Selling costs are indirect costs

The more you understand what is going on in your business, the better you position yourself to earn a profit and build an enterprise that will help you meet your personal and financial goals. Knowing the difference between your direct and indirect labor costs is critical to grasping the ways your different types of business expenses fit together. This helps you to develop a solid foundation that is fit to scale up into a profitable company. Direct labor is dedicated to producing the items you sell. Indirect labor goes toward running other aspects of your business, such as accounting, management and cleaning. Direct labor is manufacturing or production labor. It is part of your cost of goods sold, which also includes the materials that are directly used in creating your products. In a shoe plant, direct labor is dedicated toward operating machinery and doing the hands-on work of creating the actual shoes. In a food business, direct labor is time that is spent cooking or preparing the food that your customers eat. Direct labor is characterized as a variable cost, or one that fluctuates directly relative to output. It takes more time to produce six pairs of shoes than it does to produce two pairs, and the relationship between the time spent and the items manufactured is relatively direct, although you do achieve some economies of scale as your production volume increases. The fact that you can correlate direct labor costs with output volume allows you to make informed forecasts about spending relative to earning. Indirect labor includes all of the other employee hours that figure into your payroll but are not directly associated with production. These may include wages, salaries and bonuses paid to sales staff, management expenses and human resources expenditures. Unlike direct labor, which varies in proportion to the amount of goods your company produces, indirect labor is a fixed cost, or one that stays relatively steady regardless of the amount of business your company transacts. The cost of paying your payroll department does not change significantly if the personnel write five checks or ten, and you have to keep sales staff on the floor even on days when no customers show. As a result, indirect labor cost per unit tends to drop as volume increases, and the fixed cost gets spread out over a greater number of units. From an operations standpoint, it is important to develop systems that keep direct labor costs under control because these costs equally affect every unit you produce regardless of the volume you produce and transact. If your direct labor cost formula shows that you are spending 50% of your incoming revenue on production labor, your business is unlikely to be profitable even if you double or triple your sales. A 50% direct labor cost is simply too high for most businesses to operate sustainably. However, if your direct labor cost is closer to 20%, your gross profit, or income after subtracting all of your direct costs, will increase dramatically as you scale up your operations. In contrast, a problem with high indirect costs does not necessarily need to be addressed at a systems level because it can be solved as your business volume increases, and these expenditures are divided among a greater number of units. If your rent is $2,000 per month, and you make 20 sales per month, your indirect rent cost will be $100 for each sale. However, if you make 2,000 sales per month, your rent cost per sale drops to a mere $1. You can increase your sales volume to see your per unit indirect costs decrease; you do not necessarily need to streamline your systems or focus on employee productivity. Variable selling and administrative costs are critical components in both variable and absorption accounting calculations. Variable costs such as commissions, bonuses and utility bills vary based on product production and sales for the period, whereas fixed costs do not tend to fluctuate. Variable selling and administrative costs also must be distinguished from variable manufacturing costs, which often have similar account names. Variable selling and administrative expenses are used in both absorption costing and variable costing. With absorption costing, the company subtracts both fixed and variable selling and administrative costs from gross profit to calculate operating profits. This is the income statement presentation required by generally accepted accounting principles. Alternatively, some companies use variable costing for internal-use financial statements. In variable costing, variable selling and administrative costs, along with variable manufacturing costs, are deducted from sales revenue to calculate the company contribution margin. The first step in the calculation is identifying total selling and administrative expenses. These are operating expenses that a business incurs outside of product manufacturing. The most common selling and administrative costs include salaries paid to executives, sales personnel, administrators, accounting staff and human resources staff. Selling and administrative costs also include: commissions benefits insurance office rent utilities shipping computer equipment marketing materials office supplies property taxes Costs that aren't part of core business activities, like investment and financing expenses, aren't included in selling and administrative costs. Of the total selling and administrative costs, identify which are fixed and which are variable. Fixed costs such as office rent, property taxes, computer equipment and base salaries tend to be the same no matter how much the company produces. Variable selling and administrative costs, on the other hand, fluctuate based on sales and production. These include sales commissions, office supplies, utilities and shipping expenses. Exclude any variable manufacturing overhead costs accidentally included in variable selling and administrative costs. Many of the costs in the variable overhead account sound similar. For example, variable manufacturing overhead also includes utilities, supplies and certain types of commissions. The difference lies in where the costs are incurred. The utility bill for the manufacturing plant is a variable manufacturing cost, whereas the utility bills for the corporate headquarters and sales locations are variable selling and administrative costs. Similarly, supplies purchased to service manufacturing machines, as well as production