Cost accounting is a bunch of garbage. The real problem is I can’t get any work. If I apply all my overhead cost to my jobs, I would never get a job. My prices would be too high to meet competition.”

How many times have we heard the above statement from a contractor? This is the same old case of the guy so busy chopping wood, he doesn’t have time to sharpen his ax. There are several ways cost accounting can help a contractor in a tough market. One of the easiest ways is for a contractor to evaluate his overhead cost and come up with a second set of prices for tough competitive work.

Fixed overhead is normally composed of two basic types of cost: intrinsic cost and extrinsic cost.

Intrinsic cost may be described as those fixed overhead cost which are not so recognizable or tangible - cost which are not physically paid out by a business but exist in a less noticeable sense. These costs include items such as depreciation, return on investment, bad debts, etc.

In a highly competitive situation, one may consider an overhead cost structure temporarily leaving out his extrinsic operating cost. This might be a last ditch stand, but is not recommended for long periods of time.

The following is a list of extrinsic or intangible costs that might be subtracted from normal overhead cost in a critical, survival situation.

1. Owner’s salaries - perhaps you could make out with less.
2. Wife’s salary - if your wife works in your business maybe you could leave out a portion of her pay.
3. Donations.
4. Entertainment.
5. Depreciation - if you own your equipment, who are you paying the depreciation to - no one - so maybe you can get that truck to last an extra year or so.
6. Rent - can be left out only if you own the building you are in.
7. Accounting and Legal - maybe you could cut down on these services and still make it.
8. Travel Expense - maybe you can’t make your national convention this year and you go to the state convention instead.
9. Bad Debts - maybe you’ll be lucky.
10. Return on Investment - not entirely necessary to survive.

Now YOU have a new overhead cost. Divide your new overhead figure by your yearly gross payroll and you have a new overhead percentage. Multiply this percentage by the hourly rate of your mechanics and you have a new hourly cost because you have left out all extrinsic or intangible costs.

Remember, as stated from the onset, extrinsic costs are real, too, and any attempt to eliminate these costs over long periods of time would be damaging.

There is another way of decreasing overhead cost as it relates to labor cost and that is you procure enough jobs to increase your labor force, but in a tough economy this would be extremely difficult to do.

If competition is so stiff that you cannot procure a job using this rock bottom cost figure and you cannot expect to increase employment substantially beyond your normal level, you may be better off folding up tent and going fishing.