



WEBINT Series On Cost Accounting Standards

**Presentation on
CAS 7: Employee Cost
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Employee Cost

The term "*employee costs*" refers to the expenditure incurred by an entity towards the services performed by the employees of such an entity. In normal parlance employee costs include wages/salaries, allowances and bonuses, paid by an employer in cash or in kind to employee in return for the work done.

However such costs also include employer contribution to social saving schemes, payments for days not worked and remunerations in kind such as provision of free or concessional food, drink, fuel and other amenities.

There are a number of other costs which do not appear in the payroll but are employee related cost such as: recruitment costs, training costs, relocation costs, support / social costs, and personnel administration costs.

The employee cost is also sometimes termed as "Labour cost".

Employee Cost

Types of Employee

- Daily rated worker / badli worker, piece rated worker,
- Monthly paid worker,
- Contract basis,
- Temporary or regular,
- Skilled or unskilled,
- Executive / non executive

Employee cost is a significant factor of cost of production. But, its significance is decreasing due to automation in production. However in knowledge based industry such as software industry, employee cost is the single most important factor of cost of product / service.

Employee Cost

Payments made to employees

The employees are paid remuneration as per their terms of employment. Employees may be paid on monthly, weekly or piece rate basis. In case of piece work employees' quality and quantity is ensured. Payments made to employees are classified as casual labour cost, supervisory employee cost and the like. The attendance of employees is closely monitored by various methods for example biometric / clocking system / manually.

Payments made in cash or kind to employees are categorized as:

- **Salaries / wages**
- **Allowances:** Dearness allowance, House Rent allowance, Education Allowance, transport allowance,
- **Bonus**
- **Contribution to provident and other funds**

Employee Cost

Payments made to employees

- **Employee welfare:** Facilities like subsidized canteen, cooperative stores, laundry and washing services, sports, housing schemes, transport and educational facilities.
- **Other benefits:**
 - ✓ Paid holidays.
 - ✓ Leave with pay / maternity leave.
 - ✓ Medical benefits to the employees and dependents.
 - ✓ Leave travel concession.
 - ✓ Any other free or subsidised facility.
 - ✓ **Future Benefits like Gratuity:** It is a lump sum payment made based on the total service of an employee either on retirement or death.
 - ✓ **Voluntary Retirement Scheme (VRS):** To reduce the surplus strength, Voluntary retirement scheme is introduced providing a lump sum payment for the remaining year of service on seeking voluntary retirement besides other terminal benefits.

CAS – 7 Employee Cost

Introduction

*This standard deals with the principles and methods of **determining the Employee cost**. This standard deals with the principles and methods of classification, measurement and assignment of Employee cost, for determination of the Cost of product or service, and the presentation and disclosure in cost statements.*

Objective

*The objective of this standard is to **bring uniformity and consistency** in the principles and methods of determining the Employee cost with reasonable accuracy.*

Scope

*This standard should be applied to cost statements which **require classification, measurement, assignment, presentation and disclosure of Employee cost** including those requiring attestation.*

CAS – 7 Employee Cost

Important Relevant Definitions

Employee Cost: *Employee Benefits paid or payable in all forms of consideration given for the service rendered by employees (including temporary, part time and contract employees) of an entity.*

Explanation:

1. Contract employees include employees directly engaged by the employer on contract basis but does not include employees of any contractor engaged in the organisation.
2. Compensation paid to employees for the past period on account of any dispute / court orders shall not form part of Employee Cost.
3. Short provisions of prior period made up in current period shall not form part of the employee cost in the current period.
4. Employee cost includes payment made in cash or kind.

CAS – 7 Employee Cost

Important Relevant Definitions

Direct Employee Cost: *Employee cost, which can be attributed to a Cost object in an economically feasible way.*

Direct employee cost is that portion of wages and salaries which can be identified with and charged to a cost object. It may be classified as direct when:

- There is a direct relationship to the product through a process or a costing unit;
- The cost may be measured in light of this relationship; and
- The cost is significant in amount.

The general rule is that **direct employee cost is the labour spent in the actual production of the finished product** which is economically identifiable with product costs. “Economically” means cost benefit ratio be looked into before going into a detailed exercise ascertaining direct employee cost.

CAS – 7 Employee Cost

Important Relevant Definitions

Indirect Employee Cost: *Employee cost, which can not be directly attributed to a particular cost object.*

All factory employees cost other than for direct employees are classified as indirect employee costs. The distinction between direct and indirect employee is sometime difficult to establish.

The distinction between direct and indirect employee is necessary because direct employee efficiency is measured by the number of acceptable units completed, while the efficiency of other type of employee frequently has little relationship to the number of units produced. Therefore in the measurement of efficiency of a particular worker, group of workers or a department, their employees must be divided, so far as practicable, into direct and indirect employee.