commissions paid to manufacturing plant managers and employees, are manufacturing costs. If you're like many homeowners, your house is your single largest investment, and when it's time to sell, you naturally want to get as much money as possible for it. You may already know that hiring a real estate agent will cost you typically five percent to six percent of the selling price—for example, as much as $30,000 on the sale of a $500,000 house. But that's hardly the only expense you'll encounter; in fact, from preparation to make your house market-ready to unexpected complications that can arise, selling your house can be a pricey proposition. To avoid unsettling surprises and help ensure that you get top dollar, click through to discover 12 costs that go hand-in-hand with selling a home. RELATED: Ready to Sell? 17 Things to Do First Price your home too low, it may sell quickly, but you won't get its true value. Price it too high, it could sit for months without an offer. To arrive at the right price, you may opt to engage a professional appraiser who'll examine your home from top to bottom and then compare it to recent similar sales in your area. In most states, residential appraisers need to be licensed; ask your lender for a referral or check out the American Society of Appraisers to locate a professional appraiser near you. Expect to spend $350 to $500 for an independent appraisal. Home staging involves de-cluttering a room, painting (if necessary), supplying attractive furniture and draperies, and designing the space to look beautiful but also somewhat generic, so prospective buyers can imagine their taste (not yours) on display. Many professional home stagers are also interior decorators who offer staging as one of their services. You can often obtain a list of the best ones from your real estate agent. While costs run between $250 and $600 per room, per month, a staged house sells 88 percent faster than a non-staged house, for an average of 20 percent more, according to Realtor.com. RELATED: 11 Home Staging Tricks That Don't Cost a Penny Selling your home can be a bumpy road if issues such as an active termite infestation are discovered after you've signed a contract. According to the real estate website Zillow, 15 percent of house deals fail due to the discovery of problems during an inspection. So you may choose to have a pre-inspection before you put your house on the market and make any necessary repairs ahead of time. A professional home inspector will charge $250 to $450 to inspect your house. The American Society of Home Inspectors (ASHI) can help you find a certified home inspector in your area. A bank won't grant a buyer a loan if it doesn't think the investment is sound, so as a prerequisite to underwriting a mortgage, lenders require thorough inspections of a property. Real estate sales contracts often address this issue by having the buyer and seller split the cost of repairs up to a predetermined amount, such as $1,500. If the estimated repair costs are higher than that, either party has the option of backing out. If you want the deal to go through, you may choose to pay the total repair costs yourself, which could be thousands, depending on the problem. RELATED: 10 Signs Your House Isn't Ready to Go on the Market In residential developments less than 30 to 40 years old, property lines are usually clearly defined by cuts in the curb or property pins inserted below the soil level that can be pinpointed with a metal detector. It's a different story in older neighborhoods and rural settings, and in these areas a survey may be necessary to determine property lines. Expect to pay anywhere from $250 to $1,000, depending on the size and configuration of your property, to have it surveyed. If your home is listed with a real estate brokerage, this step will usually be handled by an agent; if you're selling the home yourself, you can locate a land surveyor in the white pages or ask for a reference from a local title insurance company. A lot of negotiating goes on in real estate deals, and buyers often make conditional requests to be included in the purchase price. A potential buyer may ask that you pay a share of their portion of the closing costs, leave certain household appliances, or throw in your great aunt Martha's baby grand piano as part of the deal. It's up to you to decide whether you'll agree to seller concessions. RELATED: 8 Times to Accept a Lowball Offer A number of fees are incurred during the sales process, and they're often split evenly between the buyer and the seller at closing (the last step in the sales process when the final documents are signed and you receive a check). These closing costs can run as much as three percent to seven percent of the sales price, and they include the cost of mortgage insurance, pro-rated property taxes, title insurance fees, loan processing costs, insurance charges, and the cost to record the deed. These costs will be subtracted from the amount you receive at closing. If you relocate before your house sells, you'll encounter a variety of vacant house fees to keep it on the market and looking good. These include keeping the electricity on and monthly fees to maintain the property (such as lawn mowing or snow shoveling). You'll also probably need to purchase a special "vacant house insurance policy" to guarantee your home is protected should it be damaged by vandals. This could amount to hundreds of dollars per month. RELATED: 12 Reasons Why Your House Isn't Selling If you still have a mortgage on your existing home, your lender will be paid the balance of what you owe at closing. The lender will work closely with your real estate agent and the closing company, and by the time you get your check from the sale of your home, the amount you still owe on your mortgage will have been deducted. Your lender can tell you how much the payoff is on your house. If you list your home with a real estate agent, she will obtain the payoff amount, add up other estimated costs, and then give you a good faith estimate (GFE) of how much money you can expect to get at closing. If you've hired a real estate agent to handle the sale of your home, you probably won't need legal representation because real estate transactions are highly regulated at the state and federal level. If you go the for-sale-by-owner (FSBO) route, however, it's a good idea to consult with an attorney. A lawyer who specializes in real estate transactions