FOREWORD

The Council of the Institute of Cost Accountants of India in its meeting held on 18th May 2012 has approved the release of the Guidance Note on Cost Accounting Standard on Employee Cost (CAS-7) as recommended by the CASB. I am pleased that the Technical Directorate is continuing the scorching pace it has set for itself and has released this Guidance Note.

Members of the Institute felt a pressing need on appropriate Guidance Note from the Institute on the Employee Cost which constitutes one of the important elements of cost of production.

I am confident that this Guidance Note would help the members and other readers to understand and implement the various principles of Cost Accounting Standards on Employee Cost.

I wish to place on record my appreciations for Shri Rakesh Singh, Vice President and Chairman, CASB and all the members of the CASB for bringing out guiding literature for the members.

(M GOPALAKRISHNAN)
President

PREFACE

The Cost Accounting Standards Board is working wholeheartedly to fulfil the need for the Guidance Notes on various Cost Accounting Standards issued by the Institute. I am pleased to present the Guidance Note on the Cost Accounting Standard on Employee Cost (CAS-7). This Guidance Note deals with Principles and Methods as provided in the Cost Accounting Standard on Employee Cost and practical aspects in connection with the determination of the employee cost of a product or service.

I am extremely grateful to Shri Murali Ganesan, Member Cost Accounting Standards Board of the Institute for his valuable efforts, despite his busy schedule in guiding the Secretariat in finalisation of this Guidance Note.

I am also thankful to all the members of the Cost Accounting Standards Board of the Institute for their valuable contribution in finalisation of the Guidance Note.

I am thankful to Shri M Gopalakrishnan, President of the Institute for his vision, guidance and support I have received in carrying out the activities as Chairman of the Cost Accounting Standards Board.

I would also like to place on record the efforts put in by the CASB Secretariat, headed by Shri JP Singh, Director (Technical) and Shri ML Mehta (Advisor), for all the initiatives and successful co-ordination in completing this document. I am confident that the Secretariat will come out with more and more Guidance Notes in the near future.

I am confident that this Guidance Note would be well received by the members.

(RAKESH SINGH)
Vice President and Chairman, CASB

Date: 25th May 2012

GUIDANCE NOTE
ON
COST ACCOUNTING STANDARD
ON EMPLOYEE COST (CAS-7)

Issued by

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

(A Statutory Body under an Act of Parliament)

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List of Contents

Annexure

Guidance Note on
Cost Accounting Standard on Employee Cost (CAS-7)

The Council of the Institute of Cost and Works Accountants of India (ICWAI) has issued the Cost Accounting Standard 7 (CAS-7) on Employee Cost which lays down a set of 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 the cost statements.

The Guidance Note deals with principles and methods as provided in the CAS-7 and practical aspects in connection with the determination of employee cost of a product or service.

In the preparation of cost statements including those requiring attestation, employee cost shall be determined as per CAS-7.The Cost Accounting Standards have been set in ***bold italic*** type and reference number of the standard has been retained.

Further, The Companies (Cost Accounting Records) Rules, 2011 provide that every company, including a foreign company defined under section 591 of the Companies Act, 1956 which is engaged in production, processing, manufacturing or mining activities have to maintain cost accounting records in accordance with the Generally Accepted Cost Accounting Principles (GACAP) and Cost Accounting Standards issued by the ICWAI, to the extent these are found to be relevant and applicable. The above Rules further provide that these will be applicable to companies wherein:

a) aggregate value of net worth as on the last date of the immediately preceding financial year exceeds five crores of rupees; or
b) the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds twenty crores of rupees; or
c) the company's equity or debt securities are listed or are in the process of listing on any stock exchange whether in India or outside India.

The Companies (Cost Audit Report) Rules, 2011 cast a duty on a Cost Auditor appointed under Section 233B of the Companies Act, 1956 for a company to certify inter alia that books and records maintained by the company are in conformity with the Cost Accounting Standards issued by the ICWAI to the extent these are found to be relevant and applicable.

Chapter 1 Introduction

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.

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".

Type of Employees:

Employees in an entity may be categorized as:

a. Daily rated worker / badli worker, piece rated worker,
b. Monthly paid worker,
c. Contract basis,
d. Temporary or regular,
e. Skilled or unskilled,
f. Executive / non executive.

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 kinds to employees are categorized as:

(i) Salaries / wages
(ii) Allowances: Dearness allowance, House Rent allowance, Education Allowance, transport allowance,

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

a. Statutory minimum bonus / sharing in surplus profit. The Payment of Bonus Act, 1965 deals with profit sharing bonus. It represents an additional payment.
b. Productivity linked or other efficiency related bonus including bonus payment based on agreement with trade unions (not linked to profits)
c. Incentives: quality incentive, merit incentive, service loyalty incentive, etc. An incentive is a monetary inducement for better performance in addition to regular and overtime wages. It is an extra pay for extra performance. Scheme of incentives varies from entity to entity. However incentive payments made to employees form part of employee cost.

(iv) Contribution to provident and other funds: Entity covered under Provident fund and Employee's State Insurance scheme has to deduct specified contribution from the employee's wages and salaries. Such deductions are to be deposited with the Government agencies accompanied by corresponding contribution from the employer. For example if total deduction from employees during a period is Rs 1.20 lakhs, the entity has to deposit Rs 2.40 lakhs (Rs 1.20 lakhs from employees and corresponding contribution from employer of Rs 1.20 lakhs) within the specified time.

(v) Instead of depositing the contribution with Provident Fund Commissioner, many large and medium enterprises operate their own Provident Funds, by establishing an independent Trust for managing the assets as per provisions of the Employees Provident Fund & Misc Provision Act 1952. It is a statutory requirement that the employees covered by such PF scheme should derive a specified return on the contribution made. If the actual yield on funds deployed happened to be lower than the notified rate, the shortfall is met by the employer. Thus an obligation is cast on employers to bear the difference, if any, between the notified rate, and the return generated by assets of such PF. Such shortfall forms part of employee cost.

