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# Fee determination, costing and budgeting for accounting firms; Management of an accounting practice bulletin, MAP 15

John J. Bernard

American Institute of Certified Public Accountants

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# MAP 15

MANAGEMENT OF AN ACCOUNTING PRACTICE

## Fee Determination, Costing and Budgeting for Accounting Firms

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“If good accounting is good for our clients, then good accounting is good for the individual practitioner or firm. The CPA who does not know what it costs him to perform professional services, or what his services are worth, or what he is actually paid for his services, hurts not only himself but other practicing members of his profession.”

“An Accounting System for a Small CPA Firm” by  
W. CARL DALE, *The Journal of Accountancy*, August 1960

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# Fee Determination, Costing and Budgeting for Accounting Firms

## A. INTRODUCTION

ABSORBED IN THE AFFAIRS of his clients, the practitioner may tend to overlook the importance of a suitable accounting system for his own office; a system which will provide him with adequate and informative financial and operating data. The earning power of an accounting firm depends upon the proportion of practitioners' and staff time which is spent in revenue-producing work and the fees earned for that work in relation to cost; for this reason it is essential to have available with reasonable promptness the data required to evaluate staff productivity and financial results of the practice.

The purpose of this bulletin is to outline a method of fee determination (pricing), labor costing, and budgeting that will enable a reasonable appraisal of the profitability of a practice. The procedures developed are meant to provide a guide in the following four areas of practice management:

1. *Financial and operating results*
2. *Employee performance*
3. *Individual client profitability*
4. *Time and dollar budgeting*

Some of the material in this bulletin may appear beyond the requirements of a practitioner with a small staff. Such practitioners

should nevertheless benefit from a review of this bulletin for parts of it may be immediately adaptable. Some may adopt it fully as a system to guide their future expansion.

The suggested chart of accounts and procedures included in MAP Bulletin 14, *Basic Financial Reporting for Accounting Firms*, outlines the accounts and primary records needed to produce over-all financial and operating statements. This bulletin—*Fee Determination, Costing and Budgeting for Accounting Firms*—deals with those procedures and techniques necessary to integrate record-keeping for constructive evaluation of operations.

The term “costing,” as used in this bulletin, consists of keeping an informative record of the salaries paid and the related chargeable time of each individual in producing income from professional services. It involves the use of an effective system through which the details of the salary cost incurred in producing income are ascertained and analyzed.

The basic procedure for costing in an accounting firm involves:

- (a) *Recording time*
- (b) *Summarizing time by productive and nonproductive services*
- (c) *Summarizing productive time by client for billing purposes*
- (d) *Measuring profitability by employee and client*

## **B. MEASURING PROFITABILITY**

THE INCREASED RESPONSIBILITIES and work imposed upon practitioners during the last two decades has not resulted, on the whole, in an increase in income commensurate with that of certain other professions. It is, therefore, timely for individual practitioners and firms to consider whether or not they are developing adequate data to effectively measure the profitability of their practices.

The nature of the services performed and the amount of fees earned therefrom, as well as their regularity and trend, are all significant in appraising profitability. In order for these measurements to be helpful in guiding future operations, effective financial statements and schedules that clearly exhibit the facts must be prepared.

There are a number of special measurements that may be developed from income statements, balance sheets, and supplementary financial data. Those presented in this bulletin are most frequently used by practitioners. Measures of profitability may be divided into three classes: (1) those that analyze operations in general; (2) those that analyze employee performance; and (3) those that analyze client profitability.

The measurements explained here are illustrated in Section C, "Illustrative Financial Statements" beginning on page 12. (The statements or schedules in which these measurements are illustrated are indicated in parentheses.)



## *1. Analysis of operations*

### *Income Statement:*

- a. Percentage of income to gross income by classification of professional services (Exhibit A)
- b. Percentage of salaries and outside services to gross income (Exhibit A)
- c. Percentage of each operating expense to gross income (Exhibit A)
- d. Average hourly billing rate by income classification (Exhibit A, Schedule 1, "Average Hourly Billing Rate")
- e. Average hourly cost rate based on chargeable hours and on total hours (Exhibit A, Schedule 1, "Average Hourly Cost Rate")
- f. Percentage of chargeable hours by classification of professional service (Exhibit A, Schedule 1, "Chargeable Hours")

### *Balance Sheet:*

The analyses that apply to the balance sheet generally concern only receivables (Exhibit A, Schedule 1, "Receivable Percentages"):

- a. Percentage of current accounts receivable to fees earned
- b. Percentage of accounts over 90 days to total billed receivables
- c. Percentage of unbilled receivables to fees earned

## *2. Employee performance*

The following statistics are determined monthly, quarterly or annually for each employee and principal (Exhibit A, Schedule 2):

- a. Chargeable hours and total hours

- b. Percentage of chargeable hours to total hours (productivity ratio)
- c. Fees earned at standard for the firm in dollars
- d. Salary cost for each chargeable hour
- e. Salary cost per hour based on total hours
- f. Average hourly billable fee based on chargeable hours
- g. Average hourly billable fee based on total hours
- h. Percentage of salary to fees earned at standard rates
- i. Percentage of fees earned at standard to total standard fees of the firm
- j. Staff growth listed by principals, accounting staff and others for this year and last year

### *3. Client profitability*

- a. Number of clients this year and last year (Exhibit A, Schedule 1, "Number of Clients")
- b. Number of engagements (or clients) by type of service this year and last year (Exhibit A, Schedule 1, "Number of Engagements")
- c. Number of clients by fee category (ranges \$100-\$500, \$500-\$1,000, \$1,000-\$2,000, etc., Exhibit A, Schedule 4, "Clients by Fee Category")
- d. List of clients requiring 5 per cent or more of each partner's time. The purpose of the schedule is to indicate those clients that require a disproportionate amount of partners' time in relation to over-all client requirements (not shown)
- e. Percentage of actual billings to fees at standard (Exhibit A, Schedule 3)
- f. Clients lost and gained and annual fee (Exhibit A, Schedule 4)

## C. ILLUSTRATIVE FINANCIAL STATEMENTS

EXHIBIT A

### COMPARATIVE STATEMENT OF INCOME

	Years Ended				Increase (Decrease) \$
	June 30, 1961		June 30, 1960		
	\$	%	\$	%	
<b>Income from Professional Services</b>					
Auditing .....	126,332	59.41	106,451	57.44	19,881
Taxes .....	34,716	16.33	28,693	15.49	6,023
Management and advisory services .....	9,047	4.25	11,498	6.21	(2,451)
Other accounting services .....	42,555	20.01	38,673	20.86	3,882
<b>Total</b> .....	<u>212,650</u>	<u>100.00</u>	<u>185,315</u>	<u>100.00</u>	<u>27,335</u>
<b>Salaries and Outside Services</b>					
Salaries—partners or proprietor .....	50,400	23.70	48,000	25.90	2,400
Salaries—accounting staff .....	63,933	30.06	57,649	31.11	6,284
Salaries—other .....	9,200	4.33	8,800	4.75	400
Outside services .....	1,300	.61	1,142	.62	158
<b>Total</b> .....	<u>124,833</u>	<u>58.70</u>	<u>115,591</u>	<u>62.38</u>	<u>9,242</u>
<b>Gross Profit</b> .....	<u>87,817</u>	<u>41.30</u>	<u>69,724</u>	<u>37.62</u>	<u>18,093</u>

	Years Ended				Increase (Decrease)
	June 30, 1961		June 30, 1960		
	\$	%	\$	%	
<b>Operating Expenses</b>					
Contributions	300	.14	300	.16	—
Equipment expense	4,239	1.99	3,710	2.00	529
Firm relations	1,406	.66	1,053	.57	353
Insurance	441	.21	354	.19	87
Occupancy and maintenance	7,058	3.32	6,601	3.56	457
Other operating expense	595	.28	390	.21	205
Postage and express	881	.41	715	.39	166
Professional development	750	.35	559	.30	191
Professional membership expense	1,402	.66	638	.34	764
Provision for doubtful accounts	225	.11	640	.35	(415)
Publications	1,506	.71	1,659	.90	(153)
Stationery, printing and supplies	4,053	1.91	3,949	2.13	104
Taxes—other	537	.25	342	.18	195
Taxes—payroll	2,433	1.14	2,020	1.10	413
Telephone and telegraph	2,384	1.12	2,158	1.16	226
Travel and subsistence	2,861	1.35	2,710	1.46	151
Welfare and group benefits	1,926	.91	1,609	.87	317
Total	32,997	15.52	29,407	15.87	3,590
<b>Operating Income</b>	54,820	25.78	40,317	21.75	14,503
<b>Other Income</b>	55	.02	—	—	55
<b>Net Income</b>	54,875	25.80	40,317	21.75	14,558

Note: These financial statements have been adapted from a report of a firm of certified public accountants. The statements and accompanying schedules are used to illustrate the application of the cost system described in the following sections.

