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Rajgurunagar – 410505

Second Year B.Com

IVth – Sem (CBCS 2019 Pattern)
As per the new Syllabus

Subject – Cost & Works Accounting – II

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Topic 2 – Labour cost and Payroll

- **LABOUR COST –**

Labour cost is a significant element of cost specially in an organisation using more manual operations. It is the cost of human endeavour in the product and requires coordinated efforts for its control. The management objective of keeping labour cost as low as possible is achieved by balancing productivity with wages. Low wages do not necessarily mean low labour cost. Low labour cost is possible by giving substantial increase in wages against corresponding increase in productivity. The gain is reflected both in labour cost as well as in overheads expense per unit, since overheads are distributed over larger volume. Again, the productivity of labour is quite flexible. Given right type of motivation and incentive, it can reach amazing scale. It does not have any limitation like machines. Labour cost is a vital factor not only affecting the cost of production but also industrial relations of the organization. No organization can expect to attract and attain qualified and motivated employees unless it pays them fair remuneration. Employee remuneration therefore influences vitally the growth and profitability of the company. For employees remuneration is more than a means of satisfying their physical needs. Wages and salaries have significant influence on our distribution of income, Consumption savings employment and prices. Thus employee remuneration is a very significant issue from the viewpoint of employer's employees and the nation as whole.

- **Wages –**

In economics, the price paid to labour for its contribution to the process of production is called wages.

Labour is an important factor of production. If there is no labour to work, all other factors, be it land or capital, will remain idle.

However, labour alone cannot produce as most of the production is the result of joint efforts of different factors of production. Therefore, the share of the produce paid to labour for its production activity is called wage.

Definitions:

“A wage may be defined as the sum of money paid under contract by an employer to worker for services rendered.” -Benham

“Wages is the payment to labour for its assistance to production.” -A.H. Hansen

‘Wage rate is the price paid for the use of labour.’ -Mc Connell

Types of Wages:

1. Piece Wages:

Piece wages are the wages paid according to the work done by the worker. To calculate the piece wages, the number of units produced by the worker are taken into consideration.

2. Time Wages:

If the labourer is paid for his services according to time, it is called as time wages. For example, if the labour is paid Rs. 35 per day, it will be termed as time wage.

3. Cash Wages:

Cash wages refer to the wages paid to the labour in terms of money. The salary paid to a worker is an instance of cash wages.

4. Wages in Kind:

When the labourer is paid in terms of goods rather than cash, is called the wage in kind. These types of wages are popular in rural areas.

5. Contract Wages:

Under this type, the wages are fixed in the beginning for complete work. For instance, if a contractor is told that he will be paid Rs. 25,000 for the construction of building, it will be termed as contract wages.

Concepts of Wages:

The following are the two main concepts of wages:

A. Money Wages or Nominal Wages:

The total amount of money received by the labourer in the process of production is called the money wages or nominal wages.

B. Real Wages:

Real wages mean translation of money wages into real terms or in terms of commodities and services that money can buy. They refer to the advantages of worker's occupation, i.e. the amount of the necessities, comforts and luxuries of life which the worker can command in return for his services.

- **Differences Between Salary and Wages –**

Following are the major differences between salary and wages:

