation on past assets for the year is \$18,035.

The company’s tax rate for the year is 39%. The company also receives \$25,000 in dividends and \$12,000 in savings interest and pays \$22,500 in interest. Determine the following for this company:

- a) Gross Profit from the construction business
- b) Net Profit before taxes from the construction business
- c) Marginal (total) taxable income
- d) Net profit after taxes for the company