## EXHIBIT B

## COMPARATIVE BALANCE SHEET

ASSETS	June 30			
	1961		1960	
	\$	%	\$	%
<b>Current Assets</b>				
Cash in bank and on hand .....	25,641	26.12	23,745	27.13
Notes receivable .....	2,000	2.04	—	—
Accounts receivable—current .....	32,800	33.42	29,100	33.25
Accounts receivable—over 90 days .....	823	.84	1,450	1.66
Unbilled receivables .....	20,000	20.38	17,200	19.65
Unbilled expenses .....	1,800	1.82	1,400	1.60
Total .....	57,423	58.50	49,150	56.16
Less estimated doubtful accounts .....	600	.61	1,040	1.19
Total .....	56,823	57.89	48,110	54.97
Partners' and employees' accounts .....	869	.89	1,050	1.20
Deposits and prepaid expenses .....	278	.28	308	.36
Total current assets .....	83,611	85.18	73,213	83.66
<b>Investments</b>	1,300	1.33	—	—
<b>Fixed Assets</b>				
Leasehold improvements .....	4,090	4.17	4,090	4.67
Furniture, equipment and autos .....	26,592	27.08	24,632	28.15
Library .....	634	.65	634	.72
Total .....	31,316	31.90	29,356	33.54
Less accumulated depreciation and amortization....	18,073	18.41	15,052	17.20
Total fixed assets .....	13,243	13.49	14,304	16.34
Total assets .....	98,154	100.00	87,517	100.00
<b>LIABILITIES AND CAPITAL</b>				
<b>Current Liabilities</b>				
Notes and loans payable .....	14,000	14.26	9,000	10.28
Accounts payable .....	980	1.00	1,250	1.43
Unearned income .....	4,271	4.35	3,000	3.43
Employee withholdings .....	748	.76	681	.78
Accrued expenses .....	605	.62	740	.84
Total current liabilities .....	20,604	20.99	14,671	16.76
<b>Long-Term Debt</b>	—	—	7,500	8.57
Total liabilities .....	20,604	20.99	22,171	25.33
<b>Capital</b>				
Capital account(s) .....	77,550	79.01	65,346	74.67
Total liabilities and capital .....	98,154	100.00	87,517	100.00

**EXHIBIT C**

**STATEMENT OF CHANGES IN PARTNERS' CAPITAL**  
**Year ended June 30, 1961**

	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>	<u>Total</u>
<b>Capital—July 1, 1960</b> .....	<u>\$38,321</u>	<u>\$18,025</u>	<u>\$ 4,500</u>	<u>\$ 4,500</u>	<u>\$65,346</u>
<b>Add</b>					
Income for year (after salaries)					
Profit share .....	20,236	15,176	7,588	7,588	50,588
Interest on capital balances ..	<u>2,454</u>	<u>1,162</u>	<u>325</u>	<u>346</u>	<u>4,287</u>
	<u>22,690</u>	<u>16,338</u>	<u>7,913</u>	<u>7,934</u>	<u>54,875</u>
Contributions to capital .....	—	—	—	—	—
<b>Total</b> .....	<u>61,011</u>	<u>34,363</u>	<u>12,413</u>	<u>12,434</u>	<u>120,221</u>
<b>Less</b>					
Drawings					
Profit share .....	17,427	13,037	6,313	5,894	42,671
Capital .....	—	—	—	—	—
	<u>17,427</u>	<u>13,037</u>	<u>6,313</u>	<u>5,894</u>	<u>42,671</u>
<b>Capital—June 30, 1961</b> .....	<u>\$43,584</u>	<u>\$21,326</u>	<u>\$ 6,100</u>	<u>\$ 6,540</u>	<u>\$77,550</u>
<b>Percentage of total</b> .....	<u>56.20%</u>	<u>27.50%</u>	<u>7.87%</u>	<u>8.43%</u>	<u>100.00%</u>

**EXHIBIT A**  
**Schedule 1**

**COMPARATIVE STATEMENTS OF FEE INCOME DATA**

Years ended June 30, 1961 and 1960

	Auditing	Taxes	Management services	Accounting services
<b>Number of engagements (at 6/30)</b>				
1961 .....	184	236	9	46
1960 .....	<u>173</u>	<u>216</u>	<u>11</u>	<u>38</u>
Increase or (decrease) .....	<u>11</u>	<u>20</u>	<u>(2)</u>	<u>8</u>

	1961		1960	
	Standard	Actual	Standard	Actual
<b>Gross fees<sup>(a)</sup></b>				
Auditing .....	\$145,175	\$126,332	\$126,122	\$106,451
Taxes .....	31,916	34,716	28,296	28,693
Management and advisory services.....	6,985	9,047	8,759	11,498
Other accounting services—staff.....	<u>43,238</u>	<u>41,255</u>	<u>42,444</u>	<u>37,531</u>
	227,314	211,350	205,621	184,173
Other accounting services— outside services .....	1,300	1,300	1,142	1,142
Total .....	<u>\$228,614</u>	<u>\$212,650</u>	<u>\$206,763</u>	<u>\$185,315</u>

(a) Includes report typing charges, where made.

	1961		1960	
		% of fee income		% of fee income
<b>Receivable percentages</b>				
Current receivables to fees earned for the year.....	<u>\$ 32,800</u>	15.42%	<u>\$ 29,100</u>	15.70%
Over 90 day accounts to total accounts receivable .....	<u>\$ 823</u>	2.45%	<u>\$ 1,450</u>	4.75%
Unbilled receivables to fees earned for the year.....	<u>\$ 20,000</u>	9.41%	<u>\$ 17,200</u>	9.28%
<b>Partner salary allowances</b>				
A .....	\$ 18,000	8.46	\$ 18,000	9.71
B .....	12,000	5.64	12,000	6.47
C .....	10,200	4.80	9,000	4.86
D .....	<u>10,200</u>	<u>4.80</u>	<u>9,000</u>	<u>4.86</u>
	<u>\$ 50,400</u>	<u>23.70</u>	<u>\$ 48,000</u>	<u>25.90</u>

**EXHIBIT A**  
**Schedule 1**  
**(continued)**

**COMPARATIVE STATEMENTS OF FEE INCOME DATA**  
**Years ended June 30, 1961 and 1960**

	<u>1961</u>		<u>1960</u>	
	<u>Standard</u>	<u>Actual</u>	<u>Standard</u>	<u>Actual</u>
<b>Average hourly billing rate</b>				
Auditing .....	\$10.36	\$ 9.02	\$10.19	\$ 8.60
Taxes .....	15.45	16.80	15.37	15.59
Management and advisory services.....	16.67	21.59	16.22	21.29
Other accounting services .....	8.24	7.86	9.18	8.11
Average .....	<u>\$10.45</u>	<u>\$ 9.72</u>	<u>\$10.61</u>	<u>\$ 9.50</u>

	<u>1961</u>		<u>1960</u>	
	<u>Chargeable Hours</u>	<u>Total Hours</u>	<u>Chargeable Hours</u>	<u>Total Hours</u>
<b>Average hourly cost rate</b>				
Auditing .....	\$ 5.63	\$ 3.59	\$ 5.67	\$ 3.60
Taxes .....	8.39	5.35	8.55	5.43
Management and advisory services.....	9.05	5.76	9.01	5.72
Other accounting services .....	4.48	2.86	5.11	3.24
Average .....	<u>\$ 5.68</u>	<u>\$ 3.62</u>	<u>\$ 5.90</u>	<u>\$ 4.05</u>

	<u>1961</u>		<u>1960</u>	
	<u>Hours</u>	<u>%</u>	<u>Hours</u>	<u>%</u>
<b>Chargeable hours<sup>(a)</sup></b>				
Auditing .....	14,013	64.44	12,377	63.85
Taxes .....	2,066	9.50	1,841	9.50
Management and advisory services.....	419	1.93	540	2.79
Other accounting services .....	5,246	24.13	4,625	23.86
Total .....	<u>21,744</u>	<u>100.00</u>	<u>19,383</u>	<u>100.00</u>

(a) Includes report typing time, where made.



