

Labor Burden & Profits – Part V:

Where Does Our Time Go?

Assigning Direct, Indirect, Administrative, and Owners' Time to Jobs (Intro)

Which kinds of employees should be assigned to job costs? And which to company overhead? Opinions vary, but here are some guidelines and techniques to help you sort out the numbers and apply them to job costs so that you can get a better handle on your financial results.

From Parts I, II, III, and IV of this Series:

In our last 4 “Labor Burden” articles, we’ve covered topics including:

- Frequently used terms and “big-picture labor burden calculations” and how labor burden add-on costs can make a tremendous difference in an employee’s actual cost per production hour. (Our example employee, Pat, actually cost us 82% more than his/her gross hourly wage!)
- A process to determine what to charge per hour for employees on both a stand-alone, and “weighted-cost” basis for individual projects.
- Whether, and when, overtime is a financially sound management decision.
- How to use burdened job costs and variance reports to improve estimates, bring job costs under control, and help you improve your company’s overall performance and productivity.

A Frequently Asked Question

“What’s the difference between ‘Direct labor’, ‘Indirect labor’, ‘Sales’, ‘Administrative labor’, and ‘Owner’s compensation’ and which costs should be assigned out to jobs?”

This is a common question as company owners begin to compute the true hourly (fully burdened) cost for individual employees. Because each of these expense categories can have a real impact on how you assign individual employees’ costs to specific jobs, every company will ultimately need to make decisions and calculations that make sense for their management and tax reporting needs.

Sorting Out and Accounting for Various Employee Types



Although some companies combine employment related costs into just a few accounts (e.g., Salaries, Wages, Payroll Taxes, and various employee burden and benefit accounts) you should plan your Chart of Accounts to show compensation, payroll taxes, and the burden for various types of employees in clearly identifiable groupings. **Note:** Generally speaking, differentiating between “Salaries” and “Wages” doesn’t provide any truly useful information for either owners or tax purposes, whereas grouping by type of work performed is much more useful.

For instance, accounts for Direct Labor gross compensation, payroll taxes, and various burden cost accounts should all be grouped together and sub-totaled. Indirect labor employees, Administrative employees, Sales employees, and Owners compensation and benefits should likewise each have their own similarly titled account groupings. This segregation and grouping approach:

1. Allows you to more easily see what each category of employee costs,
2. Makes it possible to clearly see your gross profit results, and
3. Assists with any Work in Process and/or Percentage of Completion adjusting entries that may be required.

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Direct Labor Costs and Burden Assignments

Let's start out with the easiest employee grouping: **Direct labor employees**. These individuals are also commonly referred to as "field employees", "front-line workers", or "hands-on" employees. They are assigned by company management to work on specific jobs to perform specific activities. It should be fairly easy to assign their time to individual jobs and/or job phases, so this is a clear-cut case where computed fully-burdened employee costs should be assigned to jobs.



For paid time not spent directly on production jobs – such as holiday, vacation, training, etc. – costs should be assigned to a special job called "NJS (Non-Job Specific)". I usually view all costs associated with direct labor employees to be part of Cost of Goods Sold (COGS) or production costs, but some accountants assign paid time off costs to company overhead. Since these costs should end up allocated back to jobs as labor burden, and for informational grouping reasons, it just seems more efficient to leave them in the COGS section of the Chart of Accounts.

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Indirect Labor Costs and Allocation Options



Indirect labor can become a bit more complex as it's a term that can cover a wide variety of employee titles. Job functions that fall into the "indirect" category include "Order Taker", "Designer", "Scheduler", "Production Manager", "Job Supervisor", "Foreman", "Lead Carpenter", "Production Support", "Purchasing Agent", "Estimator", etc. In short, we're looking at jobs related to getting production jobs underway or completed but that are a step or two away from "being on the job". So how should those costs be handled?

This varies by company, and by type of employee cost, but if you want to see what each job truly costs, here are some general guidelines to utilize:

- **First choice:** Any time that indirect labor employees can assign directly to production jobs should be designated as such, and fully burdened costs allocated accordingly.
- **Second choice:** If production supervision or support cannot be accurately assigned, a second-best solution is to ask for reasonable estimates or percentages of time spent on jobs that are underway, and assign fully burdened costs accordingly.
- **Third choice:** If it becomes impractical to use either of the first two options, the next alternative that you could utilize is to assign the fully burdened cost of supervision or support to the direct labor employees who require or utilize their service.

For example: Your production supervisor is in charge of 6 direct labor employees and has a fully burdened cost of \$72,000/year. You also have a person who runs errands, delivers materials, and handles various cleanup tasks for the same 6 employees at a fully burdened cost of \$30,000 per year. You could add the two costs, and divide by 6 to arrive at the additional \$17,000 required to "support" each direct employee. Then add that \$17,000 to each direct employee's burden costs.

This will increase the burdened costs of direct labor employees, and accomplishes the task of pushing (allocating) the indirect employees' costs out to jobs.

Remaining costs: For employees not providing direct supervision or support to other employees (e.g., "Estimating", "Purchasing", "Shop", etc.) you could create special jobs for each major type of indirect cost and assign time and fully burdened costs to those jobs (Estimating, Purchasing, or Shop "jobs"). This will allow you to identify all of the costs that are not being assigned to production jobs.



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Where Do Indirect Costs “Live”?

Some accountants believe that all indirect costs should be considered to be part of company overhead as they are somewhat “fixed” in nature, but others (myself included) argue for a more “production cost placement” approach. I then like to see as many of those costs allocated out to jobs as is reasonably possible, and where allocation is not feasible, to assign those costs to special, clearly identified “jobs” as described immediately above.

Why?

1. If all indirect production costs are assigned into the COGS accounts, this provides (in my opinion) a more realistic view of production results.
2. Keeping production costs in one section of the Profit & Loss report allows everyone to more easily see, at the end of a full year’s assignments, if the burden allocations are reasonably accurate for that year.

Next,...

Adding cost to jobs for the owner’s time (even without a standard paycheck!), assigning sales employees’ and administrative employees’ costs, and how to handle “mixed-use” employees’ fully-burdened costs.

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She is the developer of the [eCPA \(employee Cost & Pricing Analyzer\) Labor Burden Calculator](#), an Excel-based program that automatically performs comprehensive labor burden and pricing calculations for up to 200 employees and 25 departments. Contact Gilson via [email](#) or call 734-544-7620 (9-5 Eastern).