(vi) Employee welfare: These include facilities like subsidized canteen, cooperative stores, laundry and washing services, sports, housing schemes, transport and educational facilities. These facilities are as good as higher wages offering incentive to the workers to stay with the entity.

(vii) Other benefits: Payment to employees for the following items also form part of the employees cost:

- Paid holidays.
- Leave with pay / maternity leave.
- Statutory provisions for insurance against accident or health scheme:
  a) ***E.S.I. (Employees State Insurance) Scheme*** is a contributory scheme for the employees in the factories or establishments to which the Act applies. The employees are insured in a manner provided by the Employees' State Insurance Act 1948. The contribution payable to the E.S.I Corporation in respect of an employee shall comprise of employer's contribution and employee's contribution at a specified rate. The rates are revised from time to time. Presently, the employees' contribution is 1.75% of the wages and that of employers' is 4.75% of the wages paid or payable in respect of the employees in every wage period. The Scheme covers employees engaged on a monthly remuneration not exceeding Rs. 6500 ***(enhanced to Rs 15000 w.e.f. 1st May 2010)*** in a factory / establishment to which the Act applies. The employees so covered are entitled to benefits such as periodical payments in case of a sickness, periodical payments to women in case of confinement or miscarriage or sickness arising out of pregnancy etc., periodical payments for suffering from disablement as a result of an employment injury and medical treatment etc. Dependants of the employees are also entitled to the benefits provided under the Act.

  b) Statutory provisions for workman's compensation:

  In case a personal injury is caused to a workman by an accident arising out of and in the course of his employment, the employer is liable to pay compensation in accordance with the provision of the Workmen's Compensation Act, 1923. The amount paid towards such compensation also form part of employee cost.

- Medical benefits to the employees and dependents.
- Free or subsidised food.
- Free or subsidised housing.
- Free or subsidised education to children.
- Free or subsidised canteen, crèches and recreational facilities.
- Free or subsidised conveyance.
- Leave travel concession.
- Any other free or subsidised facility.
- Cost of Employees' stock option: The employees in case of certain entities are given a right to acquire shares in the entity at a future date at a predetermined price. The offer may be free of cost, or at concessional rates. Such benefit is in the form of:

a) shares, share options and other equity instrument issued to employee at less than fair value at which these instruments are issued to third parties; and
b) Cash payment, the amount of which will depend on the future market price of enterprise shares.

The aggregate amount of such expenditure which would form part of the Employee cost on account of Employee stock option plan as ascertained at the year end is carried forward as Deferred Employee Compensation Benefit to be written off over the related vesting period of individual options.

- Future Benefits Employee Cost: Employer has to provide for certain future benefits payable to employees, such as Gratuity, Superannuation benefits and the like.
  - ✓ ***Gratuity:*** It is a lump sum payment made based on the total service of an employee either on retirement or death. The gratuity is paid on the basis of the employee's basic plus dearness allowance if any. As per the Payment of Gratuity Act 1972, the gratuity amount is 15 days' wages multiplied by the number of years service put in. It is calculated based on last salary drawn divided by 26 to work out per day rate. An employee should have minimum service of 5 years' service to earn gratuity. The maximum gratuity payable is 16 ½ months emoluments for the maximum of 33 years of service and for lesser service it is proportionately paid.

    For employees who do not fall under the Gratuity Act, the amount due for them is half of the average ten months' salary multiplied by the number of years of service or as per term of employment.

    To meet its liabilities towards gratuity, a company funds the money, or opens a trust. This fund is then managed either by an insurer or on actuarial basis. The gratuity liability at the end of the year is determined on the basis of actuarial valuation.

    The superannuation liability is also assessed and provided on the above basis.

- Short term compensated absence (such as paid annual leave and paid sick leave) Employee is entitled for leave as per his term of employment. A part of leave lapses during the year and other part of leave is accumulated over a period as per policy of the entity. Leave may also be encashed during the service. Employee is also entitled for leave encashment at the time of termination of employment. It is the amount payable for the employee's leave period, depending upon the leaves to his credit and his salary at the time of termination of employment.

- 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.

The various employee benefits are to be provided in the accounts as per AS-15. These benefits form part of employee cost and their treatment is required to be indicated in the Cost Accounting Records.

Classification of Employee cost:
Employee cost, on the basis of relation with a cost centre / cost object is classified direct employee cost, or indirect employee cost of product / service.

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:

1. There is a direct relationship to the product through a process or a costing unit;
2. The cost may be measured in light of this relationship; and
3. 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.

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. Early stages of technology witnessed a major role for the workmen in the manufacturing process with output being controlled mainly by the workmen's efforts. Hence elaborate systems were built to log workmen's time for an individual jobs or products and operations and employee cost was assigned on the basis of time booking and identified as direct employee cost. As technology developed, the importance of machines in production grew with decreasing nexus between workmen's efforts and production. Work men were assigned to more than one machine producing more than one product with their role being reduced to attending to controls.

However, in case where technology is at an early stage, it is still common for direct employee cost to be assigned to products and operations on the basis of time booked for the job. This is applicable for engineering shops with conventional machines such as lathes, drilling machines, milling machines etc., and simple processing shops.

In case where fully automatic machinery is used, the worker becomes in effect a machine tender. The machine alters the size or shape of the product, while the worker merely feeds the machine at intervals and makes minor adjustments. A question may arise a machine adjuster is a direct employee or an indirect employee. A distinction is to be made that if a man is tending a productive machine, his labour is as direct as the labour of an employee producing goods manually. But if the he is repair man or set-up man, he may be classified as indirect employee.

