Unit-3

Employee Cost

Introduction:

Employee (Labour) cost: Benefits paid or payable to the employees of an entity, whether permanent, or temporary for the services rendered by them. Employee cost includes payments made in cash or kind. Employee cost includes the following:

(i) Wages and salary

(ii) Allowances and incentives;

(iii) Payment for overtimes

(iv) Employer's contribution to Provident fund and other welfare funds;

(v) Other benefits (leave with all pay, free or subsidised food, leave travel concession etc)

Classification of Employee (Labour) cost:

Employee cost are broadly classified as direct and indirect employee cost.

1. **Direct Employee (Labour) Cost:**

   Benefits paid or payable to the employees which can be attributed to a cost object in an economically feasible manner. This can be easily identified and allocated to an activity, contract, cost centre, customer, process, product etc.

2. **Indirect Employee (Labour) Cost:**

   Benefits paid or payable to the employees, which cannot be directly attributable to a particular cost object in an economically feasible manner.

EMPLOYEE (LABOUR) COST CONTROL:

Employee costs are associated with human beings. To control employee costs one has to understand human behaviour. Employee cost control means control over the cost incurred on employees. Control over employee costs does not imply control over the size of the wage bill; it also does not imply that wages of each employee should be kept as low as possible.

Methods of Labour cost control:

1. **Attendance Procedure / Time-keeping:**

   It refers to correct recording of the employees' attendance time. Students may note the difference between "time keeping" and "time booking". The latter refers to break up of time on various jobs while the former implies a record of total time spent by the employees in a factory.

   Objectives of Time-keeping: Correct recording of employees' attendance time is of utmost importance where payment is made on the basis of time worked. Where payment is made by results viz; straight piece work, it would still be necessary to correctly record attendance for the purpose of ensuring that proper discipline and adequate rate of production are maintained. The objectives of time -keeping are as follows:

   (i) For the preparation of payrolls.

   (ii) For calculating overtime.

   (iii) For ascertaining and controlling employee cost.

   (iv) For ascertaining idle time.

   (v) For disciplinary purposes.

   (vi) For overhead distribution.

Methods of Time-keeping: There are various methods of time-keeping, which may be categorized into manual and mechanical methods. The choice of a particular method depends upon the requirements and policy of an entity; but whichever method is followed, it should make a correct record of the time by incurring minimum possible expenditure and it should minimise the risk of fraudulent payments of wages. The examples of time keeping methods are follows:

A. Manual Methods

(a) **Attendance Register method**- Under this method, an attendance register is kept to record the arrival and departure time of an employee. This method is simple and expensive and is suitable for small organisations. However, this method may lead to dishonest practice of time manipulation by way of recording wrong time and back date entry in collusion with time keeper.

(b) **Metal Disc/ Token method-** This method of time recording is very old and is almost obsolete in practice. Under this method, each employee is allotted a metal disc or a token with a hole bearing his identification number. The token is kept or handed to the time keeper who record the token number in his register. Like attendance register method, this method also has some disadvantages like error in recording, proxy attendance etc.

B. **Mechanical/ Automated Methods**

(a) **Punch Card Attendance**- Under this method, each employee is provided a card for marking attendance. A punch card contains data related with the employee in digital form. In punch card attendance system, an employee needs to either insert or wave his card to a card reader which then ensures whether the correct person is logging in and/or out. This system does not require to employ any time keeper and minimises the risk of recording error and time manipulation.

(b) **Bio- Metric Attendance system-** Under bio-metric attendance system attendance is marked by recognizing an employee on the basis of physical and behavioural traits. An employee's unique identity like finger print, face and retina image etc. are kept in a database which is matched at the time of marking of attendance before the attendance device for this purpose. Bio-metric attendance system includes fingerprint recognition system, face recognition system, Time and attendance tracking technology etc. This system reduces the risk of time manipulation and proxy attendance. However, it may not be suitable for small organisations due to cost associated with set-up and maintenance.

2. Time-Booking:

Time keeping just records the time spent by an employee in the premises for production but it does not show how much time a person spent on a particular job. **Time booking refers to a method wherein each activity of an employee is recorded**. This data recorded is further used for measure the time spent on a particular job for costing, measurement of efficiency, fixation of responsibility etc.

Time booking for costing: The time spent on a particular job or activity is used to compute the cost of the job or activity.

Time booking to measure efficiency: The efficiency of the employees is measures by comparing the actual time taken by an employee with the standard time that should have been taken.

