



THE INSTITUTE OF COST AND WORKS ACCOUNTANTS OF INDIA

(Set up under an Act of Parliament)

ICWAI Bhawan, IInd Floor, 3, Institutional Area,
Lodhi Road, New Delhi-110003

Phones : 24622156-57- 58, 24618645

Fax : 43583642

Website : www.icwai.org

Tech/CASB/2011/12

Date: 13th December 2011

Shri John Joseph

Commissioner, Large Taxpayer Unit
Central Excise and Service Tax, LTU
NBCC Plaza, Pushp Vihar, Saket,
New Delhi - 110017

Dear Sir,

Subject: Costing of parts of Motor vehicles manufactured and sold to related unit.

This has reference to your letter no C.No.LTU/CEX/Adj/ITL/282/2011 dated 22.11.2011 to our Institute seeking its comments / views regarding costing of parts of motor vehicles manufactured and sold to related units by International Tractors Limited, Hoshiarpur - in particular, the compliance with cost accounting standards CAS 1 to 4. The Technical Cell of the Cost Accounting Standards Board of the ICWAI considered the above referred matter at its meeting held on 9th December 2011 and the undersigned is pleased to forward the opinion of the Technical Cell as below.

Brief Facts of the case

We note that International Tractors Limited is a manufacturer of MUV Engines and sheet metal parts of motor vehicles in addition to tractors. The sale of the sheet metal parts and MUV engines to a related unit are being assessed to excise duty on the basis of 110% of cost of production. We also note that while arriving at the cost of production, the company has considered actual material cost and allocated others costs on the basis of installed capacity. It is further noted that the Company never achieved the installed capacity during the period of 5 years ending with 2009-10.

It is also noted that while arriving at the cost of goods sold, the Department has considered the actual production of goods as the basis of allocation of costs. It is noted that there is no dispute regarding valuation of cost of material consumption, which has been done at actual material cost.

Comments

The Institute has relied upon the following cost accounting standards to arrive at the opinion for the issue under reference.

CAS-4 dealing with the determination of cost of production for captive consumption is applicable to the present case. The Standard refers to the capacity utilization in the context of absorption of overheads. The standard explicitly states that:

- *Variable overheads shall be absorbed in production cost based on actual capacity utilization.*
- *Fixed production overheads and other similar items of fixed cost such as quality control cost, R&D cost and administration overheads relating to manufacturing shall be absorbed on the basis of normal capacity or actual capacity utilization, whichever is higher.*

CAS-4 [Para 4.3] defines Normal Capacity as - "*Normal Capacity is the production achieved or achievable on an average over a period or season under normal circumstances taking into account the loss of capacity resulting from planned maintenance.*"

A constructive reading of the above would show that installed capacity cannot be considered for allocation of fixed overheads.

At the same time, actual production cannot also be considered for allocation of fixed overheads, which should be absorbed on normal capacity unless the actual production is higher than the normal capacity.

Conclusion:

- a) Valuation of cost of production for captive consumption is to be done in accordance with the procedure laid down in CAS-4.
- b) Actual Material Cost is to be considered for determination of cost of production.
- c) Variable Overheads is to be absorbed in cost of production on the basis of actual production.
- d) Fixed production overheads and other similar items of fixed costs such as quality control cost, research and development cost and administration overheads relating to manufacturing are to be absorbed in the production cost based on normal capacity or actual capacity utilization whichever is higher.

We trust our comments and views are helpful in applying the standards to the case in point. Should you require any further clarification, please feel free to write to us.

Yours faithfully,



J.P. Singh

Director (Technical) and
Secretary, Cost Accounting Standards Board of ICWAI