

Labor Burden & Profits – Part III:

To Overtime or Not to Overtime? That is the Calculation,...

Is it ever a smart move to utilize overtime, and if so, when? And for which workers? Here are more creative ways to use fully burdened labor cost information to make a positive impact in your take-home pay!

From Parts I and II of this Series:

In our last 2 articles, we:

- Presented frequently used terms and “big-picture calculations” related to labor burden and employee costs.
- Illustrated how labor burden add-on costs can make a tremendous difference in an employee’s actual cost per production hour. (Our example employee, Pat, actually cost us 82% more than his/her gross hourly wage.)
- Computed how to determine what to charge per hour for employees on both a stand-alone, and “weighted-cost” basis for individual projects.

Determine Whether, and Under What Circumstances, Overtime Can be Beneficial

Many company owners keep overtime to an absolute minimum or actually forbid overtime work. After all, overtime costs 1.5 times regular wage rates, right?

Although that may seem logical, when you actually “run the numbers” using burdened labor costs, **overtime may actually cost less per hour** because many of the fixed costs of employment (e.g., health insurance) don’t increase with overtime hours. If you actually compute the numbers on an employee-by-employee basis, and test various overtime scenarios, you will know the real answer. **Could overtime be a good financial decision for your company?** In many cases, the answer may be “yes”.

To illustrate, **here are some examples** showing standard and overtime costs for employees with different hourly rates and the same burden scenarios. The first column (Standard) shows annual hourly and burdened cost results for normal work hours (in this case, 40 hours per week). The next two columns show Overtime hours and related burdened costs at the rate of 50 hours per year and 500 hours per year.

Preceding each example you will see gross base hourly pay, the additional overtime gross pay and the comparison of burdened standard vs. overtime results:

\$10/hour employee

Overtime @ 1.5x adds \$5 per hour to gross pay. But, **actual burdened overtime costs \$3.62 per hour LESS than standard burdened pay:**

	Standard	Overtime-50	Overtime-500
Available production hours			
Beginning standard available hours	2,080.0		
(Less) Paid Time away	(184.0)		
(Less) Other non-production time	(201.5)		
Annual production hours available	1,694.6	50.0	500.0
Percent of total hours	97.1%	2.9%	22.8%
Adjusted cost per production hour			
Initial cost for year	\$ 20,800.00	\$ 750.00	\$ 7,500.00
Plus: Employer taxes	\$ 1,890.20	\$ 57.38	\$ 573.75
Plus: Other than employer taxes	\$ 13,342.75	\$ 74.71	\$ 747.12
Adjusted annual standard cost	\$ 36,032.95	\$ 882.09	\$ 8,820.87
Fully burdened cost per production hour	\$ 21.26	\$ 17.64	\$ 17.64
O/T per hour \$ cost is more/(less) than standard pay		\$ (3.62)	\$ (3.62)

\$17/hour employee

Overtime @ 1.5x adds \$8.50 per hour to gross pay. But **actual burdened overtime costs \$1.65 per hour LESS than standard burdened pay:**

	Standard	Overtime-50	Overtime-500
Available production hours			
Beginning standard available hours	2,080.0		
(Less) Paid Time away	(184.0)		
(Less) Other non-production time	(201.5)		
Annual production hours available	1,694.6	50.0	500.0
Percent of total hours	97.1%	2.9%	22.8%
Adjusted cost per production hour			
Initial cost for year	\$ 35,360.00	\$ 1,275.00	\$ 12,750.00
Plus: Employer taxes	\$ 3,004.04	\$ 97.54	\$ 975.38
Plus: Other than employer taxes	\$ 15,089.95	\$ 121.96	\$ 1,219.62
Adjusted annual standard cost	\$ 53,453.99	\$ 1,494.50	\$ 14,945.00
Fully burdened cost per production hour	\$ 31.54	\$ 29.89	\$ 29.89
O/T per hour \$ cost is more/(less) than standard pay		\$ (1.65)	\$ (1.65)

\$25/hour employee

Overtime @ 1.5x adds \$12.50 per hr to gross pay. But **actual burdened overtime costs only \$0.59 per hour MORE than standard pay:**

