



(CAS-6)

**COST ACCOUNTING STANDARD ON MATERIAL COST**

The following is the COST ACCOUNTING STANDARD 6 (CAS 6) issued by the Council of The Institute of Cost and Works Accountants of India on “MATERIAL 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 principles and methods of determining the Material Cost.

Material for the purpose of this standard includes raw materials, process materials, additives, manufactured / bought out components, sub-assemblies, accessories, semi finished goods, consumable stores, spares and other indirect materials. This standard does not deal with Packing Materials as a separate standard is being issued on the subject.

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

**1.3** The Standard deals with the following issues.

- Principle of Valuation of receipt of materials.
- Principle of Valuation of issue of materials.
- Assignment of material cost to cost objects.

**2. Objective**

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

**3. Scope**

*This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of material costs 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<sup>1</sup>.*

**4.2 Administrative overheads:** *Expenses in the nature of indirect costs, incurred for general management of an organization<sup>2</sup>.*

**4.3 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 ascertained.<sup>3</sup>*

**4.4 Defectives:** *End Product and/or intermediate product units that do not meet quality standards. This may include reworks or rejects.*

**4.4.1 Reworks:** *Defectives which can be brought up to the standards by putting in additional resources.*

Rework includes repairs, reconditioning and refurbishing.

**4.4.2 Rejects:** *Defectives which cannot meet the quality standards even after putting in additional resources.*

Rejects may be disposed off as waste or sold for salvage value or recycled in the production process.

**4.5 Imputed Costs:** *Hypothetical or notional costs, not involving cash outlay, computed only for the purpose of the decision making<sup>4</sup>.*

#### 4.6 Materials:

**4.6.1 Direct Materials:** *Materials the costs of which can be attributed to a cost object in an economically feasible way<sup>5</sup>.*

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<sup>1</sup> Adapted from CAS-1 Para 6.5.19

<sup>2</sup> Adapted from CAS-1 Para 6.3.5

<sup>3</sup> Adapted from CIMA Terminology

<sup>4</sup> CAS 1- Para 6.5.13

<sup>5</sup> Adapted from CAS 1-6.2.3



**4.6.2 Indirect Materials: *Materials, the costs of which cannot be directly attributed to a particular cost object*<sup>6</sup>.**

**4.7 Material Cost: *The cost of material of any nature used for the purpose of production of a product or a service*<sup>7</sup>.**

**4.8 Production overheads: *Indirect costs involved in the production process or in rendering service*<sup>8</sup>.**

The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably.

**4.9 Scrap: *Discarded material having some value in few cases and which is usually either disposed of without further treatment (other than reclamation and handling) or reintroduced into the production process in place of raw material*<sup>9</sup>.**

**4.10 Standard Cost: *A predetermined norm applied as a scale of reference for assessing actual cost, whether these are more or less.***

The 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.<sup>10</sup> 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.

**4.11 Waste and spoilage:**

**4.11.1 Waste: *Material loss during production or storage due to various factors such as evaporation, chemical reaction, contamination, unrecoverable residue, shrinkage, etc., and discarded material which may or may not have value*<sup>11</sup>.**

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<sup>6</sup> Adapted from CAS 1– 6.2.8

<sup>7</sup> CAS-1-6.1.2

<sup>8</sup> Adapted from CAS-1 Para 6.3.3 and 6.3.4

<sup>9</sup> Adapted from Glossary of Management Accounting Terms- Page 62

<sup>10</sup> Adapted from CAS 1\_ Para 6.7.5

<sup>11</sup> Adopted from Glossary of Management Accounting Terms page 70



**4.11.2 Spoilage: Production that does not meet with dimensional or quality standards in such a way that it cannot be rectified economically and is sold for a disposal value. Net Spoilage is the difference between costs accumulated up to the point of rejection and the salvage value.**

## **5. Principles of Measurement**

### **5.1. Principle of valuation of receipt of materials:**

**5.1.1 The material receipt should be valued at purchase price including duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited by the taxing authorities) that can be quantified with reasonable accuracy at the time of acquisition.**

Examples of taxes and duties to be deducted from cost are cenvat credits, credit for countervailing customs duty, sales tax set off/ vat credits and other similar items of credit recovered/ recoverable.

**5.1.2 Finance costs incurred in connection with the acquisition of materials shall not form part of material cost.**

**5.1.3 Self manufactured materials shall be valued including direct material cost, direct employee cost, direct expenses, factory overheads, share of administrative overheads relating to production but excluding share of other administrative overheads, finance cost and marketing overheads. In case of captive consumption, the valuation shall be in accordance with Cost Accounting Standard 4.**

**5.1.4 Spares which are specific to an item of equipment shall not be taken to inventory, but shall be capitalized with the cost of the specific equipment. Cost of capital spares and/or insurance spares, whether procured with the equipment or subsequently, shall be amortised over a period, not exceeding the useful life of the equipment.**

**5.1.5 Normal loss or spoilage of material prior to reaching the factory or at places where the services are provided shall be absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal.**



**5.1.6 Losses due to shrinkage or evaporation and gain due to elongation or absorption of moisture etc., before the material is received shall be absorbed in material cost to the extent they are normal, with corresponding adjustment in the quantity.**

The adjustment for moisture will depend on whether dry weight is used for measurement.