can provide such services as looking over your contract, preparing title insurance documents, and even holding the closing in her office. A real estate attorney (check the white pages or ask a real estate agent for a referral) will charge you by the hour, typically $200 to $400 per hour for the time they spend on your transaction. Liens (legal claims to monetary value in your property) are recorded against the deed of a property at the local Register of Deeds Office, and any lien against your property must be satisfied before you can sell your house. Liens may include money owed to a contractor who worked on your home but didn't get paid, known as a "mechanical lien," or court-ordered judgments against you resulting from a civil lawsuit or a creditor. You can either pay the lien and have it removed from the deed, or you can go to court and see if a judge will remove it. But you can't sell your home until the lien is removed. Your real estate agent may suggest that you purchase a home warranty as an incentive to homebuyers. A home warranty is a type of insurance policy that covers the cost of repairing or replacing items such as appliances, fixtures, and HVAC systems for a specified time, typically up to one year. A home warranty runs $300 to $800, depending on the size of your home and what the coverage includes. Get the help you need for the home you want—sign up for the Bob Vila newsletter today! As the owner of a startup or small business, there are crucial aspects you should understand to put your business on the path to success. One of those aspects is understanding the distinction between direct and indirect costs when pricing your products or services.When you know the true costs involved with producing and providing your goods or services to consumers, you can price both competitively and accurately. There's another benefit as well: Certain costs, both direct and indirect, are tax-deductible. And if you ever apply for and receive a grant, there are several rules around the types of indirect costs – and the maximum amount – you can claim.What are direct costs?Direct costs are expenses that a company can easily connect to a specific "cost object," which may be a product, department or project. This can include software, equipment and raw materials. It can also include labor, assuming the labor is specific to the product, department or project.For example, if an employee is hired to work on a project, either exclusively or for an assigned number of hours, their labor on that project is a direct cost. If your company develops software and needs specific assets, such as purchased frameworks or development applications, those are direct costs.Labor and direct materials constitute the majority of direct costs. For example, to create its product, an appliance maker requires steel, electronic components and other raw materials. Two popular ways of tracking these costs, depending on when your company uses materials in production, include last-in, first-out (LIFO) or first-in, first-out (FIFO). This can be helpful if the costs of your materials fluctuate in the course of production.Usually, most direct costs are variable. Smartphone hardware, for example, is a direct, variable cost because its production depends on the number of units ordered. A notable exception is direct labor costs, which usually remain constant throughout the year. Typically, an employee's wages do not increase or decrease in direct relation to the number of products produced.What are indirect costs?Indirect costs extend beyond the expenses you incur creating a product to include the costs involved with maintaining and running a company. These overhead costs are the ones left over after direct costs have been computed.The materials and supplies needed for a company's day-to-day operations are examples of indirect costs. While these items contribute to the company as a whole, they are not assigned to the creation of any one service.Indirect costs include supplies, utilities, office equipment rental, desktop computers and cell phones. Much like direct costs, indirect costs can be both fixed and variable. Fixed indirect costs include things like rent. Variable costs include the fluctuating costs of electricity and gas.Differences between direct and indirect costs, and why it's importantA simple trick to classifying payments as direct or indirect costs is that direct costs encompass the costs involved with creating, developing and releasing a product.Direct costs include: Manufacturing supplies Equipment Raw materials Labor costs Other production costs Conversely, indirect costs encompass costs not directly related to the development of your business's product or service.Indirect costs include:As a business owner, knowing the difference between both types of costs is important, because, one, it helps you have a greater understanding of your product or service, which can lead to more competitive pricing; two, you have a better grasp of your accounting and can better plan for the future of your business. [We can help you choose the best accounting software for your business.]It also matters when it's time to file your taxes. Some direct and indirect costs are tax-deductible. Examples of tax-deductible direct costs include repairs to your business equipment, such as your production line. Tax-deductible indirect costs may include rent payments, utilities and certain insurance costs.Each business's situation is different, however. Your accountant can advise you which costs qualify.Rules about direct costs and indirect costs impact funding for your small businessIn cases of government grants or other forms of external funding, identifying direct and indirect costs becomes doubly important. Grant rules are often strict about what constitutes a direct or an indirect cost and will allocate a specific amount of funding to each classification.Often, funding for a specific project will largely support direct costs. Certain government agencies might allow you an opportunity to explain why indirect costs should be funded, too, but the decision to grant funding is at their discretion.When a company accepts government funds, the funding agency may also have several strict mandates in place regarding the maximum indirect cost rate and what expenses qualify as indirect costs. Learn more about direct and indirect costs at the following websites:Matt D'Angelo contributed to the reporting and writing in this article.