



**EXPOSURE DRAFT**  
**CAS 3 (R – 1)**  
**COST ACCOUNTING STANDARD ON “OVERHEADS”**

The following is the revised COST ACCOUNTING STANDARD 3 (CAS 3) issued by the Council of The Institute of Cost and Works Accountants of India on “Overheads”. In this Standard, the standard portions have been set in ***bold italic*** type. This standard shall 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 Overheads.***

***1.2 This standard deals with the principles and methods of classification, measurement and assignment of Overheads, for determination of the cost of product or service, and for 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 Overheads with reasonable accuracy.***

**3. Scope**

***This standard shall be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of Overheads 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 Absorption of overheads: Absorption of overheads is charging of overheads from cost centers to products or services by means of absorption rates for each cost center.***

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



**4.3 Administrative Overheads: *Cost of all activities relating to general management and administration of an organisation.***

Administrative overheads shall exclude production overheads, marketing overheads and finance cost. Production overheads includes administration cost relating to production, factory, works or manufacturing.<sup>2</sup>

**4.4 Cost Centre: *It is an organisational unit, in relation to which costs are accumulated and used for the purpose of cost control.***

A cost centre includes a process, function, activity, location, item of equipment, group of persons or any other unit in relation to which cost are accumulated.

**4.5 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.***<sup>3</sup>

**4.6 Distribution Overheads: *Distribution overheads, also known as Distribution Cost, are the cost incurred in handling a product from the time it is ready for dispatch until it reaches the ultimate consumer.***<sup>4</sup>

For example:

- Secondary packing
- Transportation cost
- Warehousing cost
- Cost of delivering the products to customers etc.
- Clearing and forwarding charges
- Cost of mending or replacing packing materials at distribution point.

**4.7 Imputed Cost: *Hypothetical or notional cost, not involving cash outlay, computed for any purpose.***<sup>5</sup>

**4.8 Indirect Employee Cost: *The employee cost, which can not be directly attributed to a particular cost object.***<sup>6</sup>

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<sup>2</sup> From CAS 11 paragraph 4.3

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

<sup>4</sup> From CAS 9 paragraph 4.7

<sup>5</sup> Adapted from CAS 1 paragraph 6.5.13

<sup>6</sup> Adapted from CAS 1 paragraph 6.2.10



**4.9 Indirect Expenses:** *Expenses, which cannot be directly attributed to a particular cost object.<sup>7</sup>*

**4.10 Indirect Material Cost:** *Materials, the cost of which cannot be directly attributed to a particular cost object.<sup>8</sup>*

**4.11 Normal capacity:** *Normal Capacity is the production achieved or achievable on an average over a number of periods or seasons under normal circumstances taking into account the loss of capacity resulting from planned maintenance.<sup>9</sup>*

**4.12 Overheads:** *Overheads comprise indirect materials, indirect employee cost and indirect expenses which are not directly identifiable or allocable to a cost object in an economically feasible manner.*

Overheads are normally classified on the basis of functions to which the overheads are related. For example:

- Production Overheads
- Administrative Overheads
- Marketing Overheads

The following items, among others shall not form part of overheads

- Direct Taxes levied by the Central Government, State Government or Local Authorities that are in the nature of tax on profits such as Income Tax, Minimum Alternate Tax and other direct taxes such as Wealth Tax.
- Loss or gain on sale of assets.
- Finance cost.
- Foreign Exchange gains or losses.
- Gain or Loss on inventory valuation.
- Bad Debts
- Donations and gifts including Political donations

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<sup>7</sup> Adapted from CAS 1 paragraph 6.2.12

<sup>8</sup> Adapted from CAS 1 paragraph 6.2.8

<sup>9</sup> Adapted from CAS 2 paragraph 4.4



**4.13 Production overheads: *Indirect cost involved in the production process or in rendering service.*<sup>10</sup>**

The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably. Production overheads shall include administration cost relating to production, factory, works or manufacturing.

**4.14 Marketing Overheads: *Marketing Overheads comprises selling overheads and distribution overheads.*<sup>11</sup>**

**4.15 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.*<sup>12</sup>**

**4.16 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 cost 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.<sup>13</sup>

**5. Principles of Measurement:**

**5.1 *Overheads representing procurement of resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discounts), taxes and duties refundable or to be credited.***

**5.2 *Overheads other than those referred to in paragraph 5.2 shall be determined on the basis of amount incurred in connection therewith.***

For example machinery spare fabricated internally or a repair job carried out internally will include cost incurred on material, employees and expenses.