1. Salary is the fixed amount of compensation which is paid for the performance of an employee. Wage is the variable amount of compensation which is paid on the basis of hours spent in finishing a certain amount of work.
2. Salary is given to the skilled persons who apply their proficiencies in respective fields and generate the revenues for the firm. Whereas wages are paid to the semi-skilled or unskilled worker such as carpenter, welder, electrician, etc. who work on hourly basis.
3. In the case of salary, the cost incurred is fixed i.e. fixed amount is paid monthly. Whereas in wages, the cost is variable, because it can vary with the day to day performance of an individual.
4. Salary once decided, in the beginning, remains fixed throughout. Whereas in wage system, there is a wage rate that keeps on changing and an individual is paid on the basis of prevailing wage rate.
5. Salary is generally paid at fixed intervals i.e. monthly. Whereas wages are paid on a daily basis for the number of hours spent.
6. Salary is paid on the basis of the performance of an individual. Whereas wages are paid on hourly basis i.e. the amount of work done in hours.
7. Salary is paid to employees who possess the skills and efficiencies in completing the office work. Whereas wages are paid to the labours, who are engaged in manufacturing processes and do the work on an hourly basis.
8. Salary is given to those who are engaged in administrative or office work job. Whereas wages are paid to those, who are engaged in manufacturing processes that require unskilled or semi-skilled workers.
9. A salaried person usually has KRA i.e. key resultant area set for the month on the basis of which their performance is judged. Whereas the waged person does not have any KRA and is judged on the basis of hourly work done.
10. Salaried persons are not paid additional compensation for any extra hours. Whereas wage holder does get an additional pay for the extra hours devoted by him.

- **TIME RECORDING –**

Recording of time has two purposes - **time-keeping and time-booking**. It is necessary for both type of workers: direct and indirect. It is necessary even if the workers are paid on piece basis. Record keeping is correct when time-keeping and time-booking tally.

- **TIME-KEEPING** – Time-keeping is necessary for the purpose of recording attendance and for calculating wages.

The purpose of time-keeping is to provide basic data for:

- (i) pay-roll preparation;
- (ii) finding out the labour cost of a job/product/service;
- (iii) attendance records to meet statutory requirements;
- (iv) determining productivity and controlling labour cost;
- (v) calculating overhead cost of a job, product or service;
- (vi) to maintain discipline in attendance;
- (vii) to distinguish between normal and over-time, late attendance and early leaving; and
- (viii) to provide internal check against dummy workers.

The time-keeping office records the attendance of workers. Depending on the number of workers, a separate department may be established or it may form part of the personnel department.

- **METHODS OF TIME KEEPING –**

(1) Manual methods:

(a) Attendance register method:

An attendance register is kept at the entrance of the factory gate Lesson 3 Labour Cost 107 in this method. The in and out timing are noted, either by the worker himself or by a staff of the time office. Later, entries are made to the individual attendance records of the workmen.

(b) Disc method:

Under this method, metal discs bearing employee's numbers allotted by the personnel department are placed on hooks on a board provided either at the gate or at the entrance of the department. On entering the factory, the worker removes the disc bearing his number from the board and places it in a box kept for this purpose. The box is taken away as soon as normal reporting time is over. A worker coming late will pick up the disc and put it in the "Late" box provided in the department. Such late box is normally changed every half an hour upto the maximum late attendance time allowed. The timekeeper records the attendance in the register on the basis of these discs.

(2) Mechanical methods:

The attendance cards are used in time clocks installed at the entrance of the factory. On entering the factory, the worker takes his card from 'OUT' racks and press it inside the clock, which will print arrival time in 'IN' column. He then places it in 'IN' rack of the department where he reports for duty. Late attendance is normally reported in red ink. Similarly, when the employee leaves the factory, he collects the card from the 'IN' rack and punches the time in the clock and keeps it in the 'OUT' rack. It is necessary that the timekeeping staff are present at the time of punching the cards to supervise the procedure. The clock cards are Collected by the timekeeping staff daily or weekly for recording in Statutory Attendance Register. Correct recording of attendance time is very important where wages are paid on the basis of time worked. Where payment is made by results, such as, by piece rate method, it would still be necessary to record correctly the 'in' and 'out' timings.

- **TIME-BOOKING** – Time-booking means a record from the utilisation point of view; the purpose is cost analysis and cost apportionment.

The objectives of time-booking are:

- (i) to apportion overheads against jobs;
- (ii) to calculate the labour cost of jobs done;
- (ii) to ascertain idle time for the purpose of control;
- (iv) to find out that the time during which a worker is in the factory is properly utilised;
- (v) to evaluate labour performance, to compare actual and budgeted time;

(vi) to determine overhead rates of absorbing overhead expenses under the labour hour and machine

hour methods;

(vii) to calculate wages and bonus provided the system of payment depends on the time taken.

