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## Accounting Questions: Pro-Rating Overhead Charges, Registrars' Records

American Institute of Accountants. Bureau of Information

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## Accounting Questions

[The questions and answers which appear in this section of THE JOURNAL OF ACCOUNTANCY have been received from the bureau of information conducted by the American Institute of Accountants. The questions have been asked and answered by practising accountants and are published here for general information. The executive committee of the American Institute of Accountants, in authorizing the publication of this matter, distinctly disclaims any responsibility for the views expressed. The answers given by those who reply are purely personal opinions. They are not in any sense an expression of the Institute nor of any committee of the Institute, but they are of value because they indicate the opinions held by competent members of the profession. The fact that many differences of opinion are expressed indicates the personal nature of the answers. The questions and answers selected for publication are those believed to be of general interest.—EDITOR.]

### PRO-RATING OVERHEAD CHARGES

*Question:* At your convenience will you please indicate the approved practice in pro-rating overhead charges of contractors?

Our client who presents the proposition to us now is a builder of concrete bridges on highways and takes some fifteen or twenty such contracts a year. The labor cost is quite a factor. He had hoped that we could find an equitable way of pro-rating overhead so that it might be charged at the completion of the job and not wait until the end of the year.

Our thought up to the present time has been that probably no plan is absolutely equitable and it might be just as well to charge the same proportion of overhead as prevailed in the previous year, if conditions were practically the same, and carry an unabsorbed overhead account and let the estimated overhead stand until the end of the year when we can get a definite figure.

I appreciate that this is one of the problems that has absolutely no accurate answer but we want to render the best possible service, and welcome your suggestion.

*Answer:* In reply to your inquiry we advise you that our experience indicates that where contractors pro-rate general overhead it is ordinarily done on a fixed percentage basis. Also that such pro-rating is generally not added to contract costs on the books of account but is kept as a matter of separate statistics for information purposes only.

The difficulties of making an equitable distribution of general overhead are pointed out and discussed by Affelder in his book *Contractors' Accounting Practice*, pages 234–235, and he concludes

“that a contractor's method of conducting operations must result in some of the chief factors being uniform on all contracts before an equitable distribution of the burden of general overhead expense can be effected. These factors are (1) uniformity of size of contracts, (2) of rate of profit earned, and (3) of time required to execute and complete a contract.”

We believe the accountant making the inquiry, having had all the particulars of the business under his observation, has reached the most practical conclusion as stated in his third paragraph.

However, considering the matter from another standpoint, it would be helpful to know why the contractor is so keenly interested in an exact pro-rating of the overhead—whether it relates to the building up of estimates for bidding purposes, or to the variation of actual profit from estimated profit, or from other financial reasons as distinct from a desire to refine his accounting methods.

*Answer:* From the way the inquiry is presented I assume this is one of those cases in which there is not a fairly uniform volume of work but where there may be periods of great activity interspersed with periods of comparative idleness. I quite agree with your inquirer that there is no definite plan which can be relied upon to be absolutely equitable under such variant conditions as these. He suggests charging as the work progresses “the same proportion of overhead as prevailed in the previous year if conditions were practically the same.” This, of course, involves continuous consideration to determine if conditions are practically the same, with a possible variation in rate as the probability of variation in conditions appears. In some conditions this may be satisfactory.

In most cases, where there is as great variation as there is apt to be in the contracting business, I would be more inclined, however, to handle the matter of general overhead on a basis of under-absorbed or over-absorbed burden; that is to say, I would estimate the burden basis which could reasonably be considered as a cost for the contracts to absorb. Some estimate of this must be adopted as a basis for bids to be submitted. If the computation for the bids is intelligently and wisely made, the allowance for burden which is included therein should represent an intelligent estimate of the burden applicable to that contract. An overhead burden account which was charged with the total burden and credited with the amount which could be considered as a proper charge against each contract would then indicate whether there was an over or under absorption of burden, with the difference to be taken into account as such on the regular profit-and-loss account.

The foregoing applies, of course, only to general burden which can not be clearly assigned as an actual cost to individual contracts. Each contract should naturally be charged with all costs which are clearly applicable to it, whether these represent direct construction, labor and materials, contract supervision, or other. In other words, we probably have within each contract itself certain direct and certain overhead or general charges. Where there is a decided lack of uniformity in work it is desirable to have everything possible charged directly to the contract concerned and so minimize the general overhead burden which has to be the subject of a more or less arbitrary and perhaps rather unsatisfactory apportionment.

A careful survey of the situation will often show there is a considerable amount which can be distinguished as clearly chargeable to various separate contracts. We then have left in general overhead only such items as we can not say are real costs of any particular contract but must simply be absorbed on some kind of reasonable basis over the entire work. If, then, we charge each contract with the amount which we can consider as a reasonable allowance to it for general overhead, our under-absorbed or over-absorbed burden will stand to represent either a loss resulting from failure to have enough work to care for general overhead or a gain due to having business better than reasonable expectation.

The details of what should be done will vary so much, depending not merely on the kind of work performed but also the form and organization of the business, the nature of the contracts made, etc., that I think it is impossible to do more than state the general considerations which I have set forth above.

*Answer:* In reply to your letter of June 11th, we have been unable to find in our list of clients for whom we have done cost work any firm of contractors engaged in bridge or highway building, and we assume that such an organization as the one you refer to would own and use on various jobs a somewhat extensive group of machines and equipment that are not required by the ordinary building contractor. If that is the case, there would be an overhead expense for the use of machinery and equipment that does not enter into the ordinary building contractor's problem.

We have several building contractors who are using a somewhat uniform system of cost estimating and in each case these clients keep actual costs of labor and material under the job number, broken down into the various construction sections under which the original estimate was calculated. Overhead expenses in these instances consist primarily of administrative and office expenses, as the time keepers and foremen are charged as direct labor on the job, as calculated in the estimate. Consequently, overhead expense is a relatively small factor and is usually treated as a deduction from profits. In other words, an allowance is made in estimating the profits for the necessary overhead expense which the job must carry.

On road work or bridge building, where considerable machinery and equipment must be owned and used by the contractor, the overhead charges for this, as well as such other items of overhead as are included in the office and administration of the business, might be pro-rated on the job on a direct-hour basis or possibly at an hourly rate for the use of the machinery and equipment.

#### REGISTRARS' RECORDS

*Question:* The writer would appreciate your assistance in obtaining answers to the following specific questions covering records maintained by registrars of stock, particularly the records and procedure of the larger New York banks.

1. Can anything be omitted from, and should anything be added to the following information files of the registrar?

- (a) Specimen signatures of officers of transfer agent who may sign certificates.
- (b) Certified copy of minutes authorizing the issuance of stock and specifying terms and conditions under which stock is to be issued.
- (c) Certified copy of minutes appointing registrar and authorizing registration of . . . shares of stock.
- (d) Authenticated copy of authority from stock exchange for registration of . . . shares, and thereafter direct authority from stock exchange covering registration of additional shares.

2. Should the registrar, by reference to certificate of incorporation and by-laws, determine whether or not stock issue is as provided for therein and as approved by the state, or does this responsibility rest with the transfer agent?

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3. (a) Do the registrars keep a record of certificates issued and canceled, so as to be able to prepare a list of outstanding certificate numbers and number of shares to reconcile with total outstanding?
  - (b) If not, why is it necessary for co-registrars currently to furnish each other with a detailed list of certificate numbers and shares registered and canceled where there is no change in amount outstanding?
4. In addition to lists referred to in 3 (b), do the registrars keep any other record, such as a ledger sheet or card for each company, on which information under 1 is summarized, and to which daily totals of 3 (b) are posted?

*Answer:* In reply to your inquiry concerning the records usually maintained by registrars of stock, particularly the larger New York banks and trust companies, it would not appear advisable to us to omit from the files of the registrar any of the information listed under 1 (a) to 1 (d) of your letter. What additional information, if any, should be obtained by the registrar would of course depend upon the obligation assumed by the registrar under the particular agreements in force.

The answer to question 2 also would depend upon the terms of these agreements. It is usual for a registrar to maintain information similar to that required by a transfer agent.

With regard to question 3, we do not know of any case where a registrar does not keep a record of certificates issued and canceled so as to be able to prepare a list of outstanding certificate numbers and number of shares outstanding. Registrars are appointed for the purpose of acting as a check on transfer agents to prevent over-issues of stock.

With regard to question 4, it is usual for registrars to keep a "registration record," or ledger, containing an account for each company for which the registrar acts. A specimen form of registration record is shown on page 157 of *Trust Departments in Banks and Trust Companies* by Clay Herrick, published (1929) by McGraw-Hill Book Co., Inc.

*Answer:* In reply to your letter regarding the records maintained by registrars of stock, we would answer the questions appearing therein by number, as follows:

1. We do not think anything should be omitted from the matters listed.
2. Our understanding is that the registrar is not obligated to make inquiry regarding the regularity of the matters mentioned, this responsibility resting entirely on the transfer agent.
3. (a) Yes. The names in which certificates are issued are not recorded, however, the record being by certificate numbers.
4. All the information listed under item (1) of your letter is in the files in such form that it is available for immediate reference. We do not recall any instances where ledger sheets or special cards were used for recording it, but presume the maintenance of such records would depend largely on the system adopted by each registrar.