



INTER 2025



COSTING

THEORY है जरूरी

CHART REVISION + Q&A SERIES

CHAPTER 3 EMPLOYEE



Theory Chart

Chp3 Employee Costing & Direct Expenses

CA. Pranav Popat

Visit ultimateca.com to buy classes

Call / WhatsApp at [89830 87331](https://wa.me/8983087331) for any admission related inquiry

INTRODUCTION

Human Resources & Wages

- To manufacture a **product** or provide **service**, the role of **human exertion** is of high importance.
- The **term** used for **human resources** may include workers, employees, labourers, staffs etc.
- The **compensation** so paid, either in **monetary** terms or in **kind** is known as wages

Employee Cost/ Labour Cost

- Cost of paying wages** to workers is popularly known as labour cost/ employee cost as it relates to labour (exertion) they **put for manufacturing** of product or provision of **services**
- Employee cost is **wider term** which includes **wages, salary, bonus, incentives etc.** paid to an employee and charged to a cost object as labour cost.

EMPLOYEE COST

Meaning

- Benefits **paid or payable** to the employees of an **entity**, whether **permanent, or temporary** for the **services** rendered by them.
- It **includes**:
 - Wages and salary;
 - Allowances and incentives;
 - Payment for overtimes;
 - Employer's** contribution to Provident fund and other welfare funds;
 - Other Monetary or **Non-Monetary** benefits

Classification

- Direct Employee 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.
- Indirect Employee 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

Objective

- Control over employee costs does **not** imply control **over the amount** of the employee cost or to kept **wages** of each employee should be kept as **low as possible**.
- The aim should be to keep the **wages per unit of output** as low as possible
- It can be achieved by giving employees **adequate incentives** to **encourage efficiency** so that optimum output is obtained at given employee cost.

Important factors wrt Employee Cost Control

- Assessment** of manpower requirements.
- Control over **time-keeping and time-booking**.
- Time & Motion** Study.
- Control **idle time & overtime**.
- Control over **employee turnover**.
- Wage and **Incentive systems**.
- Job **Evaluation** and Merit **Rating**.
- Employee **productivity**.

Department associated

- Personnel Dept:** On receipt of **employee requisition** from the various departments it **searches** for the candidates **recruit** those who possess the requisite **qualification** and **skills** required for the job, arranges proper **trainings** and **workshops** for employees, **maintain** all personal and job related **records** of the employees, periodic **evaluation** of performances
- Engineering & Work Study Dept:** It prepares **plans and specifications** for each job, provides **training and guidance** to employees, **supervises** production activities, **time and motion** study, job analysis etc.
- Time-keeping Dept:** maintenance of **attendance records** i.e. **time keeping** and time spend on each job i.e. **time booking**
- Payroll Dept:** payroll preparation, salary and wages **disbursement**
- Cost Accounting Dept:** **analysis** and **allocation** of employee cost to cost objects

Collection of Employee Cost

- The task of collecting employee costs is performed **by** the **Cost Accounting** Dept. which record separately wages paid to **direct and indirect** employee
- It also **ascertain** the **effective wages paid per hour** in each department and to **analyse** the total payment of wages of each department into:
 - the amount included in the **direct cost** of goods produced or jobs completed;
 - the amount treated as **indirect employee** cost and thus included in **overheads**; and
 - the amount treated as the cost of **idle time** and hence loss.
 - the amount treated as **abnormal loss/ gain** and to be transferred to profit and loss account.

DIRECT EMPLOYEE COST vs INDIRECT EMPLOYEE COST

<ul style="list-style-type: none"> It is the cost incurred in payment of employees who are directly engaged in the production process. 	<ul style="list-style-type: none"> Cost incurred for payment of employees who are not directly engaged in the production process.
<ul style="list-style-type: none"> Direct employee cost can be easily identified and allocated to cost object. 	<ul style="list-style-type: none"> Indirect employee cost is apportioned on appropriate basis
<ul style="list-style-type: none"> Direct employee cost varies with the volume of production and has positive relationship with the volume. 	<ul style="list-style-type: none"> Indirect employee cost may not vary with the volume of production.

