

A Case Study on Direct Labour Costs for Small and Medium-sized Industrial Enterprises in China

(Relevant to ATE Paper 3 – Cost Accounting)

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Introduction

Direct labour cost is one of the main cost elements in the total cost of production. Employees are paid either a piecework/daily wage or a monthly salary. Labour cost accounting requires a different approach from other cost elements because it relates to human resources management and government regulations.

Labour Cost Accounting System in Industrial Enterprises

In industrial enterprises, methods of remuneration are broadly grouped into two categories: remuneration on a time basis and remuneration on piece work. The former is used by factories that rely heavily on labour skills. The latter is adopted where product quality is less affected by labour skills.

Remuneration on a Time Basis

The time-rate system is suitable in several situations. The first is that the quality of work is more important than the quantity produced. The second is when the nature of the work is such that it is difficult to measure piece work, such as in the case of indirect workers like supervisors, store men, cleaners, etc. The third is when the work is not repetitive in nature as in the case of jobbing works such as engineering, repair and product design. The fourth is when the volume of production is not within the control of workers. The time basis is also suitable when the amount of output cannot be accurately measured, counted or standardised.

Job Evaluation

Job evaluation enables determination of the most appropriate and effective labour remuneration structure that can be adopted for the enterprise. Based on this structure, an appropriate basic wage rate can be obtained for each job. Job evaluation also helps in understanding and arriving at the relative worth of each job and the justification and quantum variation of the wage structure of different jobs. This analysis leads to the adoption of a differential labour remuneration structure.

Merit Rating

Merit rating is the comparative analysis and evaluation of the merit of the employees within an enterprise. The difference in the performance level, between employees, who are entrusted with similar jobs, are analysed and studied under this method.

Advantages of merit rating are numerous. Employees can be merit-rated for promotion and incremental payments. A proper wage system and incentive scheme can be developed by merit rating. An employee's suitability for a particular job can be established, thereby resulting in effective use of manpower. The right worker can be found for the right job. Merit rating develops a healthy competition amongst the workers as a result of increased production. It helps each employee to know their own level of performance. Most importantly, merit rating increases output and improves labour-management relations.

Overtime Work

Overtime work is work done outside normal working hours. Payment for the work done consists of two different elements. The first part is the normal payment on the basis of normal hourly rate and the other a premium over the normal hourly rate. The second additional payment is called the overtime premium.

For the purposes of cost accounting, overtime earnings are treated separately from workers' normal wages. The booking of the overtime amount in the cost accounts depends on the reason for the overtime being required.

Bonus Plans in Group Work

Bonuses are offered to workers as a work incentive. As work is usually done in group in industrial enterprises which adopt a division of labour, group bonus plans are employed to calculate wages and bonuses which are payable to a group of workers instead of to an individual.

The advantages of group bonus plans are the development of team spirit, better quality of work, minimum wastage,

and, most importantly, increased output. There are some disadvantages. The bonus earned by the group is shared by all, irrespective of the relative efficiency of the group workers: thus group members tend to evade responsibility. Also, it is hard to define clearly the sphere of activity of each individual group member.

Labour Turnover

Labour turnover is usual where there are drawbacks in work conditions. This may be due to insufficient job satisfaction, few opportunities for promotion and training, long working hours, insufficient recreation facilities, and inadequate welfare measures. Some of the unavoidable causes of labour turnover are retirement or death of the worker, personal betterment, illness or accident, and dismissal due to negligence or inefficiency.

Frequent changes in labour normally affect output and increase costs. The effects of high labour turnover, such as increased cost of selection and training of new workers, result in higher costs of production. The overall production goes down due to lower levels of efficiency among the new team of workers and time lost between labour turnover and finding suitable replacements.

Cost accounting for direct labour in practice can be illustrated through the following case study of industrial enterprise.