Time booking for fixation of responsibility: The time booked data is used to analyse the variance in time taken by an employee on a particular job or process with respect to standard time to see the reasons for the variance. The reasons for variance is further classified as controllable and uncontrollable. The controllable reasons are those which can be avoided by due care and efficiency. On the other hand, uncontrollable reasons cannot be avoided under the normal circumstances.

3. **Payroll procedure:**

1. **Attendance and Time details: A** detailed sheet of number of days or hours worked by each employee (in case of time based payment) and units or percentage of work (in case of piece rate) as reflected by the time keeping methods are sent to the payroll department by the time keeping department. Further, payroll department with the help of time booking records calculate any further incentives such as overtime payment, bonus to be paid to the employees.

2. **List of employees and other details:** A list of employees on roll and the rate at which they will be paid is sent by the personnel/ HR department. Payroll department should ensure that no unauthorised or bogus employee is paid.

3. **Computation of wages and other incentives**: Payroll department based on the details provided by the time keeping department and personnel department calculate wages/ salary to be paid to the employees. Payroll department prepares pay slip for all employees authorized by the personnel department and forward the same to the cost/ accounting department for further deductions and payment.

4. **Payment to the employees:** Cost/ accounting department deduct all statutory deduction such as employee's contribution to provident fund and employee state insurance (ESI) scheme, TDS on salary etc. After all deductions wages/ salary is paid to the employees.

5. **Deposit of all statutory liabilities:** All statutory deduction made from wages/ salary of the employees along with employer's contributions such as provident fund and employee state insurance

scheme are paid to the respective statutory bodies.

<u>Idle time:</u>

The time during which no production is carried-out because the worker remains idle but are paid. In other words, it is the difference between the time paid and the time booked. Idle time can be normal or abnormal. The time for which employees are paid includes holidays, paid leaves, allowable rest or off time etc.

Normal idle time: It is the time which cannot be avoided or reduced in the normal course of business.

Causes	**Treatment**
1. The time lost between factory gate and the place of work	It is treated as a part of cost of production. Thus, in the case of direct workers an allowance for normal idle time is considered setting of standard hours or standard rate.
2. The interval between one job and another	In case of indirect workers, normal idle time is considered for the computation of overhead rate.
3. The setting up time for the machine	
4. Normal rest time, break for lunch etc	

Abnormal idle time: Apart from normal idle time, there may be factors which give rise to abnormal idle time.

Causes	**Treatment**
1. Idle time may also arise due to abnormal factors like lack of coordination	Abnormal idle time cost is not included as a part of production cost and is shown as a separate item in the Costing Profit and Loss Account.
2. Power failure, Breakdown of machines	The cost of abnormal idle time should be further categorised into controllable and uncontrollable. For each category, the break-up of cost due to various factors should be separately shown. This would help the management in fixing responsibility for controlling idle

	time.
3. Non-availability of raw materials, strikes, lockouts, poor supervision, fire, flood etc.	
4. The causes for abnormal idle time should be further analysed into controllable and uncontrollable. i) Controllable abnormal idle time refers to that time which could have been put to productive use had the management been more alert and efficient. All such time which could have been avoided is controllable idle time. ii) Uncontrollable abnormal idle time refers to time lost due to abnormal causes, over which management does not have any control e.g., breakdown of machines, flood etc. may be characterised as uncontrollable idle time.	Management should aim at eliminating controllable idle time and on a long term basis reducing even the normal idle time. This would require a detailed analysis of the causes leading to such idle time.

Over time:

Work done beyond normal working hours is known as 'overtime work'. Overtime payment is the amount of wages paid for working beyond normal working hours. Overtime payment consist of two elements-

(i) Normal wages for overtime work and

(ii) Premium payment for overtime work.

Causes of Overtime and Treatment of Overtime premium in cost accounting

Causes	**Treatment**
1. The customer may agree to bear the entire charge of overtime because urgency	If overtime is resorted to at the desire of the customer, then overtime premium may be

of work.	charged to the job directly.
2. Overtime may be called for to make up any shortfall in production due to some unexpected development.	If overtime is required to cope with general production programmes or for meeting urgent orders, the overtime premium should be treated as overhead cost of the particular department or cost centre which works overtime.
3. Overtime work may be necessary to make up a shortfall in production due to some fault of management.	If overtime is worked in a department due to the fault of another department, the overtime premium should be charged to the latter department.
4. Overtime work may be resorted to, to secure an out -turn in excess of the normal output to take advantage of an expanding market or of rising demand	Overtime work may be resorted to, to secure an out-turn in excess of the normal output to take advantage of an expanding market or of rising demand

Labor turnover:

Employee turnover or labour turnover in an organisation is the rate of change in the composition of employee force during a specified period measured against a suitable index. The standard of usual employee turnover in the industry or locality or the employee turnover rate for a past period may be taken as the index or norm against which actual turnover rate is compared.