ATTENDANCE & PAYROLL PROCEDURES

Time Keeping

- Time Keeping is a **record** of total **time spent** by the employees in a factory.
- It is very essential where **payment** is time based
- Also useful on **piece rate** / output basis work to ensure **proper discipline** and adequate rate of production are maintained

Requisites of a Good Time-Keeping System

- System of time-keeping should **not allow proxy** for another employee under any circumstances.
- It should have a **provision** of recording of time of **piece rate** employees so that regular attendance and **discipline** may be maintained. This is necessary to maintain **uniform flow** of production.
- Time of **arrival as well as departure** of employees should be recorded so that **total time** of employees may be recorded and **wages** may be calculated accordingly.
- It should be **mechanical** to **avoid disputes** between employees and the time-keeper.
- It should **identify late arrivals** automatically to avoid **collusion** with time-keeper
- It should be **simple, smooth and quick**. Unnecessary **queuing** for marking attendance should be **avoided**.
- The system should be **reviewed and maintained** periodically to prevent any error.

Methods of Time Keeping

- It should be **decided** in such a way that it should make a **correct record** of the time by incurring **minimum possible expenditure** and it should minimize the **risk of fraudulent payments** of wages.
- **Manual Methods:**
 - **Attendance Register Method:** here **register** is kept to record the **arrival and departure** time, method is **simple** and **not expensive** and suits to **small entities**. Demerit: time manipulation, proxy entries, collusion etc.
 - **Metal Disc/ Token Method:** its **old and obsolete** method, here token/ **metal disc** is **allotted** to employee having **identification number** which time keeper uses to record entry in **register** (was relevant for unskilled labour in mines, factories etc.) Demerit: **error** in recording, proxy entry
- **Mechanical/ Automated Methods:**
 - **Punch Card:** each employee is provided a **card** for marking attendance that contains **data** related with the employee in **digital form**, card need to **wave or insert** to a **card reader** which takes **entry** into system **digitally**, this system do **not require** any **timekeeper** and minimizes manipulation
 - **Biometric Attendance System:** here attendance is recorded based on some **unique physical identity** like **finger print, retina image, face id** which are kept in database and is **matched** at the time of marking attendance, it **reduces risk** of manipulation and **proxy** but is expensive so **not suitable** to **small entities**

Objectives of Time Keeping

- For the preparation of payrolls.
- For calculating overtime.
- For ascertaining and controlling employee cost.
- For ascertaining idle time.
- For disciplinary purposes.
- For overhead distribution.

Time Booking

- Time **keeping** 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.

Application of Time Booking

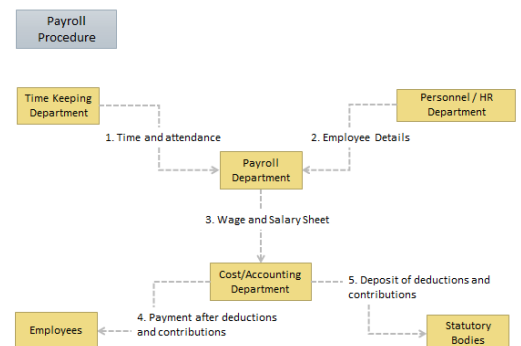
- **For Costing:** The time spent is used to **compute the cost** of the job or activity.
- **To measure efficiency:** by **comparing** the **actual time** taken by an employee with the **standard time** that should have been taken for a job.
- **For fixation of responsibility:** The time booked data 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.

Time / Job Card Types

- **One containing analysis of time with reference to each job:** job card would record the **total time spent** on a particular **job** or operation. If a number of people are engaged on the same job or operation, the time of **all those employees** would be booked on the same card.
- **The other with reference to each employee:** a separate card would be used for **each employee** for **each day or for each week** and the time which he spends on different jobs (and also any idle time) would be recorded in the same card so that the card would have a **complete history** on it as to how his time had been spent during the period.

Payroll Procedure

- **Time and Attendance details:** a detailed **sheet** having **time worked** by each employee or **units produced** (in case of piece rate) is sent to **payroll dept** by time keeping dept. Payroll dept will also check if any **incentives or overtimes and bonus** are payable.
- **List of employee and related details:** list of employees **on roll** and their **respective rates** will be sent by **HR/ Personnel Dept** to **Payroll Dept**, it should be ensured that no **unauthorized** or **bogus** payment is made.
- **Computation of wages and other incentives:** based on **data received** from time keeping and personnel dept, payroll dept will **calculate wages/ salary** payable and prepares a **payslip** for each employee to be authorized by personnel dept and then sent to **accounting dept for deductions & payments**.
- **Payment of employees:** after deductions like **TDS, contribution** to welfare funds etc. wages/ salary are **paid** to employees.
- **Deposit of all statutory liabilities:** statutory **deduction** made from wages/ salary along with **employer's contribution** of PF/ ESI etc. are paid to respective statutory bodies.