▪ **METHOD OF TIME-BOOKING –**

1. Daily Time Sheets –

Under this method, a daily time sheet is provided to each worker on which time spent by him on various work orders is mentioned. This method can be conveniently used if the worker works on various jobs of short duration like in maintenance jobs. But this method is disadvantages also as it involves considerable paper work.

2. Weekly Time Sheets –

In this method time is recorded for all the jobs done during the week instead of recording the work done for a day only. One sheet is allotted to each worker. It involves less paper work. These types of weekly time sheets are useful for intermittent types of jobs like construction work.

3. Job Card –

Job Card is a method of recording details of time with reference to the jobs or work orders undertaken by the workers. This method facilitates the computation of labour cost with reference to jobs or work orders. Job cards may be of two types, one, which is a job order cost card, and contains information regarding material consumption as well as time spent by operators. The other one is, in effect, a job ticket, which is issued to an operator by the supervisor and contains only the operation details. When the operator starts the work, he records the time either manually or through time recording clock on the card.

• **PREPARATION OF PAYROLLS –**

The payroll is a record which shows details of the gross wages earned by each worker in a particular period, the deductions made and the net wages payable. The payroll can be prepared at weekly, fortnightly or monthly periods. It can be prepared departmentwise or shiftwise.

The payroll records contain information regarding:

- (a) Department
- (b) Wage period
- (c) Workers' ticket number
- (d) Worker's name
- (e) Normal hours worked
- (f) Overtime
- (g) Output in the period
- (h) Rate of wages/hour
- (i) Rate of wages/unit
- (j) Total basic wages
- (k) Dearness Allowance (DA)
- (l) Bonus
- (m) Deductions from Wages
- (n) Net wages.

The preparation of payroll involves three steps, viz.

(a) Collection of basic data; (b) Determining the wages payable; (c) Preparing the actual payroll.

- **BASIC METHODS OF REMUNERATION SYSTEM –**

- (1) Time Rate System –

The time rate or day rate is related to the hours of wage and is commonly used. The wage rate can be fixed on hourly, daily, weekly, fortnightly or monthly basis depending on the nature of his skill. This method can be applied in the following circumstances:

- (a) The quality of work is more important;
- (b) The output of a worker cannot be measured;
- (c) Where output of a worker is not in his control;
- (d) Where the work can be closely supervised;
- (e) Where increase in output is negligible compared to the incentive.

Advantages of Time Rate System -

The advantages of time rate system are:

- (a) It is simple and easy to understand;
- (b) It is recognised by trade unions as all workers are paid alike;
- (c) It involves less clerical expenditure;

- (d) A steady income is assured;
- (e) As there is no hurry, tools and materials are handled carefully. Wastage is minimised.

Disadvantages of Time Rate System -

- (a) It does not encourage initiative;
- (b) Labour cost may rise thereby decreasing profit. This may be caused by decrease in productivity;
- (c) Standards for labour are difficult to set;
- (d) Production may decrease thus upsetting production schedules, creating production bottlenecks and increasing cost per unit;
- (e) Labour cost cannot be estimated for the purpose of quotations;
- (f) It creates more idle time;
- (g) This system encourages inefficiency;
- (h) It requires close supervision to ensure that employees are working.

(2) Piece Rate System –

The wages are paid on the basis of the output of workers, i.e., on the basis of quantity of output. It is simple and common method of wage payment. The worker is paid on the basis of his work, not taking into account the time involved.

The wage is calculated as follows: $\text{Wage} = \text{Number of units produced} \times \text{Rate per unit}$.

The piece rate can be applied in the following cases:

- (a) the work is of standard or repetitive nature;
- (b) piece rate can be easily fixed;
- (c) there is uninterrupted flow of work;
- (d) it is necessary for the employer to get maximum production; and
- (e) quantity of output depends on effort and does not require skill.