Further, in certain cases employee may be direct in nature, but for practical reasons, may not be charged directly to a given product, being prorated as direct employee cost over several products or even treated as indirect employee cost. Instances of such border line cases are spray painting, inspection and short operations e.g. buffing, polishing, etc. Spray painting can, in some instances, be easily identified with and charged to specific jobs but in many cases the spraying is done on a conveyor belt with items from various jobs being sprayed as needed. In the latter case, to charge the paint spraying employee cost directly to the separate job may entail too much clerical detail and the employee cost may be allocated to various jobs on some equitable basis.

Inspection employee may be considered direct employee or indirect employee depending upon the circumstances. It is often considered direct employee in cases where each unit must be tested or measured to ascertain that the product meets predetermined specification as in the case of manufacture of drugs where each item must be tested to guard against error. Inspection should, in other cases be considered as indirect employee if inspection is done on an intermittent or selective basis. If inspector divides his time between two or more departments or jobs, proration of his wages may be accomplished more easily by treating them as indirect employee cost than by attempting to make a direct allocation through time tickets or time cards.

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 the 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. Measurement of Employee Cost involves determining the basis of cost measurement method and establishing criteria for use of alternative cost measurement techniques.

Examples of cost measurement are:

- Use of historical cost,
- Use of actual or standard cost,
- Designation of items of cost which must be included or excluded from the Employee Cost,
- Employee Cost is measured in terms of time (man hours / man days) and rate of payment.

Measurement of Employee Cost is detailed under Chapter 3.

Assignment is tracing the employees cost to a product or service and is dealt in Chapter 4.

The principles and methods adopted for computation of employee cost in a cost statement shall be applied consistently from one period to another and for reasonable uniformity between different products / units. For example Employees working on machining operation are to be classified as Direct Employee from one period to another and those engaged in repair to be classified as indirect.

Chapter 2 *Definitions*

The following terms are used in this guidance note with the meaning specified:

Abnormal cost: ***An unusual or atypical cost whose occurrence is usually irregular and unexpected and / or due to some abnormal situation of the production or operation.***

Abnormal Idle time*: An unusual or atypical employee idle time occurrence of which is usually irregular and unexpected or due to some abnormal situations.*

Administrative overheads: ***Expenses in the nature of indirect costs, incurred for general management of an organization.***

Cost Object: ***This includes a product, service, cost centre, activity, sub-activity, project, contract, customer or distribution channel or any other unit in relation to which cost are ascertained.***

Direct Employee Cost: ***The cost of employees which can be attributed to a Cost Object in an economically feasible way.***

Distribution Overheads: ***Distribution overheads, also known as Distribution Cost, are the costs incurred in handling a product from the time it is ready for despatch until it reaches the ultimate consumer.***

Employee cost: ***The aggregate of all kinds of consideration paid, payable and provisions made for future payments for the services rendered by employees of an enterprise (including temporary, part time and contract employees). Consideration includes wages, salary, contractual payments and benefits, as applicable or any payment made on behalf of employee. This is also known as Labour Cost.***

Idle time: ***The difference between the time for which the employees are paid and the employees' time booked against the cost object.***

Imputed Costs: ***Hypothetical or notional costs, not involving cash outlay, computed for any purpose.***

Indirect Employee Cost: ***The cost which cannot be directly attributed to a particular cost object.***

Marketing overheads: ***Marketing Overheads are also known as Selling and Distribution Overheads.***

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.***

Production Overheads: ***Indirect costs involved in the production process or in rendering service.***

Selling Overheads: ***Selling Overheads, also known as Selling Costs, are the expenses related to sale of products and include all Indirect Expenses in sales management for the organization.***

Standard Cost: ***A predetermined cost of resource inputs for the cost object computed with reference to set of technical specifications and efficient operating conditions.***

Chapter 3 Principles of Measurement

5.1 ***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. The payroll department computes the gross pay, including gross amount earned and the net amount payable to employees after deductions (for PF, FPS, ESI and so on) based on the attendance details received from HRD / Time Office. Pay slip contains inter alia the personal details of an employee besides payment details. An illustration of pay slip is at ***Annexure I*.**

Based on Pay slips (which indicate department code), summary of gross earnings, deductions, working days and the like are prepared department wise / cost centre wise. Gross earning of an employee is the employee cost to the entity. An illustration of summary of gross earnings of employees cost centre wise is indicated at ***Annexure II*.**

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.

Employer's contribution to PF, FPS and ESI are identifiable with each employee. Contribution to Provident fund is to be made as per the PF Rules and the same is paid to a PF Commissioner or fund administered through a separate trust. Thus contribution to Provident Fund, Employee State Insurance Scheme and FPS are charged as incurred.

Share of employers' contribution to PF, FPS and ESI shall be identified to cost centre / department where the employee is working. In cases where it is not feasible, it shall be allocated based on employees gross earning.

To cover the cost of worker's compensation under Workmen Compensation Act for injury to employees on the job, Accident Insurance policy is taken resulting in additional employee cost. It shall be treated as Production overhead as it is not specific to any cost centre.

Non financial benefits are offered to employees in several ways.

These 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.

For example:

- Free or subsidised food.
- Free or subsidised housing.
- Free or subsidised education to children.
- Free or subsidised canteen, crèches and recreational facilities.
- Free or subsidised conveyance.
- Leave travel concession.
- Any other free or subsidised facility.
- Recreational facilities
- Protective clothing, liveries, uniforms etc.
- Tea milk etc

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. 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 centre 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 centres or objects. These can only be allocated to cost centres or cost objects on the basis of no. of employees or employee cost of each cost centre or cost object.

Cost Object or Cost Centre is the logical sub-unit for collection of cost. Cost object may be any customer, product service, contract, project, activity or other work unit for which a separate cost measurement is desired. For example, if it is desired to determine what it costs to produce a car, then the cost object is car. If it is desired to determine the operating cost of maintenance department within a plant, the cost object is maintenance department. Different costs can be assigned to the same cost object, depending on the purpose.

