

## "Boosting" Job Profits on Equipment Purchase - on Paper



**Executive summary.** Whether in a bid situation or a change order negotiation, there is a way to boost your profit on paper by not "job costing" your equipment. Let's talk depreciation.

And whatever you do, make sure to talk to your CPA after reading this. It's much more complicated than this, but you should investigate and understand the concept.

**The scenario.** When you are bidding a job, you have to include costs for labor and equipment – that's obvious. Most times we estimate the cost of equipment it is an hourly rate times the number of hours used on the job. For example, a crane costs \$200/hour, an excavator \$75/hour, et cetera. Say our estimate on bid day is 1,760 hours of crane at \$200/hour which calculates to \$352,000.

What happens if when you arrive on site, the other contractor who just finished the project adjacent to your new project wants to sell you his crane simply because he no longer needs it and/or just doesn't want to demobilize it. Let's say he sells you his crane for \$300,000. You may think that you've picked up \$52,000 on the project in equipment buy out (you had \$352,000 in your budget and you just bought the whole crane for \$300,000). Your profit is actually much more "on paper".

**The controller's move.** In the case of our crane purchase, let's look at our purchase:

Crane budget in the bid	\$352,000
On-site crane purchase by project management	\$300,000
Savings on budget (i.e. profit)	\$ 52,000

As an engineer, I think "great, I just made \$52,000 for the company!". Your controller will not let you do this. (S)he will insist upon increasing the profit for you by only including the depreciated cost on your job. Because it's a fixed asset, it cannot be "job costed". Depending on the type of equipment, the age, the intended use, et cetera, your CPA is obligated to follow the accounting rules established by GAAP (Generally Accepted Accounting Principles). If you bond your work, your accountant is definitely following these rules.

**What's the increased profit?** Your controller will consult GAAP for the asset lifetime and then will make a decision on the depreciation method. Say that the equipment is estimated to last four years and the method of depreciation is the straight line method. It will follow that the cost of your equipment will be (via straight line depreciation method):

$$\text{Cost of equipment} / 4 \text{ years} = \$300,000 / 4 \text{ years} = \$75,000/\text{year}$$

Say the duration of your project is one year. The cost to your project will be:

$$\$300,000 / 4 \text{ years} = \$75,000/\text{year (the depreciation cost)}$$

So you can see here that now you have massively boosted your profit:

Crane budget in the bid	\$352,000
Crane expense from your controller	\$ 75,000
Savings on budget (i.e. profit)	\$277,000

You thought that you made the company \$52,000, but you really made the company \$277,000!

**Careful!** These numbers sound great, but be careful. There's much more to equipment cost than what's laid out in this exercise. Don't forget you still have to expense the other three years of this cost even if the crane is sitting on a job not working. You also have maintenance costs which you didn't have if you rented this piece of gear. And, lastly, there are tax implications. So don't blindly use this approach in running your company, have an intelligent conversation with your accountant.

**My story.** This is a great method of increasing profit in the budget conformation process. I had a small mass excavation project wherein my budget on bid day for construction equipment was \$900,000. I realized that most of the equipment in this budget was everyday type equipment (loader, dozer, excavator). I went to Caterpillar and bought out the three key pieces of equipment I needed to build the job. Similar to the example above, I paid near the amount of my budget for the equipment from Caterpillar, but the cost to my job was only a fraction of the purchase price. On this \$4 million job, this transaction boosted the bottom line about \$500,000. That was a good day.



Work safe!