Chapter 3

Accounting for Labor
Learning Objectives

LO1 Distinguish between features of hourly rate and piece-rate plans.
LO2 Specify procedures for controlling labor costs.
LO3 Account for labor costs and payroll taxes.
LO4 Prepare accruals for payroll earnings and taxes.
LO5 Account for special problems in labor costing.
Payroll Accounting System for a Manufacturer

1. Record the hours worked or quantity of output by employees in total and by job, process, or department.
2. Analyze the hours worked by employees to determine how labor time is to be charged.
3. Charge payroll time to jobs, processes, departments, and factory overhead.
4. Prepare the payroll.
Direct Labor - Review

- Represents payroll costs that are traceable to individual jobs worked on during the period.
- Direct labor costs are debited to the work in process account.
Indirect Labor - Review

- Costs are incurred for a variety of jobs that are related to the production process, but are not readily identifiable with the individual jobs worked on during the period.
- Indirect labor costs are charged to factory overhead.
Hourly Rate Plan

- The employee’s wages are calculated by multiplying the established rate per hour by the number of hours worked.
- This plan does not provide an incentive for the employee to achieve a high level of productivity.
Piece-Rate Plan

- Employee’s wages based on the employer’s quantity of production.
- Number of units produced is multiplied by a predetermined rate.
- May be referred to as incentive wage plan or piece-rate plan.
- Quality may be sacrificed in order to maximize quantity.
Modified Wage Plan

- Minimum hourly wage is set even if an established quota is not attained.
- If quota is exceeded, a bonus is added to the minimum wage level.
- On days when the quota is not met, the difference (make-up guarantee) would be charged to factory overhead.
- When production work teams are utilized, a single incentive for the group would be appropriate.
Labor Time Records

- Given the magnetic card reading technology available today, the time record typically takes the form of a computer file.
- The labor hours recorded should be reviewed by a production supervisor for accuracy.
Payroll Function

- Primary responsibility is to compute the wages and salaries earned by the employees.
- Forms should include a payroll record and employees’ earnings records.
- A summary of the payroll is sent to accounting to record the payroll in the accounting records.
- The payroll record is sent to the treasurer’s department for making payments to employees.
Payroll Records

- Forms used by companies will vary, but all forms possess some common characteristics.
- Entry to record payroll.

<table>
<thead>
<tr>
<th>Payroll</th>
<th>XX</th>
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<tbody>
<tr>
<td>FICA Tax Payable</td>
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<tr>
<td>Employees Income Tax Payable</td>
<td>XX</td>
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<tr>
<td>Health Insurance Payable</td>
<td>XX</td>
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<tr>
<td>Employee Receivable</td>
<td>XX</td>
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<tr>
<td>Wages Payable</td>
<td>XX</td>
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Employee Earnings Records

- Company maintains a record of the earnings for each employee.
- The cumulative record of earnings is needed to compute earnings subject to many types of taxes.
- Information is also used to prepare Form W-2 and Form W-3.
Payment of Net Earnings

- Accounting department sends the payroll record to the treasurer’s office.
- The treasurer’s office is responsible for making the payments to employees.

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\text{Wages Payable} & \quad \text{XX} \\
\text{Cash} & \quad \text{XX} \\
\text{Entry to pay employees.} &
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Recording Salaries and Wages

- Labor-time records are sent to the payroll department on a daily basis.
- The labor costs are charged to the appropriate jobs or departments and factory overhead.
- This analysis is recorded on a labor cost summary, in the job cost ledger, and in the factory overhead ledger.
- Earnings of salaried employees are recorded in the factory overhead ledger accounts and on the labor cost summary.
Labor Cost Summary

- Hourly workers should be recording their time on a labor time record.
- Labor costs are recorded on a labor cost summary.
- This summarizes the direct labor and indirect labor charges to a department for the period.
- Salaried employees are often not required to prepare labor time records.
Flow of Costs from Subsidiary Records to General Ledger

- Labor – Time Records
  - Job Cost Sheets (Direct Labor)
  - Factory Overhead Sheets (Indirect Labor)
  - Labor Cost Summary (Direct and Indirect Labor)
    - General Journal and General Ledger (WIP-Direct Labor FOH-Indirect Labor)
Employer’s Payroll Taxes

- Federal Insurance Contributions Act (FICA)
- Federal Unemployment Tax Act (FUTA)
- State Unemployment Tax Act (SUTA)
Payroll Accrual

- When the end of the period does not coincide with the ending date for a payroll period, an accrual for payroll earnings should be made.

Payroll XX

Wages Payable XX

Entry to record accrual of payroll.
Illustration of Accounting for Labor Costs

- **General Journal Entry to Record Payroll**
  - Payroll
    - FICA Tax Payable
    - Employees Income Tax Payable
    - Health Insurance Premiums Payable
  - Wages Payable
  - Record Payment of Net Earnings to Employees
  - Wages Payable
    - Cash

- **Distribution of Payroll**
  - Work in Process
  - Factory Overhead
  - Sales Salaries
  - Administrative Salaries
    - Payroll
  - Employer’s Payroll Taxes
    - Factory Overhead
    - Payroll Tax Expense – Sales Salaries
    - Payroll Tax Expense – Admin Salaries
      - FICA Tax Payable
      - Federal Unemployment Tax Payable
      - State Unemployment Tax Payable
Special Labor Cost Problems

- Shift Premiums
- Employee Pension Costs
- Bonuses
- Vacation and Holiday Pay
Accounting for Bonuses, Vacations, and Holiday Pay

Work in Process  XX
Factory Overhead (Bonus)  XX
Factory Overhead (Vacation)  XX
Factory Overhead (Holiday)  XX
Payroll  XX
Bonus Liability  XX
Vacation Pay Liability  XX
Holiday Pay Liability  XX

Incurred payroll and bonus, vacation, and holiday pay.