

# Accounting for Labour

## AAT Level II

### AFC - Advanced Financial Accounting & Costing

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# Chapter 04

AAT 02

Advanced Financial Accounting and Costing

## Accounting for Labour



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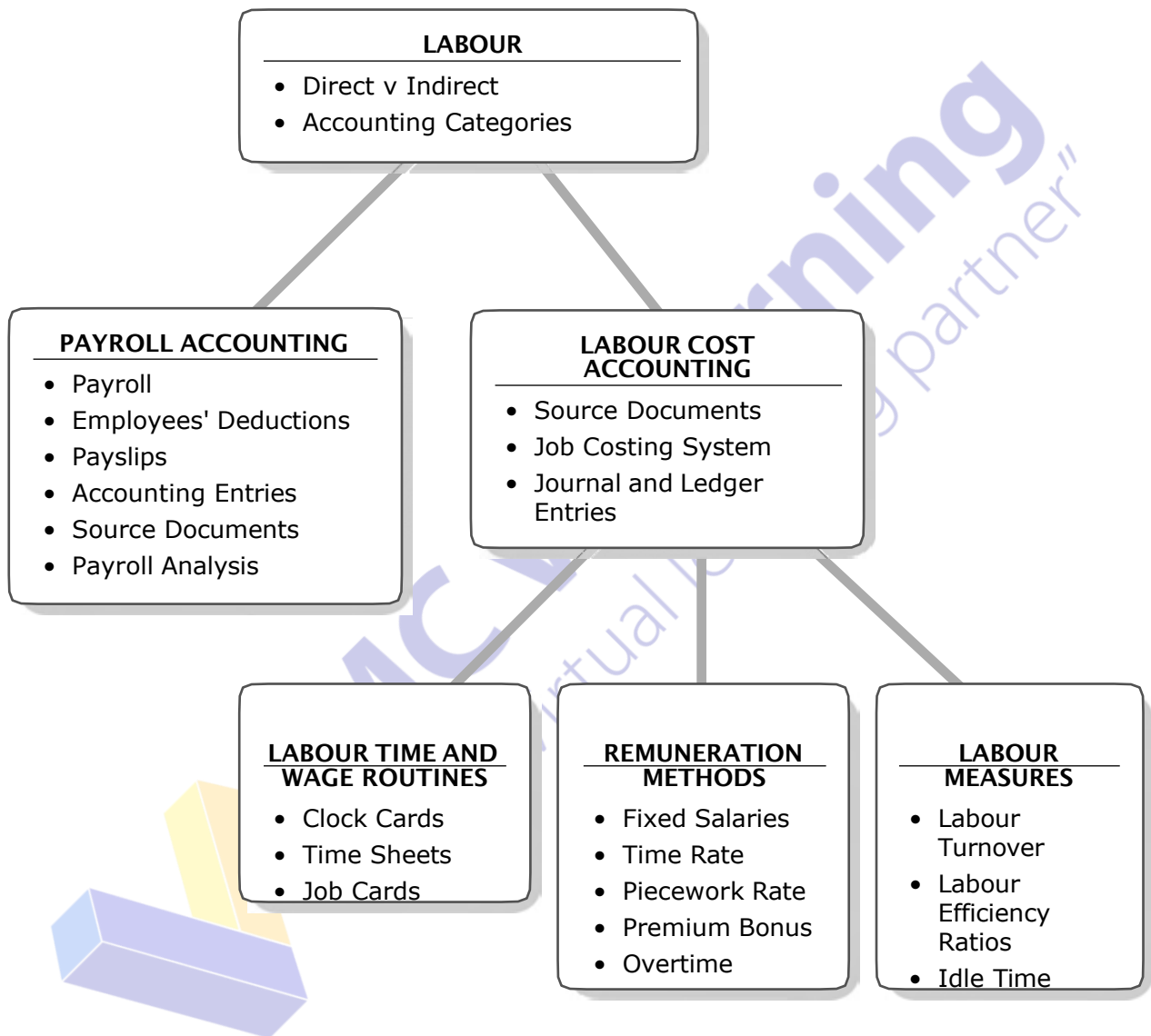
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## VISUAL OVERVIEW



# 1 Classification

## 1.1 Direct v Indirect Labour Cost

### Direct Labour Cost

Can be specifically traced to or identified with a particular product/service. Examples include:

- Wages of operatives assembling parts into finished products.
- Machine operatives engaged in production process.

### Indirect Labour Cost

Not charged directly to a product. Examples include:

- Instruction and supervision.
- Idle time.