Employee welfare expenses similarly represent a motley of benefits including canteen facilities, recreation facilities, gifts to individual employees on birthdays / marriage, dispensary facilities etc., These are legitimately treated as part of employee cost and allocated to cost centres or cost objects on the basis of no. of employees or employee cost of each centre or cost object.

Post-employment benefit schemes can take any two forms:

a. Fixed contribution to a fund by the employer with varying benefits to employees.
b. Variable contribution to a fund by the employer to assure given benefit to the employees.

The fixed contribution plans involves a defined cost per employee and can be readily assigned to cost centres or objects. The contribution under variable contribution plans are generally determined on an actuarial valuation The treatment of such benefits in Cost Accounts will be on the same basis as in financial accounts which is governed by AS-15 in India.

The allocation of the cost of such employee benefits to cost centres / Cost objects will be on the basis of no. of employees or employee cost.

Provision for gratuity, leave encashment, superannuation, termination benefit, medical benefits and the like are provided in the accounts as per AS-15 and these will form part of employee cost. The allocation of the cost of above employee benefits to cost centre / cost object shall be on the basis of number of employees or employee cost.

Employee Rate per Hour

The measure of cost to keep an employee at work an hour or a day must include all of these elements where they exist. Hourly rates are to be calculated using the available hours as the denominator. Normal health breaks or rest allowances are excluded from available hours.

In brief Employee cost includes remuneration paid or payable and provisions made for future payments. However the following payments to employees will not form part of employee cost:

As per CAS-7.4.7, the employee cost will not include the compensation paid to employees for the past period on account of any dispute / court orders for the reason that there is no contribution by the concerned employee to the production activity of the entity during the current period. Such payments for past period are items of reconciliation between cost and financial accounts.

Similarly as per explanation 3 of CAS-7.4.7, under provisions of prior period made up in current period shall not form part of employee cost in the current period and will be an item of reconciliation between cost and financial accounts.

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.

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

a) Statutory minimum bonus / sharing in surplus profit. The Payment of Bonus Act, 1965 deals with profit sharing bonus. It represents an additional payment.
b) Productivity linked or other efficiency related bonus including bonus payment based on agreement with trade unions (not linked to profits)
c) 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. Scheme of incentives varies from entity to entity. However incentive payments made to employees form part of employee cost.

   Bonus under the Payment of Bonus Act must be distinguished from performance incentives which are generally related to output and not profits. These may take the form of incentives at

   - Individual employee level – based on his or her performance.
   - Group of employees level – based on performance of a group of employees or team
   - Unit level – where the incentives are paid on the basis of performance of the factory or other unit.

   In some cases, incentives are paid to production employees based on sales as cost of production. Such incentive payment either computed on sales value of production or payable only on sales of the product shall form part of the employee cost if such payment was originally conceived as an incentive for higher production.

Any payment of bonus either as a Statutory Minimum or on a sharing of surplus / incentive shall form part of the employee cost. The bonus paid to employees shall be identified with each cost centre / department. For determining labour hour rate, bonus shall be estimated on the basis of past results and future forecast.

5.3 ***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.***

Remuneration to officers, managers and executive director of a corporate body paid as a fixed amount or paid whole or part of the remuneration as percentage of profits will be treated as employee cost. Remuneration covers fixed salary, PF contribution, leave, superannuation and severance payment, and other benefits, besides commission, etc. Other benefits include free furnished residential accommodation or house rent allowance, leave travel concession, reimbursement of medical expenses for self and family, personal accident insurance, fully maintained company's car with driver, gardener, watchmen, electricity.

Remuneration paid to managerial personnel will be identified as production, administrative or selling overhead on the basis of services provided by them. However remuneration paid to non-executive directors will be treated as Administrative Overheads.

Salary paid to an owner in the case of sole proprietorships, and fixed salary paid to a working partner in the case of a partnership shall be treated as cost to be identified as production, administrative or selling overhead on the basis of services provided by them.

5.4 ***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.

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

In economics, 'imputed' indicates an ascribed or estimated value when there is no criteria of absolute monetary value for such purpose. In simple words, 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.

5.6 ***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, and the like is treated as normal idle time. Normal idle time is built in the labour hour rate and forms part of the cost object. It is to be measured on the basis of the hourly rates of individual employee or at an average rate for closely associated group of employees or some statistical basis such as factor hours Use of individual pay rates is the most accurate but requires more clerical effort.

In addition to above, 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. However, it shall be analysed cause wise as per Annexure III for corrective action, if any. Payment for such abnormal idle time is not included in costs and is charged to Costing Profit and Loss account.

5.7 *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 analyse the causes of variances and take proper measure to control them.

When standard costing system is in vogue, there can be employee cost variance, besides material cost and other variances relating to usage of resources during the course of production. Variance is the difference between an actual amount and a target or planned amount. Variances may be due to normal or abnormal reasons. Variances due to normal reasons shall be treated as cost while the variances due to abnormal reasons are treated outside the cost of production. Direct employee cost standard consists of two phases:

1) Fixation of employee time (i.e. quantity); and
2) Setting of the employee wage rate standards for each product manufactured.

The standard time for each operation multiplied by the standard employee wage rate gives the standard employee cost for the operation. Employee time standards may be set up in any of three ways:

a. Using past records of performance
b. Time and motion study
c. Taking trial runs.

Employee rate standard

The operations to be performed; the grades of employee required to perform the various operations and the rates of pay expected to be paid to the employee is taken into consideration for fixation of employee rate standards. In case of piece work system of payment, the setting of rate standard is simple because the piece rate fixed itself form the standard rate. In case of day work system, an hourly rate of pay is fixed for each grade of employee with reference to the standard employee rate.

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

Examples of employee cost variance are at ***Annexure IV***.