PARTNER AND EMPLOYEE PERFORMANCE  
Year Ended June 30, 1961

	Hours		Productivity ratio based on 2,080 hrs.	Fees earned at standard	Actual salary	Standard gross profit	Salary Cost Per Hour based on		Average Hourly Billable Fee based on		% of salary to total fees at standard	% of fees earned at standard
	Chargeable	Nonchargeable					Chargeable hours	Total hours	Chargeable hours	Total hours		
<b>Partners</b>												
A	495	1,432	23.80%	\$ 12,845	\$ 18,000	\$ (5,155)	\$36.36	\$8.53	\$25.95	\$ 6.08	140.00	5.65
B	976	1,039	46.92%	16,885	12,000	4,885	12.30	5.46	17.30	7.68	71.07	7.43
C	1,336	572	64.23%	19,639	10,200	9,439	7.63	4.90	14.70	9.44	51.94	8.64
D	1,374	709	66.06%	20,198	10,200	9,998	7.42	4.58	14.70	9.07	50.50	8.88
	<u>4,181</u>	<u>3,752</u>	<u>50.25%</u>	<u>\$ 69,567</u>	<u>\$ 50,400</u>	<u>\$19,167</u>	<u>\$12.05</u>	<u>\$5.85</u>	<u>\$16.64</u>	<u>\$ 8.07</u>	<u>72.45</u>	<u>30.60</u>
<b>Senior Staff</b>												
E	1,743	305	83.80%	\$ 22,659	\$ 9,200	\$13,459	\$ 5.28	\$4.23	\$13.00	\$10.41	40.60	9.97
F	1,772	193	85.19%	20,910	8,327	12,583	4.70	3.93	11.80	9.88	39.82	9.20
G (T)	240	161	**57.55%	2,580	1,491	1,089	6.21	3.58	10.75	6.19	57.79	1.13
	<u>3,755</u>	<u>659</u>	<u>82.04%</u>	<u>\$ 46,149</u>	<u>\$ 19,018</u>	<u>\$27,131</u>	<u>\$ 5.06</u>	<u>\$4.04</u>	<u>\$12.29</u>	<u>\$ 9.80</u>	<u>41.21</u>	<u>20.30</u>
<b>Semi-Senior Staff</b>												
H	1,615	387	77.64%	\$ 16,796	\$ 7,400	\$ 9,396	\$ 4.58	\$3.45	\$10.40	\$ 7.83	44.06	7.39
I	1,651	361	79.38%	16,427	7,200	9,227	4.36	3.36	9.95	7.68	43.83	7.23
J	1,607	391	77.26%	15,267	6,800	8,467	4.23	3.20	9.50	7.18	44.54	6.72
K (T)	693	80	**79.75%	6,757	2,825	3,932	4.08	3.25	9.75	7.78	41.81	2.97
L	1,554	398	74.71%	14,141	6,500	7,641	4.18	3.11	9.10	6.77	45.97	6.22
	<u>7,120</u>	<u>1,617</u>	<u>77.48%</u>	<u>\$ 69,388</u>	<u>\$ 30,725</u>	<u>\$38,663</u>	<u>\$ 4.32</u>	<u>\$3.28</u>	<u>\$ 9.75</u>	<u>\$ 7.41</u>	<u>44.28</u>	<u>30.53</u>

	Hours		Productivity ratio based on 2,080 hrs.	Fees earned at standard	Actual salary	Standard gross profit	Salary Cost Per Hour based on		Average Hourly Billable Fee based on		% of fees earned at standard to total fees	
	Chargeable	Nonchargeable					Chargeable hours	Total hours	Chargeable hours	Total hours		
<b>Junior Staff</b>												
M	550	48	**73.14%	\$ 4,538	\$ 2,065	\$ 2,473	\$ 3.75	\$ 2.75	\$ 8.25	\$ 6.03	45.50	1.99
N	1,012	56	**84.26%	7,590	3,000	4,590	2.96	2.50	7.50	6.32	39.53	3.34
O	5	—	** 8.33%	41	165	(124)	33.00	2.75	8.20	.68	402.44	.02
	<u>1,567</u>	<u>342</u>	<u>77.84%</u>	<u>\$ 12,169</u>	<u>\$ 5,230</u>	<u>\$ 6,939</u>	<u>\$ 3.33</u>	<u>\$ 2.60</u>	<u>\$ 7.77</u>	<u>\$ 6.05</u>	<u>42.98</u>	<u>5.35</u>
<b>Acctg. Service Staff</b>												
P	1,590	460	76.44%	\$ 10,574	\$ 4,800	\$ 5,774	\$ 3.02	\$ 2.20	\$ 6.65	\$ 4.85	45.39	4.65
Q (T)	1,015	310	**73.07%	7,257	3,300	3,957	3.25	2.38	7.15	5.22	45.47	3.19
U	296	40	**86.05%	2,220	860	1,360	2.90	2.50	7.50	6.45	38.74	.98
	<u>2,901</u>	<u>810</u>	<u>76.08%</u>	<u>\$ 20,051</u>	<u>\$ 8,960</u>	<u>\$ 11,091</u>	<u>\$ 3.09</u>	<u>\$ 2.29</u>	<u>\$ 6.91</u>	<u>\$ 5.13</u>	<u>44.69</u>	<u>8.82</u>
<b>Total Acctg. Staff</b>	<b>15,343</b>	<b>3,428</b>	<b>78.31%</b>	<b>\$147,757</b>	<b>\$ 63,933</b>	<b>\$ 83,824</b>	<b>\$ 4.17</b>	<b>\$ 3.20</b>	<b>\$ 9.63</b>	<b>\$ 7.39</b>	<b>43.27</b>	<b>65.00</b>
<b>Partners and Staff</b>	<b>19,524</b>	<b>7,180</b>	<b>69.95%</b>	<b>\$217,324</b>	<b>\$114,333</b>	<b>\$102,991</b>	<b>\$ 5.86</b>	<b>\$ 3.99</b>	<b>\$11.13</b>	<b>\$ 7.59</b>	<b>52.61</b>	<b>95.60</b>
<b>Steno and Typing Staff (3)</b>												
	2,220	344	**40.51%	\$ 9,990	\$ 9,200	\$ 790	\$ 4.14	\$ 1.68	\$ 4.50	\$ 1.82	92.09	4.40
<b>GRAND TOTAL</b>	<b>21,744</b>	<b>10,096</b>	<b>65.12%</b>	<b>\$227,314</b>	<b>\$123,533</b>	<b>\$103,781</b>	<b>\$ 5.68</b>	<b>\$ 3.62</b>	<b>\$10.45</b>	<b>\$ 6.67</b>	<b>54.34</b>	<b>100.00</b>
<b>Prior year totals</b>	<b>19,383</b>	<b>9,157</b>	<b>64.84%</b>	<b>\$205,621</b>	<b>\$114,449</b>	<b>\$ 91,172</b>	<b>\$ 5.90</b>	<b>\$ 3.74</b>	<b>\$10.61</b>	<b>\$ 6.74</b>	<b>55.66</b>	<b>—</b>
Number of Staff (including partners)												
at June 30	18											
1961 — 18	17											
1960 — 17	17											
<b>Staff Growth:</b>												
1961:	Semi-seniors — 1											

(\*) Noncontrollable time (VHI): vacations, holidays and illness.

(T) Terminated during the year.

(\*\*) Productivity ratio based on total hours worked.

EXHIBIT A  
Schedule 3

ANNUAL CLIENT SUMMARY OF AMOUNTS BILLED

Year Ended June 30, 1961

<u>Client's Name</u>	<u>Total billed</u>	<u>Recoverable expense</u>	<u>Net fees</u>	<u>Billing adjustments</u>	<u>Fees at standard</u>	<u>Percentage of net fees to standard</u>	<u>Explanation of Write-down</u>
Abbott Construction Corporation ...	\$ 1,475.00	\$ 14.25	\$ 1,460.75	\$ (135.00)	\$ 1,595.75	91.54	Fixed fee of \$1,475, excess time involved due to preparation of permanent W/P's.
Abelard Tank Corporation .....	3,050.00	162.70	2,887.30	(335.60)	3,222.90	89.59	Staffing problem, work was done by semi-senior because of illness of junior assigned.
Accomando, Harold E. ....	180.00	—	180.00	5.40	174.60	103.09	
Adams Electric Company .....	1,450.00	—	1,450.00	42.45	1,407.55	103.02	
Alberts Frozen Food Company .....	600.00	18.90	581.10	(60.75)	641.85	90.54	
Alcott Brothers Hardware .....	300.00	—	300.00	(7.62)	307.62	97.52	Semi-senior replaced by senior to finish work. Maximum estimate was \$600.
Alden, Inc. ....	1,175.00	—	1,175.00	(120.16)	1,295.16	90.72	Excessive price testing on final inventory (nonrecurring).
Amherest, Mrs. John .....	150.00	—	150.00	45.20	104.80	143.13	
Anders, Beatrice M. ....	125.00	—	125.00	12.60	112.40	111.21	
Anderson, George F. ....	225.00	—	225.00	40.80	184.20	122.15	
Appelton, Barbara H. ....	150.00	—	150.00	(16.10)	166.10	90.31	
Arpall, Albert M. ....	325.00	—	325.00	(80.10)	405.10	80.23	
Artiss, Drilling Company .....	1,165.90	165.90	1,000.00	(278.90)	1,278.90	78.19	Required services of Partner A to convince client of need of write-off (nonrecurring problem). Leave fee estimate at \$1,000.