An Industrial Case in China – Easyweld Welding Equipment Company

Hong Kong-invested industrial enterprises are now mainly located in China, especially the Pearl River Delta, where around 55,200 such enterprises operate. Easyweld Welding Equipment Company is one of the Hong Kong-invested industrial enterprises and the company makes welding equipment in Pun Yu District, Guangzhou.

There are 30 factory workers, one assistant supervisor and one supervisor in the plant. Their daily work is to construct welding equipment on an individual or group basis. The workforce comprises three levels of workers, and the classification is by work experience and skills level. The remuneration structure is mainly based on time worked.

Level 1: Fresh workers: Newly recruited workers are offered a probation period of 3 months. The daily wages are RMB20, and the workers work 8 hours a day and 6 full days a week. As the quality of work is of prime

concern, the factory accounts for its labour cost on a time basis rather than on a piece-work basis.

Level 2: Workers with less than one year's experience on the post: Once workers have their employment confirmed after the 3-month probation period, they are paid monthly salaries. The factory adopts a merit rating, and the workers' salaries depend on their skill levels. Workers at a low to medium skill level are paid RMB500 to 600 a month, while workers at a high skill level are paid up to RMB 1,000 a month. In addition, a merit payment of RMB50 a month is offered to certain workers, depending on their attitude.

Level 3: Workers with more than one year's experience at the post: These workers, who include the assistant supervisor and the supervisor, are paid RMB1,000 to 1,500 a month. In addition, they are offered a group bonus. Since product quality is of prime concern in engineering production, there is no incentive scheme for pushing up production volume. Nevertheless, if there is premium production in any one month, these level 3 workers are granted a group bonus of RMB 3 to 8 per piece of welding equipment manufactured.

In order to maintain work quality, overtime work is not encouraged. Under the Chinese Government Labour Ordinance, the factory pays an overtime work premium that ranges from 25% to 50% basing on the duration of overtime work. By regulations, all factory workers are paid for time-and-a-quarter for overtime carried out between 6pm and 10 pm on weekdays. They are paid time-and-a-half for overtime carried out after 10 pm on weekdays and on Sundays. In addition, the factory flexibly offers extra payment to workers so as to ensure the fulfillment of minimum staff salary enforced by the Labour Ordinance. (A minimum monthly salary of RMB780 is set for the rural Guangzhou.)

For all levels of workers the factory pays for food and accommodation on top of labour wages or salaries. Both the food costs and accommodation costs are around RMB200 a month for each worker. The factory also pays RMB10 a month as social welfare contribution for each worker. This social welfare contribution by employers is mandatory in China. A pension fund contribution is not mandatory in China; it is established on mutually-agreed basis by both employers and employees. The factory also contributes RMB4 a month as medical insurance for each worker. In addition, the employer and workers contribute an equal payment for social insurance; the amount is around RMB80 to 90 a month from each side.

In order to encourage staff development, the factory offers a work-related education sponsorship of RMB600 to RMB1,000 to workers. Workers usually take work-related courses like electronic engineering, computer aided design, and/or software skills. In order to maintain the strength of the labour force, workers can have their course fee reimbursed only after completion of the course.

Bonus Scheme for Maintaining Labour

High labour turnover is a significant problem in Guangdong. In recent years, Easyweld has suffered a labour turnover rate of around 20% a year. Usually, this turnover happens when workers do not return to work after the Chinese New Year (CNY) holidays. To remedy this situation, the factory offers an annual bonus to its level 3 workers. Half of the annual bonus is paid before the CNY holidays, with the rest paid after the holidays. This type of arrangement provides a useful financial incentive to help the enterprise maintain its workforce.

Concluding Remarks

Labour cost accounting involves the study of the behaviour of labour, performance measurement, time and motion studies, control on attendance and government regulations. In modern industrial enterprises the worker's wage is based upon job evaluation, merit rating, incentive remuneration schemes and government ordinances. These elements are reviewed in the labour cost accounting system of our case study of a Hong Kong-invested industrial enterprise in China.

References:

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