5.8 ***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.***

Subsidy, grant or incentives are provided for specific purpose. For example, generation of employment in specified areas, subsidy, grant or incentives are given by government to attract setting up units in those areas. Any subsidy, grant received / receivable relating to employee cost shall be reduced from the employee cost.

5.9 ***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. It is the cost that is not normally associated with a level of activity in existing circumstances. It is to be excluded if it is material and quantifiable. The materiality has not been defined in the standard. It will depend upon situation to situation. The rationale of exclusion is that inclusion of such items in the cost will make the cost not comparable with a normal situation. It shall not form part of cost of the production as not to distort the cost due to abnormal reasons. It is dealt with in the costing profit and loss account.

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

Penalties / damages are levied by statutory authorities or third parties for failure to comply or for late compliance with statutory / contractual requirements, such as non-payment of PF contribution in time, non-compliance with any labour legislation, and the like. Since penalties / damages are abnormal items of expense, it will not form part of the employee cost and will be an item of reconciliation with financial accounts.

5.11 ***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.***

Free housing accommodation is provided to certain staff. Accommodation may be on lease or owned by the entity total expenses incurred for maintenance, repairs , depreciation, lease rent paid and any other related cost of housing is be assessed and form part of employee cost.

The above treatment is also applicable for free conveyance provided which may be leased or owned. For leased vehicle hire charges and for owned vehicles, related expenses such as petrol / diesel, maintenance and repair, depreciation of vehicles will form part of free conveyance provided to the employees.

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

Amount recovered from employee towards housing, supply of electricity, water, or for any other subsidized benefits such as canteen facility and the like shall be adjusted against the relevant cost of the benefit. Net cost of benefits provided will form part of the employee cost.

5.13 ***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.***

Principles applied for determining the employee cost should be followed consistently. For example profit sharing bonus paid to employees was required to be separately disclosed in the cost audit Proforma, after “Total cost of Sales” under previous Cost Audit Report Rules 1996.This principle was being followed consistently but due to change in the principle with the notification of Cost Audit Report Rules, 2011 bonus is now part of the employee cost and no separate disclosure is required. Thus change in cost accounting principle / law for determining the cost can be made when required by any law as illustrated above or for compliance with cost accounting standards or it results in appropriate presentation of cost statement.

6.1 ***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.***

Documents commonly used for assignment of employee cost are the "**time card**" and the "**Employee job ticket**".

A time card (clock card) is inserted in a time clock by the employee several times each day: upon arrival, going to lunch, taking a break, and when leaving for the day. By mechanically / biometrically keeping a record of total hours worked each day by employees, this procedure provides a reliable source for computing and recording total payroll costs by employee wise and cost centre wise.

Depending upon process of production, employee job tickets are prepared daily by employees for each job worked on. Employee job tickets indicate the number of hours worked, a description of the work performed, and the employee's wage rate (inserted by the payroll department). The sum of the employee cost and hours for different jobs (as shown on employee job tickets) should be equal to the total employee cost and employee hours for the period (as shown on time cards).

Time booked as Job tickets when multiplied by employee hour rate indicate the cost against jobs or production order or standing order Number as the case may be. (Standing order number is the sub-division of overhead cost for purpose of accounting and control). Valuation of the time tickets is done on the basis of the current hourly rates when a group or a number of employees work interchangeably on similar operations. In this method, an average hourly wage rate of all such workers or of the group is computed and hours in the time tickets are valued with this rate without reference to the hourly rate of the particular workers who actually perform the work.

Another method which is applicable where a worker runs several automatic machines is known as the Factor Hours Method. Each machine is known as a factor and the hours for which is referred to as factor hours. Under this method, a standard factor hour cost worked as under:

Worker's wage rate	Rs. 300 per day
Working hours per day	8
Machine or factors handled	3
Factor hours per day (3 x8)	24
Standard cost rate per factor hour	300/24 = Rs. 12.5

In brief, for job costing, time records are arranged according to production, job order or standing order no. 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 i.e., only basic + dearness allowance + allowances or be comprehensive and include all benefits. The ultimate objective is to reflect the Cost to Company (CTC). Where the rate excludes some elements of employee cost, these will be treated as overheads and absorbed in cost.

Where direct workmen are expected to carry out maintenance on the machines attended by them, it is usual to log such time separately against maintenance work orders and treat the same as Repairs and Maintenance Cost.

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

CAS 7 provides that 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.

6.3 ***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 such a manner that it is not possible to identify them with any cost centre 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.

For example:

In bulk drug industry workers attend to different equipments 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.

Another example is of group benefits extended to employees such as Group Personal Accident Insurance, Group Medical Insurance Scheme etc. It is difficult to relate these costs to individual employees and therefore to cost centres or objects. These can only be allocated to cost centres or cost objects on the basis of no. of employees or employee cost of each cost centre or cost object.

6.4 ***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.***

Voluntary retirement, retrenchment and termination cost are to be incurred, resulting in reduction in labour force and consequential reduced current employee cost. However this 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.

6.5 ***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 such as:

(i) Pre-recruitment –
  (a) job specification; and
  (b) briefing personnel department setting up recruitment process search;
(ii) Advertising
(iii) Candidates evaluation
(iv) Interviewing, including travel and substance
(v) Placement agency cost
(vi) Induction training /orientation programme 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.

6.6 ***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.

6.7 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.

The Idle time is the difference between the time for which the employees are paid and the employees' time booked against the cost object.

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.

Chapter 5 *Presentation*

7.1 ***Direct employee costs shall be presented as a separate cost head in the cost statement.***

Direct employees are those who work on a product directly, either manually or by using machines. They are directly involved in the production of a finished product, that can be easily traced to the product Examples are assembly-line workers in an automobile factory or employee working on spindle / loom in textile industry. Direct Employee cost is to be presented as a separate item in the cost statement.

