The Big Bite of Inflation

Wall and Ceiling Contractors
Must Strive For Profits
More Than Ever as Money Costs Skyrocket

By Irv Chasen

Do you ever feel like there just isn’t enough money to go around? You make more money than ever before and yet there never seems to be enough dollars available to make ends meet? Where does it all go?

Individuals and businesspeople alike are constantly faced with a tight money situation. As an owner, estimator, or secretary, you earn more and more every year, but seem to have less and less. This is a problem facing the entire US population. September 12, 1977 Business Week states that if you are currently earning $25,000 a year, you will need $57,000 to maintain your current spendable income level in 1987. This increase has been figured on a 7% annual inflation rate and current federal tax rates.

Not only does inflation take a large part of any increase in salary you may receive, but with every increase in wages, your tax rate rises. Thus Uncle Sam takes a bigger bite every year.

September 17, 1977 Business Week released the attached figures on what net affect an 8% raise would have on a person’s spendable income:

<table>
<thead>
<tr>
<th>Income</th>
<th>1976</th>
<th>1977</th>
<th>Aftertax Income</th>
<th>Effective Aftertax Income</th>
<th>Federal Tax</th>
<th>Adjusted for 6.5% Inflation</th>
<th>Net Change After Taxes &amp; Inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>$15,000</td>
<td>516,200</td>
<td>$13,339</td>
<td>$14,421</td>
<td>10.98%</td>
<td>$13,541</td>
<td>+ 202</td>
<td></td>
</tr>
<tr>
<td>20,000</td>
<td>21,600</td>
<td>17,454</td>
<td>18,759</td>
<td>13.15%</td>
<td>17,614</td>
<td>+ 160</td>
<td></td>
</tr>
<tr>
<td>25,000</td>
<td>27,000</td>
<td>21,335</td>
<td>22,833</td>
<td>15.43%</td>
<td>21,439</td>
<td>+ 104</td>
<td></td>
</tr>
<tr>
<td>30,000</td>
<td>32,400</td>
<td>24,990</td>
<td>26,744</td>
<td>17.46%</td>
<td>25,112</td>
<td>+ 122</td>
<td></td>
</tr>
<tr>
<td>45,000</td>
<td>48,600</td>
<td>35,850</td>
<td>37,743</td>
<td>22.34%</td>
<td>35,439</td>
<td>- 411</td>
<td></td>
</tr>
</tbody>
</table>

Business people must strive for strong profit margins now more than ever. Contractors are faced with the problem of keeping their current salary high enough so that they may at least enjoy the life style they are currently experiencing. Contractors will also feel the crunch of the past several years inflation when they need to replace current equipment.

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(Editor’s Note: The author of this article, Irv, Chasen, is President of PROOF and a former subcontractor, who serves as a consultant to contractors and construction industry firms.)
Depreciation alone will not provide enough money to buy new equipment.

For example, in 1970 you may have bought a truck for $3,500 and depreciated that truck at an average of $500 a year for 7 years. Now in 1977 the time comes to replace that truck. Theoretically you will have $3,500 in your depreciation account to use to purchase a new truck, but that truck now costs $5,500. Where does the other $2,000 dollars come from? In other words, that portion of overhead set aside for depreciation may not be realistic for cost accounting purposes.

Hopefully you will have enough net profits to finance the extra dollars needed to buy that new truck, so what you and your CPA had considered profit has been substantially reduced. If not, you will have to finance the difference, thus adding interest cost to an already increased cost.

Just a few years ago it was all tough times and low profit margins for many contractors around the country. Contractors who found themselves in tough markets were stretching their equipment to make it through the lean years. When work picks up, it is going to be rough going for a lot of contractors. They will be faced with an immediate need to replace their old equipment. Profits for the past several years have been thin, so it will place a strain on their company’s capital to buy new equipment. Inflation and interest on the money borrowed to fund their needs could, for the first time, cause a strain on capital.

More than ever, contractors need a strong profit picture. Inflation will become a major factor in running a business and keeping it afloat. Companies that fail to make a profit during the slow years may be in for a shock when business picks up. Is your company making a profit or merely fighting to keep up with inflation?

One solution to this problem is to become a better cost accountant. IRS will not allow you to depreciate trucks and equipment beyond a designated amount. But as you can see, that amount may not be adequate to recover equipment costs including inflation. This is just one example of why good cost accounting principles are essential to any sound business. In the “PROOF” workshop, we provide contractors with a cost system that meets their own company’s needs and can keep them abreast with the times. To administer the “PROOF” cost system you really do not need previous knowledge of accounting or bookkeeping. Ours is a common sense cost system. You may find it advantageous to work out a separate cost system for your own business. Remember, a CPA prepared statement is for tax purposes, a proper cost structure if used for competitive purposes and proper indirect cost recovery.