

Business Services Common: Inadequate monitoring of fixed overheads

The ratio of fixed overheads to gross profit is disproportionately high when compared to the industry average or the historical norm for the business.

Indicators

- Over time, the ratio of fixed overheads to gross profit has slowly increased.
- There is an increasing amount of underutilised resources (eg employees or equipment).

Causes of the problem

- There has been no analysis done on the fixed overheads in respect of their resultant productivity and necessity.
- Long term decisions regarding forecast growth have been incorrect.
- There are no departmental controls over the spending on fixed overheads.
- Lack of organisation which has resulted in duplication of duties.
- The volume of production may be decreasing and there has been no action taken to reduce fixed overheads which may then result in underutilised assets.

Short term solutions

- Conduct an analysis of all fixed overheads with a view of determining each overhead's value and individual cost. Reduce overheads which have a high cost and little value.
- Advise all departments that, for the short term, any future increase in fixed overheads must be authorised by central management.
- Analyse all departments with a view of determining whether there is any duplication of duties. In the event there are duplications occurring, consider the possibility of centralising that particular function.
- If production has decreased without a corresponding action to reduce fixed overheads (eg subletting surplus space), then the proportion of fixed overheads to gross profit will increase. If this present drop in production is considered only temporary then no action is required, although if it is possibly more permanent then the above solutions should be considered.

Long term solutions

- As part of the long term vision for the business, careful attention should be paid to the nature and terms of leases (eg if space is only required for short term, do not undertake a 20-year lease).
- Programs should be implemented which set limits on future fixed overhead expenditure. These future limits must take into account expected changes in production. Production levels should be regularly examined so if there is a long term variance in the expected production volume the limits on the fixed overhead can also be varied (eg if production space is no longer required, the business could consider subletting).



- Constant analysis must be conducted to avoid duplication of duties (eg centralisation of branch administrative activities such as raising invoices).
- Once appropriate and achievable budgets have been set a section manager should be made responsible for adhering to the budget.

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