7.2 ***Indirect employee costs shall be presented in cost statements as a part of overheads relating to respective functions e.g. manufacturing, administration, marketing etc.***

Indirect employee cost is not directly traceable to a cost object / product and forms part of overheads. The word 'overheads' is used for a type of cost that cannot be directly allocated to a cost object or product, but can be assigned to cost objects.

Employees whose services are indirectly related to production include product designers, job supervisors, foreman, product inspectors, and the like. Employee cost of such employees is considered part of Production overheads. Salaries of employees working on administrative activities such as administration, personnel, accounts, and the like are classified as part of administrative overheads. Similarly, salaries of employees engaged in marketing / selling activities and distribution activities are part of Selling and Distribution Overheads.

7.3 ***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.***

Direct employee cost is to be exhibited as a separate item in the cost statement as per CAS 7.

Chapter 6 Disclosures

The following information should be disclosed in the cost statements dealing with determination of employee cost.

8.1 ***The cost statements shall disclose the following:***

1. ***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. The concept of deferred revenue expenditure will be obsolete as per new accounting standard.***
2. ***Separation costs payable to employees.***
3. ***Any abnormal cost excluded from employee cost.***
4. ***Penalties and damages paid etc excluded from Employee cost.***
5. ***Any Subsidy, Grant, Incentive and any such payment reduced from Employee cost.***
6. ***The Employee cost paid to related parties. Related Party should be defined in the guidance note for appropriate disclosure***
7. ***Employee cost incurred in foreign exchange.***

The above paragraph requires following disclosures to be made:
If an entity undertakes any capital works or job internally, the cost of such jobs is to be capitalized. It includes material consumed, employee cost and overhead. Employee cost attributable to such jobs is to be capitalized and will not form part of cost of production.

For 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 paid / payable during the period is to be disclosed indicating the basis adopted for charging off the cost. As detailed under paragraph 6.4, amortized separation cost is to be treated as indirect cost and will form part of the overhead cost. A disclosure shall be made about the amount amortised during the period and remaining unamortized amount indicating the period to be written off.

For 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.

Abnormal cost has been dealt with in paragraph. If there is abnormal cost relating to employee during period of cost statement, the same is to be disclosed.

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

Disclosure of Penalties and damages paid etc excluded from employee cost is to be disclosed in the cost statement.

For 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 is to be reduced from the employee cost.

For 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.

Disclosure is to be made for employee cost paid to related parties. The related parties have been defined under various Acts viz. Companies Act, 1956, Central Excise Act 1944, Income Tax Act 1961. If any employee cost is paid to related parties, its relationship, nature of transaction viz. amount and other terms / conditions relating to employee cost are to be disclosed. The objective of disclosure is to ascertain that the transaction is at arm's length and on purely commercial terms.

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

Employee cost incurred in foreign exchange: Any paid in foreign exchange relating to employee cost is to be disclosed in foreign currency.

For example:

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

8.2 ***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.***

The cost accounting principles and methods applied for the measurement and assignment of employee cost is to be followed consistently from one period to subsequent period and applied uniformly for different products and divisions. If there is any change in the cost accounting principles and methods during the period resulting in material effect on the cost, the same shall be disclosed indicating its impact in the cost statement.

For example:

Indirect employee cost was being assigned on the basis of direct labour hours to the products. During the year, the indirect employee cost has been identified by activity wise and assigned to the product on the basis of relevant activity drivers. Material handling employee cost has been assigned on the basis of material handled for each product.

8.3 ***Disclosures shall be made only where material, significant and quantifiable.***

Standard provides that disclosure shall be made only where it is material significant and quantifiable. The materiality and significance of a piece of information depends on nature, size and complexity of operation. An item of employee cost of a product may have significance considering the nature of the product. For example, an employee working on critical operation at special machine is to be indicated in the cost statement as per contract agreement, it is to be disclosed to ensure compliance with the terms of contract.

In the context of cost statement, Materiality is to be judged in terms of quantity and nature of employee cost and in particular context of its omission. A piece of information is material, if its non-disclosure could influence the decision of the user.

For example:

Prior period employee cost amounting to Rs 1.56 lakh has been excluded.

8.4 ***Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.***

Disclosures may be made in the body of the cost statement or as a foot note. If there are many items of disclosures, the same may be in schedule of Notes to the cost statement.

Example of Employee cost resource wise	**Rs / Lakhs**
Direct employee cost (Time basis)	125
Piece Rate Wages	12

Annexure I

Illustration of Pay Slip

Personnel	Attendance	Monthly rate	Earning	Deductions
Department Code	Total working days	Basic	Basic	Provident Fund
Employee Number	No. of days present	Dearness allowance	Dearness allowance	E.S.I.
Employee Name	Weekly off	House rent allowance	House rent allowance	L.I.C.
Father's Name	Holidays	Transport Allowance	Transport Allowance	Income tax
Grade	Casual Leave	Wash Allowance	Wash Allowance	House rent
Bank Account Number	Earned leave / PL	Medical Allowance	Medical Allowance	Provident Fund Loan
PF Number	Medical Leave	Special Site allowance	Special Site allowance	Others
FPS Number	Special leave	Education allowance	Education allowance	Total Deductions
ESI Number	Absent			
Date of birth	Late deduction	Gross earning	Gross earning	
Date of joining	Pay days			