# 2 Documentation

## 2.1 Payroll

- This record, which is usually computerised, shows for each employee:
  - gross wages/salaries;
  - employees' deductions;
  - net salary (i.e. what the employee actually receives). This is equal to the employee's gross salary less the employee's deductions.
- It may also include details of the employer's associated employment costs (e.g. employer's EPF and ETF contributions)
  - These are additional payments made by the employer.
  - They are often based on the amount of salary and may therefore be expressed as a percentage of gross salary.
- This contains salary information relating to the entire employees of an organization.



The associated employment costs are the expense of the employer, not the employee, and so are not deducted from the employee's gross salary. The total ("gross") cost to the employer is therefore the employees' gross plus the employer's contributions.

## 2.2 Employees' Deductions

There are some deductions made from the gross salary of an employee.

The most common employees' deductions are:

- Employee Provident Fund (EPF) employee's contribution (8%)
- Loan Installements
- PAYE Tax
- Social Benefit Scheme Contributions

## 2.3 Payslips

Employees usually receive a "payslip" or a "pay cheque" showing their gross salary minus the deductions.

**Illustration 1 Payslip**

| Pay Slip<br>ABC PLC                  |                  | Division : |
|--------------------------------------|------------------|------------|
| Month of 2014                        |                  |            |
| Emp. No :                            |                  |            |
| Emp. Name :                          |                  |            |
| Basic Salary                         |                  |            |
| Allowances                           |                  |            |
| Consolidated Salary                  |                  |            |
| Overtime                             |                  |            |
| Gross Salary                         |                  |            |
| Deductions                           | EPF (8%)         |            |
|                                      | Salary Advances  |            |
|                                      | Loan Instalments |            |
|                                      | Contributions    |            |
|                                      | PAYE Tax         |            |
| Other Deductions                     |                  |            |
| Total deductions                     |                  |            |
| Net Salary                           |                  |            |
| Employer's contribution to EPF (12%) |                  |            |
| Employer's contribution to ETF (3%)  |                  |            |

**Illustration 2 Payroll**

| Pay - Roll |           |          |              |            |                     |               |              |            |                   |               |          |       |            |                                |
|------------|-----------|----------|--------------|------------|---------------------|---------------|--------------|------------|-------------------|---------------|----------|-------|------------|--------------------------------|
| Emp. Code  | Emp. Name | Division | Basic Salary | Allowances | Consolidated Salary | Over time pay | Gross salary | Deductions |                   |               |          |       | Net Salary | Acknowledgement<br>(Signature) |
|            |           |          |              |            |                     |               |              | EPF 8%     | Loan installments | Contributions | PAYE Tax | Total |            |                                |
|            |           |          |              |            |                     |               |              |            |                   |               |          |       |            |                                |

Compiled by : .....

Verified by : .....

Authorized by : ..... Date

Approved by  
Head of Finance

## 2.4 Source Documents

- When employees are salaried there may be no specific document to initiate their inclusion on the monthly payroll (e.g. for management staff).
- However, for a large workforce on the payroll some authorization for inclusion on the payroll generally will be required. This usually will take the form of attendance records (e.g. clock cards) or non-attendance records (e.g. absenteeism reports).

## 2.5 Payroll Analysis

Gross wages may be analysed for management purposes:

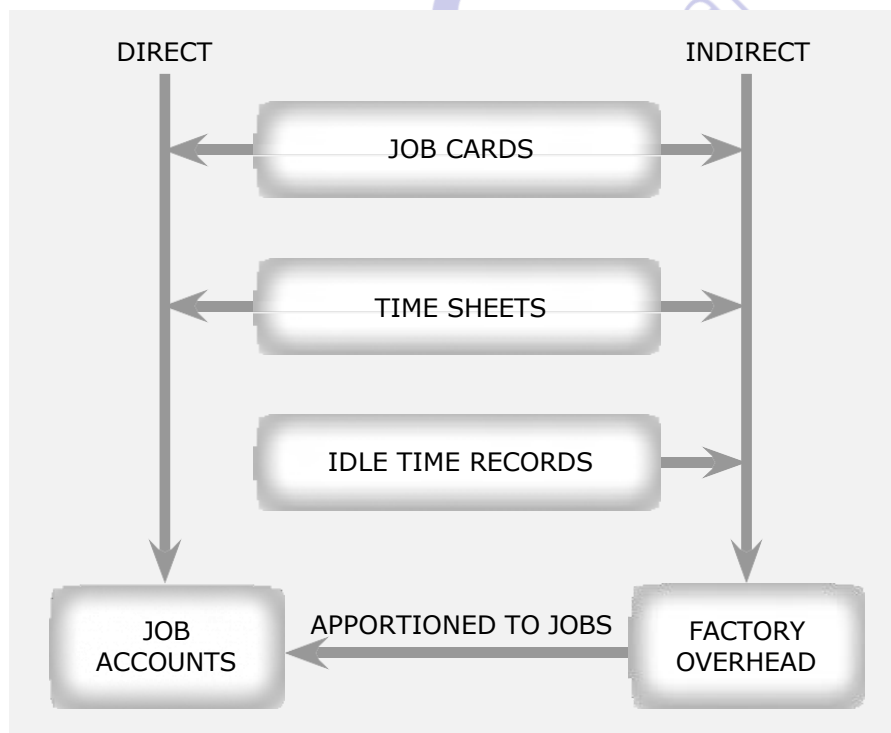
- per department or operation;
- per labour classification;
- by product; or
- by chargeable and non-chargeable (e.g. in an accounting or legal practice).

