Labor Cost

Labour is the effort mady by an employee to produce an item or service. Whatever the payments made by the employer to the employee on such effort, are referred to as labour costs.

Proper control and accounting for labour costs is one of the most important functions that it's management is involved. Accounting for labour has three primary objectives.

1. Determining labour costs in the cost of product or service
2. Reporting labour costs for planning and control
3. Reporting labour costs for decision making.

Labour is a considerable part in cost in many organizations and therefore it is vital to have a full understanding of this topic.

Remuneration Methods

There are three basic methods of remuneration.

- Time rate system
- Piece rate system
- Bonus/Incentive Schemes

Time rate system

- Under this method workers are paid based on the hours / days they worked.

Earnings	=	Hours worked	x	Rate per hour

Or

Earnings	=	Days worked	x	Rate per day

This method of remuneration is suitable in following cases;

- Where the quality of work is important than the quantity.
- Where it is difficult to measure the output.
- Where the speed of work is restricted or controlled by a machine or an equipment
- Where the operation or Job is no repetitive
- Where apprentices are working
- Where the work especially requires experts or skilled workers.

Overtime payments (OT Payments)

If an employee works for more hours than the basic daily requirement, hemay be entitled to an overtime payment. For these excessive hours, he should be paid at a higher rate. The extra amount is usually referred to as overtime payment.

Advantages of Time rate system:

- Simple to understand and administer.
- Each worker is assured of minimum wage.
- Standard quality of the product is maintained.
- It is preferred and accepted by the trade union.
- There is no discrimination among the workers.
- Average and below average workers are also equally benefitted.

Disadvantages of Time rate System:

- No incentive to efficient workers to increase output.
- All employees in the grade are paid at the same rate regardless of performance.
- Close supervision is compulsory and therefore the cost of supervision ishigh.
- Efficient and inefficient workers get the same wage. i.e. efforts and rewards are not matched.
- Equality in wages to all, will depress the superior worker.
- Labour cost per unit is difficult to estimate.
- Workers may work slowly to get overtime payments.
- In productions where the quantity is much more important than the quality, this method is not suitable.

Example - Time base labor cost

(b) Numbers of hours worked during the first week are as follows.

	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday
Amal	8	8	8	8	8	5	4
lakmal	8	8	8	8	10	6	4
Kalpani	8	8	8	8	10	-	5
Gotham	10	6	7	8	8	5	3

- They should work eight hours during week days except Saturday and Sunday.Normal hour rate is Rs. 80.
- Overtime payments are as follows.
- 1.5 times per hour during weekday rate of wage
- Two times week day rate of wage for Saturday and Sunday.

Piece rate system

- Under this method workers are paid based on the output they produced.

Earnings	=	Units produced	x	Rate of pay per unit

This method is applicable and suitable where the

- Quality of work is not much important.
- Work is of a repetitive nature.
- Job rate can easily be fixed.
- Job is a Standardized one.
- Supervision is not much needed.

There are three forms of piece rate system;

- Straight Piece rate
- Differential Piece rate
- Piece rate with guaranteed minimum wage

Straight Piece rate system:
Under this system the workers are paid at a flat rate per unit of output, whatever the quantity, they produced.

Differential Piece rate system:
In this system, the rate per piece will increase when the output level increases. Therefore there are more rates than one. This is designed to accelerate the production. By this system, inefficient workers are encouraged to earn more by producing more.

Upto		200	Units per day	-	Rs. 10 per unit
201	-	250	Units per day	-	Rs. 12 per unit
251	-	300	Units per day	-	Rs. 15 per unit

Piece rate with guaranteed minimum wage:

Straight piece rate system may be unfair to employees if there are production problems due to the faults of employer. Therefore many piece work schemes are normally accompanied by a guaranteed minimum wage, so that employees would not suffer loss ofearnings when production is low, through no fault of their own.