DEDUCTIONS FROM SALARY

Provident Funds	Statutory	Employee's contribution to the Provident fund is deducted from the salary/ wages of the concerned employee.
Employee State Insurance Scheme (ESI)	Statutory	Employee's contribution to the ESI is deducted from the salary/ wages.
Tax Deduction at Source (TDS)	Statutory	Employer is obliged to deduct tax at source if it will be paying to the employee net salary exceeding basic exemption limit , in equal monthly installments to the income department.
Professional Tax	Statutory	Professional tax is a state level tax imposed for carrying on business, profession or service.
Voluntary contribution to Provident fund	Non Statutory	If any employee so desires may contribute over and above the contribution payable by the employer.
Contribution benevolent fund.	Non Statutory	An employee may benevolent contribute to any fund voluntarily by putting a request to the payroll department.
Loan deductions	Non Statutory	Installments of any loan taken by the employee.
Other advances and dues	Non Statutory	Other advances like festival advance and unadjusted advances taken.

OVERTIME

Overtime Work

Means work done **beyond normal** working hours

Overtime Payment

Total Wages paid for overtime work. It has two components:

- **Normal Wages** for Overtime work
- **Premium payment** for overtime work (Overtime Premium)

Overtime Premium

- The **rate** for overtime work is **higher** than the normal time rate, usually it is at **double** the normal rates.
- The **extra amount** so paid **over** the **normal** rate is called overtime premium.

Rate of Overtime

- As per Factories Act 1948, it should **not be lower** than rates **specified**.

- **Condition given under act:** Where a worker works in a factory for more than **nine hours in any day** or for more than **forty eight hours in any week**, he shall, in respect of overtime work, be entitled to wages at the **rate of twice** his ordinary rate of wages

- **Note:** rate to be used for OT will be **ordinary rate** which includes basic wages + other allowances not bonus, OT, incentive

IDLE TIME

Meaning

- The time during which **no production** is carried out because the worker remains idle **but are paid**.
- **Difference** between the time **paid** and the time **booked**
- Types: Normal and Abnormal Idle Time

Normal Idle Time

- It is idle time which **cannot be avoided** or reduced in the **normal course** of business.
- It is **part of cost** and already **included in Wage Rate** for Costing Purpose. Reasons: Walking time from Gate to Plant, Break between jobs, Setup time of Machine, Lunch Break, Normal Rest Time

Abnormal Idle Time

- Idle time which is **not** classified as **normal**
- It is **not part of cost** of production and will be charged to Costing P&L.
- Examples: lack of coordination, Power Failure, Machine Breakdown, Non-availability of raw materials, strikes, lockouts, poor supervision, fire, flood
- For better management, abnormal idle time is classified as below:
 - **Controllable:** time which could have been put to productive use had the management been more alert and efficient.
 - **Uncontrollable:** time lost due to reasons over which management does not have any control e.g. flood or other natural disasters unusual machine breakdown etc.

LABOUR UTILISATION

Introduction

- For **identifying utilisation** of labour a **statement** is prepared (generally weekly) for each department / **cost centre**.
- This statement should show the **actual time** paid for, the **standard time** (including normal idle time) **allowed** for production and the **abnormal idle time** analysed for causes thereof.

Identification of utilisation of hours with cost centres, work orders, batches, jobs etc.

- For this purpose, **wage analysis sheet** is prepared
- It is a statement where total **wages paid** for a cost centre, jobs, work orders are analysed
- Data source will be **wage sheet, time card, piece work cards and job cards**.
- It serves the following purposes:
 - It analyse the labour time into direct & indirect by cost centres, jobs, work orders.
 - It provides details of direct labour cost comprises of wages, overtime to be charged as production cost
 - It provides information for treatment of indirect labour cost as overhead expenses.