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<sup>10</sup> From CAS 9 paragraph 4.13

<sup>11</sup> From CAS 9 paragraph 4.10

<sup>12</sup> From CAS 9 paragraph 4.14

<sup>13</sup> From CAS 7 paragraph 4.15



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

**5.4 Finance costs directly incurred in connection with self generated or procured resources shall not form part of overheads.**

**5.5 Overheads shall not include imputed cost.**

**5.6 Price variances related to overheads, where standard costs are in use, shall be treated as part of overheads. The portion of usage variances attributable to normal reasons shall be treated as part of overheads. Usage variances attributable to abnormal reasons shall be excluded from overheads.**

**5.7 Any subsidy / Grant / Incentive or amount of similar nature received / receivable with respect to overheads shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.**

**5.8 Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the overheads.**

**5.9 Credits/recoveries relating to the overheads, material and quantifiable, shall be deducted from the total overhead to arrive at the net overheads.**

**5.10 Any change in the cost accounting principles applied for the measurement of the overheads shall 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 entity.**

## **6. Assignment**

**6.1 While assigning overheads, traceability to a cost object in an economically feasible manner shall be the guiding principle. The cost which can be traced directly to a cost object shall be directly assigned.**



**6.2 Assignment of overheads to the cost objects shall be based on either of the following two principles;**

- i) Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost.**
- ii) Benefits received – overheads are to be apportioned to the various cost objects in proportion to the benefits received by them.**

In case of facilities created on a standby or ready to serve basis, the cost shall be assigned on the basis of expected benefits instead of actual.

### **6.3. Primary and Secondary assignment of Overheads**

***In a production environment, there are production cost centres and service cost centres which provide services to the production cost centres and other service cost centres. The first step to be followed is to assign the production overheads to the production and service cost centres on an appropriate basis. The second step is to assign the cost of service cost centres to production cost centres on an appropriate basis. The first step is termed as primary assignment and the second step is termed as secondary assignment of overheads.***

#### **6.3.1 Primary assignment of overheads**

***The basis for primary assignment of overheads is to be selected following the two principles as given in paragraph 6.2.***

#### **6.3.2 Secondary assignment of Overheads**

***Secondary assignment of overheads may be done by following either Reciprocal basis or Non-Reciprocal Basis. While reciprocal basis considers the exchange of service among the service departments, non-reciprocal basis considers only one directional service flow from a service cost centre to other service cost centres and production cost centres.***

**6.4 The overheads assigned to the production cost centres shall be charged to products/ services through an overhead absorption rate for each cost centre.**

Common bases for assignment of Production overheads to Cost Objects are:

<b>Bases of denominator</b>	<b>Applicability</b>
<b>Unit of Production</b>	<b>When single product is produced or various products are similar in</b>



	<i>specifications.</i>
<i>Material Cost</i>	<i>Where the overheads are mostly related to material</i>
<i>Direct employee cost</i>	<i>When conversion process is labour intensive and wage rates are substantially uniform</i>
<i>Direct employee hour</i>	<i>When conversion process is labour intensive</i>
<i>Machine Hour or Vessel Occupancy or Reaction Hour or Crushing Hour etc</i>	<i>When production mainly depends on performance of the machine, vessel or other facility.</i>

*A preferred approach for assignment of overheads to cost objects is to use multiple drivers instead of a single driver such as machine hour, where feasible.*

#### **6.5 Alternate approach to assignment of overheads**

*A preferred approach to assignment of overheads is the assigning of cost of resources to activities and assigning the cost of activities to Cost Objects through use of cost drivers, wherever feasible.*

### **7. Presentation**

**7.1 Overheads shall be presented as separate cost heads under various broad functions like production, general administration and marketing in the cost statement.**

**7.2 Element wise and behavior wise details of the overheads shall be presented, if material.**

### **8. Disclosures**

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

- 1. The basis of distribution of overheads to the cost objects.**
- 2. Overheads incurred in foreign exchange.**
- 3. Overheads relating to resources received from or supplied to related parties<sup>14</sup>.**
- 4. Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced from overheads.**
- 5. Credits / recoveries relating to the overheads.**
- 6. Any abnormal portion of the overheads.**
- 7. Penalties and damages excluded from the overheads.**

<sup>14</sup> Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement



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

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

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