Wren Sheet Music, Inc. ....	420.00	1.20	418.80	33.63	385.17	108.73	
Wright, Cora N. ....	100.00	—	100.00	31.60	68.40	146.20	
Wyatt, John V. ....	150.00	—	150.00	17.20	132.80	112.95	
Wycliffe School for Girls .....	300.00	—	300.00	(26.75)	326.75	91.81	Fee to stay at \$300. Can't afford more for service.
Wylie, Thomas .....	50.00	—	50.00	(6.20)	56.20	88.97	
Xenophon Record Shop .....	225.00	—	225.00	(1.70)	226.70	99.25	
Yale, Robert C. ....	75.00	—	75.00	15.00	60.00	125.00	
Yasuda Import Co., Inc. ....	425.00	11.25	413.75	(62.80)	476.55	86.82	Maximum estimate of \$425 for new client. Raise maximum to \$600 for 1962. Place on per diem.
Young Haberdashery .....	160.00	—	160.00	36.20	123.80	129.24	
York Manufacturing Co., Inc. ....	4,587.60	422.60	4,165.00	1.20	4,163.80	100.02	
Zimmerman Insurance Agency .....	342.00	42.00	300.00	(25.60)	325.60	92.14	Standard fee for past four years. (Raise to \$350 for 1962).
Zorn, Frank W. ....	125.00	—	125.00	8.10	116.90	106.93	
Zweig, Jean .....	95.00	—	95.00	14.10	80.90	117.43	
	<u>\$215,436.65</u>	<u>\$4,086.25</u>	<u>\$211,350.40</u>	<u>\$(15,964.05)</u>	<u>\$227,314.45</u>	<u>92.98</u>	

