

This is the second in our series of blog posts looking at **recording and evaluating costs and revenues (ECR) Unit 6**.

In the last post took a detailed look at stock in both the simulation and the exam. This post will cover **labour cost**. Labour cost is another piece of historic information a cost accountant would give the financial accountant for reporting purposes.

**Element 1:** record and analyse information relating to **direct costs and revenues**  
This tests your understanding of

1. Identifying which labour costs are direct and indirect.
2. Preparing cost accounting entries (often as journals).

How the information is usually provided

- In the simulation you will typically receive the data as original documents such as job cards and timesheets.
- In the exam the labour cost information is usually provided in a simpler format, sometimes as a completed card produced with errors requiring correction.

In the dim past, this area was tested primarily as basic arithmetic with hourly rates and piece rate calculations. The current examiner Les Nightingale has a more realistic approach.

I have based my examples on

- questions similar to those in recent exams.
- examples from older skills tests.

One key point is recognising how the business treats overtime premium payments:

Overtime premium is extra, paid over the normal rate, to staff working overtime. Someone working a basic 37 hour work is paid £8 per hour, but earns time and a half (£12 per hour) for any hours worked over the basic 37 hours. The overtime premium in this case would be the extra £4, the extra over the basic hourly rate.

I have taken the June 2009 exam labour cost task data and used this to ask two possible questions.

**Last month the company's direct employees worked the following hours in producing its cream of tomato soup range.**

Hours worked during normal time	420
Hours worked in the evenings and Saturdays	60
Hours worked on Sundays	40
Total hours worked	52

- **Direct employees in this department are paid at a basic rate of £7 per hour**
- **All work in the evenings and Saturdays is paid at time and a half**
- **All work on Sundays is paid at double time**
- **The overtime premium is included as part of direct labour cost**

**Task 1.3 (14 minutes)(the actual question)**

**a) Calculate the total cost of direct labour used to produce the cream of tomato soup range last month.**

I recommend you to learn a clear layout for this type of question. Look at the column headings

	Hours	Rate per hour	Total	This will enable you answer any question on this topic.  This is a cost accounting approach rather than a payroll approach.
Total hours worked	520	£7.00	£3,640.00	
Saturday/evening premium	60	£3.50	£210.00	
Sunday premium	40	£7.00	£280.00	
			£4,130.00	

**My alternative question**

If the original data had said:

- **The overtime premium is treated as an indirect labour cost and charged to the ingredients mixing overhead control account.**

The layout above allows you to answer the question below very easily.

Make the appropriate entries in the wages control account to show where the labour cost should be charged.

Wages Control Account			
	£		£
Wages expense	4,130	Ingredients Mixing - Work in Progress	3,640
		Ingredients Mixing - Production Overhead Control	490
	<u>4,130</u>		<u>4,130</u>

So read the question carefully, different businesses will treat overheads in different ways. Look out for:

1. **The overtime premium is included as part of direct labour cost, or**
2. **The overtime premium is treated as an indirect labour cost or charged to the overhead control account.**

Sometimes the skills test will look at labour costs in a broader production question where there are

- products that have not yet been completed (work in progress).
- finished products that have gone into the stores.
- products that have been completed, sold and dispatched to the customer.

Mattalot Manufacturing Co. Looks at such a question.

#### Mattalot Manufacturing Company (2)

Refer to the memo and the Statement of Production.

- a) Apportion the Cutting labour costs to the batches worked on during the week, taking account of the fact that batch no.364 is only 50 per cent complete as far as to Cutting labour costs. All complete batches incur the same Cutting labour cost. Labour cost is incurred at even rates throughout the Cutting process.
- b) Calculate the total direct cost of each batch worked on during the week.
- c) Complete the stock summary to indicate the direct cost of work in progress and finished goods stock at the end of the week.

#### MEMO

To: Assistant Management Accountant

From: General Manager

Date: 14 October 2009

Subject: Working Capital Tied Up in Stock

The company policy is to hold minimal finished goods stock. All finished batches should ideally be dispatched to customers straight away upon their completion.

Please will you help me to value the working capital tied up in stock?

I would like an analysis of the direct cost of each batch of stock of finished goods and work in progress at the end business on 11 October.