TREATMENT OF OVERTIME PREMIUM

Causes of OT Premium	Accounting Treatment
If overtime is resorted to/ opted at the request of customer	Overtime Premium will be charged to Job (consider as direct cost)
If overtime is required as a normal course of business or for meeting urgent orders (Irregular/ Healthy)	Overtime Premium should be treated as Overhead cost of concerned department / cost centre
If overtime is worked due to fault of another department	Overtime Premium should be charged to the responsible department
If overtime is worked due to abnormal conditions like flood, earthquake, etc.	Overtime Premium should be charged to Costing P&L
If overtime is required regularly because of worker's shortage	Overtime Premium should be absorbed under Wage Rate and that increased rate will be called as Average Inflated Wage Rate .

SYSTEMS OF WAGE PAYMENT

Time Based (Time Rate System)

- Under this system, the workers are paid on **time basis** i.e. hour, day, week, or month.
- The amount of wages due to a worker are arrived at by **multiplying** the **time worked** (including normal idle period) **by rate** for the time
- Time based wages payment is **suitable** for the employees:
 - whose work output **cannot be** directly or tangibly **measured** like helpers, cleaners, supervisors & clerical staff etc.
 - engaged in **highly skilled** jobs
 - where the **pace** of output is **independent** of the **operator**, e.g., automatic chemical plants.

Output Based (Piece Rate System)

- Under this system, each operation, job or unit of production is termed a **piece**.
- A rate of payment, known as the **piece rate** or piece work rate is **fixed for each piece**.
- The **wages** of the worker **depend** upon his **output** and rate of each unit of output; it is in fact **independent** of the **time** taken by him.

PREMIUM BONUS METHODS OF INCENTIVE

About Incentive Methods

- Under these methods, **standard time** is **set** for performing a job.
- The worker is **guaranteed** his **daily wages** if his output is below and up to standard.
- In case the **task** is **completed** in **less than the standard** time, **benefit** of the saved time is **shared** between the employee and the employer.
- There are two main methods: Halsey Premium Plan, Rowan Premium Plan

Halsey Premium Plan

Features	<ul style="list-style-type: none"> Under Halsey Premium Plan a standard time is fixed for each job or process. If there is no saving or excess time taken, the worker is paid as per actual time with daily wage guaranteed If he does the job in less than the standard time, he gets a bonus equal to 50 percent of the wages of time saved. This scheme is also called as the Halsey Fifty Percent Plan & is given by Frederick A. Halsey
Advantages	<ul style="list-style-type: none"> Time rate is guaranteed while there is opportunity for increased earnings by increasing production. The system is equitable for employer as he gets a direct return for his efforts in improving methods and equipment.
Disadvantages	<ul style="list-style-type: none"> Incentive is not so strong as with piece rate system. In fact, the harder the worker works, the less he gets per piece. The sharing principle may not be liked by employees. Encouraging very high efficiency which may undermine quality.

Rowan Premium Plan

Features	<ul style="list-style-type: none"> According to this system a standard time allowance is fixed for the performance of a job and bonus is paid if time is saved. Under Rowan System the bonus is that proportion of the time wages as time saved bears to the standard time. Here we are not directly using any percentage, but the factor is designed in such a way that it discourage very high efficiency to protect quality
Advantages	<ul style="list-style-type: none"> It is claimed to be a fool-proof system in as much as a worker can never double his earnings even if there is bad rate setting. It is admirably suitable for encouraging moderately efficient workers as it provides a better return for moderate efficiency than under the Halsey Plan The sharing principle appeals to the employer as being equitable
Disadvantages	<ul style="list-style-type: none"> The system is complicated. The incentive is weak at a high production level where the time saved is more than 50% of the time allowed The sharing principle is not generally welcomed by employees.

ABSORPTION OF WAGES

Elements of Wages

- Usually, the term '**wages**' represents **monetary payment** which an employee receives at **regular intervals** for their work
- But from cost point of view, employer will include **non-monetary benefits also** which an employee receives under employment.
- Such non-monetary benefits may include: Medical facilities, Educational and training facilities, Recreational and sports facilities, Housing and social welfare, Cost of subsidised canteen and co-operative societies etc.

