

The WIP computer software ledger account has been omitted from this exemplar.

Legal Eagles

Direct costs	Partners' hours: 850 x \$70	59,500
	Associate lawyer hours: 1,350 x \$40	54,000
	Travel	1,500
	Photocopying	2,300
	Telephone	2,700
		\$120,000
Indirect costs	Overhead rate: \$70,000/70,000 = \$1 per partner hour	
	Overhead costs: 850 x \$1	850
	Total cost	\$120,850
	Mark-up	145,020
	Selling price	\$265,870
	GST	39,881
		\$305,751

①

Levin Law

Direct costs	Partners' hours: 850 x \$70	59,500
	Associate lawyer hours; 1,350 x \$40	54,000
		\$113,500
Indirect costs	Overhead rate: \$98,000/70,000 = \$1.40 per partner hour	
	Overhead costs: 850 x \$1.40	1,190
	Total cost	\$114,690
	Mark-up	137,628
	Selling price	\$252,318
	GST	37,848
		\$290,166

③

Legal Eagles Overhead Control Account					
Date		Dr	Cr	Bal	Dr/Cr
	Accounting	8,500		8,500	Dr
	Rental	34,000		42,500	Dr
	Support wages	19,000		61,500	Dr
	Cleaning	3,500		65,000	Dr
	Other expenses	2,500		67,500	Dr
	Overhead applied		74,000	6,500	Cr
	Cost of goods sold	6,500		---	

Legal Eagles runs a job cost subsystem where all costs for each job (case) are recorded. Some will be direct costs that can be directly traceable to the case. Any indirect costs of generally running the law firm, such as electricity, cleaning and rent are costed using an overhead rate based on the number of partners' hours that the case uses. When a new job comes in a partner will cost it, that is, estimate how many hours of partner and lawyer time it will take to complete the case. Using this information and overheads, the total cost plus mark-up plus GST will give the estimated total cost of the job to quote to the client.

4

A systematic job cost subsystem will ensure that all direct costs related to a particular law case are recorded against the client's name and included on their invoice. For example, if partners or associate lawyers have to travel to interview experts or do research for the copyright case, travel costs will be paid by Legal Eagles but passed onto the client. Lawyers and support staff would be trained to keep an accurate log of travel time and costs, and other costs directly traceable to each case so that the client is charged for them and Legal Eagles doesn't end up having to absorb the expenses. If the firm didn't charge these expenses to the clients their profit margin would be reduced, possibly placing the future of Legal Eagles in jeopardy.

4

Legal Eagles uses partners' hours as their cost driver for allocating overheads to the legal cases because partners' hours determine the overheads used. For example, it is estimated that it will take the partners 850 hours to argue the copyright case. Behind the work partners do on the case, support staff will be attending meetings, researching, gathering data, producing documents, etc to help the partners prepare their legal argument. Partners and support staff will be occupying the offices, using electricity, using consumables, incurring cleaning costs, and so on. A very simple case that might take only 10 hours of partner time would incur a proportionately smaller amount of overhead, making partners' hours the best overhead driver for a law practice.

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The quoted price for Levin Law is lower than Legal Eagles due to Levin Law not allocating all of their direct costs to the case (travel, photocopying and telephone haven't been allocated). These direct costs are treated as overhead for Levin Law and are spread across all jobs which might not be fair to all of their clients. This doesn't give an accurate indication of the cost of a job as the direct costs are not being charged to clients. On an annual basis the mark-up of 120% may not be reached, that is, income may not be 120% higher than COGS. Since the quote from Levin Law is almost \$16,000 lower, Legal Eagles will probably lose out on getting the job.

2

Legal Eagles' overhead rate of \$1 per partner hour is based on estimates so at times there may be over- or under-applied overhead. For the year, Legal Eagles expected the partners to work on cases for 70,000 hours and that overhead costs would be \$70,000. But partners actually worked 74,000 hours and the actual overheads were \$67,500 so Legal Eagles over-applied overheads of \$6,500. As a proportion of total costs this is reasonably insignificant, and it is better that overheads are over-charged rather than under-charged.

6

Some sections of the student's narrative response have been omitted from this exemplar.