Many thanks

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Mattalot Manufacturing Company

Statement of Production

Week ending October 11, 2009

Batch Number	Direct Material Cost £	Cutting Labour Cost £	Assembly Labour Cost £	Packing Labour Cost £	Total Direct Cost £	Status of Batch D/F/P*
360	45		18	12		D
361	85		32	14		F
362	55		46	14		D
363	75		66	14		F
364	60		-	-		P
Total	320	540	162	54	1076	

- \*D = Dispatched to customer
- \*F = Finished goods stock
- \*P = Part finished goods

Stock summary	Direct Cost £
Part-finished goods(W.I.P)	
Finished goods	
Total	

Tips: Read the question carefully. Note the following:

- a) batch no.364 is only 50 per cent complete as far as to Cutting labour costs, and All complete batches incur the same Cutting labour cost, and

<p>Labour cost is incurred at even rates throughout the Cutting process.</p> <p>From the statement: total cutting labour cost was £540, and a total of 5 batches were started.</p>
<p>So the cutting labour cost total needs to be divided by 4.5 to find the cost per batch.</p> <p>Then charge this amount to all 4 completed batches and half to batch 364.</p>
<p>Total direct cost should be easy, and this question gives you the chance to double check your total.</p>
<p>Then the analysis gives you the opportunity to separate the WIP costs from the remainder.</p>

The third example I have makes you think about the overtime premium. As far as a member of staff is concerned (and the payroll clerk for that matter), overtime adds to gross pay. As far as a cost accountant is concerned, overtime premium is either a part of direct cost or an overhead.

At the washing machine repair company (TWMRC) there are two types of overtime premium; one where an anxious customer rings up to request out of hours work; the other is when out of hours work has to be provided, but has not been specifically requested by a customer.

### The washing machine repair company (TWMRC)

1. Nothing different in this paragraph from Mattalot

Note that the basic working week is eight hours per day from Monday to Friday inclusive. Any hours in excess of eight per day are paid at the basic hourly rate plus an overtime premium of 50 per cent of basic pay. Any hours, worked on Saturday and Sunday, are paid an overtime premium of 100 per cent of basic pay.

2. But watch this one

The costing treatment of overtime premium depends on whether the overtime worked was agreed by the customer.

If a customer requests an engineer to repair a washing machine outside the normal hours of 9.00am to 5.00pm Monday to Friday the charge is higher. The overtime premium for these hours should be treated as direct labour cost.

If the overtime premium has been incurred for other reasons, the overtime premium should be treated as indirect labour cost.

### Task

Overtime was worked on Monday, and Tuesday. Which accounts should be debited?

Monday: Miss Toone requested a repair to be carried out, time of work 6pm to 8pm. She agreed to a higher cost for out-of-hours work.

	Debit	Credit
Wages Control Account		30.00
Service Visits (direct labour)		
Service Overheads (indirect costs)		

Tuesday: Mr Monk requested a repair to be carried out. The original time was agreed as between 2 and 4pm, but the engineer was delayed, so the time of work was 6pm to 8pm. He had agreed to the normal charge for the work.

	Debit	Credit
Wages Control Account		30.00
Service Visits (direct labour)		
Service Overheads (indirect costs)		

The fourth example looks at multiple job cards and bonuses for workers who complete their tasks within the target time.

### Barnham Electrical Repairs and Aerial Servicing

All work connected with a job is treated as direct labour.

The week worked is Saturday to Friday inclusive.

18/4          24/4

The labour records relate to one engineer Warren Shaygood.

1. His normal working day is 7 hours, any work after 5 pm is entitled to time and a half. Hourly rates are £8 per normal hour and £12 for overtime. Overtime premiums are treated as indirect wage costs.
2. Saturday and Sunday work is treated exactly the same as Monday to Friday.
3. He attended a health & safety training course on 23 April and had 21<sup>st</sup> and 24<sup>th</sup> as his days off.

4. He was paid for 38 hours over the week.
5. Any time which is not related to a job (i.e. not travelling or on-site time) should be treated as indirect time.
6. A bonus is paid for time saved on a job. The rate is £6.00 per hour saved.

Cost Centres	Expenditure Codes
100 Sales Department	100 Materials
200 Servicing Department	300 Direct Wages
300 Administration	350 Indirect Wages
400 Canteen	351 Bonus Payments
900 Suspense account	370 Admin. Wages

Job Card - Labour Record			Job No: 1798		
CUSTOMER DETAILS			FAULT DETAILS		
Mrs Murray 27 Avery Crescent Chichester PO19 7PZ			Aerial damaged in light winds		
Work commenced on		22/4/09			
ACTIVITY	DATE	TIME STARTED	TIME FINISHED	TOTAL MINUTES	CONVERT TO HOURS
Travel to job	22/4/09	09.00	0.920	20	
On Site	22/4/09	09.20	12.30	190	
Total hours spent on job					
Estimated labour hours					3
Time saved (hours					

Job Card - Labour Record			Job No: 1799		
CUSTOMER DETAILS			FAULT DETAILS		
Mrs B Darby 12 Burton Crescent Fontwell PO22 5TP			Electric curtains not closing properly		
Work commenced on		22/4/09			
ACTIVITY	DATE	TIME STARTED	TIME FINISHED	TOTAL MINUTES	CONVERT TO HOURS
Travel to job	22/4/09	1.30	2.05	35	

On Site	22/4/09	2.05	8.00	355	
Total hours spent on job					
Estimated labour hours					6
Time saved (hours)					