Components of Salary and Wages

- Basic Wage:** is the **payment** for **work** done, measured in terms of **hours** attended or the **units** produced, as the case may be, it usually remains **unchanged** unless there is a big change in work
- Dearness Allowance:** is an allowance provided to **cover the increase in cost of living** from one period to another, it may be as a **percent** of basics or a **fixed** amount
- Overtime Allowance:** allowance paid for the **extra hours** beyond normal working hours worked
- Production Bonus:** incentive payment made to workers **for efficiency** that results in **production above the standard**.
- Non-Monetary Benefits:** Medical Facilities, Educational and training facilities, Recreational, Sports, Housing and Welfare, Cost of Canteen
- Employer's Contribution of Provident Fund:** is part of salary and CTC i.e. **Cost to Company** as it is added by employer other than main salary and deposited to Govt on employee's behalf

Absorption Rates of Employee Cost

$$\text{Wage Rate for Costing Purpose} = \frac{\text{Total employee cost including non-monetary benefits}}{\text{effective hours}}$$

$$\text{Effective Hours} = \text{Total Hours} - \text{Normal Idle Time Hours}$$

EFFICIENCY RATING PROCEDURE

Efficiency

- Efficiency is measured by **comparing** the **time taken** with the **standard time** allotted to perform the given job/task.
- If the time taken by a worker on a job equals or **less than the standard** time, then he is rated **efficient**.
- Efficiency in % = $\frac{\text{Time Allowed}}{\text{Time Taken}} \times 100$

Procedures for Efficiency Rating

- **Determining standard time/performance standards:** The standard time can be determined by using **Time & Motion** study or Work study techniques.
- **Measuring Actual Performance:** a system should be developed where **record of output** of each worker is taken along **with the time** taken by him.
- **Computation of Efficiency Rating:** The efficiency rating of each worker can be computed by using the above **Formula**.

Employee Productivity

- It is **used** for measuring the efficiency of **individual** workers.
- It is an **index of efficiency** in the utilisation of human resources, materials, capital, power and all kinds of services and facilities.
- Factors for **increasing** Employee Productivity:
 - Employing only those workers who **possess** the **right** type of **skill**.
 - **Placing** a right type of person to a **right job**.
 - **Training** young and old workers by providing them the right types of opportunities.
 - Taking appropriate measures to **avoid** the situation of **excess or shortage** of employees.
 - Carrying out work study for fixation of wages and for the simplification and **standardisation** of work.

Need for Efficiency Rating

The efficiency rating **helps** the management in preparing **employee requirement** budget or for preparing manpower requirements.

DIRECT EXPENSES

Meaning

- Expenses other than direct material cost and direct employee cost,
- which are **incurred** to manufacture a product or for provision of service and can be **directly traced** in an economically feasible manner to a cost object.

Examples

- **Royalty** paid/ payable for production or provision of service;
- **Hire charges** paid for hiring specific equipment;
- Cost for product/ service specific **design or drawing**;
- Cost of product/ service specific **software**;
- Other expenses which are directly related with the production of goods or provision of service.

Measurement of Direct Expenses

- The direct expenses are **measured** at **invoice or agreed** price net of rebate or discount but includes duties and taxes (for which input credit not available), commission and other **directly attributable** costs.
- In case of **sub-contracting**, where goods are get manufactured by job workers **independent** of the principal entity, are measured at **agreed price**. Where the **principal supplies** some materials to the job workers, the value of such materials and other incidental expenses **are added** with the job charges paid to the job workers.

Treatment of Direct Expenses

- Direct Expenses form **part of the prime cost** for the product or service to which it can be directly traceable and attributable.
- In case of **lump-sum payment** or onetime payment, the cost is **amortised** over the estimated production volume or benefit derived.
- If the expenses incurred are of **insignificant amount** i.e. not material, it can be treated as part of **overheads**.

EMPLOYEE / LABOUR TURNOVER

Meaning

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.

Costs related to Turnover

- **Preventive Costs:** Cost to prevent turnover like Medical Benefits, Wage hike etc.
- **Replacement Costs:** cost due to turnover – recruitment, training etc.

Cause and Effects of Turnover

- **Causes:**
 - **Personal:** Change, ill, family problem, discontent work env.
 - **Unavoidable:** Seasonal, input shortage, location change, disability
 - **Avoidable:** Dissatisfaction of job, hours, supervisor, training, facilities, low wages
- **Effects:**
 - Disturbance in **flow** of production
 - **Low efficiency** of new workers
 - Increased **cost of training**, cost of **recruitment**