**EXHIBIT A**  
**Schedule 4**

**SCHEDULE OF CLIENTS LOST AND GAINED**  
**For the Year Ended June 30, 1961**

	Fees		
	1959	1960	1961
<b>Lost</b>			
Ashworth Trucking Company, Inc. ....	\$ —	\$ 560	
Gresser Hosiery Mills .....	2,300	2,500	
Lutter, Carl G. ....	100	100	
Nest-Egg Farms .....	500	600	
Rona, Simon, Estate of .....	225	450	
Woods, Joan .....	50	50	
	<b>\$3,175</b>	<b>\$4,260</b>	
<b>Gained</b>			
Abbott Construction Corporation .....			\$ 1,461
Albert Frozen Food Company .....			581
Benjamin, Gail .....			75
Filing Systems, Inc. ....			1,650
~~~~~			
Wall Stationers, Inc. ....			600
Wren Sheet Music, Inc. ....			419
Xenophon Record Shop .....			225
Yasuda Import Co., Inc. ....			414
			<b>\$23,586</b>

**Clients by Fee Category**

	1960	1961
\$ 100- 500 .....	150	161
500-1,000 .....	27	31
1,000-2,000 .....	16	19
2,000-3,000 .....	9	11
3,000-4,000 .....	7	9
4,000-5,000 .....	7	8
5,000-6,000 .....	3	3
over 6,000 .....	2	2
	<b>221</b>	<b>244</b>

## **D. DEVELOPING A COST SYSTEM**

**THERE HAS BEEN** a constantly increasing demand for information on managing a public accounting practice. Accounting firms are now experiencing much higher overhead costs as well as spiraling salary costs. Generally, salary costs constitute about 80 per cent of a firm's total expense (this includes a provision for proprietor's or partners' salaries). Therefore, it is important for a public accounting firm to investigate every possible way of controlling salary costs through costing and budgeting.

The costing system outlined in this bulletin can be used by practitioners interested in a convenient and practical method for assembling charges to clients for services rendered and costing for these services. The system provides for accurate costing, for firm growth and for obtaining a great deal of managerial information necessary to effectively manage a firm's activities.

A costing system for an accounting practice should provide the following:

1. Classification of the type of service rendered on each engagement
2. Accumulation of hours, costs and billable fees for each engagement performed during the year
3. Accumulation of fees earned by each partner and staff member (before write-ups or write-downs)
4. Accounting for and utilization of each partner's and staff member's time
5. Adequate information for internal reporting

## 1. *Classification of services*

MAP BULLETIN 14—*Basic Financial Reporting for Accounting Firms*, divides services into four classifications, each of which is explained in the bulletin. The four general classifications are as follows:

1. Auditing
2. Taxes
3. Management and advisory services
4. Other accounting services

Depending on the size and type of practice, it may be desirable to enlarge upon and further classify certain types of services. The cost system outlined in this bulletin, however, is predicated on accounting for the four classifications of services indicated above.

## 2. *Billing rates*

THE SECOND ITEM in developing a cost system is the method of determining billing rates. Putting aside the fact that “time alone may not measure the fee,” and that “we should bill for the value of the services rendered,” what is the billing rate which should be generally applied for the staff and partners? Although other factors\* may be of equal or greater importance, the time element plays a significant role. It is the major cost ingredient, and cost provides an irreducible minimum in the establishing of fees. Properly figured, cost gives a fundamental starting point for the application of other relevant factors and for the determination of a reasonable profit. Other factors may be pertinent on occasion, but cost is always pertinent.

Each person in a firm is generally given a standard billing rate depending on salary level and years of experience. Some firms

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\* These are listed in *Economics of an Accounting Practice* Bulletin No. 3, p. 8.

use rounded dollar amounts, others may round off to the nearest dime. It is important, however, to relate the standard billing rate to an individual's base remuneration or some other consistent method so that the rate has a direct relation to the individual's salary. Aside from arbitrary billing rates which may vary from job to job or type of work, the following are the more usual methods for determining hourly billing rates:

- (a) Two times salary divided by estimated chargeable hours
- (b) Two and a half times salary plus payroll taxes and fringe benefits divided by estimated total normal hours (coincides with per diem rate of 1 per cent of annual salary)
- (c) Three times the hourly base salary rate (exclusive of bonus or overtime payments)

The method for establishing billing rates in this bulletin is predicated upon method (c), which is a multiple of the hourly base salary rate for principals and staff (where typing and secretarial services are billed, which is a desirable practice, the billing rate is determined in the same manner). The reason for this approach is that it simplifies costing, as further developed later, by providing a consistent method in which it is known that the standard billing rate is, say, always three times the direct hourly cost rate. It also simplifies recording of work-in-process on the clients' ledger sheets. Salary costs can be readily approximated merely by reviewing billings at standard since it is known that the salary rate is pretty much one-third of that amount. Furthermore, write-ups and write-downs on each engagement can be easily and accurately assessed as to their effect on profitability.

It is a simple matter to determine a man's hourly cost. The usual way of determining the cost rate is to divide the annual salary by the number of normal hours for the year which the man is expected to be paid. The normal hours can vary from 1,820 hours for a thirty-five hour week to 2,080 hours for a forty hour week.

Each time there is a salary increase for a staff man, the billing rate will be increased. Therefore, there will always be a *consistent profit ratio* where the over-all percentage of chargeable time does not fluctuate widely.



### *3. Nonchargeable time*

THE THIRD ITEM to be considered in developing a cost system is the method and degree of accounting for nonchargeable time. Nonchargeable time is generally shown separately on the time report. The following classifications for nonchargeable time are the most usual ones:

1. Vacation, holidays and illness (VHI)
2. Time off (for personal reasons—death in family, visit to doctor, etc., and for time off when given in lieu of overtime payments)
3. Administration (office management), recruiting, bookkeeping and firm relations (public relations in character, would include civic activities)
4. Professional activities (committee meetings, national and state CPA association work, conventions, speeches, articles for magazines, etc.)
5. Staff training and professional development
6. Unassigned time (includes unassigned time of office personnel)

Some of the classifications that are combined could be recorded separately.

Other classifications of nonchargeable time in use are:

7. Jury duty and military training
8. Separation (when paid for time not worked)
9. Office outing
10. Firm publications or releases
11. Study (time spent studying to maintain professional proficiency when such study is required during regular office hours)
12. Tardiness

Nonchargeable time for secretaries, typists and other office em-

ployees may also be recorded under the following classifications:

13. Secretarial services not charged
14. Typing services not charged
15. Switchboard, receptionist, etc.
16. Mail department and messenger service
17. Office work (office bookkeeping and library)

The suggested costing procedures that follow make use of the first six classifications for nonchargeable time which are segregated into two major categories, (1) controllable and (2) noncontrollable. Noncontrollable time covers only vacation, holidays and illness (VHI), all other nonchargeable time is considered to be controllable.

Nonchargeable time may be separately costed in the records according to the time classifications desired. However, the costing system developed in this bulletin provides for this information to be separately developed on work sheets and not separately costed. These work sheets, or time summaries as they are called, are an integral part of the time records and as such are integrated into the costing system. (These records are discussed in Section E.) Nonchargeable time is accounted for under the two headings of controllable and noncontrollable (VHI) discussed above.

#### *4. Distribution of salary cost*

THE FOURTH ITEM in developing a cost system is the method of distributing salary costs. Ordinarily, the larger the practice the less problem there is with indicating salary cost in producing each classification of income, for it is a simple matter to assign individual men on the staff to the various departments—audit, tax, management services, etc., and to charge these departments with the salaries of the staff men concerned. The smaller firm, on the other hand, with its staff performing various kinds of work, has a problem if it wishes to apportion staff salaries to conform with the

classifications of income in order to determine a gross profit for each type of service performed. It can be apportioned, however, at the end of a period by distributing salaries in proportion to fees earned at standard.

There are three main ways of distributing salary cost:

**(a) By Department**

Each person is assigned to a department and payrolls are distributed by department.

The usual departmental breakdown for salaries is as follows:

- (1) Partners
- (2) Audit Staff
- (3) Tax Department
- (4) Management Services
- (5) Typing and Report Department  
(includes stenographic section)
- (6) Office Management  
(includes cashier, bookkeeper, telephone operator and receptionist)

**(b) By Classification of Services**

All salaries are apportioned according to the classification of services indicated in the time reports as follows:

- (1) Auditing
- (2) Taxes
- (3) Management and advisory services
- (4) Other accounting services

A monthly recap of each person's time distribution provides the basis for apportioning payrolls. Actual salary cost is apportioned among the cost classifications, which conform to the income classifications.

**(c) By Classification of Staff**

All salaries are charged to staff salary classifications as follows:

- Salaries — partners or proprietor
- Salaries — accounting staff
- Salaries — office staff

As mentioned previously, the first method lends itself to the operation of a large office and by its separate cost classification is not suitable for small and medium-sized practices. Some medium-sized practices, however, may be in a position to use it.

The second method gives the actual cost breakdown for performing the various classifications of service. In view of the extra effort involved in apportioning salaries by this method, it should be ascertained whether or not this breakdown is desired prior to adoption for record-keeping purposes. This method becomes cumbersome when overtime payments are involved or when annual bonuses are apportioned throughout the year. Nevertheless, there is no reason why this cost breakdown cannot be prepared annually from the annual totals shown in the individual time summaries (page 35) by apportioning the annual earnings for each individual among the income classifications based on total chargeable time.

The third method is by far the simplest method for record keeping in the small or medium-sized practice and is the method described in detail in this bulletin. It provides for the keeping of separate work sheets for determining profits on each engagement, and profits generated by each partner and staff man.

## **E. BASIC COST SYSTEM**

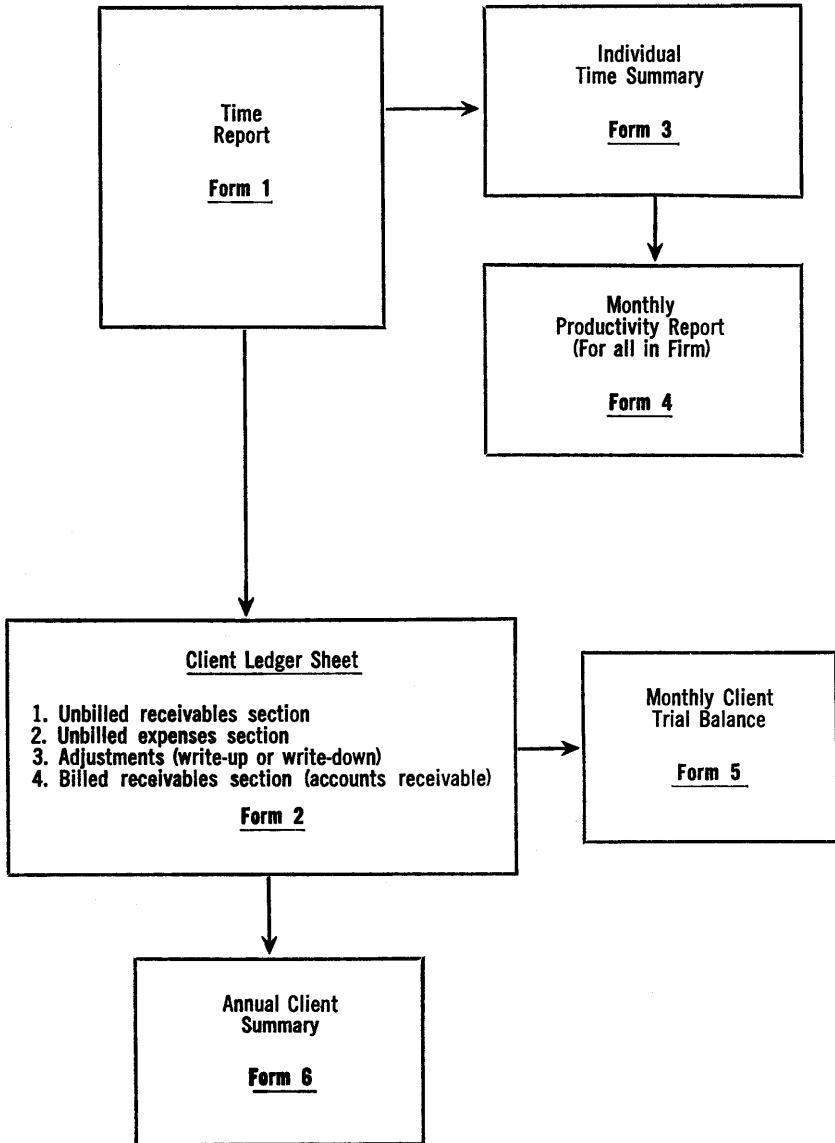
<u>Form</u>	<u>Description of Forms</u>