**5.1.7 The forex component of imported material cost shall be converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise shall not form part of the material cost.**

Explanation: The date on which a transaction (whether for goods or services) is recognised in accounting in conformity with generally accepted accounting principles

**5.1.8 Any demurrage or detention charges, or penalty levied by transport or other authorities shall not form part of the cost of materials.**

**5.1.9 Subsidy/Grant/Incentive and any such payment received/receivable with respect to any material shall be reduced from cost for ascertainment of the cost of the cost object to which such amounts are related.**

## **5.2. Principle of valuation of issue of material**

**5.2.1 Issues shall be valued using appropriate assumptions on cost flow.**

E.g. First In First Out, Last In First Out, Weighted Average Rate.

The method of valuation shall be followed on a consistent basis.

**5.2.2 Where materials are accounted at standard cost, the price variances related to materials shall be treated as part of material cost.**

**5.2.3 Any abnormal cost shall be excluded from the material cost.**

**5.2.4 Wherever, material costs include transportation costs, determination of costs of transportation shall be governed by CAS 5 – Cost Accounting Standard on Determination of Average (Equalized) Cost of Transportation.**

**5.2.5 Material cost may include imputed costs not considered in financial accounts.** Such costs which are not recognized in financial accounts may be determined by imputing a cost to the usage or by measuring the benefit from an alternate use of the resource.



**5.3 Self manufactured components and sub-assemblies shall be valued including direct material cost, direct employee cost, direct expenses, factory overheads, share of administrative overheads relating to production but excluding share of other administrative overheads, finance cost and marketing overheads. In case of captive consumption, the valuation shall be in accordance with Cost Accounting Standard 4.**

**5.4 The material cost of normal scrap/ defectives which are rejects shall be included in the material cost of goods manufactured. The material cost of actual scrap / defectives, not exceeding the normal shall be adjusted in the material cost of good production. Material Cost of abnormal scrap /defectives should not be included in material cost but treated as loss after giving credit to the realisable value of such scrap / defectives.**

## **6. Assignment of costs**

The basis of assignment of costs to the cost of product or service is dealt within this section.

### **6.1 Assignment of costs – Materials**

**6.1.1 Assignment of material costs to cost objects: Material costs shall be directly traced to a Cost object to the extent it is economically feasible and /or shall be assigned to the cost object on the basis of material quantity consumed or similar identifiable measure and valued as per the principles laid under Paragraph 5.**

**6.1.2 Where the material costs are not directly traceable to the cost object, these may be assigned on a suitable basis like technical estimates.**

### **6.2 Assignment of costs – Direct Expenses**

**6.2.1 Where a material is processed or part manufactured by a third party according to specifications provided by the buyer, the processing/ manufacturing charges payable to the third party shall be treated as part of the material cost.**

**6.2.2 Wherever part of the manufacturing operations / activity is subcontracted, the subcontract charges related to materials shall be treated as direct expenses and assigned directly to the cost object.**

### **6.3 Assignment of costs– Indirect materials**



**6.3.1 The cost of indirect materials shall be assigned to the various Cost objects based on a suitable basis such as actual usage or technical norms or a similar identifiable measure.**

**6.3.2 The cost of materials like catalysts, dies, tools, moulds, patterns etc, which are relatable to production over a period of time shall be amortized over the production units benefited by such cost.**

**6.3.3 The cost of indirect material with life exceeding one year shall be included in cost over the useful life of the material.**

## **7. Presentation**

Cost Statements governed by this standard, shall present material costs as detailed below:

**7.1 Direct Materials shall be classified in the cost statement under suitable heads.**

E.g.

- Raw materials,
- Components,
- Semi finished goods and
- Sub-assemblies

**7.2 Direct Materials shall be classified as Purchased - indigenous, imported and self manufactured.**

**7.3 Indirect Materials shall be classified in the cost statement under suitable heads.**

Indirect materials may be grouped under major heads like tools, stores and spares, machinery spares, jigs and fixtures, consumable stores, etc., if they are significant.

## **8. Disclosures**

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

**8.1 Quantity and rates of major items of materials shall be disclosed. Major items are defined as those who form 5% of cost of materials.**



**8.2 The basis of valuation of materials shall be disclosed.**

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

**8.4 Any abnormal cost excluded from the material cost shall be disclosed.**

**8.5 Any demurrage or detention charges, penalty levied by transport or other authorities excluded from the material cost shall be disclosed.**

**8.6 Any Subsidy/Grant/Incentive or any such payment reduced from material cost shall be disclosed.**

**8.7 Cost of Materials procured from related parties<sup>12</sup> shall be disclosed**

**8.8 Any cost imputed in arriving at the material cost shall be disclosed.**

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

**8.10 Disclosures may be made in the body of the Cost statement or as a footnote or as a separate schedule.**

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<sup>12</sup> Related party as per the applicable legal requirements relating to the cost statement as on the date of statements