CAS – 7 Employee Cost

Important Relevant Definitions

Overtime Premium: Overtime is the time spent beyond the normal working hours which is usually paid at a higher rate than the normal time rate. The extra amount beyond the normal wages and salaries paid is called overtime premium.

Abnormal Idle time: An unusual or a typical idle time occurrence of which is irregular and unexpected or due to some abnormal situations. E.g.: Idle time due to a strike, lockout or an accident

Idle time: The difference between the time for which employees are paid /payable to employees and the employees' time booked against cost objects. The time for which the employees are paid includes holidays, paid leave and other allowable time offs such as lunch, tea breaks.

CAS – 7 Employee Cost

Principles of Measurement

*Employee Cost shall be ascertained taking into account the **gross pay including all allowances payable** along with the cost to the employer of all the benefits.*

- The gross pay and allowances payable to an employee are indicated in the **pay slip of an employee**.
- Based on Pay slips summary of gross earnings, deductions, working days and the like are prepared **department wise / cost center wise**.
- **Gross earning of an employee is the employee cost** to the entity.
- **Gross Employees costs generally exceed the cost of gross wages or salaries paid to employees**. Employers are required to match the employee's contribution to PF, FPS, ESI, Workmen Compensation, paid holidays, leave, pension gratuity and the like.

CAS – 7 Employee Cost

Principles of Measurement

- **Non financial benefits** are the benefits in the form of amenities or facilities which do not offer cash reward to the employee for any specific or measured work done.
- Such non monetary benefits make the **working conditions and terms of employment lucrative** so as to induce the employee to increase his efforts/productivity.
- The benefit goes to all the employees in the undertaking and is not limited to any individual, class, or group.
- They are non-financial only so far as the employee is concerned, but the employer has to incur expenditure to provide for the incentives. The above payments to employees are ascertainable at the end of each month.

CAS – 7 Employee Cost

Principles of Measurement

- In case of subsidized benefits, **token money recovered from the employee is credited to the relevant benefit scheme**. Net cost of benefits is allocated to the departments / cost center on the basis of gross earning / number of employee or may be treated as overhead.
- There are group benefits extended to employees such as **Group Personal Accident Insurance, Group Medical Insurance Scheme etc**. It is difficult to relate such costs to individual employees and therefore to cost centers or objects. These can only be allocated to cost centers or cost objects on the basis of no. of employees or employee cost of each cost center or cost object.
- **Employee cost does not include workers hired through contractor or agents** as they are not on the roll of the entity and payments are made to the contractor and not to such workers.

CAS – 7 Employee Cost

Principles of Measurement

*Bonus whether payable as a Statutory Minimum or on a sharing of surplus **shall be treated as part of employee cost.** Ex gratia payable in lieu of or in addition to Bonus shall also be treated as part of the employee cost.*

Remuneration packages include profit sharing or production bonus plans subject to fulfilment of certain pre-conditions. Payments under this head are:

- **Statutory minimum bonus** / sharing in surplus profit.
- **Productivity linked or other efficiency related bonus** including bonus payment based on agreement with trade unions (not linked to profits)
- **Incentives:** quality incentive, merit incentive, service loyalty incentive, and the like. An incentive is a monetary inducement for better performance in addition to regular and overtime wages. It is an extra pay for extra performance. However incentive payments made to employees form part of employee cost.

CAS – 7 Employee Cost

Principles of Measurement

Remuneration payable to Managerial Personnel including Executive Directors on the Board and other officers of a corporate body under a statute will be considered as part of the Employee Cost of the year under reference whether the whole or part of the remuneration is computed as a percentage of profits.

Explanation: Remuneration paid to non executive directors shall not form part of Employee Cost but shall form part of Administrative Overheads.

- **Remuneration to officers, managers and executive director** paid as a fixed amount or whole or part of remuneration as percentage of profits will be treated as employee cost.
- **Remuneration paid to managerial personnel** will be identified as production, administrative or selling overhead on the basis of services provided by them.
- **Salary paid to owner, and fixed salary paid to a working partner** shall be treated as cost and be identified as production, administrative or selling overhead on the basis of services provided by them.

CAS – 7 Employee Cost

Principles of Measurement

Separation costs related to voluntary retirement, retrenchment, termination etc. shall be amortized over the period benefitting from such costs.

These benefits are amortized over the period benefitting from such additional cost resulting in reduction of current employee cost.

Lump sum payment under the above scheme shall be amortized normally over 5 years and will form part of employee cost.

The accounting for the unamortised is an issue, since there is no Costing Balance Sheet available for carrying forward the amount in the future periods. Memoranda account shall be maintained for the purpose.

CAS – 7 Employee Cost

Principles of Measurement

*Employee cost shall **not include imputed costs.***

it is a cost which does not involve at any time any outright expenses or cash outlay.