1	Semimonthly Time and Expense Report
2	Client Ledger Sheet—combines unbilled receivables, unbilled expenses and billed receivables
3	Individual Time Summary Sheet
4	Monthly Productivity Report
5	Monthly Client Trial Balance
6	Annual Client Summary

### Costing Procedure in Brief

1. Each staff man (and each principal) fills out a semimonthly time report in which he accounts for all of his chargeable and nonchargeable time.
2. Each time report is priced out at the man's standard billing rate by the bookkeeper, for chargeable time only, and totaled.
3. Both chargeable and nonchargeable time are posted from the time report to the individual's time summary sheet.
4. Hours and dollar amounts are recorded in the client ledger sheets from the time reports and chargeable expenses are recorded from the expense reports.

## COST SYSTEM FLOW CHART

Cash or Accrual Basis





# SEMI-MONTHLY EXPENSE REPORT

DATE	FILE No.	CLIENT'S NAME	DETAILS	Trans- portation	HOTEL	MEALS	OTHER	TOTAL
6/7	1234	Alford Construction Corp.	Lunch with chief accountant			14 25		14 25
6/13	1485	York Mfg. Co. Inc.	Round trip mileage to Detroit	3 20				3 20
6/14	1485	do	do (32)	3 20				3 20
6/15	1485	do	do	3 20				3 20
TOTAL EXPENSE				9 60		14 25		23 85

SUMMARY OF EXPENSES				CASH REPORT	
FILE No.	CLIENT'S NAME OR ACCOUNT	CHARGEABLE EXPENSE	NON-CHARGEABLE ACCT	DETAIL	AMOUNT
1234	Alford Construction Corp.	14 25		BALANCE ON HAND - FROM LAST REPORT	6 40
1485	York Manufacturing Co. Inc.	9 60		RECEIVED FROM <i>Office</i>	50 00
				TOTAL TO BE ACCOUNTED FOR	56 40
				DISBURSEMENTS AS ABOVE	23 85
				CASH TRANSFERRED TO	
				CASH RETURNED TO OFFICE	
				TOTAL DISBURSEMENTS	23 85
				BALANCE DUE OFFICE	32 55
				BALANCE DUE ME	

AUDITED	<i>Bo</i>	Entered on Records:	<i>Bozzo</i>	APPROVED	<i>Waffle</i>
		Entered in Client's Ledger:	<i>Bozzo</i>	SIGNED	<i>James R. Bennett</i>



FORM 2

NAME Albert Construction Corp  
 ADDRESS 1500 Merritt Road  
 CITY Pittsburgh, Pa.

# CLIENT LEDGER SHEET

BILLING INSTRUCTIONS

Filed fee \$ 1475. Bill upon completion of work

PARTNER

W. Able

DATE	FILE No.	AUDITOR	Hours	AUDIT	TAX	Management	OTHER		Cumulative Unbilled Receivable	Unbilled Expenses	Billing Adj.	Date Billed	Inv. No.	ACCOUNTS RECEIVABLE	
							AMOUNT	DESCRIPTION						DR.	CR.
4/30/61	1234	V. Thompson	13	130 00											
4/30/61	1234	J. Bennett	40	368 40				498 40							
5/15/61	1234	V. Thompson	2	20 00											
5/15/61	1234	J. Bennett	40	368 40				876 80							
5/31/61	1234	J. Bennett	14 1/4	130 24				1 017 04							
6/15/61	1234	J. Bennett	56	515 76					14 25						
6/15/61	1234	W. Able	2	34 62											
6/15/61	1234	P. Gross	1 1/2	11 25				1 595 75							
6/15/61	1234	H. Joyce	3/2	17 08											
								1 595 75	14 25	135 00	556 61	6254	1475 00	1 475 00	
											7/10/61	CR62	1475 00	-0-	



FORM 3

INDIVIDUAL TIME SUMMARY

NAME OF EMPLOYEE	FIRM YEAR		Hours				Productivity Ratio*	Fees Earned at Standard	Actual Salary	Standard Gross Profit
	Year	Month	Chargeable	Nonchargeable	Control-able	V H I				
Month	Cost Rate	Billing Rate								
July 15										
July 31										
August 15										
August 31										
September 15										
September 30										
<b>Total</b>										
October 15										
October 31										
November 15										
November 30										
December 15										
December 31										
<b>Total Cumulative</b>										
January 15										
January 31										
February 15										
February 28										
March 15										
March 31										
<b>Total Cumulative</b>										
April 15										
April 30										
May 15										
May 31										
June 15										
June 30										
<b>Grand Total</b>										

\*Based on normal work week of 40 hours.

**FORM 4**  
**MONTHLY PRODUCTIVITY REPORT**

Name	Rate		Hours			Productivity Ratio*	Gross Profit at Standard	
	Cost Rate	Billing Rate	Chargeable	Nonchargeable	Fees Earned at Standard		Actual Salary	Standard Gross Profit
				Control- lable	V H I			
<b>Partners</b>								
A								
B								
<b>Total Partners</b>								
<b>Seniors</b>								
C								
D								
E								
<b>Semi-Seniors</b>								
F								
G								
H								
<b>Juniors</b>								
I								
J								
K								
<b>Total Accounting Staff</b>								
<b>Stenos</b>								
L								
M								
<b>Total Stenos</b>								
<b>Others</b> (bookkeepers, etc.)								
N								
O								
<b>Total Others</b>								
<b>TOTAL</b>								
<b>Previous Months' Totals</b>								
<b>Year to Date</b>								

\*Based on normal work week of 40 hours.

**FORM 5**  
**MONTHLY CLIENT TRIAL BALANCE**

<u>Client's Name</u>	<u>MONTH</u>
<u>Unbilled Receivables</u>	<u>Accounts Receivable</u>
<u>Unbilled Expenses</u>	<u>Total</u>

This form is optional. However, where more than one person in the firm is interested in a trial balance of receivables, it is advisable to prepare one. It may also be advisable to age the accounts receivable to indicate those accounts unpaid for 90 days or more.

**FORM 6**  
**ANNUAL CLIENT SUMMARY OF AMOUNTS BILLED**

<u>Client's Name</u>	<u>Total Billed</u>	<u>Recoverable Expense</u>	<u>Net Fees</u>	<u>Billing Adjustments</u>	<u>Fees at Standard</u>	<u>Percentage of Net Fees to Standard</u>	<u>Explanation of Write-downs</u>
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## *Description of costing system*

THE BASIC FORMS used in the costing system are those illustrated on pages 32 through 37.

The fundamental clerical job which provides information relating to productivity consists of recording and distributing the time of principals and employees as reported semimonthly on the time report prepared by each person in the organization. (Weekly or monthly reporting may be just as suitable.) The time sheets account for all hours comprising the normal working day as well as any additional time worked. There is also shown, as a minimum, the partner's or employee's name, date, name of client, client file number\* and the number of chargeable or nonchargeable hours. The billing record is easier to control if time is converted to billing terms. It is assumed that the accumulated work-in-process at billing value, based on assigned hours at some consistent standard method of valuation, will be adjusted upward or downward to reflect the particular circumstances bearing upon each engagement and the adjustment to the amount billed will be shown on the receivable record. Such adjustments may be made monthly as the engagement progresses in order to indicate more properly the value of services performed.

The method of summarizing, analyzing, and costing is as follows: Extensions are made on the time reports at standard billing rates. No extensions are made for nonchargeable time. The dollar totals on the time sheets are summarized in the lower left portion of the time report ("For Office Use") by classification of service. These totals are summarized for posting to the unbilled receivables control and to income by class of services performed. Time and dollar amounts are then recorded on client ledger sheets; however, only the dollar amounts are recorded by type of service performed. The hours and the fees earned at standard are posted from the time reports to the individual time summary sheets.

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\* The file number may be the client number or the engagement number, depending on the manner of treatment within the firm. The system described provides for either procedure.

## *Time summaries*

THOSE PERSONS RESPONSIBLE for managing the practice should expect the accounting records and reports to furnish adequate information for controlling the assignable time of productive personnel. This purpose is accomplished by using individual time summaries and monthly productivity reports. The ratio of total chargeable hours to normal hours of all productive personnel should be computed each period and placed on the individual time summaries. By studying comparisons and trends indicated, management should be able to determine whether or not the practice is properly staffed, whether or not minimum standards of production are being met, and whether or not the work load is properly distributed throughout the period.

As stated earlier, a separate individual time summary sheet is kept for each principal and employee. From the time reports both chargeable and nonchargeable hours are entered on the individual time summaries. After it has been ascertained that all of the time reports have been received and entered on the individual time summaries, the monthly productivity reports are prepared. The totals will show how many of the aggregate working hours of all personnel have been charged during the month (or any other period) to clients and how many were of a nonchargeable nature. The relationship between the number of hours charged to clients by an employee during the month, and the normal working hours for the month, constitute that employee's "productivity ratio" for the month. For example, if a firm's normal working day is eight hours, the month containing 20 working days (160 hours) in which a man had 144 chargeable hours, the productivity ratio would be 90 per cent (144 hours divided by 160 hours). If the man worked 9 hours overtime during this period, his productivity ratio would remain the same unless the overtime worked represented chargeable hours.

If a majority of a firm's clients require services on a monthly basis, the productivity ratio for that firm's staff will probably remain reasonably constant from month to month. On the other hand, it may fluctuate widely in firms whose work is concentrated

during certain months of the year. In either event, it indicates the extent to which the staff is being gainfully employed and, in a general way, the efficiency in scheduling assignments.

### *Productivity ratio*

IT IS ADVISABLE that all time for which an individual is paid be included in his productivity ratio including vacation, holidays, and illness in order to simplify computation and to provide direct comparisons among employees. Regardless of how the productivity ratio is determined, the basic principle to follow is that time should be reported in sufficient detail to provide the firm with the information it requires to determine actual staff productivity.

### *Monthly productivity report*

AS PREVIOUSLY NOTED, the totals of the individual time summaries kept for each person, including principals, show total chargeable hours and time charged to nonchargeable classifications. The monthly recapitulation of these totals as shown in the productivity report (see page 36) serves a double purpose: (1) it reflects, in summary form, an accounting for the month's time for which the principals and staff were available, and (2) it provides the basis for determining the standard gross profit based on salary cost for each individual and for the entire firm. Space is not provided to show the cost of nonchargeable time. If, however, nonchargeable time is costed, effect must be given to overtime payments. For those employees who are not paid overtime, any nonchargeable time in excess of normal hours that are chargeable should not be costed. The cost of nonchargeable time can be computed by determining the difference between salary paid and one-third the total billings at standard. The cost of nonchargeable time as shown in the productivity report is not recorded anywhere in the books; when calculated, it serves only to indicate in a general way the cost of nonchargeable time.

In the monthly productivity report, the names of principals and employees and their cost and billing rates per hour appear on the left side of the sheet. Memorandum columns showing hours accumulate the make-up of hours worked.

The standard billing rates used in the foregoing schedule are three times the direct hourly cost and are amended at the time of salary adjustments. A salary adjustment coming within any day of the month changes the billing rate for the entire month. Therefore, to simplify billing value, the extensions on the time reports and individual time summaries are based on hourly rates in effect at the end of the month. Consequently, salary adjustments should be made effective at the beginning of a month.