Example

Silva is employed by ABC limited on a piece rate system. He is paid Rs. 10 for each unit he produces and a normal employee used to produce 20 units per day. Any units produced, above this quantity (20 units), are paid at Rs. 12 per unit. The minimum guaranteed wage per day is Rs. 120. On a particular day, Silva could produce only 10 units.

His piece work earnings (10 units x Rs. 10/-) =	100
Whereas, minimum guaranteed wage per day =	120

Since his actual piece work earning is below the minimum guaranteed wage, he is paid Rs. 120.

Advantages of Piece rate system:

01. Increased output
02. This system itself calculates an incentive to worker.
03. Workers' efforts and rewards are matched
04. Level of supervision is low and consequently cost of supervision is low.
05. Machines are handled with care since machine break-downs will reduce output.
06. No place for idle time.
07. Overhead costs are favourably reduced.
08. Efficient employees are compensated.
09. Wage calculations are easy.
10. Employees act an their own directions and are not waiting for directionsof their superiors.

Disadvantages of Piece rate system:

01. Not a suitable method where the quality is important than the quantity.
02. Extra cost to check the quality of products.
03. When there is less demand, over production may arise.
04. Workers are always in hurry, hence accidents may be common.
05. Minimum attention on wastage/losses.
06. In order to maximize production, it is possible that machines are used recklessly.
07. Breakdown of machine or power failure may disappoint the workers.
08. Trade unions will disagree with the rate.

Bonus / Incentive scheme

Initially bonus schemes were introduced to compensate workers paid undera time-based system for their inability to increase earnings by working more efficiently. Whereas piece work earners could increase their earnings by producing more due to their efficiency. Almost, all the bonus schemes are similar. A target is set and actual performance iscompared with that target, and thereby the employees are paid more for their efficiency. The savings resulted from the employee's efficiency, are then shared between the employee and the employer on an appropriate basis.

Factors to be considered before to introduce a Bonus scheme.

The following factors may be taken in to account, before the introduction of a bonus scheme.

- It must be simple and understandable to workers (So that they would be able to calculate their own bonus amount)
- It must be fair to both – employer and employee.
- Payments should reflect workers' effort and performance.
- Payments should be made without any delay, preferably soon after completion of the task.
- Performance levels or targets should be achievable to average workers.
- Cost of operating the system should be minimum.
- The workers or their unions should not have a room in the system to raise objections.
- It should be able to minimize labour turnover.
- The system should benefit the direct as well as indirect workers.
- The system should maintain the consistency;
  i.e. It should not be subject to rapid changes
- The worker should be safeguarded by the system, when problems arise outside the worker's control.

Various types of bonus schemes

1. Individual bonus scheme
2. Group bonus schemes
3. Profit sharing schemes
4. Shift Bonus

Advantages:

- Non-production employees can also be included in the system.
- Administration is reduced in all aspects.
- Working arrangements may be more flexible
- A team spirit may develop between members

Disadvantages:

- Conflicts may arise in sharing the bonus between individuals
- Incentive is not directly related to the individual's performance.
- Friction may develop within the group if some are less hardworking members

Let's Do Past Papers

2025 July

(A) The following information of an employee is provided for the first week of June 2025 of **Victor (Pvt) Ltd.**:

Normal working hours per week	8 hours per day and 5 working days a week
Basic labour rate per hour	Rs.450/-
Standard time allowed to produce one unit	10 minutes
Bonus	125% of the saved time at basic labour rate
No. of units produced by the employee during the first week	360 units

Based on the above information:

You are required to:

Calculate the total earnings of the employee for the first week of June 2025. (04 marks)

2025 January

1.10 XYZ Ltd. is a manufacturer and the following information is relating to an employee of the company for last week of December 2024:

Normal working hours per day	8 hours (5 working days per week)
Basic labour rate per hour	Rs.300/-
Standard time allowed to complete a unit	20 minutes
Premium bonus	70% of saved time at basic hourly rate
Actual output	210 units

Calculate total earning of the above employee for the last week of December 2024.

(04 marks)

2024 July

(B) The following wage details of an employee have been extracted from the records of **Moon Ltd.**

Hourly wage rate	Rs.200/-
Standard time taken per piece	24 minutes
Actual output for the week	120 pieces
Weekly working hours	40 hours

You are required to:

Calculate the weekly earnings of the employee, if employee is entitled for a bonus on saved time at 150% of hourly wage rate. (05 marks)

2024 January

(b) **Tharushi Garments (Pvt) Ltd.** is a garment manufacturer.

The following information of an employee is provided for the last week:

Normal working hours per day	8 hours (5 working days per week)
Basic labour rate per hour	Rs.300/-
Standard time allowed to produce one shirt	15 minutes
Premium bonus	80% on the saved time at basic pay
During the last week, the employee produced 275 shirts.	

You are required to:

Calculate total earnings of the employee for the last week. (05 marks)

2023 January

1.8 The following information is extracted from **Deen (Pvt) Ltd.**:

Normal working hours per day	8 hours
Basic rate of pay per hour	Rs.300/-
Standard time allowed to produce 1 unit	2.5 minutes
Bonus	80% of the time saved at basic rate

Calculate the earning per day of a worker if he makes 252 units per day. (04 marks)

Controlling the labor cost

- More attention is needed for labour cost than other resources reason being labour is a human resources,
- A control of labour cost is important because large proportion of cost unit comprises of labour cost.
- Can minimize cost time per unit by increasing production capacity through an improvement of labour productivity.

Recording the labor cost

Recording of **labor cost** can be **two** types,

1. Time record
2. Output record

Time Record	Output Record
1. Attendance register 2. Time recording machine 3. Fingerprint machine 4. Cards with bar codes 5. Time sheets	• Records time spent by workers in different jobs or process for determining labor cost. • Methods: 1. Timecards (Daily or weekly) 2. Job cost sheet / Job card 3. Piece work ticket 4. Idle timecard

6.9.1.1 Attendance Register

This is the most traditional and user friendly method used to record attendance of employees. This is very useful to organizations which have a limited number of employees.

A typical page of an attendance register is shown below. (one page is for a day)

Date:	ATTENDANCE RECORD				
Employee Code	Employee Name	Time In	Time Out	Signature	Comments of Supervisor

Labor turnover

Labour Turnover can be defined as the rate of change in the labour force. i.e. it denotes the percentage of change in the labour force of an organization. It is measured by using following formula.

$$\text{Labour Turnover Ratio} = \frac{\text{Number of employees replaced per period}}{\text{Average No. of employees in the period}}$$

6.10.2 Causes for Labour Turnover

Employees leave jobs for a variety of reasons. Some of them are avoidable and some are not. Therefore it is important to interview the employees who leave the organization to be aware of the reasons and to take corrective actions where possible. Following are the typical reasons for labour turn over.

1. Lack of work
2. Dissatisfaction with the job
3. Dissatisfaction with the wage
4. Poor working conditions and poor management
5. Lack of promotions and unfair promotions
6. Long or unsuitable working hours
7. Retirement or death
8. Accidents or illness.

6.10.3 Costs associated with Labour Turnover

A high turnover is costly for an organization. The costs arised are in following forms;

- Costs on interviews, preparation of documents ... etc
- Costs on advertising, selection and deploying
- Training costs
- Learning costs

6.10.4 How to minimize labour Turnover?

Following measures can be suggested to the management to minimize and to maintain it at lower rate.

- Providing better working conditions to employees.
- Selection of candidates should be on a scientific principle.
- Placing or deploying employees on appropriate jobs.
- Well organized programmes to increase their efficiency.
- Maintaining cordial relationships between employer and employees.
- Enhanced job security and opportunities for career advancements
- Devising a good wage policy and incentive plans.
- Adopting an effective grievance procedure.
- Encouragement of labour participation in management.
- Preparing periodical reports by Human Resource (HR) department to analyse reasons for Labour Turnover and to suggest remedies.

Thank You