

# Overhead Recovery in a Bookkeeping Practice

Editorial

This month we focus on an issue that has been the concern of accountants and indeed bookkeepers for decades, the treatment of overheads and their recovery in the price of a product or service rendered. I am sure this case will be of most interest to those of who in practice that are faced with this problem but will also give those of you that are employed as bookkeepers and financial administrators an insight as to how overhead needs to be recovered so that a business can achieve its profitability objective. I hope that you can use this as a model from a practical perspective.

Enjoy your reading

Dr Philip E Dunn  
Editor

## Case Study

One of your clients Pauline Musgrave runs a tea shop and café in a North Yorkshire village. Pauline's cousin Vera Stelling is a qualified bookkeeper and in the past has been employed by a variety of small businesses, so her experience is most wide and varied.

Vera has decided to join a former colleague who has recently formed a bookkeeping practice based in North Yorkshire where their clients will be: farmers, bed and breakfast and small hotels, cafes and restaurants and small owner-managed shops.

Vera approaches you with a number of questions regarding the management of a small business and specifically the issue of charge out rates and pricing – the question of overhead recovery.

For your preliminary meeting you ask her to bring details of:

- Number of employees (including herself and business partner)
- Planned salary levels
- Planned hours per person 1 year
- A budget for overhead items; to include:
  - Rent and business rates on premises
  - Occupancy costs, heat and light, insurance, cleaning
  - Stationery and consumables
  - Telephone and postage
  - Professional indemnity
  - Motor vehicle running costs
  - Advertising
  - Software costs
  - Training and continuing professional development

## Notes from the meeting with Vera

She supplies you with the following planned expenditure:

- (1) Staffing:
- |  |   |                   |
|--|---|-------------------|
| Vera Stelling                                  | } | business partners |
| Carol Barker                                   |   |                   |
| Kathy Mugglestone – administration / reception |   |                   |

- (2) Remuneration:

Vera Stelling	£25000	}	in form of drawings
Carol Barker	£25000		
Kathy Mugglestone	£12000		salary

- (3) Planned hours:

$$48 \text{ weeks each} \quad \times \quad 37.5 \quad = \quad (1800 \times 2)$$

$$= \quad 3600 \text{ hours}$$

$$\text{Utilisation say} \quad 90\% \quad = \quad \underline{3240} \text{ chargeable hours}$$

The administrator's salary considered to be overhead.

- (4) Planned Overhead Expenditure

	<b>£</b>
Rent, rates on premises	5500
Heat, light and power	750
Cleaning	150
Insurance	210
Stationery and consumables	400
Telephone and postage	1100
Professional indemnity	1000
Motor vehicle running costs	1400
Advertising	800
Software costs	480
Training and professional development	600
Administrator's salary	12000
Partners non-utilised time	5000
Depreciation	500
	<u>£29890</u>

The overhead recovery rate per chargeable hour, needs to be:

$$= \frac{\text{Total Overheads}}{\text{Chargeable Hours}}$$

$$= \frac{\pounds 29890}{3240} = \pounds 9.23$$

Direct labour charge out rate ie:  $(2 \times \pounds 25000 \times 90\%) / (3600 \text{ hrs} \times 90\%)$

$$= \frac{\pounds 45000}{3240} = \pounds 13.89$$

### Pricing

Let us now assume that Vera and Carol are approached by Crescent Garden House Hotel with a view to writing up their books on a monthly basis, preparing quarterly VAT returns and preparing all necessary documentation ready for their accountant to prepare the year end accounts.

Say 4 hours per month for 8 months and 6 hours per month for 4 months, 56 hours in total.

In determining price we need to build in an element for profit – suggest 25% on cost.

Estimated fees for Crescent Garden House:

	<b>£</b>
<b>56 hours @ £13.89 (Direct Labour Cost)</b>	<b>777.84</b>
<b>56 hours x overhead recovery rate per chargeable hour @ £9.23</b>	<b>516.88</b>
	<hr/>
	<b>1294.72</b>
<b>+ 25% profit margin</b>	<b>323.68</b>
	<hr/>
	<b>1618.40</b>

This would then be subject to VAT @ 17½%

The approximate cost to the client is £29 / hour

If the business is extremely price sensitive then within this price there would be some flexibility for negotiation.