As such it does not appear in the financial books. In farming operations, the wages or salaries of owner are imputed. Imputed costs are similar to opportunity costs.

Imputed cost of an employee shall not form part of the employee cost as there is no cash payment and it is being used for the purpose of decision making.

CAS – 7 Employee Cost

Principles of Measurement

*Cost of Idle time is **ascertained by the idle hours multiplied by the hourly rate** applicable to the idle employee or a group of employees.*

Idle time happens due to various causes for which an employee is not responsible but full payment may be required to be made.

Idle time may arise due to time lost between gate and place of work, break for tea, personal needs, time interval between one job and another, time for tool setting, adjustment of machine etc. **It is treated as normal idle time. Normal idle time is built in the labour hour rate and forms part of the cost object.**

There is loss of time due to breakdown of machinery, power failures, non-availability of material, lock out, atmosphere conditions, flood etc. **It is abnormal idle time lost and is not part of the cost object.**

Payment for such abnormal idle time is not included in costs and is charged to Costing Profit and Loss account.

CAS – 7 Employee Cost

Principles of Measurement

*Where Employee cost is accounted at standard cost, **variances due to normal reasons related to Employee cost shall be treated as part of Employee cost. Variances due to abnormal reasons shall be treated as part of abnormal cost.***

Standard cost serves as a basis of cost control and as a measure of productive efficiency when ultimately posed with an actual cost. It provides management with a medium by which the effectiveness of current results is measured and responsibility for deviation is placed.

Standard costs are used to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyses the causes of variances and take proper measure to control them.

Direct employee cost variance is the difference between standard direct employee cost specified for the activity achieved and the actual direct employee wages paid.

CAS – 7 Employee Cost

Principles of Measurement

*Any Subsidy, Grant, Incentive or any such payment received or receivable with respect to any Employee cost shall be **reduced for ascertainment of cost of the cost object** to which such amounts are related.*

*Any abnormal cost where it is material and quantifiable shall **not form part of the Employee cost.***

Abnormal cost arises due to major breakdown of equipment for considerable period, non-availability of raw materials, lack of business, faulty supervision, abnormal process loss, strike, or lock-outs, fire, flood, storm, or other similar causes. Payment made to employees for time lost due to fire and natural calamities are abnormal employee cost. **It not considered in the cost of production and charged to Costing profit & loss account.**

CAS – 7 Employee Cost

Principles of Measurement

*Penalties, damages paid to statutory authorities or other third parties **shall not form part of the Employee cost.***

*The cost of free housing, free conveyance and any other similar benefits provided to an employee **shall be determined at the total cost of all resources consumed** in providing such benefits.*

*Any recovery from the employee towards any benefit provided e.g. **housing shall be reduced from the employee cost.***

Any change in the cost accounting principles applied for the determination of the cost should be made only if it is required by law or for compliance with the requirements of a cost accounting standard or a change would result in a more appropriate preparation or presentation of cost statements of an enterprise.

CAS – 7 Employee Cost

Assignment of costs

*Where the Employee services **are traceable to a cost object**, such Employees' cost shall be assigned to the cost object on the basis such as time consumed or number of employees engaged etc or similar identifiable measure.*

For job costing, time records are arranged according to production, job order or standing order number. Thus Information from time tickets, time sheets and daily production records are used as a basis for distributing the payroll cost to products, processes or to indirect labour accounts.

In process industry, there is no job card system, as employees are identified with each process and their employee cost is assigned accordingly.

It is usual for employee cost, particularly direct employee cost, to be converted to hourly rates for ease of assignment to jobs or products. Such hourly rate may reflect only payroll costs The ultimate objective is to reflect the Cost to Company (CTC).

CAS – 7 Employee Cost

Assignment of costs

*While determining whether a particular Employee cost **is chargeable to a separate cost object**, the principle of materiality shall be adhered to.*

The principle of materiality shall be kept in view while assigning a particular cost to a separate cost object.

Materiality and significance of a piece of information depends on nature, size of operation and the like.

For example Employee Cost for generation of solar power is not significant in terms of product cost and forms part of overhead, but for subsidy requirement, it may be indicated separately.

CAS – 7 Employee Cost

Assignment of costs

*Where the Employee costs are **not directly traceable to the cost object**, these may be assigned on suitable basis like estimates of time based on time study.*

Some employees work in a manner that it is not possible to identify them with any cost center or department. Their employee cost is to be assigned on technical estimates, such as factor hours for machine operator attending to more than one machine/ work study and the like.

In bulk drug industry workers attend to different equipment in a sequence. Degree of attention devoted to different process equipment varies and is therefore not in constant ratio to equipment hours. For this purpose some weights are pre-determined for different equipment. Allocations of employee cost are made on the basis of equipment hours after adjustments are made with such predetermined weights.

