

## PB-07-PART C

### MAINTAINING PROFITABILITY – MANAGEMENT CONTROL

#### SUMMARY

Practice Bulletin 07- Part A & B identified the importance of establishing an offices' realistic calculation of production hours and overhead and so we may now move to more serious concern of the actual expenditure of overhead, and the management control necessary to keep it at an acceptable level. Any expense in operating an office affects the profitability and ultimately the income it generates, so it's wise for all practitioners, whether in partnership or as individuals, to constantly review the practice's cost and expense. Large practices must do this at least monthly and preferably weekly, smaller ones, at least every 2-3 months. A practice should not allow overhead to run unchecked for any period of time. This could lead to some very server repercussions.

#### CONTROL OF OVERHEAD

How can overhead be controlled? In today's business world, the answer is "with great difficulty". Every effort must be made to implement and monitor controls. Overhead can help an office establish optimum production staff levels. For example, if the acceptable office overhead is 100 percent, and every effort has been made to keep it to a minimum, the total of overhead should equal production salaries. If it doesn't, profit will become eroded or disappear. If the value of overhead doesn't exceed the equivalent value of production salaries, and normal workload is maintained, an office can expect a profit at year's end.

What are the most important items that can cause overhead to exceed a realistic level? Few practices own their own office building and must rent accommodations. Rent can vary greatly depending on location. A practice should be located wherever it is most convenient for your clients. Study your requirements in detail and don't rent more than is actually required including an allowance for expansion. Every practice should make a five-year projection of staff requirements, even when the economy lags. It is recommended that a practice should establish various cost centers for each expected allowance of 100 percent of production salaries, and try to ensure expected expenditures stay within these guidelines. For example, if an office anticipates a yearly overhead of \$100,000, of which fifteen percent is allocated for accommodation, office rental should not exceed \$15,000. To enter into a rental agreement exceeding this will affect your other anticipated expenditures, which in turn may affect the final profit expectation.

Non-billable staff such as receptionist, assistants, accounting, etc. is another element of overhead to be carefully monitored. For non-billable staff members, most will recommend listing their expected duties, as well as salary levels. This will not only help the employee, but will assist you in keeping this type of staffing cost at an economical level.

The type and cost of office equipment, another key element likely to increase over time, should be looked at carefully. Many types are now available, with sophisticated features that are never used; yet many offices will lease or purchase one and incur an unnecessarily high overhead. Business development is another element of overhead expense. To stay in business, every office must spend money on procurement of future work. Determine how much you're going to spend on this, and stick to it. Experience shows that a prospective client is not greatly influenced by the slickness of a firm's brochure or website, but rather by its content and what it says about the firm's capabilities. It is recommended that firm's bring forward a simple, factual message without

expensive reproduction gimmicks. Carefully weigh your actual needs before you get involved in the printing of brochures or what information might be better on your website.

Finally, a small item that creates much concern to principals: office supplies. While supplies aren't a great expenditure in themselves, principals seem to view wastage as a large associated cost. For necessary items, assign one person to purchase and distribute, this imposing a perceived control. Setting budget guidelines is also a way to ensure control.

## CONTROL OF PRODUCTION HOURS

Establishing a firm's available production hours is essential for control, as well as for determining whether a project is making money. It's also important in distinguishing overhead from fees agreed upon, based on the availability of the office to work on that particular project. When a fee has been negotiated, whether it is a percentage of the cost of the work, a lump sum, or any other arrangement, know from the start the anticipated production hours available to complete the work. Every project, regardless of size, should have a project fee information sheet prepared for the fiscal control of the project.

**To establish the anticipated hours available for any project, the following is a common method established over the years, and which has proven to be the most successful;**

Assume a fee has been negotiated at 6% on an anticipated construction cost of \$10 million. The fee to be earned is therefore 6% of \$10 million, or \$600,000.

**Allow for all engineering, structural, mechanical and electrical consultation cost which subject to final fee arrangements with engineers, is usually in around 40% including coordination. To keep this example simple 40% is used, obviously, based on the nature of the project, this will differ.**

40% of \$600,000 = \$240,000. [Sub Consultant Fees - varies per project]  
 \$600,000 - \$240,000 = \$360,000 [Net Architectural Fee]  
 20% of \$600,000 = \$120,000. [Allow 20% for Profit and Partner Involvement]  
 \$360,000 - \$120,000 = \$240,000 [Net amount available for Production]  
 50% or \$240,000 = \$120,000 [Overhead = 50% of Production Allowance]  
 The net total available for production is \$120,000.

**The net total for production should then be broken down into percentage values for Basic and Agreed Services ..**

Schematic Design	15% of 120,000 =	\$ 18,000
Design Development	15% of 120,000 =	\$ 18,000
Working Drawings & Specifications	45% of 120,000 =	\$ 54,000
Tenders and Negotiation	5% of 120,000 =	\$ 6,000
<u>Construction Administration</u>	<u>20% of 120,000 =</u>	<u>\$ 24,000</u>
Total	100%	\$120,000

The total of these elements is 100% of work involvement.

**Available hours can be applied to each element by dividing fee by production hourly rates, using \$50.00 per hour as an average for production and support staff.**

Schematic Design	15% of 120,000 = \$ 18,000 /50 =	360
Design Development	15% of 120,000 = \$ 18,000 /50 =	360
Working Drawings & Specifications	45% of 120,000 = \$ 54,000 /50 =	108
Tenders and Negotiation	5% of 120,000 = \$ 6,000 /50 =	120
<u>Construction Administration</u>	<u>20% of 120,000 = \$ 24,000 /50 =</u>	<u>480</u>
<b>Total</b>	<b>100%</b>	<b>\$120,000      2400 Production Hours</b>

These are guidelines only. They must be monitored regularly, especially as each identified element is completed. It is also important to utilize your own factors for overhead, hourly rates, etc. and use them accordingly. In this manner, any adjustment can be made to the remaining allocations. For example, when the design has been completed, if the hours spend exceed the 20% allocated, deduct the cost of the exact time spend from the net available, using the balance remaining for production instead of the original net allowance. Again, remember this is a guide only and not a factual figure, and should be used as a tool for your office operation.

This exercise is also useful for appropriate allocation of staff resources and ensuring that the project can be completed in the time allocated. It's also extremely useful in establishing available production hours for all projects in the office, and thus future workload and allocations.

As they're reviewed each month, the remaining totals, based on present allocation of time of productive personnel, will provide a guide to your office's remaining workload and when further work will be required. All of this is contingent on your present workload and negotiated fees.

#### NOTES

The *Alberta Association of Architects* thanks Barbara Komisar for kindly providing this article. Ms. Komisar is a lawyer with *Ogilvie and Company* and practices in the areas of corporate and commercial law.  
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