Reasons of employee turnover:

The reasons for employee turnover in an organisation can be classified under the following three heads:

(a) Personal Causes;

(b) Unavoidable Causes; and

(c) Avoidable Causes.

(a) **Personal causes**: All the personal reasons which induce or compel an employee to leave his job; such causes include the following:

(i) Change of jobs for betterment.

(ii) Premature retirement due to ill health or old age.

(iii)Domestic problems and family responsibilities.

(iv) Discontent over the jobs and working environment. In all the above cases the employee leaves the organisation at his will and, therefore, it is difficult to suggest any possible remedy in the first three cases. But the last one can be overcome by creating conditions leading to a healthy working environment. For this, officers should play a positive role and make sure that their subordinates work under healthy working conditions.

(b) **Unavoidable Causes**: Unavoidable causes are those under which it becomes obligatory on the part of management to ask one or more of their employees to leave the organisation; such causes are summed up as listed below:

- Seasonal nature of the business;
- Shortage of raw material, power, slack market for the product etc.;
- Change in the plant location;
- Disability, making a worker unfit for work;
- Disciplinary measures;
- Marriage (generally in the case of women).

(c) **Avoidable Causes:** Avoidable causes are those which require the attention of management on a continuous basis so as to keep employee turnover ratio as low as possible. The main causes under this case are indicated below:

(1) Dissatisfaction with job, remuneration, hours of work, working conditions, etc.,

(2) Strained relationship with management, supervisors or fellow workers;

(3) Lack of training facilities and promotional avenues;

(4) Lack of recreational and medical facilities;

Effects of Employee (Labour) Turnover:

High employee turnover increases the cost of production in the following ways:

(i) Even flow of production is disturbed;

(ii) Efficiency of new workers is low; productivity of new but experienced workers is low in the beginning;

(iii) There is increased cost of training and induction;

(iv) New workers cause increased breakage of tools, wastage of materials, etc.

(v) Cost of recruitment and training increases.

<u>**Methods of Wage Payment:**</u>

There are mainly two system of paying wages to employees viz., Time wage system and Piece wage system which are explained below:

1. <u>Time wage:</u>

   Time wage system is also called day wage system is a system in which wages are paid on the basis of time spent by the worker like per day, week or month instead of output produced or amount of work done. Here presence of employee is more important than performance of employee. The wage rate is determined by negotiation considering prevailing local wage rate or job evaluation.

2. <u>Piece wage:</u>

   In this system of wage payment, remuneration is paid to the employees on the basis of unit produced or amount of work done. Unit of output produced or amount of work done is the basis of payment of wages. Therefore, greater is the number of unit produced, higher is the remuneration of employees and vice-versa, hence this method is called payment by result. Under this system efficient and hardworking employees get higher remuneration whereas learner or beginner gets lower amount of remuneration.

<u>Incentive Schemes:</u>

Incentives schemes or bonus system is a compromise between the two, combining the good points of each system. Under incentive schemes, time rate and piece rate systems are in such a way that workers are induced to increase their productivity.

Important Incentives Schemes.

- Halsey Plan
- Rowan Plan
- Taylor's Plan

Halsey Plan:

It is a simple combination of time and piece method of wage payment. Under this plan, amount of bonus depends upon the time saved by the worker. A standard time is fixed for each job and if a worker completes the job in less than the standard time, he gets wages for the time worked plus a bonus equal to 50% of the value of time saved.

1. **Bonus = 50%(Time Saved x Rate Per Hour)**
2. **Total Earnings = (Time taken x Rate Per Hour) + 50%(Time Saved x Rate Per Hour)**
3. **Time saved = Standard time – Time Taken**

Rowan Plan:

This plan was introduced by David Rowan and is similar to Halsey plan, except in the calculation of the amount of bonus. In this plan, bonus is that proportion of the wages of the time taken which the time saved bears to the standard time. Its formula is:

1. Bonus= Time saved /Standard time x Time taken x Rate per hour

2. Total Earnings = (Time taken x Rate per hour)+Bonus.

Taylor's Differential Piece Rate System:

- F.W. Taylor as a part of the scheme of scientific management. Under this system, the standard task is established after careful time and motion study and two piece rates are set.
- Day wages are not guaranteed
- A standard time for jobs is established
- Two piece rates are fixed. If the worker does the work within the standard time, he receives the higher piece rate, whereas if he takes longer time he receives the lower piece rate.

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