	Standard	Overtime-50	Overtime-500
Available production hours			
Beginning standard available hours	2,080.0		
(Less) Paid Time away	(184.0)		
(Less) Other non-production time	(201.5)		
Annual production hours available	1,694.6	50.0	500.0
Percent of total hours	97.1%	2.9%	22.8%
Adjusted cost per production hour			
Initial cost for year	\$ 52,000.00	\$ 1,875.00	\$ 18,750.00
Plus: Employer taxes	\$ 4,277.00	\$ 143.44	\$ 1,434.38
Plus: Other than employer taxes	\$ 17,086.75	\$ 175.96	\$ 1,759.62
Adjusted annual standard cost	\$ 73,363.75	\$ 2,194.40	\$ 21,944.00
Fully burdened cost per production hour	\$ 43.29	\$ 43.89	\$ 43.89
O/T per hour \$ cost is more/(less) than standard pay		\$ 0.59	\$ 0.59

As you can see from these examples (based on this set of circumstances), when you look at the burdened hourly costs, overtime **does not** cost 50% more than regular pay as most company owners believe. In some cases, ***overtime actually costs less per hour than standard hours!***

[Click here to review an easy-to-use Labor Burden and Employee Profitability Calculator](#)

The Annual Impact

As you review the preceding examples, please notice that whether the employee works 50 or 500 hours of overtime the hourly burdened rate (and difference from standard) stays the same.

However, even though the hourly savings on burdened overtime stay consistent, **the more overtime worked, the lower the “blended” annual hourly cost of the employee.** For example for our \$10 per hour worker:

- The standard burdened hourly rate is \$21.26 per hour.
- If that same worker puts in 500 hours of overtime (excluding vacation that would be a little over 10 hours per work week), at a savings per hour of \$3.62 you have paid \$1,810 less for this 500 hours of work than if you were paying another similarly-burdened worker at standard rates.
- Therefore **the burdened “blended” annual rate for this worker lowers to \$20.44 per hour.** (Total cost of [\$36,032.95+\$8,820.87] ÷ total hours of [1,694.6+500] = \$20.44/hour.)

It would be nice to be able to provide some general “rules of thumb” about burdened overtime costs, such as “overtime for lower-paid workers pays off, but doesn’t pay off for more highly-paid workers”, but **every situation is unique because it is the combined result of an employee’s hours, pay rate, benefits, and other added costs. That’s why you need to compute specific numbers for individual employees to determine the best scenario for your company.**

Think of the auto companies,...you can bet that they have their management accountants calculating and re-calculating labor costs and overtime scenarios on a regular basis!

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People Issues,...

Of course you will want to consider employees’ view points when it comes to overtime:

- Some employees find the idea of overtime a real burden and an infringement on their “other life”, and you may encounter resistance – which could ultimately negate the value of overtime work.
- Others are diligent workers, could really use the money, and welcome the opportunity to contribute, and earn, a bit more. So, if you have calculated your burden numbers and reviewed the impact of overtime, you may decide that it’s actually a sound business decision to add overtime into their work mix.
- In certain cases, even if you determine that you’re paying a small amount more per hour, it may still be to your benefit to let the “good folks” earn the overtime rather than bring on a new, unknown worker as each extra worker brings additional time, cost, and risk to the human resources aspect of your company.
- Remember that even for the enthusiastic and willing, the “law of diminishing returns” applies to overtime productivity. Most people can’t work intensive overtime, week after week, without suffering some loss of efficiency, so you’ll want to monitor results to be sure that the overtime is paying off.



In Summary,...

- Should you add overtime into your labor pool, or should you keep (or hire) extra workers?
- How much overtime is optimal for your company?
- How do you handle employees’ requests for, and reactions to, overtime issues?

Of course, the decisions ultimately lie with you. But if you have access to accurate, burdened labor cost information, you’ll be able to add additional, objective information into your decision-making resource kit.

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Next,...

More ways to use Labor Burden and employee cost information to enhance your bottom line,...

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Author: Diane C.O. Gilson, CPA. Diane is also an Advanced Certified QuickBooks ProAdvisor and Certified QuickBooks Enterprise ProAdvisor. She is an author, trainer and construction accounting coach, as well as a frequent speaker at The International Builders' Show. Her firm, [Info Plus Accounting Inc.](#) offers Internet-based QuickBooks® training and accounting support services for construction companies throughout the U.S.

She is the developer of the [eCPA \(employee Cost & Pricing Analyzer\) Labor Burden Calculator](#), an Excel-based program that automatically performs comprehensive labor burden and pricing calculations for up to 200 employees and 25 departments. Contact Gilson via [email](#) or call 734-544-7620 (9-5 Eastern).