

LABOR COSTING (I)

- Labor accounting assumes importance, as it is the second major item of cost of production
- Like material, cost of labor also should be controlled for reducing cost of production and improving the effectiveness
- The total amount of wages and salaries paid by a company to its employees is called payroll

9.1 Payroll

- ✓ A list of a company's employees and the amount of money they are to be paid is called payroll
- ✓ Payroll expense consists of:
 - Labor cost (Direct and indirect)
 - Administrative staff expenses (Fixed and variable)
 - Selling and distribution staff expenses (Fixed and variable)
 - Labor related cost (Commission, Overtime pay, bonus pay, shift allowances, and other benefits)

9.2 Employee pay

- Financial compensation paid to an employee by an employer for work done
- Amount of money paid to an employee by an employer in return for work performed
- Pay has two parts i.e. Gross pay and Net pay

9.2.1 Gross Pay or Employer's Payment

- ❖ The amount of pay to which an employee is entitled may be earned in a variety of different ways. These include:
 - a. Basic pay, such as:
 - Wages paid according to the number of hours worked
 - Wages paid according to the output of the employee
 - Salaries, for salaried staff
 - b. Allowances, such as:
 - House rent
 - Compensatory allowance
 - Medical allowance etc.
 - c. Bonuses and commission, such as:
 - Bonuses paid under bonus schemes, based on productivity, or profitability
 - Commission paid, normally based on sales
 - d. Other pay, such as:
 - Overtime pay, for extra hours worked by the employee
 - Shift pay, to compensate for unsocial hours

9.2.2 Net Pay or Take Home Pay

- Net pay is equal to Gross pay minus Total Deductions
- Deductions are two type i.e. Statutory and Non-Statutory Deductions
 - Statutory deductions are deductions from pay that are made by state or law. In the Pakistan income tax is taken away from gross pay and paid to Income Tax Department
 - Non-statutory deductions are voluntary deductions from pay that the employee chooses to make Examples of these are:
 - Contributions by the employee to a pension scheme
 - Any advance taken by employee
 - Insurance etc.

Example 1: The following figures have been extracted from a trader's records in respect of salaries for July.

Basic Pay	Rs. 16,300	Income tax	Rs. 1,600
Employees' pension contributions	700	Employer's pension contributions	700
House Rent	3,500	Medical Allowance	2,200
Insurance	400	Car Advance Deduction	1,800
Compensatory Allowance	800	Other Allowances	3,000

Requirement (A): What is the total amount the trader will have to pay?

Requirement (B): What is the net pay received by employee?

9.3 Payroll Entries

- ❖ There are three entries have been passed in this regard:
 - Payroll Preparation
 - Payroll Distribution
 - Payroll Payment

Example 2: Prepare journal entries to record payroll preparation, distribution and payment as on June 30th, 2011

Direct Labor	Rs. 15,000
Indirect Labor	10,000
Sales Salaries	7,000
Administrative Salaries	8,000
Total	Rs. 40,000

Deductions:

Income tax	Rs. 4,000
Group insurance	1,000

Solution (a) Payroll Preparation

General Journal				
Date		Account Titles and Explanation	Ref	Amount (Rs)
				Debit Credit
2011				
June	30			
		Total		Rs. 40,000 Rs. 40,000

Solution (b) Payroll Distribution

General Journal				
Date		Account Titles and Explanation	Ref	Amount (Rs)
				Debit Credit
2011				
June	30			
		Total		Rs. 40,000 Rs. 40,000

Solution (c) Payroll Payment

General Journal				
Date		Account Titles and Explanation	Ref	Amount (Rs)
				Debit Credit
2011				
June	30			
		Total		Rs. 35,000 Rs. 35,000

Further Study and Practice of Labor Costing

Video Lecture (Labor Costing)

<https://youtu.be/0CfJIPJ751E>

Workbook Solution (Labor Costing)

<https://www.accountancyknowledge.com/labor-cost/>

Practice MCQs (Labor Costing)

<https://www.accountancyknowledge.com/labor-cost-mcqs/>