Job Card - Labour Record			Job No: 1794		
CUSTOMER DETAILS			FAULT DETAILS		
Mr N Stiles 14 Boulder Drive Westhampnett PO20 8JJ			Damaged Satellite Dish		
Work commenced on		19/4			
ACTIVITY	DATE	TIME STARTED	TIME FINISHED	TOTAL MINUTES	CONVERT TO HOURS
Travel to job	19/4/09	09.00	0.920	20	
On Site	19/4/09	09.20	12.30	190	
	19/4/09	2.00	4.00	120	
Total hours spent on job					
Estimated labour hours					2.5
Time saved (hours)					

Job Card - Labour Record			Job No: 1795		
CUSTOMER DETAILS			FAULT DETAILS		
Mr B Moore 12 Boulder Drive Westhampnett PO20 8JJ			Damaged Satellite Dish		
Work commenced date		19/4/09			
ACTIVITY	DATE	TIME STARTED	TIME FINISHED	TOTAL MINUTES	CONVERT TO HOURS
Travel to job	19/4/09	12.30	12.45	15	
On Site	19/4/09	12.45	1.00	15	
Total hours spent on job					
Estimated labour hours					2.5
Time saved (hours)					



Job Card - Labour Record			Job No: 1796		
CUSTOMER DETAILS			FAULT DETAILS		
Mrs A Langrish 23 Australia Boulevard Aldingbourne PO21 7JW			Loud banging noise in tumble drier		
Work commenced date		20/4/09			
ACTIVITY	DATE	TIME STARTED	TIME FINISHED	TOTAL MINUTES	CONVERT TO HOURS
Travel to job	20/4/09	09.00	9.15	15	
On Site	20/4/09	9.15	11.45	150	
Total hours spent on job					
Estimated labour hours					2.5
Time saved (hours)					

Job Card - Labour Record			Job No: 1797		
CUSTOMER DETAILS			FAULT DETAILS		
Mrs K Jones 12 Mumma Drive Fontwell PO22 6SJ			Clicking noise from Satellite box		
Work commenced date		20/4/09			
ACTIVITY	DATE	TIME STARTED	TIME FINISHED	TOTAL MINUTES	CONVERT TO HOURS
Travel to job	20/4/09	11.45	12.30	45	
On Site	20/4/09	12.30	1.00	30	
	20/4/09	2.00	3.00	60	
Total hours spent on job					
Estimated labour hours					2.5
Time saved (hours)					

Analysis and coding of labour costs (18<sup>th</sup> to 24<sup>th</sup> April)

Job Number	Hours
Total direct	
Total indirect	
Total hours	

@£...../hr

@£...../hr

Charge to account number		
	Cost centre	Expenditure Code
£		
£		

Bonus payable for week

Time saved on

Job number	Hours
Total time saved	
Overtime Premium	
Overtime premium hours	

@£...../hr

@£...../hr

Charge to account number		
	Cost centre	Expenditure Code
£		
£		

#### TASK 4

Please write an internal memo to Sandy Hood, the Repairs and Servicing Manager. Identify any discrepancies you have identified within your labour cost calculations and analysis.

## **Barnham Electrical Repairs and Aerial Servicing**

### **INTERNAL MEMORANDUM**

**To:** Sandy Hood

**From:**

**Date:**

**Subject:**

Go through each job one at a time.

- Once you have completed all six job cards, start completing the analysis and coding of labour costs sheet.

4. Enter the job number and total hours worked in the first table, total the hours. These are all direct as they are "...connected with jobs.." as stated at the beginning of the data.
5. The data states (point 4) that "... he was paid for 38 hours..." and that "...time which is not related to a job should be treated as indirect...", so enter the total hours and find the total indirect by subtracting the total direct from the total hours.
6. The charges to account numbers can be found from the cost centre and expenditure codes given, and the amounts found by multiplying the hours worked by the hourly rate.
7. The bonus payable section relates to the jobs where the time spent has been less than the estimated labour hours. Only those need to be recorded. Then total the hours saved, multiply by the rate paid for time saved and code appropriately.
8. The overtime premium section relates to the time worked over the normal working week. The hours worked were included in the section where you entered the total direct hours and the total indirect hours, so you are only recording the "premium" part of the overtime pay here. The premium rate is not stated so you would need to calculate it using the two hourly rates that you are given, and then code it appropriately.
9. Task 4 is a memo. Many students resent having to "do words", but they are part of the standards. Look at the practicalities of what Warren Shaygood has been doing, try to see the general picture. Of course we don't know exactly what has happened, he is our only source of information. But we need to ask the right questions based on what he has provided. Do any of these job cards look wrong? I am not expecting to be able to state that anything has been deliberately recorded incorrectly, or that a genuine mistake has taken place, or even that a

job may well have not been quite the same as the fault details says. But I would want to question something that appears inconsistent.

The standards say:

6.1E Resolve or refer queries to the appropriate person

These four examples will hopefully help with mastering the labour cost part of the standards.