

## Lesson 4:

### Introduction to Cost Accounting & Elements of Cost: Direct Labour Cost

#### 4.1 Introduction

Overheads are known as indirect cost. In most organisations the costing system is set up to measure the costs of individual managers' areas of responsibilities, such as departments, work centres or activity centres. An indirect cost is one which cannot trace into a particular department, work centres or activity centres.

#### 4.2 Learning Outcomes

By the end of this lesson, you should be able to:

- explain labour recording, method of remuneration, time-based schemes;
- compute labour cost based on time-based schemes, premium bonus schemes labour turnover;
- define and explain overhead cost and classification of overhead cost;
- define allocation, apportionment and absorption and compute overhead cost; and
- identify and compute under/over overhead cost

#### 4.3 Required Readings

Drury, Chapter 3

#### 4.4 Points to Ponder/Takeaways

**Overhead cost**      Overheads are known as total indirect cost. It cannot be traced directly into a cost object because they are usually common to several cost objects.

#### 4.5 Learning Material

##### 1.Types of labour

##### Labour Costs

- Directly involved in production
- Easily traced to product

- Major part of prime cost
- E.g. Salaries (wages) & OT for production workers

### Indirect Labour Costs

- Indirectly involved in production
- Cannot be identified with product
- Manufacturing overhead (Bonus, allowance)
- E.g. Maintenance staff, factory supervisors & canteen staff

## 2. Two phases of recording

1. Payroll accounting, which is concerned with computation of the amount of the gross pay due to employees, inland revenue, pension funds etc.

2. Labour cost accounting, which allocates labour costs to cost objects (e.g. products/services, individual customers' orders, overhead accounts).

### 3. Source documents:

Clock cards, piecework tickets, job cards, time sheets

Accounting treatment:

Direct labour costs – directly assign to the cost object

Indirect labour costs – assign to overhead account, and then allocate to the cost object based on an arbitrary basis

## 4. Components of labour cost

### Wages and Salaries

Wages – Payment made on hourly, daily or piecework basis.

Salaries – Fixed monthly payment.

### Overtime Premium

Overtime premium - Extra compensation paid for overtime is separated from regular wages and charged to factory overhead.

### Bonuses

Bonus – Additional compensation generally given in recognition of exceptional productivity.

### Shift Premium

Shift premium - Above normal wage, paid for undesirable shifts (i.e night shifts). Charged to factory overhead.