

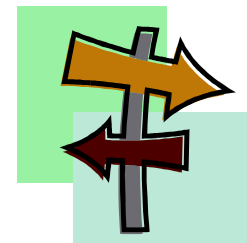


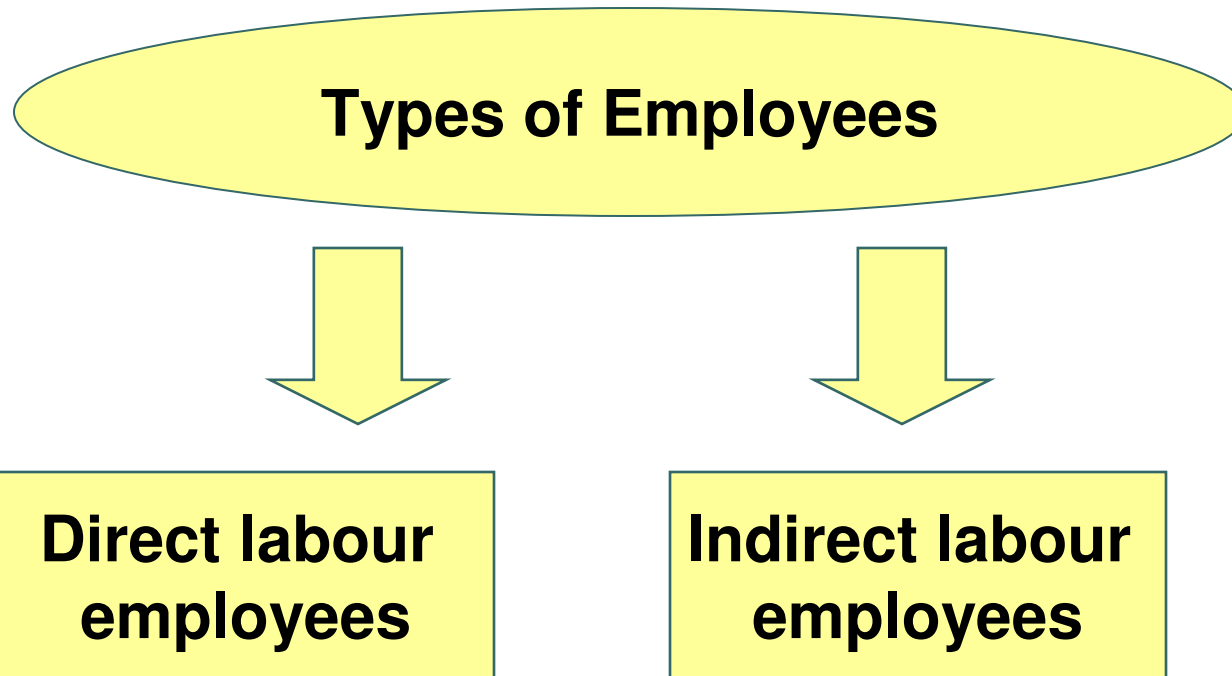
Topic 6

Accounting for Labour

Session Objectives

- Identify direct and indirect costs of labour
- Explain the methods used to relate input labour costs to work done
- Describe different remuneration methods: time-based systems, piecework systems and individual and group incentive schemes
- Calculate the level, and analyse the costs and causes of labour turnover
- Explain and calculate labour efficiency, capacity and production volume ratios





Direct Employees

- **Manufacturing business** = production workers, machine operators etc.
- **Building contractors business** = bricklayers, roof-builders, plasterers
- **Audit business** = employees doing audit work

Indirect Employees

- Support staff such as repairs and maintenance engineers, stores staff, supervisors
- Administrative positions
- Selling and distribution positions



Direct and Indirect Labour Cost

- Indirect labour costs are overhead costs
- Some labour costs associated with direct labour may also be treated as indirect labour costs



Calculation of Direct Labour Cost

Direct Labour Cost

= Hours worked on direct labour operations x basic rate of pay per hour



Guidelines for Calculating Labour Cost

○ Indirect Labour Cost

- Idle time or time spent on training or hours not engaged in direct operations
- Overtime premium
- Group bonus schemes

○ Direct Labour Cost

- Overtime for a specific reason like special customer request
- Bonus payments if they can be traced directly to items of direct labour work

Overtime Premium

- Overtime is premium is time in excess of the basic hours for a period for which employees are paid.
- Usually overtime hours are paid at a higher rate than the basic hourly rate



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Idle Time

- Some organisations record how employees spend their time by using job cards or time sheets so as to monitor the work force
- Reasons:
 - Idle time can be measured and monitored
 - Labour cost of different activities can be identified



Question

- A company pays a group of employees £9 per hour for a 37-hour week. Time worked in excess of 37 hours is overtime, which is paid in time and one third. During one week the work force works 407 hours in normal time and additional 40 hours in overtime. Calculate the labour cost

Solution

$$\begin{aligned} \text{Overtime Pay} &= \text{Basic Pay} + \text{Overtime} \\ \text{Premium} &= (447 * \text{£}9) + (40 * \text{£}3) = \\ &\text{£}4,143 \end{aligned}$$

OR

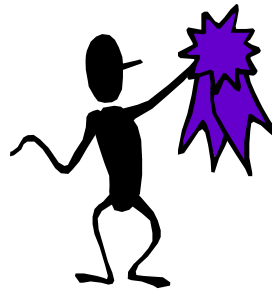
$$\begin{aligned} \text{Overtime Pay} &= (407 * \text{£}9) + (40 * \text{£}12) = \\ &\text{£}4,143 \end{aligned}$$

Is Overtime Premium Direct or Indirect Cost?

- **Direct:** If overtime is at the specific request of the customer
- **Indirect:** All other cases

Bonus Payments

- Bonus is an additional payment in addition to basic salary or wage
- Paid for either achieving or exceeding certain targets
- Bonus schemes vary and can be schemes for individual employees or group schemes



Determining Time Spent

- Time sheets
- Time cards
- Job sheets

Payroll Department

- Preparation of payroll involves calculating gross wages from time and activity records
- Payroll department also calculates wages after deductions from payroll
- Payroll department carries out an analysis of direct and indirect wages

Remuneration Methods

- Time Related or Time-Based
- Output Related or Piecework

Time-Based Systems

- Employees are paid at a basic rate per hour, day , week or month
- Do not provide any incentive for the employee to improve productivity
- Require close supervision
- Total Wages = (Hours worked x basic rate per hour) + (overtime hours worked x overtime premium per hour)

Piece Work

- Under this method more of the risks and rewards fall on the employee rather than the employer.
- Under this, employees are paid for each piece they produce
- Rigid inspection procedures are required to ensure work is of an adequate standard

Piece Work

- Straight piece work is almost extinct today due to legislation and trade unions
- An employee might be paid on a piece-work basis subject to receiving a guaranteed minimum wage each week

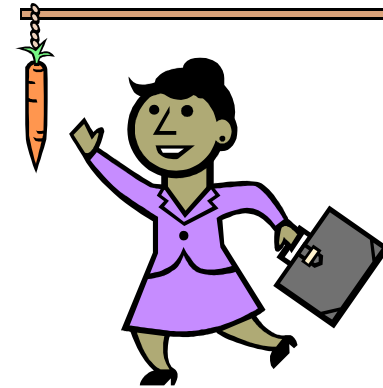
Differential Piece Rate

- A low piece rate is paid for first units of production and high piece rate for subsequent units



Incentive Schemes

- Halsey
- Rowan
- Measured Day work
- Share of Production



Halsey

- The employee receives 50% of the saved time
- Bonus
= $[(\text{Time allowed} - \text{Time Taken}) / 2] * \text{Time rate}$

Rowan

- Bonus

$$= \left(\frac{\text{Time taken}}{\text{Time allowed}} \right) * \text{Time rate} * \text{Time saved}$$



Measured Day Work

- Pay a high time rate based on analysis of past performance
 - Calculate allowed time per unit
 - Compare this with time actually taken in the past by the employee
 - If allowed time > actual time, agree on an incentive

Share of Production

- The management and labour representatives agree on a constant share in production
- Any gains in value added are shared with employees

Labour Turnover

- It is a measure of the proportion of people leaving relative to average number of people employed.
- Labour Turnover
= (No. of leavers who require replacement) / Average number of employees x 100

Labour Turnover and Personnel Department

- Main objective of the Personnel Department is to minimise turnover rate
- Each time an employee is replaced following costs are incurred:
 - Advertising and selection
 - Administering departure and replacement
 - Training
 - Reduced efficiency until new employee reaches the required skill level

Reasons for Leaving

○ Avoidable

- Poor remuneration
- Poor working conditions
- Lack of training opportunities
- Lack of promotion prospects

○ Unavoidable

- Retirement
- Illness / death
- Family reasons
- Relocation



Labour Efficiency and Utilisation

- Compare actual efficiency with budgeted efficiency using standard hours
- A standard hour is the number of production units which should be achieved by an experienced worker within a period of one hour
- **Efficiency Ratio**
= (Actual output measured in standard hours / Actual Hours) x 100%

Labour Capacity Ratio

- Labour capacity ratio measures the number of hours spent actively working as a % of total hours available for work
- Labour Capacity Ratio=
[Number of hours spent working (active production) / Total hours available (budgeted)] x 100%

Labour Production Volume Ratio

- Compares the number of hours expected to be worked to produce actual output with the total hours available for work (full capacity or budgeted)
- Labour Production Volume Ratio =
(Expected hours to produce actual output / Total hours available) x 100%

Sample Exam Question

- Overtime premium wages contained in direct wages are normally classified as:
 - A. Prime cost
 - B. Factory overheads
 - C. Direct labour costs
 - D. Non-production costs

Answer

- **B**
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- If overtime is at the specific request of the customer it is classified as a direct cost in all other cases it is classified as indirect cost or factory overheads.

Sample Exam Question

- Pelican plc defines its production standards as 1 unit in 30 minutes. It has budgeted 400 production hours. John and his team produce 1800 units in 700 hours. What is his team's efficiency ratio?
 - A. 96.3%
 - B. 112.4%
 - C. 118.5%
 - D. 128.57%

Answer

- D
- 1800 units should have taken 900 hours. However, the team took only 700 hours.
- Labour Efficiency Ratio
- = (Expected hours to produce output / (Actual hours to produce output) x 100
- = (900/ 700) x 100 = 128.57%