The piece rate can be fixed by determining the time required to complete a piece. This can be done from past experience or estimation or time and motion study. In case the job is new, a few trial runs can enable fixation of piece rates. After this, the time is correlated to the wage rate to determine the piece rate.

Merits of Piece Rate System -

- (a) A worker becomes an expert by continuously doing the work. Thus he can earn more.
- (b) It increases efficiency.

- (c) It reduces costs.
- (d) Idle time is automatically controlled.
- (e) The reward is related to effort. Efficiency is recognized.
- (f) Quotations can be easily made as cost per unit is known.
- (g) Supervision can be reduced as workers are paid according to performance.
- (h) Workers endeavor to increase production by discovering new techniques of producing goods.

Demerits of Piece Rate System -

- (a) Quality may be sacrificed to increase production.
- (b) Wastage may be high if not properly supervised.
- (c) It necessitates more supervision and inspection so that units attain the standard quality.
- (d) In order to maximize output, the workers may use machines and tools recklessly.
- (e) If work stops due to machine break down, power failure etc., the workers may feel insecure.
- (f) The workers' health may be affected due to over-strain.
- (g) The inefficient and less efficient people may feel frustrated.
- (h) Lack of ready market may cause over production and surplus.
- (i) Determination of piece rate is difficult.

(3) INCENTIVE SCHEMES –

Both time rate and piece rate systems have their merits and demerits. Incentive system attempts to combine the good aspects of both systems. The main objective of incentive plan is to induce a worker to produce more to earn a higher wage. Producing more in the same period of time should result in higher pay for the worker. Because if greater number of units produced, it should also result in a lower cost per unit for fixed factory cost and also for labour cost.

A good incentive plan should have the following characteristics:

- (1) It should be simple and easy to understand;
- (2) Operating cost of the system should be low;
- (3) It should permit less supervision;
- (4) The time lag between effort and reward should be minimum;
- (5) It should be fair to the employees and employer;
- (6) The standard set should be attainable;
- (7) Performance above standard should be well rewarded;
- (8) It should be flexible;
- (9) The premium should be large enough to induce workers to work hard;

- (10) All workers should be given equal opportunity to earn;
- (11) It should facilitate the budgetary control and standard cost systems;
- (12) Inspection should be good;
- (13) Good working conditions must be available;
- (14) The system should be introduced on a permanent basis and should not be ambiguous;
- (15) No rate cutting should be permitted and an individual's earnings should not be curtailed;
- (16) There should be uniformity of reward for same amount of effort;
- (17) Indirect workers should also be included.

Advantages of Incentive Schemes -

- (1) Less supervision is required;
- (2) The employee morale is high because they can earn more;
- (3) There is increased productivity
- (4) Increased production reduces cost;
- (5) Labour cost can be estimated;
- (6) It is possible to set standards for labour with accuracy;
- (7) There is maximum utilization of resources;
- (8) A task is done in the most economical manner which reduces labour cost.

Disadvantages of Incentive Schemes -

- (1) If rates are not uniform for same type of jobs, it causes discontent.
- (2) Quality may deteriorate and may be sacrificed in order to increase quantity.
- (3) It involves more calculations.
- (4) The workers may not adhere to the safety precautions in order to increase production.
Hence accidents may occur.
- (5) The workers' health may be affected due to over-strain.
- (6) There may be apprehensions regarding rate cutting.
- (7) Inefficient workers may envy the efficient ones which may cause unrest.
- (8) Unskilled workers sometimes earn more than skilled workers if the latter have to work on time basis.

• CLASSIFICATION OF INCENTIVE SCHEMES –

Incentive schemes can be classified as follows:

(A) DIFFERENTIAL PIECE RATE –

Efficient and inefficient workers are distinguished. More than one piece rate is determined. Standards are set for each operation or job. Efficient workers, i.e., those who attain or better the standard set are given a higher rate and inefficient ones are given a lower rate. Hence, there is encouragement to improve the performance. As the level of output increases the piece rate also increases. This ratio may be proportionate or proportionately less or more than the increase in output. Hence output is maximised.