The distribution of each principal's and employee's total hours for the month is posted from the individual time summaries (Form 3, page 35) to the appropriate columns of the productivity report (Form 4, page 36). It is desirable to use in the fees-earned column the total of the dollar extensions on the time report at standard, in order to have the individual time summaries and productivity reports show amounts before write-ups or write-downs. By using the fees earned at standard, a gross profit is developed for each individual based on his standard billing rate.

The hourly figures are also a convenient source of information as to the amount of overtime worked by each employee during the month, and for the year. The totals of the various hourly columns constitute an analysis of the total time worked for the entire firm for the current month, and with the addition of cumulative figures at the prior month-end, for the year-to-date. Comparative operating statistics may readily be prepared from the analysis for individual employees and for the firm as a whole.

### *Fixed fee accounts*

FIXED FEE ENGAGEMENTS are handled in the same manner as per diem engagements except that the client ledger sheets should indicate that the client is on a fixed fee basis. The write-ups or



write-downs will show on the client ledger sheets to indicate the difference from standard billing rates. A separate ledger account should be used for absorbing these adjustments by class or services. These adjustments should be applied against income for financial statement purposes.

For fixed fee engagements, it may be advisable to indicate the budgeted time, by class of service, on the top of the client ledger sheet in order to compare the actual time as the work progresses for conformity with the budgeted time.

### *Unbilled expenses*

EXPENSE REPORTS are prepared on the reverse side of the time reports for out-of-pocket expenditures made for clients by staff personnel. A summary is prepared on the expense report by the office bookkeeper (lower left-hand side of expense report) to facilitate posting to the client ledger sheets. A cash reconciliation is provided for the employee to account for all monies received, spent and returned. The unbilled expenses portion on the client ledger sheets should be separately controlled until billed.

### *Cash or accrual basis*

*Management of an Accounting Practice* Bulletin No. 14, pages 18-21, reviewed the methods of accounting and discussed the advantages of the accrual basis over the cash basis of accounting.

Many firms on the cash basis pay all their expenses at the end of each period, and, therefore, find no need to accrue expenses, while recording unbilled receivables as memorandum entries on the client ledger sheets. The system outlined in this bulletin provides for recording receivables in this manner for firms filing on the cash basis.

## **F. USE OF MECHANICAL DATA PROCESSING**

**MECHANICAL METHODS** of record-keeping, under the proper circumstances, are just as good for use in accounting firms as in clients' offices. This is particularly true in the case of time records and fee computations.

The many bookkeeping machines that are available for preparing accounts receivable records are useful in accounting firms and are used by many firms. These machines usually produce payroll records and other records similar to the time summaries discussed. They are extremely helpful in posting to client ledger sheets and updating cumulative balances while simultaneously producing a journal and accumulating total balances.

In recent years tabulating equipment has been put to increasing use by public accounting firms in preparing personnel time summaries and earnings records, and client work-in-process and accounts receivable records. These are processed in three different ways:

1. The time reports (after coding) may be sent directly to a service bureau which punches the cards. The information can be prepared in whatever form desired. There is a charge for the manual keypunching and verification punching of every card punched.
2. A punched tape adding machine is used to prepare a tape in the office of the firm from the time reports. This tape, after

being checked, is sent to a processing center where it is placed on a machine that converts the information into punched cards which may then be re-sorted to print any listed information required. This is the cheapest and is presently the most popular method.

3. A card punch machine that punches the information into tabulating cards can be installed in the office of the accounting firm. The punched cards, after verification, may be sent to a processing center where they are used to print the required information.

In some large firms with branches, where the accounting is centralized, a complete tabulating system may be installed to handle the entire job.

While there is little doubt that electronic computing equipment certainly could produce the results offered by punched card equipment, no installation of this equipment for time and cost analysis is known to be in use by any accounting firm at this time.

## G. BUDGETING

WHEN A FIRM CONSIDERS the preparation of a budget it may approach it in three ways: (1) time budgeting; (2) dollar budgeting; or (3) a combination of time and dollar budgeting.

### *1. Time budgeting—a key to profit*

THE MOST IMPORTANT BUDGET is the time budget, which is basically an *annual assignment schedule* (Budgeting of Personnel). Every firm is strongly advised to prepare one.

If only a time budget is to be prepared, it would be prepared somewhat differently from a combined time and dollar budget described later. However, the *annual assignment schedule* as described here should still be prepared even though a combined time and dollar budget is prepared. Time budgeting serves many purposes. It helps in determining when staff increases are necessary and allows the firm ample time to choose suitable employees rather than being rushed into obtaining new employees upon a purely expedient basis. Basically, however, the *annual assignment schedule* is important for anticipating staff requirements to help the firm control and correct staffing situations before they develop into problems. No effort is too great to be sure that personnel will be available when required and to have the available personnel assigned throughout the year.

It is best to prepare this schedule prior to the start of the summer season (early part of May), and to include within the twelve-

month period the peak seasonal cycles of the firm. It is strongly suggested that a *continuous schedule be available by adding one month when each expired month is dropped in order to have a constant twelve-month forecast.*

As an extremely helpful aid in preparing the *annual assignment schedule*, it is advisable to prepare a schedule of assignments as actually carried out (including vacations) for the previous corresponding period of time. This historical schedule can be prepared from the time reports for the previous year and the task may be delegated to office personnel. The assignment schedule in Exhibit 1 illustrates how such historical assignment information is accumulated and the type of form that may be used for this purpose. It should be noted that this form is adaptable to the needs of both small and large firms.

The *annual assignment schedule* is then prepared for all known engagements (in the same format as the one prepared for assignments actually carried out) using this historical information as a starting point. The following additional information must also be considered:

- New clients, and engagement time estimates for each
- Lost clients
- Changes in fiscal years of present clients
- Changes in staff personnel
- Staff promotions
- Probable changes in starting dates of certain audits
- Facts requiring a major increase or reduction in time of present engagements

The preparation of the *annual assignment schedule* cannot be delegated and must be performed by the person having administrative responsibility for assignments. It is his responsibility to obtain the best results from staff members by using them so that their special abilities can be put to the best possible advantage. In plotting the assignments, space can be provided for inserting

EXHIBIT 1

# STAFF ASSIGNMENT SCHEDULE

JULY 3, 1961 TO AUGUST 27, 1961

U - UNASSIGNED  
I - ILLNESS  
T - TIME OFF  
H - HOLIDAY

## JULY

DATE	3	4	5	6	7	8	9	10	11	12	13	14	15	16
DAY	M	T	W	T	F	S	S	M	T	W	T	F	S	S
<b>SENIORS</b>		H												
E					Aberland Tank Corp									
F					Allen, Inc. * Brakes Electric									
G					Amper * Marshall Fields * Labels Machinery									
<b>SEMI-SENIORS</b>		H												
H					Allen, Inc. * Vacation									
I					Aberland Tank Corp									
J					Instalco Homes * Fallon Research									
K					Vacation									
K					Vacation * Barnabas									
L					Walt's Book Store → T Books									
<b>JUNIORS</b>		H												
M					Aberland Tank Corp									
N		I	I	U						Labels Machinery				
O					Allen, Inc. * Brakes Electric									

## AUGUST

DATE	14	15	16	17	18	19	20	21	22	23	24	25	26	27
DAY	M	T	W	T	F	S	S	M	T	W	T	F	S	S
									Vacation					
									Parker Products					
									Greiner Industries					
									Rockwood * Bow * Spring Jobs					
									Vacation					
									Johnston, Inc.					
									Fife * Joyce * Franklin Agency					
									U U					
									Parker Products					
									Vacation					
									Greiner Industries					
									Parker Products					
									Florian Flower					

the word senior, semi-senior or junior (depending on the firm's staff classifications) in the first column, and for writing the clients' names on the same line with the employee's name. Shortages in manpower requirements will become evident and the assignment of personnel to certain engagements will have to be deferred until completion of the entire schedule.

After considerable reworking and reshuffling of staff personnel and assignments, estimated manpower requirements for the coming year will be available at least with respect to recurring assignments. If when plotting assignments all of the engagements cannot be adequately covered by present personnel, space should be left under the respective staff classifications (with the names of the clients plotted with the time requirements on the same line). This will give an indication of the number of new personnel required.

In this connection, it should be pointed out that firms with small staffs who have their personnel engaged in preparing tax returns during the tax season should plot this time on the *annual assignment schedule* as "tax return preparation" rather than indicate the names of the individual clients. If desired, the forecasted hours may be summarized on a schedule similar to the one illustrated in Exhibit 4, page 57.

In larger firms, the *annual assignment schedule* should be used mainly for audit or similar engagements rather than for tax and management advisory services unless they are big jobs which can be planned in advance. Time budgets for these other services should also be carefully prepared, however, based on the experience of prior years after giving effect to additional information as listed above. (Exhibit 4, page 57, can be used for this purpose.)

As a general principle, it would be well *not to assign personnel for more than 85 per cent of their normal hours* (a firm with a forty-hour week will have 2,080 normal hours for the year) in order to allow for vacations, holidays, illness, and time off. A firm which budgets time beyond an 85 per cent productivity ratio is not making provision for new engagements.

It is also advisable to budget time to permit the staff to attend professional development courses offered by the Institute and the

state societies in order to improve their ability and value to the firm.