CAS – 7 Employee Cost

Assignment of costs

The amortised separation costs related to voluntary retirement, retrenchment, and termination etc. for the period shall be treated as indirect cost and assigned to the cost objects in an appropriate manner. However unamortised amount related to discontinued operations, shall not be treated as cost.

Separation cost benefit is to accrue in future. It is therefore desirable that such payments shall be pro-rated over the years to be benefited by such payment, amortize the separation cost over a period, say five years, to cost objects on suitable basis, such as, direct employee hours or direct employee cost.

However, unamortized separation cost shall not be amortized over the remaining period, if the relevant production operation has been discontinued. For example in a textile mill Dyeing activity has been discontinued after one year of the voluntary retirement scheme. Thus portion of unamortized separation cost relating to Dye activity is to be charged to Costing Profit and Loss account and will not be amortized for the balance period.

CAS – 7 Employee Cost

Assignment of costs

Recruitment costs, training cost and other such costs shall be treated as overheads and dealt with accordingly.

For recruiting employee, various activities are to be carried out like Pre-recruitment job specification, briefing personnel department for setting up recruitment process search, Advertising, Candidates evaluation, Interviewing, including travel and substance, Placement agency cost and Induction training /orientation program etc.

Cost incurred in regard to above activities is to be treated as overhead and assigned to the cost object on appropriate basis, such as number of employee recruited department wise.

CAS – 7 Employee Cost

Assignment of costs

Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime.

Overtime premium is the time spent beyond the normal working hours which is usually paid at a higher rate than the normal time rate. The overtime premium is to be assigned in one of the following ways:

- Where the overtime working is caused by a “rush order” of the customer or other special requirement of a job, the overtime premium is assigned to the job or product.
- In all other cases, it is usual to treat the overtime premium as overheads and absorb the same as part of overheads.

CAS – 7 Employee Cost

Assignment of costs

Idle time cost shall be assigned direct to the cost object or treated as overheads depending on the economic feasibility and the specific circumstances causing such idle time.

Idle time for reasons such as lunchtime, holidays, personal needs etc. are built in the cost per hour of an employee and it is a part of the employee cost for an object. Idle time cost (other than stated above) should be recorded as separate time on time ticket and standing code numbers established for this purpose.

Idle time is to be assigned to the cost object to the extent economically feasible. In other cases it may be treated as overhead.

CAS – 7 Employee Cost

Presentation

- *Direct employee costs shall be **presented as a separate cost head** in the cost statement.*
- *Indirect employee costs shall be **presented in cost statements as a part of overheads relating to respective functions e.g. manufacturing, administration, marketing etc.***
- *The cost statement shall **furnish the resources consumed on account of Employee cost, category wise** such as wages salaries to permanent, temporary, part time and contract employees, piece rate payments, overtime payments, employee benefits (category wise) etc. wherever such items form a material part of the total employee cost.*

CAS – 7 Employee Cost

Disclosures

The cost statements shall disclose the following:

- ***Employees cost attributable to capital works or jobs in the nature of deferred revenue expenditure indicating the method followed in determining the cost of such capital work.***

Example: During the current year, modernization of assembly line was carried out departmentally amounting to Rs 50 lakhs, out of which Rs 2 lakhs is for employee cost.

- ***Separation costs payable to employees.***

Example: Under the Employee Separation Scheme of the Company, the net present value of the future liability for pension payable is amortized equally over five years. The increase in the net present value of the future liability for pension payable to employees who have opted for retirement under Employees Separation Scheme of the company is charged to the profit account. During the current year amount charged to Profit & Loss account is Rs 15 lakhs.

CAS – 7 Employee Cost

Disclosures

- ***Any abnormal cost excluded from employee cost.***

Example: Due to major breakdown in the plant, abnormal idle employee cost of Rs 4 lakhs has been excluded from the cost of production.

- ***Penalties and damages paid etc. excluded from Employee cost.***

Example: Penalty of Rs 50,000 has been levied for delayed deposit of PF contribution with the concerned authority and the same has been excluded from the employee cost.

- ***Any Subsidy, Grant, Incentive and any such payment reduced from Employee cost.***

Example: The State Government has given grant for training locally employed man power of Rs 3 lakhs. The same has been excluded from the employee cost.

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Disclosures

- ***The Employee cost paid to related parties.***

Example: A is holding company of B Company. Employees of B Company attended training program conducted by A Company. Share of training cost paid to A is Rs 1 lakh.

- ***Employee cost incurred in foreign exchange.***

Example: A sum of US\$ 500000/- has been paid as salary to staff posted in USA branch.

- ***Disclosures shall be made only where material, significant and quantifiable.***
- ***Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.***

CAS – 7 Employee Cost

Disclosures

- *Any change in the cost accounting principles and methods applied for the measurement and assignment of the Employee Cost during the period covered by the cost statement which has a material effect on the Employee Cost. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*

Thank You !!