

## **The \$40.00 Grass Mower; HOW CAN THAT BE?**

I do not know where this rumor comes from, but we do not pay PCM employees who mow our grass \$40.00/hour. In 2010, however, we will be paying a billing rate of \$34.58 for that service. How is that rate determined?

Service industry accounting practices are quite different from manufacturing industry accounting practices, with which most individuals are familiar, particularly when it comes to establishing hourly rates for work being performed. The hourly rate that is charged to the client must recover all of the costs incurred by the organization to provide that service. This is without consideration of any profit that the organization may wish to earn.

The first step is to determine the billable hours available for each direct labor employee. There are 2080 hours in a year when an individual works the standard legal 8 hours/day and neglecting the fraction of a week:  $40\text{hours/week} \times 52\text{ weeks} = 2080\text{ hours}$ . Let recognize that every employee has some time off for vacation (average 15 days or 120 hours), illness (8 days or 64 hours), holidays (10 days or 80 hours) and will take some breaks, travel time, recording and disability (average 1.3 hours/day or 346 hours). Using these assumptions, then the billable hours for each hourly employee becomes:  $\text{Billable Hours} = 2080 - 120 - 64 - 80 - 346 = 1470$  or 70% effectiveness. Therefore, if an individual is paid \$15.00/hour, the basic billable rate without any other expenses is  $\$15.00/0.70 = \$21.43/\text{hour}$ . This becomes the bare labor cost even though the employee is being paid at the rate of \$15.00/hour.

To the Bare Labor Cost, we must now apply the cost of FICA, Workman's Compensation, Medical insurance and Pension contributions. Unfortunately, this varies significantly depending on the rate of pay. For a gardener, this is closer to 40% but for a skilled trade foreman it's more like 27%. The reason is that medical and pension costs are the same \$ amount for each employee, regardless of their pay rate. For example, the same medical/dental insurance costs are about 18% of a gardener's pay but only 8% of a skilled foreman's pay. Same with pension – the annual union pension contribution is the same for each employee. Therefore, let's use the mid-point of 33.5% for the total of these costs. These costs then are  $\$21.43/\text{hour} \times 33.5\% = \$7.18/\text{hour}$ . At this point, the total billable compensation cost for the organization is  $\$21.43 + 7.18 = \$28.61$  for the individual who is earning \$15.00/hour.

Additionally, there are costs associated with the employee that must be recovered, such as, incidental materials and supplies, uniforms and shoes, repair and maintenance of equipment used by the employee and other outside services to support the employee's activities. These costs often range between \$0.50 to \$2.00/hour for landscaping. Let's assume the average of \$1.25/hour. At this point, our employee billable hourly rate is \$29.86 ( $\$28.61 + \$1.25$ ) and we still have not applied any overhead for Accounting, services, MIS, Warehouse services, Maintenance Administration and Vehicle and Building maintenance. These overhead costs again range between \$1.00 to \$3.00/hour. Let's assume the average of \$2.00/hour.

Therefore, our total billable rate for our employee is \$31.86/hour ( $\$29.86 + \$2.00$ ) and this is only absorbing the costs that can be directly associated with the activities of the employee.

Please note that if this service firm was one of my clients, I would be suggesting an hourly billing rate of at least \$75.00 to \$90.00/hour because there is still additional costs associated with

sales and marketing, financial and administrative management expenses, such as, management salaries and their employment costs, depreciation, banking and financing costs, property and income taxes (assuming a profitable business) and finally profit. This is why your appliance repairman charges \$125.00/hour for the first hour (travel time and account setup costs are often included in the first hour's rate) and \$75.00 for each additional hour.

Now let's look at our \$34.58/hour mower employee and determine how much is he making. If we assume the same buildup of costs, then the mower employee would be making \$16.28/hour, which in Orange County is not "out of line" for a skilled union employee operating a riding lawn mower.

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