### *Scheduling (short-range forecast)*

SCHEDULING IS THE ASSIGNMENT of personnel to engagements cleared for starting on definite dates. The format is the same as the *annual assignment schedule*.

A multitude of factors thwart even the most careful planning of assignments. Failure to meet completion dates on schedule, personal problems of staff men, and internal and personal problems of the client make it almost impossible to schedule assignments precisely. As a consequence, if unassigned time is to be kept to a minimum, there must be considerable flexibility on the part of everyone in the firm, from the principals down to the newest staff member.

At least a month prior to the starting dates indicated in the twelve-month assignment schedule, the clients should be contacted to confirm the scheduled starting dates. In addition, those in charge of assignments from which personnel are to be released must also be contacted to confirm the availability dates of such personnel. It is only after such information is determined that personnel commitments can be made with any reasonable degree of accuracy.

## *2. Dollar budgeting*

THE REASON for dollar budgeting is twofold: (1) a dollar budget is prepared to show costs so fees can be set more intelligently. Profit on each job should be planned so that unprofitable jobs can be placed on a profitable basis, minimized or eliminated; (2) a dollar budget is prepared to reach a goal, an income goal. This budget is prepared (and designed) to help run an office efficiently by keeping costs in line and nonchargeable time to a minimum.

Dollar budgets are usually started from the income side, follow-



ing the theory that income must be generated in order to have expenses. The next step is to estimate or budget the expenses for the ensuing fiscal year. Expenses chargeable to clients as out-of-pocket expenses should be ignored.

A dollar budget is relatively simple to prepare. There are at least two ways of preparing it. The first method is to take the current year's actual income and expenses and apply a factor (judgment) to bring the income and expenses to what it is believed they will be during the ensuing year. This method is based on past history and is widely used. The other method, based on a future estimate, is more involved, and is ordinarily combined with budgeting for time. It should, of course, be more accurate than the past history method, but no budget is 100 per cent accurate—one large new client would in all probability cause a drastic change in the budgeted figures. A dollar budget can be prepared on both the cash and the accrual basis.

### *Statement of cash requirements*

A CASH BUDGET should always be part of the dollar budgeting procedure. Periodic or monthly cash budgets should be prepared as well as an annual cash budget.

The cash budget consists of a forecast of cash receipts and disbursements. The estimated receipts include the probable collections of accounts receivable along with any other anticipated items. The disbursements are based upon the forecast of payments for salaries, outside services and operating expenses.

### *3. Combined time and dollar budgeting*

THE APPROACH TO THE PREPARATION of a combined budget is different from the way a dollar budget or a separate time budget is prepared. Preparing a combination time and dollar budget is different from preparing a time budget prepared without a tie-in

with a dollar budget. However, an *annual assignment schedule* and a short-range forecast (scheduling), are still required. The annual time budget described earlier (illustrated as an *assignment schedule*) serves as a basis for determining chargeable hours for known clients in preparing a combined budget. The forms for preparing a combined budget are illustrated in Exhibits 2 through 6 beginning on page 54. The chargeable hours estimated on the *annual assignment schedule*, however, should be adjusted to give effect to prospective growth based on the firm's experience in obtaining new clients.

The procedures recommended for a combined time and dollar budget are separated into three parts:

*Part I — Budgeting income*

A. By client

B. By practitioner or partners and staff

*Part II — Budgeting salaries and outside service*

*Part III — Budgeting operating expenses*

**Part I — Budgeting Income.** Before the suggested budgeting procedures are developed, it is necessary to decide when to begin a combined budget.

If the fiscal year ends June 30, for example, and an annual budget is prepared, next year's budget should be ready by July 1 (a year in advance). Most accountants believe that next year's budget should be prepared as far in advance as possible and adjusted before the start of the year. Some well-managed firms prepare their budgets a year in advance by adding quarters as they go along. Those firms that have large staffs will find it advisable to judge staff requirements by projecting for the firm's fiscal year. Many large firms prepare three-year forecasts primarily to plan for personnel requirements and some forecast their personnel and space requirements a decade in advance.

(A) *Budgeting Income by Client.* One way to prepare an annual income budget by client is to prepare a schedule listing

each client and fee income for the past period (Section C, Exhibit A, Schedule 3). In preparing a schedule of this kind it is desirable to have columnar headings to indicate fees in the following suggested categories:

- a. This period
  1. Auditing
  2. Taxes
  3. Management and advisory services
  4. Other accounting services
  5. Total
  
- b. Next period (prepare the same columnar headings with estimates under each category of service)

When fees are separated by categories, it enables reviewing the source of income as well as providing a vehicle for a more accurate forecast of future income.

The person estimating future income should have a thorough knowledge of the present clients of the firm. It may be necessary to determine the amount of income from some clients for two years previous. Consideration should be given to trends or influences that will cause business to contract or expand, especially if the clients are concentrated in any single industry or line of business. How much of the previous income represents regular work that is repetitive in nature, and how much represents special work that may not be repeated must also be considered.

Certain special work may be known in advance; however, an allowance should be made, by client, for prospective special work. This "guesstimate" of work for each client can be facilitated by past experience trends. One firm has approached this problem by preparing a schedule of nonopinion clients indicating what further work can be done for each of these clients in order to render an opinion on their financial statements and the estimated cost to the client. There is no reason that, after this avenue is fully developed, a schedule of further work cannot be prepared for all clients in the management-services area.

An over-all estimate should be made for possible new clients. Here again, past history is a normal guide.

*(B) Budgeting Income by Partner and Staff.* The second portion of the combined budget is estimating chargeable time of the principals and staff (see exhibits). Extending the estimated chargeable hours by standard billing rates for partners and staff and then totaling the result, should produce a total dollar amount that compares reasonably closely to the developed budget of annual income by client. Any major difference between these two budgets may indicate that the office is understaffed or overstaffed, or it could mean that there is an error in either the *client budget* or the *staff budget*. Here the planning part of the budgeting process comes into focus, and the real value of preparing a combined budget is obtained.

**Part II — Budgeting Salaries and Outside Services.** When the schedules forecasting chargeable time by partners and staff are prepared, a column should be provided for estimating their compensation.

Estimating the costs of outside services is based chiefly on historical costs. The nature of new work forecasted may, however, have a marked effect on the estimate.

**Part III — Operating Expenses.** Budgeting operating expenses results is one way of controlling them. Careful analysis is required along with prior years' comparisons. The recommended budgeting method obviates prorating operating expenses to the different departments or income classifications.

### *Comparison of budget with actual results*

A BUDGET MAY OR MAY NOT be tied into the records. It is, however, not used to its full advantage until it is compared with actual results. Favorable variances are a pleasure to explain. Unfavorable ones need to be segregated, analyzed and prevented in the future.



	ACTUAL				FORECAST			
	Last Period		This Period		Next Period			
	Charge-able Hours	Dollars	Avg. Per Hour	Charge-able Hours	Dollars	Avg. Per Hour	Charge-able Hours	Dollars
<b>Operating Expenses</b>								
Professional development .....								
Professional membership expense .....								
Provision for doubtful accounts .....								
Publications .....								
Stationery, printing and supplies .....								
Taxes—other .....								
Taxes—payroll .....								
Telephone and telegraph .....								
Travel and subsistence .....								
Welfare and group benefits .....								
Total .....								
<b>Operating Income</b> .....								
<b>Other Income</b> .....								
<b>Net Income</b> .....								

EXHIBIT 3

FORECAST OF CHARGEABLE TIME—PARTNERS

	Forecast Next Period		This Period Actual		Next Period Forecast	
	Total Hours	Chargeable Hours	Total Hours	Chargeable Hours	Total Hours	Fees
		% To Total			% To Total	\$
		Hours		Hours	Hours	
July .....						
August .....						
September .....						
October .....						
November .....						
December .....						
January .....						
February .....						
March .....						
April .....						
May .....						
June .....						
Total for period ...						

SUMMARY  
 FORECAST OF CHARGEABLE TIME—STAFF

	Forecast Next Period		This Period Actual		Next Period Forecast		% of Salary Costs to Estimated Fees	
	Total Hours	Chargeable Hours	Total Hours	Chargeable Hours	Estimated Fees	Salary, Bonus & Overtime	Next Period Forecast	This Period Actual
					\$	\$	%	%
July .....								
August .....								
September .....								
October .....								
November .....								
December .....								
January .....								
February .....								
March .....								
April .....								
May .....								
June .....								
Total for period ...					\$	\$	%	%



EXHIBIT 5

FORECAST OF PAYROLL COSTS TO ESTIMATED FEES—STAFF  
YEAR ENDING NEXT PERIOD

Employee	Total Compensation This Period**	Estimated Compensation Year Ending Next Period		Billing Rate For Years		Estimated For Next Period		Per Cent Cost	
	Salary	Bonus*	Total	Next Period	This Period	Chargeable Hours	Estimated Fees	Next Period	This Period

Note: All amounts except billing rates are to be stated in even dollars. Percentages to be carried to nearest whole percentage.

\* Indicate overtime with an asterisk.

\*\* Total compensation should be annualized for those not employed for the full fiscal year of this period.

Indicate these with double asterisk.

THREE-YEAR FORECAST

	Period Ending					
	Next Year		Two Periods Hence		Three Periods Hence	
	No. of Personnel	Charge-able Hours	Dollars	No. of Personnel	Charge-able Hours	Dollars
<b>Income</b>						
Auditing .....			\$			\$
Taxes .....						
Management and advisory services .....						
Other accounting services .....						
<b>Total</b> .....			\$			\$
<b>Salaries and Outside Services</b>						
Salaries—partners or proprietor .....			\$			\$
Salaries—accounting staff .....						
Salaries—other .....						
Outside services .....						
<b>Total</b> .....			\$			\$
<b>Operating Expenses</b> .....			\$			\$
<b>Net Income</b> .....			\$			\$
<b>Floor Space</b>						
Square Feet .....						
Occupancy Costs .....			\$			\$