Taylor's Differential Piece Rate System –

F.W. Taylor (known as the father of scientific management) originated this scheme. No minimum wage is guaranteed. The standard output is determined on the basis of time and motion studies. Wages are calculated on the basis of two widely different piece rates. Those attaining or crossing the standard get a higher piece rate and those not attaining it get a lower rate.

The lower rate is based on 83% of the day wage rate. This rate is applicable to those who don't attain the standard. The higher rate is based on 125% of the day rate and an incentive of 50% of the day rate.

The efficiency of a worker can be determined either by comparing standard time and actual time taken or by comparing actual output and standard output. Hence, this system penalises the slow worker and rewards the efficient one.

(B) PREMIUM BONUS PLANS –

All the gains of efficient workers and all the losses of inefficient workers benefit the employer under the time rate system. Under the piece rate system, it is the workers who gain or lose. Under the premium bonus system, the gains are shared by the employer and employees in agreed proportions. Apart from the minimum guaranteed wages, the efficient workers get bonus which depends on the time saved. The standard is determined scientifically. The various incentive schemes should be chosen keeping in mind the nature of the work, with the consent of trade unions in order to make it successful.

▪ Halsey plan -

Under this plan originated by T.A. Halsey, time rate is guaranteed. Standard time and work are predetermined. The bonus is 50% of the standard time saved.

Total wages = Time taken x Hourly rate + 1/2 (Time saved) x Hourly rate.

▪ Halsey Weir plan

The bonus under this plan is 33-1/3% of the standard time saved.

Total wages = Time taken x Hourly rate + 33-1/3% (Time saved) x Hourly rate

▪ **Rowan Plan -**

The time rate is guaranteed under the plan originated by J. Rowan. The percentage of bonus to the wages earned is that which the time saved bears to the standard time.

$$\text{Total wages} = \text{Time taken} \times \text{Hourly rate} + \left(\frac{\text{Time Saved}}{\text{Standard Time}} \right) \times \text{Time taken} \times \text{Hourly rate}$$

(C) GROUP BONUS PLANS –

There are certain jobs which have to be performed collectively by a group of workers. The ultimate production depends on the efficiency of the whole group. Under group bonus plans, payment is made by results to all the workers in the group. Bonus may be shared equally or in different proportion according to the levels of skill required. These proportions may be based on time rates or some previously agreed ratios.

These plans may increase production and reduce costs per unit. It creates team spirit. But efficient and inefficient workers are rewarded alike. Efforts and rewards are not properly linked.

Advantages of group bonus plans -

- (a) There is more co-operation and team work;
- (b) Inspection and supervision can be reduced as every worker is concerned about output;
- (c) There is self-discipline;
- (d) Production increases;
- (e) Cost of production decreases and also the spoiled and defective goods;
- (f) It simplifies payroll and cost accounting.

Disadvantages of group bonus plans -

- (a) The amount of bonus given is too insignificant.
- (b) No distinction is made between efficient and inefficient workers.
- (c) Time gap between effort and reward is very wide.

(D) OTHER NON-MONETARY INCENTIVE SCHEMES –

- (a) Health and safety benefits.
- (b) Favorable working conditions.
- (c) Cheap grains.

- (d) Housing facility.
- (e) Subsidised canteen.
- (f) Sports and recreational facilities.
- (g) Welfare measures.
- (h) Medical facilities for the individual and family.
- (i) Education (free or subsidised) to employees and their dependents.
- (j) Leave travel facilities
- (k) Pension, contribution to P.F., gratuity.
- (l) Subsidized excursions and tours.
- (m) Free tea, milk, snacks etc.
- (n) Free uniforms, protective clothing etc.

Reference –

The Institute of Company Secretaries of India (ICSI)