Annexure II

XYZ COMPANY

STATEMENT SHOWING EMPLOYEE EARNINGS

PERIOD FROM 01/04/2009 TO 30/04/2009

DEPTT.	HAND	BASIC	DA	PL BASIC	PL DA	S.S. ALLOW	CONV	HRA	SPL. AL L	WASH. ALL.	OTHER	CASH CMP.	INCENTIVE	GWR	SHIFT-ALL	DUTY_AL L.	MED ALL.	SPL_PAY	SPL_HRA	R. OFF	GROSS EARNING
2101	12	63600	38600	0	0	3500	10300	9500	0	500	0	3500	7400	9300	1400	0	1550	0	0	24	149174
2111	15	66000	41000	0	0	3800	11000	10000	0	520	0	7100	7600	15000	1800	0	1400	0	0	30	165250
2125	12	64200	38000	0	0	3500	11000	9700	0	500	0	4850	7150	18200	1600	0	1700	0	0	30	160430
2155	31	160520	98250	0	0	8900	26500	24400	0	1250	0	18700	14500	30300	4000	0	4200	0	0	90	391610
2260	28	149400	88600	0	0	8050	23700	22800	0	1100	500	13500	13700	32500	3650	0	4200	0	0	60	361760
6505	20	107200	63900	0	0	5800	17900	16200	0	800	0	11200	12500	49700	2500	0	2500	0	0	50	290250
TOTAL	**118**	**610920**	**368350**	0	0	**33550**	**100400**	**92600**	0	**4670**	**500**	**58850**	**62850**	**155000**	**14950**	0	**15550**	0	0	**284**	**1518474**

GROSS EARNING OF THE EMPLOYEEs COST CENTER WISE ARE IN THE ABOVE STATEMENT.

SIMILAR STATEMENT OF DEDUCTIONS FROM EMPLOYEE COST CENTRE WISE IS ALSO PREPARED.

Annexure III

Analysis of Idle time										
		Idle time due to								
	Total	Productive		Maintenance		No material		Transport		
Department	DLH	DLH	%	DLH	%	DLH	%	DLH	%	
A	1000	800	80	150	15			50	5	
B	1900	1710	90			85	4.5	105	5.5	
C	850	765	90	45	5			40	4.7	
D	300	255	85	15	5	15	5	15	5	
DLH = Direct labour hour										
Maintenance = waiting for maintenance										
No Material = waiting for material										
Transport = Waiting for transport										

Annexure IV

Examples of employee cost variance (rate, efficiency and mix): Standard and actual employee cost for a period is as under:-

	Standard Cost			**Actual Cost**		
Item	**hours**	**Rate per hr**	**Total**	**Hours**	**Rate per hr**	**Total**
Hours produced	2000	40	80000	2800	28.00	78400
Direct employee cost Variance	(Actual hrs x actual rate) – (standard hrs x standard rate)					

Variances calculation:		
Direct Employee cost variance: (Actual hrs x actual rate) – (standard hrs x standard rate) = (2800x 28) –(2000x 40)	Rs. 1600	<u>Favourable</u>
Employee Rate Variance: Actual hours (Standard rate –Actual rate) 2800 x (40 -28)	Rs. 33600	Favourable
Employee Efficiency Variance Standard rate x(Standard hours – Actual hours) 40 x (2000 – 2800)	Rs. 32000	Adverse
Total employee Variance: (Employee Rate variance – Efficiency Variance) (Rs. 33600 Favourable – Rs. 32000 Adverse)	Rs. 1600	Favourable

Employee Mix Variance: The variance arises due to change in the composition of labour force.	
Standard Gang 2 men @ Rs. 20 per hour 5 men @ Rs. 16 per hour 1 men @ Rs. 25 per hour	**Actual Gang worked** 4 men @ Rs. 20 per hour 2 men @ Rs. 16 per hour 2 men @ Rs. 25 per hour
Standard cost per hour = (2xRs20+5xRs 16+ 1x Rs25) = Rs. 145 per hour	Actual cost per hour = (4 x Rs 20 + 2 x Rs 16 +2 x Rs 25)= Rs. 162 per hr
Hours worked 48 hrs Standard employee cost 48 X Rs 145 = Rs. 6960	Hours worked 48 hrs Actual employee cost 48 x Rs162 = Rs. 7776
Mix variance = Standard mix cost – actual mix cost Rs. 6960 – Rs. 7776 = Rs. 816 Adverse Variance	

Employee (wage) rate variance:

This is the portion of the wage variance which is due to the difference between the actual wage rate paid and the standard rate of pay specified.
Reasons for wage rate variances are:

a) Change in basic wage structure or change in piece rate

b) Engagement of workers of grades and rates of pay different from those specified due to shortage of labour of the proper category
c) Payment of guaranteed wages to works that are unable to earn their normal wages, if such guaranteed wages form part of direct labour cost.
d) Overtime and night shift work in excess of or less than the standard
e) Composition of a gang as regards the skill and rates of wages being different from that laid down in the standard.

Wage rate variance are uncontrollable except for the portion which arises due to deployment of wrong grade of employee or overtime work and such other controllable factors for which the departmental executive may be held responsible.

Employee Efficiency variance: It is the portion of the direct wages variances which is due to the difference between the standard employee hours specified and the actual employee hours expended. The employee efficiency variance is the result of taking more or less time than the standard for the performance of an operation or process

Reasons for variance are:

a) Lack of proper supervision
b) Poor working conditions
c) Delays due to waiting for materials, tools, instructions etc if not treated as idle time.
d) Defective machines, tools and other equipment
e) Work on new machines requiring less time than provided.
f) Basic inefficiency of works due to low morale, insufficient training, faulty instructions etc.
g) Use of non-standard material requiring more or less operation time.

Variances are to be analyzed. Normal variances will form part of the employee cost and abnormal variance will not form part of the employee cost.

For example: Abnormal employee cost variance may be due to slow down tactics or waiting for material or breakdown of machinery.

Annexure V

CAS – 7
COST ACCOUNTING STANDARD ON EMPLOYEE COST

The following is the COST ACCOUNTING STANDARD 7 (CAS - 7) issued by the Council of The Institute of Cost and Works Accountants of India on "EMPLOYEE COST". In this Standard, the standard portions have been set in ***bold italic*** type. This standard should be read in the context of the background material, which has been set in normal type.

1 Introduction

1.1 This standard deals with the principles and methods of determining the Employee cost.

1.2 ***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.***

2 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*.**

3 Scope

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

4 Definitions

The following terms are being used in this standard with the meaning specified.