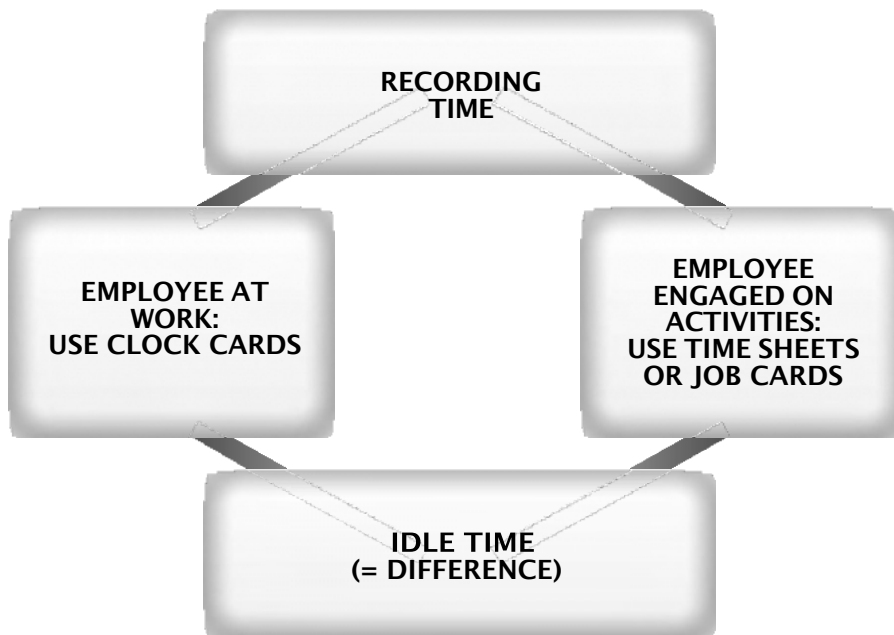
# 3 Documentation (Cont.d)

## 3.1 Source Documents

- Clock cards or other labour records
- Time sheets
- Job cards
- Idle time records

## 3.2 Job Costing System





### 3.3 Clock Cards

- "Gate timekeeping" records are needed to record time at work (for payment purposes).
- Modern time-recording systems may not use physical cards (e.g. computers logging users in/out).

**Illustration 3** Clock Card

| Clock Card |       |     |    |     |     |
|------------|-------|-----|----|-----|-----|
| No :       | Name: |     |    |     |     |
|            | In    | Out | In | Out | Hrs |
| M          |       |     |    |     |     |
| T          |       |     |    |     |     |
| W          |       |     |    |     |     |
| Th         |       |     |    |     |     |
| F          |       |     |    |     |     |
| S          |       |     |    |     |     |
| Su         |       |     |    |     |     |

### 3.4 Time Sheets

- Made out for each *employee*.
- A common method of relating time to activities.

Two types:

- **Weekly**, which has the risk of being forgotten and/or manipulated.
- **Daily**, which has the disadvantage of requiring a large volume of paperwork

### Illustration 4 Time Sheet

| Time sheet No: .....        |            |             |     |                    |     |      |           |
|-----------------------------|------------|-------------|-----|--------------------|-----|------|-----------|
| Employee Name : .....       |            |             |     | Clock code : ..... |     |      |           |
|                             |            |             |     | Dept : .....       |     |      |           |
| Date : .....                |            |             |     | Week No. : .....   |     |      |           |
| Job No.                     | Start Time | Finish Time | Qty | Checker            | Hrs | Rate | Extension |
|                             |            |             |     |                    |     |      |           |
| Foreman's Signature : ..... |            |             |     | Analysis           |     |      |           |
|                             |            |             |     | Direct .....       |     |      |           |
|                             |            |             |     | Indirect .....     |     |      |           |
|                             |            |             |     | Total .....        |     |      |           |
| Date : .....                |            |             |     |                    |     |      |           |

### 3.5 Job Cards

Made out for each *job*. There are two kinds:

1. One per complete job.
  - ✓ Advantage—card stays with job (can be accurately costed on completion).
  - ✗ Disadvantage—cost is not known until completion.
2. One per operation.
  - ✗ Disadvantage—each job has a card for every operation (generates paperwork).

### Illustration 5 Job Card

| Job Card               |       |                         |      |
|------------------------|-------|-------------------------|------|
| Department : .....     |       | Job No : .....          |      |
| Date : .....           |       | Operation No : .....    |      |
|                        |       | Time started : .....    |      |
| Time allowance : ..... |       | Time finished : .....   |      |
|                        |       | Hrs. on the job : ..... |      |
| Description of job     | Hours | Rate                    | Cost |
|                        |       |                         |      |
| Employee No : .....    |       | Certified by : .....    |      |
| Signature : .....      |       |                         |      |



# 5 Remuneration

Remuneration methods are the different ways of paying for labour.

## 5.1 Fixed Salaries

Paid for a calendar period (week, month or year).

- Will be fixed for *any* production level, so cost per unit will decrease as production increases.
- Management will be paid on this basis, as may most of the permanent workforce.

### 5.1.1 Advantages

- ✓ Easier to calculate the monthly payroll and prepare budgets.
- ✓ No requirement to pay for overtime.
- ✓ Salaried staff may be better motivated and have more loyalty/commitment to the firm because they will generally have greater job security.

### 5.1.2 Disadvantages

- ✗ Less motivation for salaried employees to work more efficiently or outside normal working hours.
- ✗ Calculating labour cost per unit becomes more complicated and is subjective as assumptions will have to be made. The cost of salaried employees is most likely to be treated as an overhead (see *Session 7*).

## 5.2 Time Rate System (Also Called "Day Work")

- A fixed amount or "flat rate" per unit of attendance time (e.g. hour or day).
- The method used when payment based on quantities produced would be unsuitable (e.g. temporary secretaries and maintenance workers).
- If the production rate is fairly standard, the labour cost will be approximately constant per unit. If not, it could vary widely from unit to unit.
- This is suitable in following cases.
  - Where the quality is more concerned than quantity
  - When it is difficult to measure the output
  - Where the speed of work is restricted by a machine
  - Where the job is not repetitive
  - When the work requires special skills and experience

| Advantages                      | Disadvantages   |
|---------------------------------|---|
| Easy to administrate            | Employees are not motivated to increase <i>productivity</i> (i.e. output per hour). |
| Simple to negotiate             | Constant supervision may be required.   |
| No discrimination among workers | Encourages laziness   |
|                                 | Labour cost per unit is difficult to estimate                                       |

## 5.1 Piecework Rate

- A fixed amount per *unit of output* achieved (results in a constant cost per unit).
- Often operated based on standard time per unit (e.g. bricklaying) (although a higher rate may be paid for higher levels of output).
- This is suitable in following cases.
  - Where the quantity is more concerned than quality
  - When the job rate is easily can be fixed
  - Where the job is repetitive in nature
  - When the job is standardized

### Activity 01 - Piecework Rate

Sarah Kowalski carves wooden animals for a small company supplying the tourist market. In week 26 her production was as follows:

|          | <b>Standard time<br/>allowed/unit</b> |
|----------|---------------------------------------|
| 6 Deer   | 2 hours                               |
| 5 Mink   | 1.5 hours                             |
| 12 Owls  | 1 hour                                |
| 6 Eagles | 2 hours                               |

She is paid \$6 per standard hour of production (irrespective of actual time worked).

**Required:**

**Calculate Sarah's earnings for week 26.**

| <b>Advantages</b>                                | <b>Disadvantages</b>   |
|--|--|
| Constant labour cost per unit                    | Lack of income security  |
| Encourages efficient work (if standard is fair). | Quality may fall or inspection costs increase (e.g. if no guaranteed minimum payment)  |
| Increased Output                                 | Less concern on wastage  |
| Less supervision                                 | Labourers may suffer financially due to factors they cannot control (e.g. faulty materials). Therefore, if production is low, the piecework rate method of payment may be accompanied by a guaranteed minimum payment) |
| Easy to calculate the wages                      |  |
| Less space for the idle time                     |  |

## 5.2 Premium Bonus Schemes

Premium bonus is a combination of:

Day Rate: based on *hours worked*  
+  
Bonus: related to *time saved for output achieved*

Bonus schemes may operate on an individual or group basis.

- Under **individual** schemes, the achievement of each individual is assessed separately and a bonus is calculated based on the work of the individual.
- Under **group** schemes, a group of people share a reward based on an assessment of their collective performance.

### Activity - 02 Premium Bonus Scheme

XYZ PLC is an engineering company which is undertaking various jobs of clients. Mr. Fernando is an engineer worked for XYZ PLC and he is paid Rs. 1,300 per hour. Each job he does, has a time allowance and he is paid 60 percent of any time he saves each week as a bonus paid at his hourly rate.

During last week, Mr. Fernando had worked for 40 hours and completed jobs having a total time allowed of 48 hours.

**Calculate** his earnings for last week.

## 5.3 Overtime

- Usually arises from working outside normal hours, including weekends and national holidays.
- Is usually paid at some rate over the normal (time and a half or double time). The excess over the normal rate is an *overtime premium*. Charging of the overtime premium will vary according to the circumstances.
- Overtime costs should be allocated based on the specific circumstances that led to the overtime:
  - Allocate directly to the job—if overtime worked on customer's specific instructions.
  - Allocate to a separate general production overhead a/c—if arising from general pressure of work.
  - Allocate to the department responsible for the delay which resulted in the overtime.
  - Charge directly to costing income statement—if due to circumstances beyond the control of any department (e.g. power failure, fire, national strike, etc).



### Exam Advice

On the exam be sure to use the combined rate and not just the premium (alone).

# 6 Labour Measures

## 6.1 Labour Turnover

### 6.1.1 Meaning

- This is the rate at which employees *who have to be replaced* leave:

$$\text{Labour Turnover} = \frac{\text{Leavers replaced}}{\text{Average number of employees}} \times 100\%$$

### 6.1.2 Reasons for Labour Turnover\*

- Low rates of pay (result in higher rates of turnover).
- Lack of supervision and/or training.
- No job and/or promotion prospects.
- Usually closely linked to:
  - remuneration (i.e. lower remuneration results in higher turnover);
  - working conditions;
  - training opportunities;
  - promotion prospects.
- Other contributory factors include retirement, illness, death and pregnancy.

#### \*Commentary

\*Although some factors which cause labour turnover are uncontrollable/unavoidable, labour turnover generally can be manageable.

### 6.1.3 Labour Turnover Costs\*

- Leaving costs—administering documentation (e.g. for taxation authority and payroll changes) and leaving tasks (e.g. conducting exit interviews).
- "Cover" costs—the costs of covering a vacancy (e.g. through employment of "temps" or overtime working) until it is filled.
- Recruitment costs and tasks—advertising, selection and engagement (may include agency fees and costs of relocation).
- Learning and/or induction costs—may include retraining costs and lower productivity (initially).
- Possible disruption of workflow and missed deadlines.
- Lower productivity and/or customer service—due to low morale (especially if the person leaving was popular and/or particularly good at the job and/or remaining staff are required to absorb that person's workload).
- High incidence of stress-related absenteeism.
- Other staff members expressing a desire to leave.

#### \*Commentary

\*Many labour turnover costs are usually measurable in terms of time and/or cost. However, some costs are difficult, if not impossible, to quantify.

#### 6.1.4 Ways to Reduce Labour Turnover

- Offer competitive pay levels (i.e. in line with industry).
- Offer relevant incentives and other staff benefits (e.g. subsidised staff canteen, recreational/sports facilities, product discounts, etc).
- Incentivise key staff (e.g. with performance-related pay, individual or team productivity bonuses, etc).
- Ensure that the working environment is suitably designed (e.g. acceptable levels of heat, light, noise, etc).
- Improve pay structures to remove inequalities and ensure that pay system is transparent.
- Provide better promotional opportunities (e.g. by adopting a "promotions from within" policy).
- Formalise training programmes and career structures within the organisation.
- Consult regularly with employees (about morale, working conditions, etc). Provide a system that allows employees to offer ideas for improvements and to which management responds.
- Provide staff members with regular feedback on their performance.

#### 6.2 Idle ("Waiting") Time

- Non-productive hours that are nevertheless paid for ("downtime") should obviously be prevented as far as possible.
- It is important to analyse causes of idle time so that necessary corrective action can be taken. Three types of causes are:
  1. *productive* causes (e.g. machine breakdown, power failure or time spent waiting for tools, materials, etc);
  2. *administrative* causes (e.g. surplus capacity, unforeseen drop in demand);
  3. *economic* causes (e.g. seasonal fluctuations in demand)



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