4.1 Abnormal cost: ***An unusual or atypical cost whose occurrence is usually irregular and unexpected and/ or due to some abnormal situation of the production or operation.***[1]

4.2 Abnormal Idle time*: An unusual or atypical employee idle time occurrence of which is usually irregular and unexpected or due to some abnormal situations.*

E.g.: Idle time due to a strike, lockout or an accident

4.3 Administrative overheads: ***Expenses in the nature of indirect costs, incurred for general management of an organization***[2]***.***

4.4 Cost Object: ***This includes a product, service, cost centre, activity, sub-activity, project, contract, customer or distribution channel or any other unit in relation to which costs are finally ascertained.***[3]

4.5 Distribution Overheads: ***Distribution overheads, also known as Distribution Cost, are the costs incurred in handling a product from the time it is ready for despatch until it reaches the ultimate consumer.***[4]

The cost of any non manufacturing operations such as packing, repacking, labelling, etc. at an intermediate storage location will be part of distribution cost.

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[1] Adapted from CAS 1 paragraph 6.5.19
[2] Adapted from CAS 1 paragraph 6.3.5
[3] Adapted from CIMA Terminology
[4] Adapted from CAS 1 paragraph 6.3.9

4.6 Direct Employee Cost: ***The cost of employees which can be attributed to a Cost Object in an economically feasible way.***[5]

4.7 Employee cost: ***The aggregate of all kinds of consideration paid, payable and provisions made for future payments for the services rendered by employees of an enterprise (including temporary, part time and contract employees). Consideration includes wages, salary, contractual payments and benefits, as applicable or any payment made on behalf of employee. This is also known as Labour Cost.***[6]

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.

Employee cost includes payment made in cash or kind.

For example:

- **Employee cost**
  - Salaries, wages, allowances and bonus / incentives.
  - Contribution to provident and other funds.
  - Employee welfare
  - Other benefits
- **Employee cost – Future benefits**
  - Gratuity.
  - Leave encashment.
  - Other retirement/separation benefits.
  - VRS/ other deferred Employee cost.
  - Other future benefits

Benefits generally include

- Paid holidays.
- Leave with pay.
- Statutory provisions for insurance against accident or health scheme.
- Statutory provisions for workman's compensation.
- Medical benefits to the Employees and dependents.
- Free or subsidised food.
- Free or subsidised housing.
- Free or subsidised education to children.
- Free or subsidised canteen, crèches and recreational facilities.
- Free or subsidised conveyance.
- Leave travel concession.
- Any other free or subsidised facility.
- Cost of Employees' stock option.

4.8 Idle time: ***The difference between the time for which the employees are paid and the employees' time booked against the cost object.***

[5] Adapted from CAS 1 paragraph 6.2.4 (Direct labor cost)
[6] Adapted from CAS 1 paragraph 6.1.4

The time for which the employees are paid includes holidays, paid leave and other allowable time offs such as lunch, tea breaks.

4.9 Imputed Costs: ***Hypothetical or notional costs, not involving cash outlay, computed for any purpose.***[7]

4.10 Indirect Employee Cost: ***The cost which cannot be directly attributed to a particular cost object.***[8]

4.11 Marketing overheads: ***Marketing Overheads are also known as Selling and Distribution Overheads.***

4.12 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.***

4.13 Production Overheads: ***Indirect costs involved in the production process or in rendering service.***[9]
The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably.

4.14 Selling Overheads: ***Selling Overheads, also known as Selling Costs, are the expenses related to sale of products and include all Indirect Expenses in sales management for the organization.***[10]

4.15 Standard Cost: ***A predetermined cost of resource inputs for the cost object computed with reference to set of technical specifications and efficient operating conditions.***
Standard costs are used as scale of reference to compare the actual costs with the standard cost with a view to determine the variances, if any, and analyse the causes of variances and take proper measure to control them. Standard costs are also used for estimation.

5 Principles of Measurement

5.1 ***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.***

5.2 ***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.***

5.3 ***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.

5.4 **S*eparation costs related to voluntary retirement, retrenchment, termination etc. shall be amortised over the period benefitting from such costs.***

[7] Adapted from CAS 1 paragraph 6.5.13
[8] Adapted from CAS 1 paragraph 6.2.10
[9] Adapted from CAS 1 paragraph 6.3.3
[10] Adapted from CAS 1 paragraph 6.3.7

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

5.6 ***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.***

5.7 ***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.***

5.8 ***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.***

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

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

5.11 ***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.***

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

5.13 ***Any change in the cost accounting principles applied for the determination of the Employee 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.***

6 Assignment of costs

6.1 ***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.***

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

6.3 ***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.***

6.4 ***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 employee cost.***

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

6.6 ***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.***

6.7 ***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.***
Cost of idle time for reasons anticipated like normal lunchtime, holidays etc is normally loaded in the Employee cost while arriving at the cost per hour of an Employee/a group of Employees whose time is attributed direct to cost objects.

7 Presentation

7.1 ***Direct Employee costs shall be presented as a separate cost head in the cost statement.***

7.2 ***Indirect Employee costs shall be presented in cost statements as a part of overheads relating to respective functions e.g. manufacturing, administration, marketing etc.***

7.3 ***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.***

8 Disclosures

8.1 *The cost statements shall disclose the following:*

1. ***Employee 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.***
2. ***Separation costs payable to employees.***
3. ***Any abnormal cost excluded from Employee cost.***
4. ***Penalties and damages paid etc excluded from Employee cost.***
5. ***Any Subsidy, Grant, Incentive and any such payment reduced from Employee cost***
6. ***The Employee cost paid to related parties[11].***
7. ***Employee cost incurred in foreign exchange.***

8.2 ***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.***

8.3 ***Disclosures shall be made only where material, significant and quantifiable.***

8.4 ***Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.***

[11] Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement