

Compendium of **COST ACCOUNTING STANDARDS** *Including* **GUIDANCE NOTES**



Issued by

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

(Statutory body under an Act of Parliament)

12, Sudder Street, Kolkata - 700 016

Delhi Office

CMA Bhawan,

3, Institutional Area, Lodi Road, New Delhi-110003

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CAS-8	12th September 2009	1st April 2010
CAS-9	14th December 2009	1st April 2010
CAS-10	14th December 2009	1st April 2010
CAS-11	27th March 2010	1st April 2010
CAS-12	27th March 2010	1st April 2010
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Part	Chapter	Page
A.	Generally Accepted Cost Accounting Principles (GACAP)	9 - 79
B.	Cost Accounting Standards (1 to 17) (Including Guidance Note)	81 - 409
	i) Guidance Note on Cost of production for Captive Consumption (CAS - 4)	
	ii) Guidance Note on Material Cost (CAS-6)	
	iii) Guidance Note on Employee Cost (CAS-7)	
	iv) Guidance Note on Cost of Utilities (CAS-8)	
	v) Guidance Note on Packing Material (CAS-9)	
	vi) Guidance Note on Direct Expenses (CAS-10)	
	vii) Guidance Note on Administrative Overheads (CAS-11)	

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FOREWORD



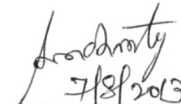
The Government of India through the Ministry of Corporate Affairs has progressively attempted to strengthen the Cost Management System of the companies through issuance of various notifications and circulars mandating a set of prescribed procedures and structure of Cost Accounting information to be maintained by the Companies.

The mandate casts enhanced professional responsibility on the Practicing CMAs to ensure that the industry imbibes cost accounting principles which form the basis of a comprehensive and effective cost accounting system.

I am glad that the Cost Accounting Standards Board (CASB) of the Institute is actively involved in the continuous process of Issuing new Cost Accounting Standards and Guidance Notes and reviewing/ revising the existing standards on need basis so to make them relevant to the current needs of the industry and professionals.

I congratulate the Chairman and members of the Cost Accounting Standards Board for their commendable efforts in bringing out a Compendium of Cost Accounting Standards including Guidance Notes.

I am sure that the users of this publication will find it very user friendly.


(CMA S.C. MOHANTY)



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PREFACE



I am pleased to present updated Compendium of Cost Accounting Standards 1 - 17 including Guidance Notes issued by the Institute of Cost Accountants of India.

The Corporate world is getting highly volatile and competitive. There is also a growing need and demand from the stakeholders for appropriate and standardized system and procedure for cost accumulation, assignment, presentation and disclosure of cost information so as to form the basis of management decision making and enterprise performance management. This compilation would provide the necessary guidance and mandatory structure to the Cost information management system required to be implemented by the organizations.

I would like to express my sincere thanks to Shri S A Muraliprasad, Practicing Cost Accountant and Shri M.L. Mehta - Advisor and other members of CASB for their efforts and valuable contribution in developing and presenting this document.

I am thankful to Shri. S.C. Mohanty, President of the Institute for his able guidance and committed professional support which facilitated the development of this document.

I would also like to place on record the initiatives taken and efforts put in by the CASB Secretariat, headed by Dr. S.K.Gupta, Director(Technical) which has made the compilation and issuance of this document possible.

I earnestly request all the professional members, academicians, Industry Associations and representatives of the industry to share their professional feedback with the Technical Directorate of the Institute for continuous updation and improvement of this document.

(CMA RAKESH SINGH)

Chairman, CASB



PART - A

List of contents

Serial	Chapter	Page
1	Introduction	9
2	Objectives	12
3	Scope	13
4	Nature of Content and Format	14
5	Conceptual Frame Work	15
6	Definitions	17
7	Principles Application to Elements of Cost	27
8	Presentation and Disclosure	51
9	Conclusion	52
10	Applicability of Cost Accounting Practices	79

Serial	Appendix	Page
1	Appendix I: Application Guidance	53



The compilation of Generally Accepted Cost Accounting Principles (GACAP) by the Institute of Cost and Works Accountants of India is a unique effort to record principles and practices in the discipline of Cost Accountancy in India, which takes into consideration the global practices as well. There have been compilations of financial accounting principles such as Paul Grady's work. ("Inventory of generally accepted accounting principles", American Institute of Certified Public Accountants, New York, 1961). While cost data is being used by various stakeholders, the focus has been more on management use. The absence of institutionalization of external cost reporting might explain this lacuna in theory. The Cost Accounting Standards issued by the Cost Accounting Standards Board in the United States is the nearest to such compilation though this is in the context of Defence Contract Costing.

The formalization of Cost Accounting Principles in use in India started acquiring a more cohesive form in the regime of administered prices ushered in the 1950 through the work of Tariff Commission mandated to fix tariffs and prices in a variety of industries. The movement acquired further fillip through the work of other statutory price-fixing authorities including the Bureau of Industrial Costs and Prices, Cost Accounts Branch of Ministry of Finance. Since the price enquiries by these bodies covered a wide range of industries, industry specific practices started unifying into a common body of cost accounting principles.

The introduction of the industry-wise Cost Accounting Record Rules further strengthened the evolution of a uniform body of cost accounting principles. Even though intended to prescribe the Cost Accounting records to be maintained by various industries, the Rules carried nuggets of Cost Accounting principles in the body of the Rules and in footnotes to format of prescribed cost statements. When some of these got repeated in the Rules prescribed for different industries, it helped towards the evolution of a generally accepted set of cost accounting principles. Thus the Rules contained directions on valuation of purchased materials (all direct costs up to the works), the treatment of major repairs (to be prorated over the period of benefit derived by such repairs), the costing of transfers of raw materials from own farms (sugar cane at government controlled price) and the like. It, however, cannot be denied that the Rules framed from time to time did have certain contradictions – for example, the valuation of sugarcane from own farm to be valued at market price and valuation of wood from own forest to be valued at cost – but the Cost Accounting Record Rules did play a major role in unifying cost accounting principles as applied to various industries.

Similarly the regulatory agencies in charge of individual industries, particularly Fertilizer Industry Co-ordination Committee, Drug Price Control Authority, Central Electricity Regulatory Commission and Telecom Regulatory Authority of India, all played a role in evolving a more consistent set of cost accounting principles.



Generally Accepted Cost Accounting Principles (GACAP)

The Cost Audit Report Rules as amended from time to time did not lay down any cost accounting principles as such but by requiring disclosure of principles and methods used, it focused attention on them. The amendment of the Rules in 2001 prescribing a single Proforma for cost reporting for all industries was a landmark event. It ushered in “General Purpose Cost Statement”, which is unique in the global practice of cost accounting.

The requirement for determination of cost of production of manufactured goods used for captive consumption further focussed attention on the subject of GACAP. According to the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, the assessable value of goods used for captive consumption is 110% of cost of production of such goods and as may be prescribed by the Government from time to time. The cost accounting principles for determination of cost of production were also well established. Their codification and standardization in a single document viz. Cost Accounting Standard 4 (CAS 4) issued on January 3, 2003 became a landmark event. The standard contains a format for reporting the cost of production of products manufactured for captive consumption. The Certificate for the cost statement carried a reference to the basis being “Generally Accepted Cost Accounting Principles and Practices”. Thus was born the phrase forming the title of this document.

The Expert Group constituted by the Ministry of Corporate Affairs under the Chairmanship of **Mr. B.B. Goyal, Advisor (Cost), Ministry of Corporate Affairs, Government of India** acknowledged the existence of an un-codified set of generally accepted cost accounting principles in use in Indian industries and by the practicing cost accountants for attestation of Cost Statements. The Expert Group suggested that the principles be codified to provide a formal basis for the practice of Cost Accounting. The Expert Group also recommended review of alternate treatment of items in cost accounting thus eliminating needless diversities in practice leading to the development of cost accounting standards.

The Ministry of Corporate Affairs decided to implement the recommendations of the Expert Group and notified the Companies (Cost Accounting Records) Rules, 2011 on June 3, 2011. These Rules introduced a common set of record rules for industries other than regulated industries specified in the Rules, in place of industry specific rules in vogue earlier. The Rules require every company to which the rules apply, including all units and branches thereof, to keep cost records in respect of each of its products and activities on regular basis. The cost records are to be maintained in accordance with the ***generally accepted cost accounting principles and cost accounting standards*** issued by the Institute of Cost and Works Accountants of India (ICWAI) to the extent these are found to be relevant and applicable. The variations, if any, are to be clearly indicated and explained.



Generally Accepted Cost Accounting Principles (GACAP)

The present effort of codifying the GACAP and presenting them in a single volume is the culmination of all the above developments in the practice of cost accounting in India.

Whereas Cost Accounting Standard 4 (CAS 4) issued in 2003 focused attention on GACAP, the Companies (Cost Accounting Records) Rules, 2011 which require maintenance of cost records according to GACAP and Cost Accounting Standards gave the mandate for a compilation of GACAP. Moreover, the supersession of the erstwhile industry-wise detailed Rules providing guidance on cost accounting principles and practices to be followed by the companies further necessitated the issuance of this document.



The objectives of this document are:

1. to codify the GACAP as applied in the Indian industry;
2. to narrow down diversities in cost accounting practices facilitating the process of development of cost accounting standards;
3. to provide a reference source to industry and practitioners in preparation and attestation of Cost Statements, where specific cost accounting standards are yet to be issued;
4. to provide a reference source to all the stakeholders in the understanding and interpreting the cost statement; and,
5. to provide a base for monitoring the evolution of new concepts and practices in cost accounting and to codify them as and when they become generally accepted.



The scope is to codify the cost accounting principles to be followed by business and other entities in India in preparing and presenting cost information – more particularly the General Purpose Cost Statements covered by Cost Audit. This document also encompasses the generally accepted cost accounting practices presently being followed by such entities.

It draws on the Cost Accounting Record Rules which inter alia also lay down some principles, the Guidance Notes issued by the ICWAI, the Cost Accounting Standards 1-5 issued by ICWAI during 2001-2005 which have been applied in practice for some years now, Cost Accounting Standards 6-15 which have been on the Standards book for a period ranging up to three years and which have been mandated for application for more than a year now and the observed practices of Indian Corporate in preparing Cost Statements for audit purposes and by business entities and others.



1. This document titled Generally Accepted Cost Accounting Principles (GACAP) contains a summary of the Cost accounting principles currently followed by business entities in India in preparing and presenting cost information in the context of general purpose cost statements for statutory reporting and covered by Cost Audit.
2. It explicitly incorporates the principles already contained in the Cost Accounting Standards 1-15 issued by the Cost Accounting Standards Board (CASB) in India without necessarily repeating them.
3. In areas not covered by the standards, it reflects the cost accounting principles found in the Cost Accounting Record Rules (CARR) prescribed for the 44 industries in the past.
4. Where somewhat conflicting principles have been laid down by the CARR in different industries, attempt has been made to harmonize the principles so as to evolve a generally acceptable framework. Where use of alternate principles are sanctioned by the Rules or where alternate principles are applied in practice in the absence of explicit guidance in Rules, the alternates have been mentioned with an indication of the preferred practice.
5. Because the Rules were framed at different points of time spread over many years, it is likely that the principles contained in the Rules and the practice based on them do not reflect current concepts. In such cases, the document reflects the current concepts.
6. It also reflects the Cost Accounting Principles contained in the Guidance Notes and other publications issued by ICWAI from time to time.
7. Cost Accounting principles which are gathering wide spread acceptance in Indian Companies for management reporting, even though not adopted for statutory cost reporting (for example, Activity Based Costing), are mentioned with suitable caveats regarding their lack of applicability for general purpose cost statements for statutory reporting, where applicable.
8. The document stipulates the main principles in **bold letters** followed by explanation in normal type.



There is a need for a conceptual frame work that underlies the GACAP detailed in the succeeding sections. The conceptual frame work, as the name suggests, is a frame work and not a superset of cost accounting principles. It does not attempt to lay down a principle for any particular costing issue or to amplify the GACAP. The frame work helps to understand the GACAP that follow, in the appropriate perspective and guides in modifying them or developing new principles;

- **Focus on drivers of value**

Costing is necessary for an informed understanding of the organizational drivers of cost, revenue, profits and value. Costing has to fulfil this role both in a historical and in a forward looking context.

- **Cost for a purpose**

Over a long time it has been recognized that there is a cost concept relevant for a purpose. Thus external reporting requires historical and full absorption costing while performance evaluation requires attention directing and diagnostic information; planning and decision making requires analytical and predictive information. It is, therefore, not possible for the same set of cost data to fit all purposes, thereby resulting in a wide range of cost concepts from which preparers and users of cost information choose a concept relevant to the purpose.

- **Reality driven**

Cost models must reflect the entity's business model, its operational processes, its strategy, its organizational structure and its competitive environment. Organizational processes and activities drive the costs and these are in turn influenced by other factors mentioned above.

- **Materiality and cost effectiveness**

The selection of the methods of implementing the costing principles should have regard to the issues of materiality and cost effectiveness. Materiality of cost information is to be judged from the perspective of the user of that information. The degree of detail and accuracy required are governed by the perspective of materiality. From the preparers' viewpoint there is the need to balance the cost of maintaining a cost accounting system with corresponding benefits. This is the reason why in a number of places, while dealing with methods of implementing cost accounting principles, the expression "economically feasible way" has been used in this document.

Hence, for preparation and disclosure of cost information, one is required to judge the materiality aspect in conjunction with economic feasibility of maintaining such data and information. For example, maintenance of product/activity-wise cost details



Generally Accepted Cost Accounting Principles (GACAP)

for each of the ancillary product or activity of an entity would neither be material nor economically feasible.

Any product or activity of an entity which is incidental to its main operations and does not constitute its main line of business and whose total turnover from the sale/supply of such product or activity does not exceed 2% of the total turnover of the entity or Rs.20 crores, whichever is lower, should be treated as an ancillary product or activity.

- **Comparability and consistency**

Cost information should be prepared and presented in a way which provides for comparability over time and consistency. The methods used for preparing and presenting cost information should be changed only where for valid reasons such as those required by law, compliance with new cost accounting standards or on the ground that it would result in a more appropriate presentation of cost information.

- **Transparency and auditability**

Since cost information is used generally by various stakeholders like management, regulators and Government with a business outlook, there is a need for transparency regarding the definitions used and sources of data. It should be possible for those who wish to review such cost information to follow an audit trail. Auditability of cost information is a prerequisite to the effective use of such information.



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.*

Abnormal idle Capacity: *Abnormal idle Capacity is the difference between practical capacity and normal capacity or actual capacity utilization whichever is higher.*

Abnormal Idle time: *An unusual or atypical employee idle time occurrence of which is usually irregular and unexpected or due to some abnormal situations.*

E.g. Idle time due to a strike, lockout or an accident

Absorption of overheads: *Absorption of overheads is charging of overheads to Cost Objects by means of appropriate absorption rate.*

Overhead Absorption Rate = $\frac{\text{Overheads of the Cost object}}{\text{Quantum of base}}$

Actual Capacity Utilization: *Actual Capacity Utilization is the volume of production achieved in relation to installed capacity.*

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.

Allocation of overheads: *Allocation of overheads is assigning a whole item of cost directly to a cost centre.*

An item of expense which can be directly related to a cost centre is to be allocated to the cost centre. For example, depreciation of a particular machine should be allocated to a particular cost centre if the machine is directly attached to the cost centre.

Apportionment of overhead: *Apportionment of overhead is distribution of overheads to more than one cost centre on some equitable basis.*

When the indirect costs are common to different cost centres, these are to be apportioned to the cost centres on an equitable basis. For example, the expenditure on general repair and maintenance pertaining to a department can be allocated to that department but has to be apportioned to various machines (Cost Centres) in the department. If the department is involved in the production of a single product, the whole repair & maintenance of the department may be allocated to the product.



Generally Accepted Cost Accounting Principles (GACAP)

Captive Consumption: *Captive Consumption means the consumption of goods manufactured by one division or unit and consumed by another division or unit of the same organization or related undertaking for manufacturing another product(s).*

Cartage: *Cartage is the expenses incurred for movement of goods covering short distance for further transportation for delivery to customer or storage.*

Collection of Overheads: *Collection of overheads means the pooling of indirect items of expenses from books of account and supportive / corroborative records in logical groups having regards to their nature and purpose.*

Overheads are collected on the basis of pre-planned groupings, called cost pools. Homogeneity of the cost components in respect of their behaviour and character is to be considered in developing the cost pool. Variable and fixed overheads should be collected in separate cost pools under a cost centre. A great degree of homogeneity in the cost pools are to be maintained to make the apportionment of overheads more rational and scientific. A cost pool for maintenance expenses will help in apportioning them to different cost centres which use the maintenance service.

Committed Cost: *The cost of maintaining stand-by utilities shall be the committed cost.*

Cost: *Cost is a measurement, in monetary terms, of the amount of resources used for the purpose of production of goods or rendering services.*

Manufacturing of goods or rendering services involves consumption of resources. Cost is measured by the sacrifice made in terms of resources or price paid to acquire goods and services. The type of cost is often referred in the costing system depends on the purpose for which cost is incurred. For example material cost is the price of materials acquired for manufacturing a product.

Cost Centre: *Any unit of Cost Accounting selected with a view to accumulating all cost under that unit. The unit may be a product, a service, division, department, section, a group of plant and machinery, a group of employees or a combination of several units. This may also be a budget centre.*

Cost Centre or Cost Object is the logical sub-unit for collection of cost. Cost Centre may be of two types – personal and impersonal cost centres. Personal cost centre consists of a person or a group of persons. Cost centres which are not personal cost centres are impersonal cost centres. Again Cost centres may be divided into broad types i.e. Production Cost Centres and Service Cost Centres. Production Cost Centres are those which are engaged in production like Machine shop, Welding shop, Assembly shop etc. Service Cost centres are for rendering service to production cost centre like Power house, Maintenance, Stores, Purchase office etc.



Generally Accepted Cost Accounting Principles (GACAP)

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 finally ascertained.*

Cost of Production: *Cost of production shall consist of Material Consumed, Direct Wages and Salaries, Direct Expenses, Works Overheads, Quality Control cost, Research and Development Cost, Packing cost, Administrative Overheads relating to production.*

To arrive at cost of production of goods dispatched for captive consumption, adjustment for Stock of work-in-Process, finished goods, recoveries for sales of scrap, wastage etc shall be made.

Cost of Transportation: *Cost of Transportation comprises of the cost of freight, cartage, transit insurance and cost of operating fleet and other incidental charges whether incurred internally or paid to an outside agency for transportation of goods but does not include detention and demurrage charges.*

Cost of transportation is classified as inward transportation cost and outward transportation Cost.

Cost unit: *Cost unit is a form of measurement of volume of production or service. This unit is generally adopted on the basis of convenience and practice in the industry concerned.*

Defectives: *The materials that do not meet quality standards. This may include reworks or rejects.*

Depot: *Depot is the bounded premises / place managed internally or by an agent, including consignment agent and C & F agent, franchisee for storing of materials / goods for further dispatch including the premises of Consignment Agent and C&F Agent for the purpose.*

Depot includes warehouses, go-downs, storage yards, stock yards etc.

Direct Expenses: *Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost.*

Examples of Direct Expenses are royalties charged on production, job charges, hire charges for use of specific equipment for a specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling Expenses for a specific job.

Direct Employee Cost: *The cost of employees which can be attributed to a cost object in an economically feasible way.*



Generally Accepted Cost Accounting Principles (GACAP)

Direct Material Cost: *The cost of material which can be attributed to a cost object in an economically feasible way.*

Distribution Overheads: *Distribution overheads, also known as Distribution Cost, are the costs incurred in handling a product from the time it is ready for despatch until it reaches the ultimate consumer.*

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.

Employee Cost: *The aggregate of all kinds of consideration paid, payable and provisions made for future payments for the services rendered by employees of an enterprise (including temporary, part time and contract employees). Consideration includes wages, salary, contractual payments and benefits, as applicable or any payment made on behalf of employee. This is also known as Labour Cost.*

Explanation:

- 1 Contract employees include employees directly engaged by the employer on contract basis but does not include employees of any contractor engaged in the organisation.
- 2 Compensation paid to employees for the past period on account of any dispute / court orders shall not form part of Employee Cost.
- 3 Short provisions of prior period made up in current period shall not form part of the employee cost in the current period.

Employee cost includes payment made in cash or kind.

For example:

- **Employee cost**
 - Salaries, wages, allowances and bonus / incentives.
 - Contribution to provident and other funds.
 - Employee welfare
 - Other benefits



- **Employee cost – Future benefits**
 - Gratuity.
 - Leave encashment.
 - Other retirement/separation benefits.
 - VRS/ other deferred Employee cost.
 - Other future benefits
- **Benefits generally include actual cost of**
 - Paid holidays.
 - Leave with pay.
 - Statutory provisions for insurance against accident or health scheme.
 - Statutory provisions for workman's compensation.
 - Medical benefits to the Employees and dependents.
 - Free or subsidised food.
 - Free or subsidised housing.
 - Free or subsidised education to children.
 - Free or subsidised canteen, crèches and recreational facilities.
 - Free or subsidised conveyance.
 - Leave travel concession.
 - Any other free or subsidised facility.
 - Cost of Employees' stock option.

Equalized Freight: *Equalized Freight means average freight.*

Equalized Transportation Cost: *Equalized Transportation Cost means average transportation cost incurred during a specified period.*

Excess Capacity Utilization: *Excess Capacity Utilization is the difference between installed capacity and the actual capacity utilization when actual capacity utilization is more than installed capacity.*

Finance Costs: *Costs incurred by an enterprise in connection with the borrowing of funds.* This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they



Generally Accepted Cost Accounting Principles (GACAP)

are regarded as an adjustment to the interest costs. The terms Finance costs and Borrowing costs are used interchangeably.

Fixed Cost: *Fixed Cost is the cost which does not vary with the change in the volume of activity in the short run. These costs are not affected by temporary fluctuation in activity of an enterprise. These are also known as period costs.*

Freight: *Freight is the charge paid or payable to an outside agency for transporting materials/ goods from one place to another place.*

Idle Capacity: *Idle Capacity is the difference between installed capacity and the actual capacity utilization when actual capacity utilization is less than installed capacity.*

Idle time: *The difference between the time for which the employees are paid and the employees' time booked against the cost object.*

The time for which the employees are paid includes holidays, paid leave and other allowable time offs such as lunch, tea breaks.

Imputed Costs: *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.*

Indirect Employee Cost: *The cost which cannot be directly attributed to a particular cost object.*

Indirect Materials: *Materials, the costs of which cannot be directly attributed to a particular cost object.*

Installed Capacity: *Installed Capacity is the maximum productive capacity according to the manufacturers' specification of machines / equipments. Installed capacity of the unit / plant is determined after taking into account imbalances in different machines / equipment in the various departments / production cost centres in the unit / plant and number of working shifts.*

Inward Transportation cost: *Inward Transportation cost is the transportation expenses incurred in connection with materials / goods received at factory or place of use or sale / removal.*

Licensed Capacity: *Licensed Capacity is the production capacity of the plant for which license has been issued by an appropriate authority.*

Marketing overheads: *Marketing Overheads are also known as Selling and Distribution Overheads.*

Material Cost: *The cost of material of any nature used for the purpose of production of a product or a service.*



Generally Accepted Cost Accounting Principles (GACAP)

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.*

Outward Transportation Cost: *Outward Transportation Cost is the transportation expenses incurred in connection with the sale or delivery of materials or goods from factory or depot or any other place from where goods are sold / removed.*

Overheads: *Overheads comprise of indirect materials, indirect employee costs and indirect expenses which are not directly identifiable or allocable to a cost object.*

Overtime Premium: *Overtime is the time spent beyond the normal working hours which is usually paid at a higher rate than the normal time rate. The extra amount beyond the normal wages and salaries paid is called overtime premium.*

Packing Materials: *Materials used to hold, identify, describe, store, protect, display, transport, promote and make the product marketable and communicate with the consumer.*

Packing Material Cost: *The cost of material of any nature used for the purpose of packing of a product.*

Packing Material Development Cost: *Cost of evaluation of packing material such as pilot test, field test, consumer research, feedback, and final evaluation cost.*

Practical or Achievable Capacity: *Practical or Achievable Capacity is the maximum productive capacity of a plant reduced by the predictable and unavoidable factors of interruption pertaining to internal causes.*

Thus, practical capacity is the installed capacity minus the inevitable interruptions due to time lost for preventive maintenance, repairs, set ups, normal delays, weekly off-days and holidays etc. Practical capacity does not consider the external factors causing reduction in production e.g. lack of orders.

Primary Packing Material: *Packing material which is essential to hold the product and bring it to a condition in which it can be used by or sold to a customer.*

For example:

- Pharmaceutical industry: Insertions related to product, Foils for strips of tablets / capsules, vials.
- Industrial gases: Cylinders / bottles used for filling the gaseous products
- Confectionary Industry: Butter paper and wrappers.

Production Overheads: *Indirect costs involved in the production process or in rendering service.*



Generally Accepted Cost Accounting Principles (GACAP)

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

Rejects: *Defectives which cannot meet the quality standards even after putting in additional resource*

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

Repairs and Maintenance Cost: *Cost of all activities which have the objective of maintaining or restoring an asset in or to a state in which it can perform its required function at intended capacity and efficiency.*

Repairs and Maintenance activities for the purpose of this standard include routine or preventive maintenance, planned (predictive or corrective) maintenance and breakdown maintenance. The repair or overhaul of an asset which results in restoration of the asset to intended condition would also be a part of Repairs and Maintenance activity. Major overhaul is a periodic (generally more than one year) repair work carried out to substantially restore the asset to intended working condition.

Research & Development Cost: *Research & Development Cost is the cost for undertaking research to improve quality of a present product or improve process of manufacture, develop a new product, market research etc. and commercialization thereof.*

Research Cost comprises the cost of development of new product and manufacturing process; improvement of existing products, process and equipment; finding new uses for known products; solving technical problem arising in manufacture and application of products etc. Development cost includes the cost incurred for commercialization / implementation of research findings.

Reusable Packing Material: *Packing materials that are used more than once to pack the product.*

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

Rework includes repairs, reconditioning and refurbishing.

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.*

Secondary Packing Material: *Packing material that enables to store, transport, inform the customer, promote and otherwise make the product marketable.*



Generally Accepted Cost Accounting Principles (GACAP)

For example:

- Pharmaceutical industry: Cartons used for holding strips of tablets and card board boxes used for holding cartons.
- Textile industry: Card board boxes used for holding cones on which yarn is woven.
- Confectionary Industry: Jars for holding wrapped chocolates, Cartons containing packs of biscuits.

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.*

Semi Variable Costs: *Semi Variable Costs contain both fixed and variable elements. They are partly affected by fluctuation in the level of activity.*

Service Cost Centre: *The cost centre which primarily provides auxiliary services across the enterprise.*

The cost centre which provides services to Production, Operation or other Service Cost Centre but not directly engaged in manufacturing process or operation is a service cost centre. A service cost centre renders services to other cost centres / other units and in some cases to outside parties.

Examples of service cost centres are engineering, workshop, research & development, quality control, quality assurance, designing, laboratory, welfare services, safety, transport, Component, Tool stores, Pollution Control, Computer Cell, dispensary, school, crèche, township, Security etc.

Administrative Overheads include cost of administrative Service Cost Centre.

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.*

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 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. Standard costs are also used for estimation.

Stand-by Service: *Any facility created to safeguard against the failure of the main source of service.*



Generally Accepted Cost Accounting Principles (GACAP)

Stand-by Utilities: *Any utility created to safeguard against the failure of the main source of inputs.*

Transit Insurance Cost: *Transit Insurance Cost is the amount of premium to be paid to cover the risk of loss /damage to the goods in transit.*

Utilities: *Significant inputs such as power, steam, water, compressed air and the like which are used for manufacturing process but do not form part of the final product.*

Variable Cost: *Variable Cost is the cost of elements which tends to directly vary with the volume of activity. Variable cost has two parts – (a) Variable direct cost; and (b) Variable indirect costs. Variable indirect costs are termed as variable overhead.*

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.*



The following section deal with GACAP applicable to individual elements of cost.

Before proceeding with element-wise principles, it is useful to summarise the principles applicable to all elements of cost.

- 1. When an element of cost is accounted at standard cost, variances due to normal reasons are treated as a part of the element-wise cost. Variances due to abnormal reasons will not form part of the cost.**
- 2. Any Subsidy / Grant / Incentive and any such payment received / receivable with respect to the input cost is reduced from cost for ascertainment of the cost of the cost object to which such amount pertains.**
- 3. Any abnormal cost where it is material and quantifiable will not form part of the cost.**
- 4. Penalties, damages paid to statutory authorities or other third parties will not form part of the cost.**
- 5. Costs reported under various elements of cost will not include imputed costs.**
- 6. Finance costs incurred in connection with acquisition of resources such as materials, utilities and the like will not form part of the cost of such resources.**
- 7. Any credits or recoveries from employees or suppliers or other parties towards costs incurred by the entity for a resource will be netted against such costs.**
- 8. Except otherwise stated, the measurement of costs for cost accounting purposes will follow the same principles as set out in Generally Accepted Accounting Principles, applicable to the concerned entity.**



Material Cost

- 1. Material Cost usually includes all costs required to bring the materials to the present condition and location.**

In case of manufacturing units, the location means the factory gate / works. In case of service organisation, the location means the place from which the services are rendered or activities are carried out.

- 2. Material receipt is 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 acquisition¹.**

The test that the expenditure must be capable of being quantified with reasonable accuracy at the time of acquisition is significant. For large volume small value purchases, it is usual to take freight or other costs at a predetermined percentage of purchase prices and recognise any difference as expense for the period when actual costs are booked as expenses of the period. For small value items of purchase, it is usual even to treat all freight on such purchases as overheads.

- 3. Procurement costs are not generally included in material cost. However, those costs which can be directly identified with a material are included in the material cost.**

Purchase Department Overheads are not generally included in material cost. But the procurement expenses incurred at Collection Centres in the Paper Industry such as Salaries & Wages, Stores, Repairs & Maintenance, Other Expenses, Share of Forest Development Expenses, if any, are included as part of the cost of wood. Similarly expenses incurred at Cane Collection Centres are included in the cost of sugar cane procured by a Sugar Mill.

- 4. Development expenses incurred in respect of materials procured is included in the cost of material to the extent that the material procured is the result of such developments.**

For example, the Forest Development Expenses incurred by a paper mill is included in the cost of wood on an equitable basis. It is usual to relate the development expenses to the area under development and charge a share to the quantity of wood received during the period as a proportion of expected yield. It is less preferable to charge the Forest Development Expenses as period cost and charge the whole of it to the quantity of wood procured during the period.

¹CAS 6 Paragraph 5.1.1



Generally Accepted Cost Accounting Principles (GACAP)

- 5. Where a material is acquired in exchange for other materials or services supplied, the cost of material acquired is taken as the cost of material supplied or services provided plus other applicable costs such as freight.**

In the Paper industry where bagasse from the Sugar mills is obtained by the paper mill by supplying coal to the sugar mills, in the cost statement, the cost of coal supplied is considered as the cost of bagasse procured.

- 6. Normal loss or spoilage of material prior to reaching the factory or at places where the services are provided is absorbed in the cost of balance of materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal².**
- 7. Losses due to shrinkage or evaporation and gain due to elongation or absorption of moisture etc., before the material is received is absorbed in material cost to the extent they are normal, with corresponding adjustment in the quantity³.**
- 8. Where the material procured represents an agricultural produce from own sources, the same is valued at market price or cost where it can be determined with reasonable accuracy.**

The cane supplied from own farm to a Sugar Mill is charged at state advisory price / control rate and profit / loss on farm taken to profit & loss account directly. This is permitted by the Cost Accounting Record Rules for Sugar Industry. Such a treatment is advised where the correct determination of cost of the production of items procured from own farm, is fraught with difficulty. Costing of agricultural produce in many cases has not reached a level of maturity that the cost of an item produced by an agricultural process can be used in a General Purpose Cost Statement subject to attest function. The use of a fair market value is indicated in such cases. However in the Paper industry, where bamboo/wood is grown in forests owned or taken on lease by the company and collection is made by departmental operations or by contract, detailed records are generally maintained in a suitable form so as to enable computation of the cost of such bamboo or wood. In such cases, cost is taken as the basis of valuation of material. Similar is the case of cost of green leaf produced in tea plantations where cost of green leaf produced can be determined based on detailed plantation records maintained for the purpose.

²CAS 6 Paragraph 5.1.5

³CAS 6 Paragraph 5.1.6



Generally Accepted Cost Accounting Principles (GACAP)

9. The forex component of imported material cost is converted at the rate on the date of the transaction. Any subsequent change in the exchange rate till payment or otherwise will not form part of the material cost⁴.
10. Self Manufactured Materials (and Self manufactured components and sub assemblies) are valued at cost including Direct Material Cost, Direct Employee Cost, Direct Expenses, Factory Overheads and share of Administrative Overheads relating to production. Share of other Administrative Overheads, Finance Cost and Marketing Overheads are excluded⁵.
11. The material cost of normal scrap / defectives, which are rejects, is included in the material cost of goods manufactured. This cost not exceeding the normal is adjusted in the material cost of good production. Material cost of abnormal scrap / defectives should not be included in the material cost, but treated as loss after giving credit to the realizable value of such scrap / defectives⁶.
12. Issues of materials are valued using appropriate assumptions on cost flow⁷.
Examples are FIFO, LIFO, and Weighted Average rate.
13. Material Costs are assigned to cost objects on the basis of material quantity consumed where traceable and where not traceable on technical norms or estimates⁸.
14. When 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 is treated as part of the material cost⁹.
15. When the part of the manufacturing operations / activity is subcontracted, the subcontract charges related to materials is treated as direct expenses and assigned directly to the cost object¹⁰.
16. Cost of materials like catalysts, dies, tools, patterns etc., which are relatable to production over a period of time, is amortized over the production units benefited by such cost. Cost of materials with life exceeding one year is included in the cost over the useful life of the material¹¹.

⁴CAS 6 Paragraph 5.1.7

⁵CAS 6 Paragraph 5.1.3, 5.3

⁶CAS 6 Paragraph 5.4

⁷CAS 6 Paragraph 5.2.1

⁸CAS 6 Paragraph 6.3.1

⁹CAS 6 Paragraph 6.2.1

¹⁰CAS 6 Paragraph 6.2.2

¹¹CAS 6 Paragraph 6.3.2



Generally Accepted Cost Accounting Principles (GACAP)

- 17. Where the cost of materials is written off or written down in the financial books as per the accounting policy followed by the entity, such write off or write down amount is not treated as cost.**

It is usual for the companies to write off or write down the cost of non-moving / slow-moving items, say items which have not moved for three years or more.

- 18. When the material referred to in paragraph 17 above, is subsequently issued, the issue is valued at the original cost in cost accounting records and the difference between the original cost and the carrying amount is presented in the reconciliation statement, wherever, economically feasible.**

When it is not economically feasible to apply the above principle, the issue is valued at the carrying amount in the cost accounting records.



Employee Cost

1. **Employee cost or Labour cost is ascertained taking into account the gross pay including all allowances payable along with the cost to the employer of all benefits¹².**
2. **Bonus, whether payable as a statutory minimum or on a sharing of surplus and Ex gratia payable in lieu of or in addition to Bonus is treated as part of the employee cost¹³.**
3. **Remuneration payable to Managerial Personnel including Executive Directors on the Board and other officers of a corporate body under a statute is considered as part of the Employee Cost of the year under reference whether the whole or part of the remuneration is computed as a percentage of profits¹⁴.**
Remuneration of Non Executive Directors will not be considered as part of Employee cost but treated as part of administrative overheads.
4. **Performance Incentives must be accumulated over the entire production and not recognised after the threshold limit for earning the incentive is reached.**
5. **Separation costs related to voluntary retirement, retrenchment, termination etc. should be amortized over the period benefiting from such costs¹⁵.**
6. **Amount payable to employees during the lay off period or for the strike period or during suspension, is not included in cost.**
7. **Cost of employee share options is treated part of employee cost provided the same is not a notional cost and involves an actual cash outlay.**
8. **Gratuity, pension and other superannuation benefits, measured using actuarial valuation method or any other methods, are part of Employee Cost.**
9. **Amortized separation costs related to voluntary retirement, retrenchment, and termination etc. for the period is treated as indirect cost and assigned to the cost objects. Unamortized amount relating to discontinued operations should not be treated as employee cost¹⁶.**

¹²CAS 7 Paragraph 5.1

¹³CAS 7 Paragraph 5.2

¹⁴CAS 7 Paragraph 5.3

¹⁵CAS 7 Paragraph 5.4

¹⁶CAS 7 Paragraph 6.4



- 10. Recruitment costs, Training costs and other such costs is treated as overheads and dealt with accordingly¹⁷.**
- 11. Overtime premium and idle time cost should be assigned directly to a cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime or idle time¹⁸.**
- 12. Where the employee service is directly traceable to a Cost object, such cost is assigned on the basis of time consumed¹⁹.**
- 13. When employee costs are not directly traceable to a Cost object, they are assigned on a suitable basis like estimates of time based on time study²⁰.**

¹⁷CAS 7 Paragraph 6.5

¹⁸CAS 7 Paragraph 6.6, 6.7

¹⁹CAS 7 Paragraph 6.1

²⁰CAS 7 Paragraph 6.3



Direct Expenses

- 1. The identification of Direct Expenses is based on traceability in an economically feasible manner²¹.**

Many expenses in real life may be capable of identified as Direct Expenses but often they are grouped as overheads because it is not economically feasible to trace them to cost objects.

- 2. Similarly if an item of the expense does not meet the test of materiality, it can be treated as part of overheads²².**
- 3. Expenses incurred for the use of bought out resources are determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited²³.**
- 4. Other Direct Expenses other than those referred above are determined on the basis of amount incurred in connection therewith²⁴.**
- 5. Expenses paid or incurred in lump sum or which is in the nature of 'one-time' payment, is amortized on the basis of the estimated output or benefit to be derived from such expenses²⁵.**
- 6. Direct Expenses are by definition directly traceable to cost objects and hence no special principles are involved for them to be assigned to cost object²⁶.**

²¹CAS 10 Paragraph 5.1

²²CAS 10 Paragraph 5.2.3

²³CAS 10 Paragraph 5.2.1

²⁴CAS 10 Paragraph 5.2.2

²⁵CAS 10 Paragraph 5.3

²⁶CAS 10 Paragraph 6.1



Utilities

1. **The cost of utilities purchased is measured at cost of purchase including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited²⁷.**

This is subject to the usual condition that it can be quantified with reasonable accuracy at the time of acquisition.

2. **The cost of generated utilities includes direct materials, direct labour, direct expenses and factory overheads²⁸.**

Example of Direct materials for utilities is fuel used in generation of power and for Direct Expenses, electricity tax for generation.

3. **Cost of Utilities generated for the purpose of inter unit transfers is arrived as Cost of self generated utilities with Distribution cost added²⁹.**

4. **Cost of Utilities generated for Inter company transfer is arrived as Cost of self generated utilities plus Distribution cost plus share of administrative overheads³⁰.**

5. **Cost of Utilities generated for sale to outside parties is arrived as Cost of self generated utilities plus Distribution cost plus share of administrative overheads plus marketing overheads³¹.**

6. **The Cost of Utilities includes Cost of distribution of such utilities³².**

7. **Cost of production and distribution of utilities is determined based on the normal or actual capacity whichever is higher and unabsorbed cost, if any, is treated as abnormal cost³³.**

²⁷CAS 8 Paragraph 5.2

²⁸CAS 8 Paragraph 5.3.1

²⁹CAS 8 Paragraph 5.3.2

³⁰CAS 8 Paragraph 5.3.3

³¹CAS 8 Paragraph 5.3.4

³²CAS 8 Paragraph 5.3.4

³³CAS 8 Paragraph 5.9



Generally Accepted Cost Accounting Principles (GACAP)

- 8. Cost of stand by utility includes the committed costs of maintaining such utility³⁴.**
- 9. While assigning cost of utilities, traceability to a cost object in an economically feasible manner is the guiding principle³⁵.**

Accurate recording of utilities consumed by various users' calls for significant investment in measuring instruments and manpower for recording and analysis of such metered data. The benefit from such expenditure needs to be justified.
- 10. The most appropriate basis for distribution of cost of a utility to the departments consuming services is to be derived from usage parameters³⁶.**

³⁴CAS 8 Paragraph 5.9

³⁵CAS 8 Paragraph 6.1

³⁶CAS 8 Paragraph 6.3



Repairs and Maintenance Cost

1. The cost of Repairs and Maintenance is the aggregate of direct and indirect cost relating to repairs and maintenance activity³⁷.
2. Cost of in-house Repairs and Maintenance activity will include cost of materials, consumable stores, spares, manpower, equipment usage, utilities and other resources used in the activity³⁸.
3. Cost of Repairs and Maintenance activity carried out by outside contractors inside the entity will include the charges payable to the contractor apart from the above in-house cost³⁹.
4. Cost of Repairs and Maintenance activity carried out by contractors at his premises is determined at invoice or agreed price including duties and taxes and other expenditure directly attributable net of discounts (other than cash discount), taxes and duties refundable or to be credited. It will also include the cost of other resources provided to the contractors⁴⁰.
5. Each type of Repairs and Maintenance is treated as a distinct activity, if material and identifiable⁴¹.
6. The cost is measured for each major asset category separately⁴².
7. Cost of spares replaced which do not enhance the future economic benefits of the existing asset beyond its previously assessed standard of performance is included under Repairs and Maintenance cost⁴³, when Repairs and Maintenance is considered as a separate cost centre, the cost of which is apportioned to user centres.

³⁷CAS 12 Paragraph 5.1

³⁸CAS 12 Paragraph 5.2

³⁹CAS 12 Paragraph 5.3

⁴⁰CAS 12 Paragraph 5.4

⁴¹CAS 12 Paragraph 5.6.1

⁴²CAS 12 Paragraph 5.6.2

⁴³CAS 12 Paragraph 5.7



Generally Accepted Cost Accounting Principles (GACAP)

- 8. Where a high value spare is replaced, and the replaced spare is reconditioned and such spare is expected to result in future economic benefits, it is taken into stock. Such a spare is valued at an amount that measures its service potential in relation to a new spare, the amount of which will not exceed the cost of reconditioning the spare. The difference between the total of the cost of the new spare and the reconditioning cost and the value of the reconditioned spare should be treated as Repairs and Maintenance cost⁴⁴.**
- 9. Cost of major overhaul is amortized on a rational basis⁴⁵.**

Major overhaul is the periodic (generally more than one year) repair work carried out to substantially restore the asset to the intended working condition.
- 10. Repairs and Maintenance cost is traced to a cost object to the extent economically feasible⁴⁶.**
- 11. Where the Repairs and Maintenance cost is not directly traceable, it is assigned based on either of the principles of Cause and Effect or Benefits Received⁴⁷.**

⁴⁴CAS 12 Paragraph 5.8

⁴⁵CAS 12 Paragraph 5.9

⁴⁶CAS 12 Paragraph 6.1

⁴⁷CAS 12 Paragraph 6.2



Production Overheads

1. Overheads comprise of indirect material cost, indirect employee cost and indirect expenses. They are termed indirect because they are not directly identifiable or allocable to the ultimate cost object – usually a product or service – in an economically feasible way.
2. **Production Overheads are indirect costs involved in the production process or in rendering services.** Production Overheads include **administration cost relating to production, factory, works or manufacturing.** Production related expenses incurred at corporate office, e.g. design office expenses, materials management and industrial relations will also be covered by the term⁴⁸.
3. The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning and are used interchangeably⁴⁹.
4. Since overheads cannot be economically traced to products and services, they are assigned to them on some equitable basis.
5. **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 assigned⁵⁰.**
6. **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 them⁵¹.**
7. **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 production cost(s)⁵².**

⁴⁸CAS 13 Paragraph 4.9

⁴⁹CAS 13 Paragraph 4.2

⁵⁰CAS 3 (R-1) Paragraph 6.1

⁵¹CAS 3 (R-1) Paragraph 6.2

⁵²CAS 3 (R-1) Paragraph 6.3.2



Generally Accepted Cost Accounting Principles (GACAP)

8. It is not a good practice to allocate overheads to Cost Centres/ Cost Objects on the basis of “what the traffic will bear” – that is by size of the user.
9. There is a distinct preference for allocating overheads on the basis of “cause and effect” analysis. What or who causes the costs to be incurred is a more rational criterion to assign costs rather than size or benefits received.
10. 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.
11. Production Overheads are usually accumulated under production cost centres to facilitate absorption by products or services.
12. These costs are absorbed by the products on the basis of resources used by the product at the production centre.
13. The overheads assigned to the production cost centres are charged to products/ services through an overhead absorption rate for each cost centre.

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

Bases of denominator	Applicability
Unit of Production	When single product is produced or various products are similar in specifications.
Material Cost	Where the overheads are mostly related to material.
Direct employee cost	When conversion process is labour intensive and wage rates are substantially uniform
Direct employee hour	When conversion process is labour intensive
Machine Hour or Vessel Occupancy or Reaction Hour or Crushing Hour etc.	When production mainly depends on performance of the base



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 feasible⁵³.

14. 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 feasible⁵⁴.

15. Also there are service cost centres through which the product does not pass through but which provide a support function to the production cost centres.

16. Where the cost of services rendered by a service cost centre is not directly traceable to a cost object, it shall be assigned on the most appropriate basis⁵⁵.

17. The most appropriate basis of distribution of cost of a service cost centre to the cost centres consuming services is to be derived from logical parameters which could be related to the usage of the service rendered. The parameter shall be equitable, reasonable and consistent⁵⁶.

18. Charging overheads on the basis of “benefits received” by the various users is preferred. This requires some measure of “receipt of benefit” to be developed.

19. Sometimes capacity in a service department is created in anticipation of demand for services. It is appropriate to allocate such capacity costs on the basis of “capacity to serve” rather than actual usage of services.

Ultimately all overheads must be charged to products of services. Hence the total production overheads of Production Cost Centres are applied to products passing through them using a suitable absorption base.

20. Before the final step of absorption, production overheads of production cost centres have to be segregated between fixed overheads and variable overheads. The fixed overheads are absorbed by products based on normal capacity or actual capacity utilization whichever is higher. Variable overheads are absorbed by products based on actual capacity utilization. This treatment is in line with Accounting Standard 2 as well.

⁵³CAS 3 (R-1) Paragraph 6.4

⁵⁴CAS 3 (R-1) Paragraph 6.5

⁵⁵CAS 3 (R-1) Paragraph 6.2

⁵⁶CAS 3 (R-1) Paragraph 6.3



Generally Accepted Cost Accounting Principles (GACAP)

- 21. Normal capacity is defined in Cost Accounting Standard 2 as 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. It is practical capacity minus the loss of productive capacity due to external factors⁵⁷.**
- 22. Under-absorbed fixed overheads are charged off to Costing Profit & Loss Account and shown as an item of Reconciliation with financial accounts.**

⁵⁷ CAS 2 Paragraph 4.4



Generally Accepted Cost Accounting Principles (GACAP)

Depreciation

1. Depreciation, though part of overheads, generally appears as a separate line item in the cost statements instead of being grouped under overheads. This is because of its size in the technology driven business of today and its unique characteristic of being non-cash cost.
2. Amortization of intangible assets tends to be grouped with depreciation because intangible assets themselves are grouped with Fixed Assets in the presentation under Schedule VI of the Companies Act 1956.
3. The measurement of depreciation in Cost accounts tends to mirror the practices in financial accounts.
4. However the treatment of depreciation in Cost Accounts must address the following issues:
 - Depreciation not calculated on period of use basis.
 - Depreciation on idle assets
 - 100% of depreciation on certain class of assets
 - Write-off of small value assets
 - Depreciation on fully depreciated assets
 - Depreciation on revalued assets
5. Sometimes depreciation in books is not calculated on period of use, for example 50% of annual depreciation is taken for an asset put into use for a day in financial accounts keeping in mind Income Tax provisions. **Cost accounts will always use the depreciation computed on period of use basis and take the balance to Costing P & L or reconciliation with financial accounts.**
6. Even where 100% of the depreciation is allowed in the first year for income tax purposes, companies are required to use regular rates of depreciation for cost accounting purposes. Even where an entity uses 100% depreciation rates in financial books of accounts, **depreciation based on estimated life is used for costing purposes with the difference taken to costing Profit & Loss or Reconciliation with Financial Accounts.**
7. **Where small value items are written off fully at the time of purchase in financial accounts, the same is generally adopted for cost accounts.**



Generally Accepted Cost Accounting Principles (GACAP)

8. **In the case of old plants, there is the special case for fully depreciated assets which however continue in regular service. Some entities continue to provide a notional depreciation on such assets for decision making purposes.**
9. Depreciation on the amount by which the asset is written up on Revaluation is charged to Revaluation Reserve in financial books. **Some entities compute the depreciation on the revalued figure for costing purposes to reflect the true cost of depreciation.**
10. **It goes without saying that the cumulative depreciation charged in the Cost Accounts against any individual item of fixed asset will not exceed the original cost of the asset.**
11. The assignment of depreciation to various cost centres should not pose a problem so long as detailed Fixed Asset records are maintained by the Company. However there are some common items of fixed assets between cost centres e.g. yard piping carrying products from one process to another, common storage tanks and the like. **Depreciation on common assets are apportioned to individual cost centre on some suitable basis e.g. yard piping is assigned to the cost centre receiving the material.**



Administrative Overheads

1. **Administrative overheads are the aggregate cost of resources consumed in activities relating to general management and administration of an organisation⁵⁸.**

The principles of measurement of Material Cost, Employee Cost, Utilities, Repairs & Maintenance and Depreciation found in the respective standards will apply if included in administrative overheads.

2. **In case of leased assets, if it is an operating lease – the entire rentals will be treated as a part of administrative overheads, while in case of a financial lease – the finance cost portion will be segregated and treated as a part of finance cost⁵⁹.**

3. **The cost of software (developed in house, purchased, licensed or customized), including up-gradation should be amortized over its useful life⁶⁰.**

When hardware requires up-gradation along with the software, it is recommended to use compatible estimated lives for the two sets of cost.

4. **The cost of the administrative services procured from outside is determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable net of discounts (other than cash discount), taxes and duties refundable or to be credited⁶¹. The assignment of administrative overheads to cost objects is based on either of the principles of Cause and Effect or Benefits received, if it is not directly traceable⁶².**

The cost of shared services is best assigned to user activities on the basis of actual usage, infrastructure costs on the basis of readiness to serve and general management costs on a rational basis. For e.g.: Number of employees, turnover, investment size etc.

5. Since most administrative costs are fixed in nature, it is preferable to change them to users on “readiness to serve” basis such as installed capacity, budgeted sales etc. rather than actual production or actual sales. Even the drivers mentioned in (9) above can be on the basis of expected driver qualities rather than actual.

⁵⁸ CAS 11 Paragraph 5.1

⁵⁹ CAS 11 Paragraph 5.2

⁶⁰ CAS 11 Paragraph 5.3

⁶¹ CAS 11 Paragraph 5.4

⁶² CAS 11 Paragraph 6.2



Selling and Distribution Overheads

- 1. Selling costs can be recorded in a manner which will facilitate customer / product profitability analysis, as appropriate. Thus selling costs can be identified to markets, distribution channels, territories, salesman etc., before being assigned to customer / product as applicable.**
- 2. The acceptable bases for apportionment of common selling costs to customers / products are:**
 - a. Weight**
 - b. Units / equivalent units**
 - c. Value of goods**
 - d. Any other appropriate and equitable basis**
- 3. The acceptable bases for assigning common transport costs to products are:**
 - a. Weight**
 - b. Volume of goods**
 - c. Tonne km**
 - d. Units / equivalent units**
 - e. Value of goods**
- 4. The transportation costs assigned to products are charged to units based on some measure which factors in the distance e.g. tonne km.**



Interest and Finance Charges

- 1. Interest and Finance Charges have come to be included in cost of sales though not in cost of production. Such costs are also assigned to products before arriving at margins by product.**
- 2. For the purpose of assignment, Interest charges are grouped under**
 - interest on long term funds**
 - interest on working capital funds**
- 3. The former is assigned to product lines based on fixed capital investment (including fixed assets and mould and dies) in such product lines. A portion of the interest is also charged to outside investments, if they exist, and excluded from cost of sales. For this purpose, it is usual to develop an average cost of long term funds and apply it to fixed capital investment in each product line.**
- 4. It is not the accepted practice to charge imputed interest on owners' funds in cost accounting.**



Generally Accepted Cost Accounting Principles (GACAP)

Sales

1. Cost of sales statements lead right up to margin and hence sales also have to be handled in Cost Accounting.
2. **Since costing is always by product, cost accounting requires product wise analysis of sales.** This is usually produced by other modules of the enterprise system.
3. What is critical is the value of sales produced by such analysis. Often sales analysis produce invoiced value of sales. **What is required for cost accounting is net value of sales net of trade discounts, returns, allowances, volume discounts, special discounts based on market conditions etc.**
4. Many of these deductions from sales are transacted through credit notes which also must be processed through the sales analysis to arrive at product wise break up.
5. **Some of these deductions from sales may be available only in total and hence may have to be allocated to products on a suitable basis, say, sales value.**
6. It is not unusual for businesses to focus on net realization from sales ex-factory gate. This means that freight (both primary and secondary), transit insurance, loading and unloading charges, handling charges and the like are deducted from net sales as arrived at in 3 above to arrive at net sales realization ex-factory gate. This also entails freight and other transport costs not being shown under the head Distribution costs. So long as these costs are shown separately as deductions from net sales value, the practice is acceptable.
7. Some Cost Accounting Record Rules require gross sales to be shown in addition to net sales in cost statement. This requires that excise duty, sales tax (VAT) etc is added to net sales to arrive at gross sales by product.



Generally Accepted Cost Accounting Principles (GACAP)

Joint Costs

1. Joint Costs are the costs of a production process that yields multiple products simultaneously, for example, in the refining of Petroleum which yields Petrol, Kerosene, Diesel, Naphta, Grease, Tar and several other products or the distillation of coal, which yields coke, natural gas, and other products.
2. The costs of the common process are the joint costs.
3. **Joint costs are allocated**
 - (a) **Based on a measure of the number of units, weight, or volume of the joint products, or**
 - (b) **Based on the values attributed to the joint products.**
4. By-product is a special case of Joint Product where one or more of the joint product has minor value compared to others.
5. **Such by-products are generally valued at their value at the split-off point with such value being credited to the costs of the main product. The split-off point value is arrived at on the basis of the ultimate realizable value of the by-product less the post split-off costs.**



Generally Accepted Cost Accounting Principles (GACAP)

Common Costs

1. A common cost is the cost of operating a common facility, activity or service or that is shared by two or more cost objects.
2. The common cost is generally lower than the stand-alone individual cost to each cost object was the facility not shared.
3. **Common costs are therefore allocated to each cost object based on the individual costs of the cost object.**



Generally the presentation requirements of cost information for statutory purposes are laid down in the respective rules. Similarly the requirements of reporting for regulatory purposes are laid down by the regulatory agencies. Managements stipulate the presentation formats for managerial purposes. It is therefore not considered necessary to lay down any model statements or formats in this document.

However it is considered appropriate to stress certain disclosure practices which are generally applicable.

1. Cost Statements must contain, besides total cost, unit cost per unit of output.
2. Output quantities with unit of measure must appear in the Cost Statements.
3. Input costs are best broken up as quantity and rate.
4. The basis of valuation of inputs must be stated.
5. The basis of distribution of costs to cost objects or cost centres must be disclosed.
6. Costs incurred in foreign currency must be stated separately.
7. Any costs excluded must be disclosed.
8. Any credits or recoveries netted against cost must be disclosed separately.
9. Transactions with related parties must be highlighted or disclosed separately.
10. Cost elements, which are material for a product or activity, must be disclosed separately.
11. Cost details of all ancillary products or activities may be maintained under a miscellaneous group and disclosed appropriately.
12. Changes in the costing principles and methods applied must be disclosed with the effect.



This document contains a discussion of the generally accepted cost accounting principles in the context of today and the times gone by. It must be understood that cost accounting principles and methods of applying them are in a constant flux influenced by fresh thinking by experts, regulatory influences, parallel developments in financial accounting standards and the like. Professional accountants will be well advised to use this document as a guide and not as a set of rules.



APPLICATION GUIDANCE

Material Cost

1. Under the erstwhile Cost Accounting Record Rules, the Cost of purchased materials is reckoned inclusive of all “direct charges up to works”. The term “works” can be taken to mean any place of operations.
2. The direct charges include in the case of indigenous materials, the invoice cost, freight, transit insurance, loading and unloading charges. In the case of imported materials, they include FOB value, overseas freight, insurance, customs duty, clearing charges, inland freight etc.
3. Demurrage or detention charges at port or by carrier or penalty levied by them are not treated as cost, being abnormal cost.
4. Penalties levied by tax authorities such as customs, excise sales tax authorities on consignments of goods are not treated as cost.
5. Taxes for which the buyer gets credit like Vat, cenvat, countervailing import duty are excluded from Cost.
6. Purchase Tax is sometimes levied by State Governments on inputs with or without relief against tax payable on sale. Such tax is to be taken as part of cost except to the extent it is allowed to be offset against tax on sale.
7. Octroi levied by local authorities on inputs entering the local limits must be added to cost. If subsequently the goods are taken out of local limits, the amounts can be retrenched from cost.
8. The levy of additional tax for non compliance with filing declaration forms e.g. ‘C’ or ‘D’ forms under central sales tax is treated differently with the additional tax being treated as part of cost if known at the time of recording the transaction.
9. Cost is net of trade discount. Cash discount is generally treated as a financial income and not netted against cost. But there may be circumstances in a transaction which suggest that the cash discount is not a prompt payment discount but a price discount offered in the garb of a cash discount.



Generally Accepted Cost Accounting Principles (GACAP)

10. Cost is to be taken net of Volume discounts to the extent these can be anticipated. Where there is uncertainty regarding the eligibility or the quantum, these may be netted against consumption as when they become confirmed.
11. Bank charges for negotiation of documents in connection with a purchase transaction are generally treated as finance costs and not included in material cost. This is based on the premise that sale documents are negotiated through bank to avoid credit risks or to avail bank finance. Hence Bank Charges on bills negotiated through bank on collection or acceptance basis are often added to material cost but are best excluded from material cost. Interest, when charged by the supplier for the whole or part of the credit period extended, is generally treated as a finance charge. This is so even if the interest appears on the face of the invoice.
12. Imports of materials from certain countries are often available with extended periods of credit with zero or concessional rate of interest. Whether the concession in the matter of interest should be treated as cost is unsettled.
13. Exchange losses or gains incurred after the purchase transaction is completed is not treated as material cost but is to be treated as finance cost.
14. In some industries, the material purchased is the output of mining or quarrying operations from owned mines or quarries. For example, limestone which is a key raw material is obtained by a cement mill from its own mines. The cost of material mines is determined by taking into account royalty to government, cost of explosives used, and mining costs. The question of principle that arises is the treatment of mines development costs which occur regularly over the years. The cost of mines development is treated as cost of mining the output of the current year but there is much in favour of spreading the development costs over the period over based on a development to run-of-the mines ratio.
15. The cost of materials obtained in returnable containers where there is a credit on return is taken net of the credit. Where rent is payable for the period for which the container is retained, such rent is treated as overheads.
16. The rate to be adopted for a material in cost accounting is generally taken after adjusting material losses- in transit, in storage or other losses. This is however permissible only if the losses are normal. Transit losses can be reflected in the rate by deducting such losses from the billed quantity provided such losses are incidental to transport. The percentage of such normal losses can be quite high for some materials e.g. coal.



Generally Accepted Cost Accounting Principles (GACAP)

17. Apart from physical loss, there can be losses due to evaporation or shrinkage. They are also treated in the same way.
18. An abnormal loss in transit e.g. loss due to accident cannot be reflected in the rate. It will be treated as a loss and taken to Profit or Loss net of recoveries from insurance, or carrier.
19. Storage losses are also treated similarly provided they are incidental to storage and the period of storage is normal in the given case.
20. On a slightly different footing are moisture losses in transit or storage. Since most technical calculations are based on dry weight, it is advisable to account for materials which absorb moisture on a dry weight basis grossing up the rate. Dry weight can be air-dry or bone dry. In the case of wood used in paper industry, given that wood contains some moisture, the rate for wood is accounted on the basis of Air Dry weight which may be obtained after deducting standard or average moisture contents of such wood. Alternatively it can be accounted on bone-dry weight after deducting the entire moisture on actual basis.
21. Similar adjustments are called for when consumption quantities of materials in cost accounting are to be aligned with technical calculations which adjust physical quantities for strength, purity or other factors. In these cases also, the rates are grossed up to reflect quantity restatements.
22. Exchange losses or gains incurred after the purchase transaction is completed is not treated as material cost but is to be treated as finance cost.
23. Sometimes, materials are sent outside for pre-processing before it is used in the production process, e.g. cotton for ginning / cleaning, steel rods for blanking etc. Charges paid to outsiders for pre-processing are added to material cost.
24. If the same operations are performed in-house, it is usual to treat them as production cost and not as part of material cost.
25. Material is often held for long periods for seasoning, maturing etc. The storage and interest cost for such storage is treated as part of material cost.
26. Some materials may require special storage facilities e.g. prawns in freezers. A cost of such special storage is often treated as part of material costs.



Generally Accepted Cost Accounting Principles (GACAP)

27. Materials may undergo discolouration, deterioration in quality or outline the shelf-life. Losses for such reasons are not treated as part of material cost.
28. Amount of recovery from disposable containers in which material is received is best treated as miscellaneous income and not reduced from material cost.
29. The treatment in the case of returnable containers where credit is obtained from the supplier on a regular basis can be different. Such credit is generally reduced from material cost. Where the container cost is not included in the price charged but a charge is made for non-return or late return, such charge is treated as abnormal cost and excluded from cost.
30. When material is supplied in returnable containers and a rent is charged for such container based on the period of use, the cost is treated as overheads.
31. Material is often held in storage under special conditions e.g. LSHS at higher than ambient temperature to prevent solidifying, the associated costs are not treated as part of material costs but as part of production costs.
32. The costs of operating and maintaining pipe lines for moving materials from storage to production are not treated as part of material costs but as part of production costs. So also the pumping charges for liquids. The feeding charge for materials to equipment at an elevated level is also treated as production costs.
33. Any Subsidy / Grant / Incentive and any such payment received / receivable with respect to the input cost is reduced from the cost of the cost object to which such amount pertains. In case of any subsidy / grant received / receivable with respect to price of the product is to be treated as income and not reduced from the cost of the cost object.



Generally Accepted Cost Accounting Principles (GACAP)

Employee Costs

1. Employee Cost or Labour cost includes all remuneration paid to employees of the company including allowances, benefits or any payment made in behalf of employees.
2. Employee cost includes remuneration paid or payable and provisions made for future payments.
3. For cost accounting purposes, employee cost includes amounts paid to temporary, part time and casual or contract employees including benefits extended to them.
4. Bonus has been described by courts as “deferred wage” and customary payments by way of bonus have come to acquire the characteristic of mandatory payment. There is little reason to deny such payments the status of cost.
5. Ex-gratia payments are after often paid along with statutory bonus. These may take the form of;
 - a. Amount paid as a rate higher than the rate arrived at as per Payment of Bonus Act calculations.
 - b. Extending full rate of bonus to those to whom the maximum bonus under the Payment of Bonus Act will apply- presently limited to Rs.8500/- per month by way of Basic + DA.
 - c. Extending the bonus to employees not covered under the Payment of Bonus Act – presently Rs.10000/- per month or more by way of Basic + DA.
 - d. These payments which are in the nature of goodwill payment by managements and are in no way related to the amount of allocable surplus are generally treated as part of employee cost.
6. Bonus under the Payment of Bonus Act must be distinguished from performance incentives which are generally related to output and not profits. These may take the form of incentives at;
 - Individual employee level – based on his or her performance.
 - Group of employees level – based on performance of a group of employees or team
 - Unit level – where the incentives are paid on the basis of performance of the factory or other unit.



Generally Accepted Cost Accounting Principles (GACAP)

Incentives at all three levels may be based on performance covering the production of more than one product; then an assignment issue arises. It is generally accepted that the incentives have to be prorated over all the products on the production of which the incentive is earned, not merely to the products produced after the threshold limit for earning the incentive is reached.

7. There has been generally a reluctance to treat incentives based on sales as cost of production, even though it is paid to production employees. The basis for calculating the incentive or the timing of payment should not determine the treatment of such incentive. The fact that such payment is computed on sales value of production or is payable only on sales of the product cannot change the character of an incentive – if it was originally conceived as an incentive for higher production.
8. Some will argue that managerial personnel are owners of the business and hence the payment to them must be regarded as return to owners. Others will argue that the remuneration to managerial personnel is as executive directors, manager etc and hence must be regarded as cost. The latter view gets higher credence with greater professionalization of management and whole-time Directors with no or little shareholding in the company drawing managerial remuneration which includes a commission as a % of profits.
9. In the case of sole proprietorships, salary paid to owner and in the case of a partnership fixed salary paid to a working partner must qualify as cost.
10. It is customary for senior management to be extended perquisites in the form of free housing, free car, services of waterman / gardener, free telephone, leave travel concession for self and family.
11. The Income-Tax rules provide for the valuation of these perquisites. But these cannot in anyway enter into cost calculations. Employee cost includes the cost to company of extending these benefits. The cost to company (CTC) calculations made at the time of appointment or later is a good guide on what should enter into employee cost. The fact that some portion of the perquisites is disallowed in the assessment of the employee as being personal in nature can not influence the treatment in cost accounts.
12. There are group benefits extended to employees such as Group Personal Accident Insurance, Group Medical Insurance Scheme etc. It is difficult to relate such costs to individual employees and therefore to cost centres or objects. These can only be allocated to cost centres or cost objects on the basis of number of employees or employee cost of each cost centre or cost object.



Generally Accepted Cost Accounting Principles (GACAP)

13. Employee welfare expenses similarly represent motley of benefits including canteen facilities, recreation facilities, gifts to individual employees on birthdays / marriage, dispensary facilities etc. These are legitimately treated as part of employee cost and allocated to cost centres or cost objects on the basis of no. of employees or employee cost of each centre or cost object.
14. Post-employment benefit schemes can take any two forms;
 - a. Fixed contribution to a fund by the employer with varying benefits to employees.
 - b. Variable contribution to a fund by the employer to assure given benefit to the employees.
 - c. The fixed contribution plans involves a defined cost per employee and can be readily assigned to cost centres or objects. The contribution under variable contribution plans are generally determined on an actuarial valuation The treatment of such benefits in Cost Accounts will be on the same basis as in financial accounts which is governed by AS-15 in India.
 - d. The allocation of the cost of such employee benefits to cost centres / Cost objects will be on the basis of no. of employees or employee cost.
15. Voluntary retirement plan costs have been treated in varying ways in India. The treatment of the same will be as per Cost Accounting Standard 7.
16. It is usual for employee cost, particularly direct employee cost, to be converted to hourly rates for ease of assignment to jobs or products. Such hourly rate may reflect only payroll costs i.e., only basic + dearness allowance + allowances or be comprehensive and include all benefits. The ultimate is for the rate to reflect the Cost to Company (CTC). Where the rate excludes some elements of employee cost, these will be treated as overheads and absorbed in cost.
17. Hourly rates are arrived at using the available hours as the divisor. Normal health breaks or rest allowances are excluded from available hours. It is important to note that any time like rest time which gets included in job times cannot be excluded from available hours.
18. It is not unusual for regular costing to proceed on the basis of standard hourly rates based on budgeted employee cost and budgeted hours and for the variances in labour rates to be treated as overheads or taken to costing P&L or reconciliation.
19. Labour cost falls into two categories;
 - Direct Employee cost
 - Indirect Employee cost



Generally Accepted Cost Accounting Principles (GACAP)

20. Early stages of technology witnessed a major role for the workmen in the manufacturing process with output being controlled mainly by the workmen's efforts. Hence elaborate systems were built to log workmen's time on individual jobs or products and operations and employee cost was assigned on the basis of time booking.
21. As technology grew, the importance of machines in production grew with decreasing nexus between workmen's efforts and production. Work men were assigned to more than one machine producing more than one product with his role being reduced to attending to controls.
22. Where technology is at an early stage, it is still common for direct employee cost to be assigned to products and operations on the basis of time booked. This is typical of engineering shops with conventional machines such as lathes, drilling machines, milling machines etc., and simple processing shops.
23. Where sophisticated technology is deployed such as computer numerically controlled machines are employed, it is usual for employee cost to be absorbed in products as part of a comprehensive machine hour rate.
24. Where a gang of workmen or a team of employees are assigned to a job, it is usual to assign direct employee cost on the basis of gang hours or time logged by the team.
25. The wheel turns a full circle when assembly operations are controlled in the main by robots and one or two work men control the whole assembly line only to attend to disruptions. Direct employee cost even the entire cost including equipment cost – in such cases is assigned on the time honoured direct labour hour basis.
26. In a balanced production line in a lean manufacturing set-up where workmen stand in fixed location, the belt carrying the work moves at fixed speed and work men are expected to complete their operations within the allotted time. In such cases, it is usual to charge employee cost as well as equipment cost on the basis of "Cycle Time" rather than labour hours.
27. Overtime which is based on single rate poses no special issues in costing. But where overtime is compensated at double or triple rate, the overtime premium is handled in one of the following ways;
 - Where the overtime working is caused by a "rush order" of the customer or other special requirement of a job, the premium is assigned to the job or product.



Generally Accepted Cost Accounting Principles (GACAP)

- In all other cases, it is usual to treat the premium as overheads and absorb the same as part of overheads.
28. Idle time of direct workmen is generally logged separately. Normal idle time is absorbed in product cost as part of overheads and abnormal idle time is taken to costing profit and loss or reconciliation.
29. Where direct workmen are expected to carry out maintenance on the machines attended by them, it is usual to log such time separately against maintenance work orders and treat the same as Repairs and Maintenance Cost.
30. Booking of time spent on jobs or products is relevant in job or batch operations but loses its relevance in continuous process industries where direct employee cost is treated as part of processing cost.
31. Changing direct employee cost on the basis of standard time is prevalent. In such cases, the efficiency variance is isolated and absorbed in product cost except where it is abnormal, where it is taken to costing P&L or reconciliation.



Generally Accepted Cost Accounting Principles (GACAP)

Direct Expenses

1. Direct expenses are those relating to manufacture of a product or rendering a service, which can be readily identified or linked with cost objects other than Direct Material and Direct Employee cost.
2. Examples are:
 - a. Royalties charged on production,
 - b. Job charges,
 - c. Hire charges for use of specific equipment for a specific job,
 - d. Cost of special designs or drawings for a job,
 - e. Software services specifically required for a job,
 - f. Travelling Expenses for a specific job.
3. The need for direct expenses to be amortised arises when for example Royalty or Technical know-how fees, or drawing designing fees, are paid for which the benefit accrues in the future period. In such case, the production / service volumes are estimated for the effective period and based on volume achieved during the current period, the charge for amortisation is determined.



Generally Accepted Cost Accounting Principles (GACAP)

Cost of Utilities

1. Utilities are a special class of service cost centres which generally produce a measurable output which are used as inputs in the process of manufacture of products and services but do not form of the products. Examples are power, steam, water (treated, demineralised etc.) compressed air and the like.
2. Utilities are generally meant for captive consumption even though it is not unusual for part of the output to be sold to a nearby plant of the same entity or another entity.
3. Utilities are also purchased by an entity from an outside source usually a public utility (e.g. power from an electricity authority) or steam from neighbouring plant.
4. It is also not usual for utilities produced to have more than one use – steam generated being used both to drive turbines to generate electricity (high pressure steam) and also for heating purposes in the process (low pressure steam) giving rise to interesting issues in costing.
5. Sometimes a utility is held to safeguard against the failure of the main source of input of the utility e.g., stand-by generators held against failure of power supply from the grid.
6. Administrative overheads are generally not allocated to captively used utilities. Where the utilities are largely meant for transfer to other units or sale to outside parties such as sale of generated power to the official grid, administrative overheads may also be allocated to the utilities.
7. Since the cost of utilities is significant in many entities and there is a measurable output, it is usual to do the costing of utilities with the same rigour as in the case of products and services. The Cost Accounting Record Rules require the preparation of separate cost statements for each major utility such as power, steam and the like. The Cost Accounting Standard 8 on Cost of Utilities requires each type of utility to be treated as a separate cost object.
8. Costs of distributing the utilities e.g. power through distribution lines including transformers, motor control centres and the like are treated differently based on end use. Costs of distribution of utilities for captive use are often captured in a separate service cost centre and treated as a service cost centre. Cost of utilities used for inter unit transfer often include the proportionate cost of distribution.
9. Costs of utilities meant for sale to outside parties will include marketing costs if the



Generally Accepted Cost Accounting Principles (GACAP)

generated utility is mainly meant for sale but this takes the context out of captive generation and consumption of utilities in the manufacture of products and rendering of services.

10. Where part of the utility generated is used within the utility e.g. electricity used within the power house, cost of such consumption is generally absorbed by the cost of output meant for other users. This has got the effect of grossing up the unit cost of the utility for the costs of internal consumption of the respective utilities.
11. Output of utilities is generally distinguished in terms of quality. In the case of water, raising of water from bore wells or pumped from a nearby river is identified as raw water, whereas the output of a Water Treatment Plant is identified as treated water; the output from a cooling tower as cooling water; and the output from a chilling plant as chilled water. Similarly steam produced is classified as low pressure, medium pressure or high pressure or into bands of pressure rating.
12. Costs of generation of various types of water involve progressively additional costs while costs of steam generation have to be allocated to steam at different pressures based on some measure of work for e.g. British Thermal Units (BTUs)
13. The use of by-products from the manufacturing process as fuel in utilities e.g. bagasse as fuel in the boiler calls for special treatment. These by- products are evaluated on the basis of their calorific value in relation to the principal fuel used by the entity e.g. coal. If the by-product is the only fuel used by the entity, it is evaluated on the basis of its calorific value in relation to alternate fuels that can be used by the entity. In other cases, the market value of such by-product, e.g. price of bagasse in open market sales, can be used for valuing the by-product.
14. Sometimes, waste material recovered from input materials may be used as fuels in the utilities, e.g. pith from bagasse or bark from wood used as raw material in a paper mill.
15. The methods of assignment of costs of generated utilities to the consuming centres vary considerably depending on the system of measurement of usage, e.g. metering, instrumentation system and the like used in the entity. It may be safely said that it may be uneconomical to meter the consumption of utilities to the last unit. Some technical estimates may have to be used. The problem is complicated because distribution lines are not always laid out in such a way that measuring instruments can be installed at each distribution point. It is not uncommon to tap power from a nearby line carrying power to another consuming centre or to divert steam from a nearby pipe carrying steam to another consuming centre. These problems get accentuated as the plant advances in years when new requirements of utilities are



Generally Accepted Cost Accounting Principles (GACAP)

met in an ad hoc manner such that the original drawings of distribution lines are no longer representative.

16. Wherever meters are installed, utility costs are assigned on the basis of actual usage as metered.
17. Alternatively, utility costs are assigned on the basis of ratings of consuming equipment weighted by a usage factor, e.g. in the case of power, based on HP rating of equipment multiplied by number of hours in use. As a last resort, technical estimates based on process specifications of power or steam consumed are used to develop the bases for allocation.
18. Distribution losses or unaccounted consumption of utilities are netted against the generated quantity before assignment to consuming cost centres so as to reflect such cost in grossed- up unit rates.
19. Any abnormal losses like venting of large quantities of high pressure steam to avoid an accident will of course be evaluated separately and treated as loss in the costing Profit & Loss or the Reconciliation with financial accounts.



Repairs and Maintenance Cost

1. Repairs and Maintenance cost is the cost of all activities required to restore the asset to a condition to perform its function at intended capacity and efficiency.
2. Repairs and Maintenance cost includes cost of;
 - a. Repair materials
 - b. Spares
 - c. Consumable stores
 - d. Manpower
 - e. Utilities
 - f. Repair equipment costs
 - g. Allocated costs from other service cost centres.
3. Repairs and Maintenance can be classified into
 - a. Preventive Maintenance
 - b. Planned Maintenance
 - c. Breakdown Maintenance
4. Preventive Maintenance costs are generally booked through standing orders which are in essence continuing work orders, all issues of material time of maintenance crew and other resources used are booked against the standing orders.
5. Alternatively Preventive Maintenance schedules carry a standard bill of materials and standard usage of maintenance crew time and other resources and these are blown up based on no. of jobs completed. Actual usage of materials, time and other resources are recorded in detail and allocated to various preventive maintenance jobs based on standard usage.
6. Planned Maintenance jobs are jobs like Annual shutdowns, periodic overhaul etc. These carry a standard bill of materials to be used for the maintenance jobs, parts to be replaced during the planned maintenance, number and skill category of maintenance crew required, heavy maintenance equipment like cranes to be used and other resources. Actual of these resources is booked against the planned maintenance jobs.
7. Break down maintenance jobs are triggered by a Fault Report which generates a work order with a number. All issues of materials, time of crew and other resources are booked against these work orders to provide cost of individual maintenance jobs.



Generally Accepted Cost Accounting Principles (GACAP)

8. In a computerized environment, robust systems are in place to open and close work orders for all types of maintenance jobs with authorizations and sign offs, standard bills of materials type and number of persons and other resources required with automatic generation of issue requisitions and requests for personnel and equipment. Costs of closed work orders are transferred to relevant accounts in the books of accounts.
9. In a non-computerized environment, there is often a tendency to keep the paperwork to a minimum while ensuring accurate costing. In such an environment, work orders are opened only for large maintenance jobs. The threshold limit is fixed in terms of time taken for the maintenance job to be completed (or shut down time) the cost of materials requisitioned, the number of crew involved, special equipment required or a combination of these. Costs are booked by work orders for the major repairs and for others, costs are booked by cost centres or equipment number.
10. It is also usual to treat the maintenance crew as fixed resources and not attempt to book their time against maintenance jobs. The allocations to cost centres are based on the principle of "readiness to serve" with the estimate of demand from various cost centres prepared at the time of manpower planning acting as the base for allocation of manpower costs.
11. Maintenance jobs often require the use of heavy equipment such as cranes, hoists etc. The costs of this maintenance equipment are accumulated by equipment number. These are charged to maintenance jobs based on recorded usage in hours or to cost centres based on estimated usage prepared at the time of planning the capital expenditure on these items of equipment.
12. Many large production facilities have a captive workshop where parts are turned, machined or otherwise repaired. These workshops also produce some spare parts. Often, the workshop is treated similar to production cost centres with job orders being opened for production jobs and work orders for repair jobs. The costs of the workshop which comprises costs of materials, labour, equipment and other resources are assigned to jobs and work orders based on some suitable basis such as labour hours.
13. It is true that maintenance jobs are increasingly being outsourced. Maintenance Labour is almost completely outsourced with only a small crew of specialized craftsman retained on the company's rolls.
14. The outsourcing may be of the entire job or may take the form of a contract for supply of labour. In the former case, bill for completed jobs are generally available and lead to accurate costing of labour for such jobs. When outsourcing takes the form of a contract for supply of labour, no time recording by jobs is generally available and only deployment by department or cost centre is available.



Generally Accepted Cost Accounting Principles (GACAP)

15. With increasing sophistication of technology, maintenance of specialized equipment is entrusted on a turnkey basis to the vendor of the equipment or other specialized maintenance outfits. This may involve costs of travel of technicians besides bill for services from the agency rendering the services. It is usual to accumulate all costs of such maintenance jobs and treat them appropriately as outlined later.
16. It is usual to have Annual Maintenance Contracts (AMC) for specialized equipment particularly electronic equipment subject to sudden failures. These take the form of only servicing or servicing with parts (comprehensive). The AMCs specify the number of routine servicing calls that will be made in a year. Where a single machine is covered by an AMC, costing becomes simple. But where a fleet of machines are covered by a single AMC, allocation of costs to cost centres can be made on the basis of number of machines in each cost centre. Where the machine in various cost centres require different levels of service or vary in cost, a suitable allocation base has to be evolved based on such differences.
17. It has been customary in the past to treat major repair jobs differently with their cost being spread over the periods benefiting from such expenditure. Increasingly such expenditure is charged to the Profit and Loss Account of the period in financial accounts, which is driven largely by tax deductibility considerations. Further, with Accounting Standard 26 on Intangible Assets coming into force, creation of Deferred Revenue Expenditure is not allowed. However in Cost Accounts, these major repair job costs may be prorated over the year(s) of benefits with appropriate disclosure in Reconciliation statements of the respective years. The treatment in cost accounts would depend on the nature and benefit accruing from such expenditure.



Generally Accepted Cost Accounting Principles (GACAP)

Production Overheads

1. Overheads comprise of indirect material, indirect labour and indirect expenses. They are termed indirect because they are not directly identifiable or allocable to the ultimate cost object, usually a product or service, in an economically feasible way. Instead of using the term 'overheads', it is more appropriate to refer to them as Indirect Costs.
2. Increasingly with the spread of information technology, more and more costs can be identified with the final cost object. Even small materials which could not be previously identified with the products in an economically feasible way can now have the issues recorded by product.
3. On the contrary, the sophistication of manufacturing technology renders workman as observers of machines working or instrument watchers or console operators instead of tending to the machine or product directly. Thus a greater part of the labour cost is becoming indirect to the product.
4. Since overheads cannot be economically traced to products, they are traced to production centres through which the product passes to be absorbed by the product generally on the basis of time spent by the product at the production centre.
5. Also there are service cost centres through which the product does not pass through but which provide a support function to the production cost centres. The service department costs are assigned to production cost centres before being traced to products and services.
6. In traditional cost systems, a cost distribution sheet is prepared to capture the expenses in the nature of overheads booked in the books of accounts and supporting records like stores records. These are then analysed by cost centres.
7. Some overheads are booked in the system by cost centres. For this purpose, many General Ledger systems have extensions to account codes to book transactions by cost centres.
8. In other cases, the overheads individually or after being grouped into homogenous groups are apportioned to cost centres on some suitable basis. The following table reproduced from Cost Accounting Standard 3 lists the commonly used bases.



Generally Accepted Cost Accounting Principles (GACAP)

<i>Item of Cost</i>	<i>Basis of Apportionment</i>
Power	- HP Rating of Machines x hours x LF
Fuel	- Consumption rate x hour
Jigs, Tools & Fixtures	- Machine hours or Man-hours
Crane Hire Charges	- Crane hours or weight of material handled
Supervisor's salary & fringe Benefits	- Number of employees
Labour Welfare cost	- Number of employees
Rent & Rates	- Floor or space area
Insurance	- Value of fixed Asset
Depreciation	- Value of fixed Asset

9. For a long time the method of apportionment used was based on "charging what the traffic will bear", i.e. the bigger the cost centre the greater the charge to it. This is actively discouraged now.
10. Charging overheads on the basis of benefits received by the various cost centres is preferred. This requires some measure of benefit to be developed.
11. After the spread of modern cost accounting concepts, particularly activity-based costing (ABC), there is a distinct preference for apportioning overheads on the basis of cause and effect analysis. What or who causes the costs to be incurred is a more rational criterion to charge costs rather than size or benefits received.
12. Thus the Purchase Department costs are best charged based on an analysis of what causes the Purchase Department to be manned and be operating at the present level. It could be the number of purchase requisitions, the no of items being ordered, the degree of inspection required by various items, the logistics requirements involved or a weighted combination of these.
13. After the overheads are allocated or apportioned to various cost centres, the costs apportioned to service cost centres are redistributed to production cost centres and other service cost centres, generally based on one of the bases described above.
14. Given the information processing capability, individual items of overheads or groups of them are taken up for redistribution.
15. Rendering of service by one or more service cost centres to other service cost centres or even rendering of services inter se by service cost centres are adequately handled in a spread sheet environment.



Generally Accepted Cost Accounting Principles (GACAP)

16. It is useful to remember that the use of sophistication in distribution methods does not improve the quality of the costing system. It is the direct capturing of costs to cost centres, the appropriateness of defining the cost centres and the use of proper measures of benefits received that will improve the costing. Ultimately it is the analysis of what triggers the cost that is relevant.
17. Ultimately all overheads must be charged to products of services. Hence the total production overheads of Production Cost Centres are applied to products passing through them using a suitable absorption base. The absorption bases commonly used are listed below (reproduced from Cost Accounting Standard 3 paragraph 5.6)

Base of Denominator	Applicability
Unit of Production	When single product is produced or various products are similar in specification
Direct labour cost	When conversion process is labour intensive and wage rates are substantially uniform
Direct labour hour	When conversion process is labour intensive
Machine hour or Vessel Occupancy or Reaction hour or Crushing hour etc	When production mainly depends on performance of the base

18. Before the final step of absorption, production overheads of production cost centres have to be segregated between fixed overheads and variable overheads. The fixed overheads are absorbed by products based on normal capacity or actual capacity utilization whichever is higher. Variable overheads are absorbed by products based on actual capacity utilization. This treatment is in line with Accounting Standard as well.
19. Under absorbed fixed overheads are charged to Costing Profit & Loss Account and shown as an item of Reconciliation with financial accounts.
20. Normal capacity is defined in Cost Accounting Standard - 2 as 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. It is practical capacity minus the loss of productive capacity due to external factors⁶³. In arriving at the practical capacity, the following are factored:



Generally Accepted Cost Accounting Principles (GACAP)

- holidays
 - number of shifts
 - shift duration
 - annual maintenance
 - preventive maintenance if it involves overtime
 - batch change over time
 - lunch break, personnel changeover etc.,
 - production per hour which is in turn based technical specifications, loss in efficiency due to ageing, operational constraints etc.
21. It is usual to employ a predetermined overheads rate throughout the year based on budgeted overheads and budgeted production base and to absorb overheads on the basis of actual production multiplied by the predetermined overhead rate.
22. The difference between the absorbed overheads and the actual overheads arises due to,
- variation between the budgeted level of capacity utilization and actual production and
 - variation between budgeted level of overheads and actual overheads.
23. It is easy to lose perspective on the amount of overhead absorbed by different product in the web of calculations involved in allocation, apportionment and absorption. Operating managers have great difficulty in comprehending the result of a complex allocation, apportionment and absorption algorithm. A simple casual relationship is better understood. It may be preferable to limit complex distribution models if required to major items of overheads and to use simple ad hoc methods for the balance overheads.



Generally Accepted Cost Accounting Principles (GACAP)

Administrative Overheads

1. Administrative overheads must be understood as costs of administrative functions in an entity and not as a collection of elements of costs such as travel, communication, printing and stationery etc.
2. Administrative overheads are of two types:
 - a) Costs of administrative support functions which support operations such as Purchase, Personnel, Accounts, Factory Administration, Marketing Support etc.,
 - b) Costs of policy making and strategic management such as Finance, Human Resource Development etc.
3. The functions covered in (a) above are generally attached to a unit like Factory Administration or Marketing administration and are readily identified with production or selling and distribution function.
4. Even when they are located in a Head Office or Corporate Office, it should make little difference, because they cater to the needs of specific functions in the entity. For example, purchase may be located in a central office but they cater to the requirements of specific factories or manufacturing and costs can be assigned to such units.
5. The assignment of such costs to functions and activities benefited by them is feasible subject to limits. The use of activity- based costing can lead to identification of activities within the administrative function and what causes them. Thus the Head office Purchase activity costs can be assigned to user functions based on some measure of activity like no of purchase requisitions.
6. The use of the terms “share of administrative overheads relating to production” and “share of administrative overheads relating to selling” in the erstwhile Cost Accounting Record Rules has led to arbitrary practices in some entities to assign all administrative overheads on an arbitrary ratio say 60:40 between production and selling. These terms can only refer to administrative costs of functions attached to production or selling. There will be a residuary head of “Administrative Overheads” which cannot be assigned to production or selling functions representing costs of policy making and strategic management and are to be treated as period costs. Also included in this category are expenses such as Directors sitting fees, audit fees, filing fees and other corporate expenses. Paragraph 6.3 in Cost Accounting Standard 3 on overheads should be interpreted in the light of the above discussions.



Generally Accepted Cost Accounting Principles (GACAP)

7. It is significant to note that the reporting format under the new Cost Audit Report Rules has a separate line item for Administrative overheads.
8. The assignment of as much of the administrative overheads as possible based on identified cost drivers is recommended. The balance of administrative overheads can only be assigned to cost centres or objects based on capacity or sales value. It is usual in textile industry to charge corporate office cost to mills based on installed spindle capacity.



Selling and Distribution Overheads

1. The use of the term “Selling and Distribution Overheads” includes items of costs that are not “overheads” but are direct to products such as commission on sales, freight etc. The use of the term “Selling and Distribution Costs” is to be preferred.
2. It is necessary to distinguish “selling” costs from “distribution costs”. The latter relate mainly to costs incurred before sales are generated and are therefore indirect to product while distribution costs are more direct to products.
3. It is also usual to speak of “order getting” costs and “order filling” costs to distinguish between the two sets of costs.
4. Selling costs are generally fixed in nature except for commission on sales and the like.

Examples of selling costs are:

- a. Salaries of sales personnel
 - b. Travelling expenses of sales personnel
 - c. Commission to sales agents
 - d. Advertisement costs
 - e. Sales promotion expenses including cost of promotional material such as product brochures, catalogues etc.,
 - f. Collection costs including legal expenses for recovery of dues
 - g. After sales service costs
 - h. Warranty costs etc.,
5. Selling overheads or selling costs are a combination of direct costs relating to selling of products or service and indirect costs of sales management.
 6. Distribution overheads or distribution costs are the costs incurred in handling a product from the time it is ready for dispatch until it reaches the ultimate consumer.
 7. Distribution costs include:
 - a. Secondary packing cost
 - b. Packing repacking / labelling at an intermediate storage location
 - c. Transportation costs
 - d. Cost of warehousing (cover depots, godowns, storage yards, stock yards etc.,)



Generally Accepted Cost Accounting Principles (GACAP)

8. Transportation costs comprises of the cost of freight, loading and unloading, transit insurance, costs of operating a fleet and other incidental charges whether incurred internally or paid to an outside agency for transportation of goods.
9. Broadly transportation costs are divided into two categories;
 - a. Cost of operating own fleet
 - b. Cost of hired transport
10. Costs under either category may include costs;
 - a. Directly allocable to products or
 - b. To be apportioned to products
11. A good costing system should be able to record separately transportation cost from factory to depots and from depot to customers place, wherever practicable and economically feasible.
12. Penalty, detention charges, demurrage charges and other abnormal costs are excluded from transportation cost.



Interest and Finance Charges

1. This cost head includes the following items of cost;
 - a. Interest on debentures and bonds
 - b. Interest on long term loans
 - c. Interest on working capital finance in the form of cash, credit or overdraft including short term loans
 - d. Interest on overdue payments to suppliers and others
 - e. Discounting charges on bills of exchange
 - f. Bank charges on bills negotiated through Bank for sales or purchases
 - g. Letter of credit charges
 - h. Guarantee commission/ commitment charges
 - i. Cash discount and many more

Interest and Finance charges are accumulated under suitable heads as in (1) above in the financial books before they are taken to cost accounts.

2. For a long time, it was the practice in India to ignore interest as an element of cost following text book discussions on whether interest is a cost.
3. In the last few years, following the new set of Cost Accounting Record Rules and Cost Audit Report Rules, there is recognition for interest and finance charges as cost.
4. Similarly it is usual to develop an average rate of interest paid on various forms of finance for working capital and apply it to working capital investment in product lines or products.
5. Working capital investment by product line is arrived at directly in most cases or apportioned on the following
 - Raw material stocks – Direct or on the basis of raw materials consumed
 - Stores – generally on the basis of stores consumed excluding special high value items which can be identified directly.
 - Work-in-process and finished goods - Direct
 - Book debts – Direct or on the basis of sales (gross)
 - Other current assets – except high value items which can be directly identified with products, on the basis of sales or cost of sales.



Generally Accepted Cost Accounting Principles (GACAP)

6. It is also not unusual to arrive at the working capital investment on the basis of length of the operating cycle in no of days for each product line multiplied by cost of sales or sales.
7. Other finance charges are identified by product lines or products for big items of expenditure or otherwise grouped and charged to product lines or products based on cost of materials consumed, cost of production, and cost of sales or sales.
8. Where the assignment is done initially to product lines as for interest on long term loans, such charges are assigned to individual products on the basis of cost of sales or sales.



1. The above discussions embody the cost accounting practices followed in various industries while applying the cost accounting principles.

However they may vary from practices adopted by specific regulated industries like banks, electricity, fertilisers. In many cases these practice are laid down by the regulator and are followed without fail in the industry. For example, depreciation rates based on life of equipment are prescribed by the regulatory agency in the electricity generation industry and will prevail over the practices mentioned earlier regarding depreciation rates.



PART - B

COST ACCOUNTING STANDARDS (1 to 17)

Including

GUIDANCE NOTES



Annexure 1

List of 39 items on which CASs are to be developed

A. COMPONENTS OF COST:	B. COST ACCOUNTING METHODOLOGY AND PROCEDURES:
1. Materials Cost (CAS 6)	21. Classification of Cost (CAS 1)
2. Employee Cost (CAS 7)	22. Presentation of the cost statements
3. Cost of Utilities (CAS 8)	23. Identification & recognition of Cost Centres
4. Packing Material Cost (CAS 9)	24. Capacity Determination (CAS 2)
5. Direct Expenses (CAS 10)	25. Valuation of Captive Consumption. (CAS -4)
6. Administrative Overheads (CAS 11)	26. Stock Valuation/ WIP
7. Repairs and Maintenance Cost (CAS 12)	27. Treatment of Cost Variances
8. Cost of Service Cost Centre (CAS 13)	28. Cost of conversion
9. Transportation cost	29. Determination of Arm's Length Price.
10. Pollution Control Expenses (CAS 14)	30. Joint Costs (In- Progress)
11. Overheads (CAS 3)	31. Determination of Average Transportation Cost (CAS 5)
12. Production/ Operation Overheads.	32. Reconciliation of Cost and Financial Statements.
13. Head/Corporate Office Overheads.	33. Shared Services Cost including outsourcing.
14. Selling and Distribution Overheads (CAS 15)	34. Profit Centres and Reportable Segments under Cost Reporting.
15. Depreciation & Amortization (CAS 16)	35. Return on Capital Employed.
16. Royalty, Technical Know-how and Intellectual Property Charges.	36. Predatory Pricing.
17. Research and Development Expenses.(In- Progress)	37. Capital Assets manufactured in house
18. Quality Control Expenses.	38. Credit for Recoveries
19. Interest and Financing Charges (CAS 17)	39. Cost of Traded Finished Goods/ Stock Audit
20. Treatment of Revenue for Cost Statements (Including treatment of Government Grants, subsidies and incentives in Cost Accounts)	

GUIDANCE NOTES RELEASED SO FAR

S.No	Name
1	Valuation of Captive Consumption (CAS -4)
2	Materials Cost (CAS 6)
3	Employee Cost (CAS 7)
4	Cost of Utilities (CAS 8)
5	Packing Material Cost (CAS 9)
6	Direct Expenses (CAS 10)
7	Administrative Overheads (CAS 11)



List of Contents

<i>Contents</i>	<i>Pages</i>
Preface to Cost Accounting Standard	89
<i>CAS - 1 Cost Accounting standard on Classification of Cost</i>	
Introduction	94
Objective	94
Scope	94
Definition	95
Basic Rules for Classification of Cost	95
Classification of Cost	96
Presentation and Disclosure	108
<i>CAS - 2 Cost Accounting Standard on Capacity Determination</i>	
Introduction	110
Objective	110
Scope	110
Definition	111
Determination of Installed Capacity	111
Determination of Practical / Achievable Capacity	112
Determination of Normal Capacity	112
Disclosure	113
<i>CAS - 2 (Revised 2012) Cost Accounting Standard on Overheads</i>	
Introduction	115
Objective	115
Scope	115
Definition	115
Determination of Capacity	116
Presentation	117
Disclosure	117
<i>CAS - 3 Cost Accounting Standard on Overheads</i>	
Introduction	119
Objective	119
Scope	119
Definition	120
Apportionment and absorption of Production Overheads	122
Apportionment and absorption of Administrative Overheads	126
Apportionment and absorption of Selling overheads & Distribution overheads	127
Presentation and Disclosure	127



Contents	Pages
<i>CAS - 3 (Revised 2011)¹ Cost Accounting Standard on Overheads</i>	
Introduction	131
Objective	131
Scope	131
Definition	131
Principles of Measurement	134
Assignment	135
Presentation	136
Disclosures	136
<i>CAS - 4 Cost Accounting Standard on Cost of Production for Captive Consumption</i>	
Introduction	138
Objective	138
Scope	138
Definition	139
Determination of Cost of Production for Captive Consumption	139
Cost Sheet	143
Disclosure	144
<i>Guidance Note</i>	146
<i>CAS - 5 Cost Accounting Standard on determination of average (equalized) cost of transportaion</i>	
Introduction	191
Objective	191
Scope	191
Definition	192
Maintenance of records for ascertaining Transportation Cost	193
Treatment of cost	194
Cost Sheet	194
Transaction value	195
The standard will be operative from the date of issue	195
<i>CAS - 6 Cost Accounting Standard on Material Cost</i>	
Introduction	199
Objective	199
Scope	199
Definition	200
Principles of Measurement	201
Assignment of costs	203



Contents	Pages
Presentation	204
Disclosures	204
Guidance Note	206
CAS - 7 Cost Accounting Standard on Employee Cost	
Introduction	246
Objective	246
Scope	246
Definition	246
Principles of Measurement	249
Assignment of costs	250
Presentation	251
Disclosures	251
Guidance Note	253
CAS - 8 Cost Accounting Standard on Cost of Utilities	
Introduction	282
Objective	282
Scope	282
Definition	282
Principles of measurement	284
Assignment of costs	285
Presentation	285
Disclosures	285
Guidance Note	287
CAS - 9 Cost Accounting Standard on Packing Material Cost	
Introduction	309
Objective	309
Scope	309
Definition	309
Principles of Measurement	312
Assignment of Cost	314
Presentation	314
Disclosure	315
Guidance Note	316
CAS - 10 Cost Accounting Standard on Direct Expenses	
Introduction	340
Objective	340



Contents	Pages
Scope	340
Definition	340
Principles of Measurement	341
Assignment of costs	343
Presentation	343
Disclosures	343
Guidance Note	345
CAS - 11 Cost Accounting Standard on Administrative Overheads	
Introduction	357
Objective	357
Scope	357
Definition	357
Principles of Measurement	358
Assignment of Cost	359
Presentation	360
Disclosures	360
Guidance Note	361
CAS- 12 Cost Accounting Standard on Repairs and Maintenance Cost	
Introduction	378
Objective	378
Scope	378
Definition	378
Principles of Measurement	380
Assignment of costs	382
Presentation	382
Disclosures	382
CAS - 13 Cost Accounting Standard on Cost of Service Cost Centre	
Introduction	384
Objective	384
Scope	384
Definition	384
Principles of Measurement	386
Assignment of Cost	388
Presentation	388
Disclosures	388



Contents	Pages
<i>CAS - 14 Cost Accounting Standard on Pollution Control Cost</i>	
Introduction	390
Objective	390
Scope	390
Definition	390
Principles of Measurement	392
Assignment of costs	394
Presentation	395
Disclosures	395
<i>CAS - 15 Cost Accounting Standard on Selling And Distribution Overheads</i>	
Introduction	397
Objective	397
Scope	397
Definition	397
Principles of Measurement	399
Assignment of Cost	399
Presentation	400
Disclosures	400
Effective date	401
<i>CAS - 16 Cost Accounting Standard on Depreciation and Amortisation</i>	
Introduction	402
Objective	402
Scope	402
Definition	402
Principles of Measurement	403
Assignment of Cost	405
Presentation	406
Disclosures	406
Effective date	406
<i>CAS - 17 Cost Accounting Standard on Interest and Financing Charges</i>	
Introduction	407
Objective	407
Scope	407
Definition	407
Principles of Measurement	408
Assignment of Cost	409
Presentation	409
Disclosures	409
Effective date	409



Preface to the Cost Accounting Standards

The erstwhile ICWAI set up National Management Accounting Standards Board (NAMASB) in 1981 with the objective to draft and circulate Standard Management Accounting Practices to elicit a wide consensus and opinion from various bodies such as Industry Associations, Government etc.

NAMASB issues guidelines relating to Capacity determination and also draft guidelines Inventory Valuation

Constitution of the Cost Accounting Standards Board

The Council of the Institute of Cost and Work Accountants of India (ICWAI), recognizing the need for structured approach to the measurement of cost so as to provide guidance to the user organizations, government bodies, regulators, research agencies, academic institutions and others to achieve uniformity and consistency in classification, measurement and assignment of cost, has constituted the Cost Accounting Standards Board (CASB) in 2001-02 with the objective of formulating the Cost Accounting Standards.

Many of the principles stipulated in the Cost Accounting Standards issued by CASB are applicable to entities engaged in manufacture of goods and/or rendering of services. At later date CASB might issue Cost Accounting Standards specific to service sector.

The composition of the CASB will be broad based and ensure participation of all interest groups in the standard setting process. The Chairman of the CASB will be nominated by the Council of the Institute. Apart from six members of the Council nominated on the CASB, the following will be represented on the CASB:

1. A nominee of the Central Government representing Ministry of Corporate Affairs, Government of India.
2. Adviser (Cost), Cost Audit Branch, Ministry of Corporate Affairs, Government of India.
3. A nominee of the Central Government representing Central Board of Excise and Customs, Government of India.
4. A nominee of the Central Government representing Central Board of Direct Taxes, Government of India.
5. Two members of the Institute representing leading companies.
6. Four nominees from regulators viz, CAG, RBI, TRAI, SEBI, CCI, CERC, IRDA, PNGRB etc.
7. Two nominees from professional Institutions viz, ICAI, ICSI etc.
8. Three nominees of Industry Associations viz, ASSOCHAM, CII, PHDCCI, FICCI etc.
9. Two nominee from academic Institutions viz, IIM, MDI, Universities etc.
10. Four eminent practicing members of the Institute.



Preface to the Cost Accounting Standards

11. President is authorized to include a maximum of two eminent persons having knowledge and expertise in the Cost and Management Accounting / Accounting Standards not falling under the categories as defined in the constitution.

The quorum of the Board shall be eight members.

The terms and period of appointment will be decided by the Council.

Objectives and Functions of the Cost Accounting Standards Board

The objectives of the Cost Accounting Standards Board are to develop high quality Cost Accounting Standards to enable the management to take informed decisions and to enable regulators to function more effectively by Integrating, harmonizing, and standardizing cost accounting principles and practices.

The following will be the functions of the CASB:

- (i) To issue the framework for the Cost Accounting Standards.
- (ii) To equip the Cost and Management Accounting professionals with better guidelines on Cost Accounting Practices.
- (iii) To assist the members in preparation of uniform cost statements under various statutes.
- (iv) To provide from time to time interpretations on Cost Accounting Standards.
- (v) To issue application guidance relating to a particular standard.
- (vi) To propagate the Cost Accounting Standards and to persuade the users to adopt them in the preparation and presentation of General Purpose Cost Statement.
- (vii) To persuade the Government and appropriate authorities to enforce Cost Accounting Standards, to facilitate the adoption thereof, by industry and corporate entities in order to achieve the desired objectives of standardization of Cost Accounting practices.
- (viii) To educate the users about the utility and need for compliance of cost accounting standards.

Procedure for issuing the Cost Accounting Standards

The following procedure shall be adopted for formulating and issuing Cost Accounting Standards:

- I. The selection of topics which the Cost Accounting Standards have to be formulated and the sequence in which they will be developed will be decided by the CASB, on its own volition or on the basis of requests received from an interest group.
- II. The CASB will constitute a Task Force for each issue taken up for the formulation of the Cost Accounting Standard. The Task force will prepare the initial draft of the proposed standard.



Preface to the Cost Accounting Standards

- III. The draft of the proposed standard will generally be in the following format:
1. Introduction;
 2. Objectives;
 3. Scope;
 4. Definitions and explanations of the terms used;
 5. Principles of Measurement;
 6. Assignment of Cost;
 7. Presentation;
 8. Disclosure;

Application Guidance will be provided as annexure, wherever required.

In case of deviation from the above format, suitable explanation shall be provided by the Task Force preparing the standard.

The standards formulated by the Cost Accounting Standards Board include paragraphs in **bold italic** type and plain type, which have equal authority. Paragraphs in **bold italic** type indicate the main principles. An individual Cost Accounting Standard should be read in the context of the objective stated in that standard and this Preface.

- IV. The initial draft prepared by the Task Force shall be examined by the CASB, with inputs from the Technical Directorate.
- V. The CASB will issue an Exposure Draft with or without modification to the initial draft.
- VI. The Exposure draft of the Cost Accounting Standard will be hosted on the website of the Institute and published in Management journal for comments of stakeholders and public at large.
- VII. The Exposure Draft will be sent to the members of the Central Council, Past Presidents, members of the regional councils and chapters and the leading entities in public and private sectors and circulated among bodies for their comments.
- VIII. After taking into consideration the comments received, the draft of the proposed Standard will be finalized by the CASB as Cost Accounting Standard and will be submitted to the Council of the ICWAI for approval.
- IX. The Council of the ICWAI will consider the proposed Standard, and if found necessary, will modify the same in consultation with the CASB. After the Council recommends adoption, the Cost Accounting Standard on the relevant subject will then be issued by the ICWAI.



Preface to the Cost Accounting Standards

- X. The Cost Accounting Standards shall be issued under the authority of the Council of the ICWAI
- XI. The effective date of implementation of the Standard will be decided by the Council of the ICWAI in consultation with CASB. However, no standards will have retrospective application unless otherwise stated.

Authority attaching to Cost Accounting Standards

While formulating the Cost Accounting Standards, the CASB will take into consideration the applicable laws, usage and business environment prevailing in India. CASB will also give due consideration to the Cost Accounting Standards, principles and practices being followed by the other countries in the world. If a particular standard or part thereof is inconsistent with a law, the provisions of the said law shall prevail.

The Cost Accounting Standards are intended to apply to the items which are material.

The Cost Accounting Standards Board may consider any issue requiring interpretation of and Cost Accounting Standard. Interpretations will be issued under the authority of the Council. The authority of interpretations is the same as that of Cost Accounting Standard to which it relates.

Procedure for and Authority of Application Guidance

This preface recognizes, as one of the functions of the Cost Accounting Standards Board (CASB), the issuance of Application Guidance (AG) relating to individual Cost Accounting Standards. For the purpose, the CASB will identify implementation issues and consider how CASB can best respond to such issues.

The response will take the form of Application Guidance which may take several forms—narratives, FAQ's, Illustrative examples and others. The objective is to help preparers of cost statement, auditors, and users to understand Cost Accounting Standards better, particularly first-time preparers and users and to ensure consistent application of a standard.

Procedure for preparation and issue of the Application Guidance

The procedure to be followed in this regard will be as follows:

1. The Cost Accounting Standards Board will constitute an Application Guidance Committee (AGC) for a Standard for which Application Guidance is required.
2. The Committee will have a minimum of four members, of which at least one will be a member of the CASB and others with backgrounds as preparers of Cost Statements, auditors, regulators. The member of the CASB will be the Chairman of the said committee and is authorized to co-opt maximum two members with consent of the Chairman, CASB.



Preface to the Cost Accounting Standards

3. The Application Guidance will be drafted by the CASB Secretariat with or without the support of outside experts; the draft shall take into account issues identified by the Board and queries or opinions received from various stakeholders during the exposure period of the Standard and after its publication.
4. The draft Application Guidance will be approved by the Application Guidance Committee and the same shall be posted on the CASB website at least for thirty days for public comments.
5. The Application Guidance Committee will finalise the Application Guidance based on the comments received from the public and recommend the same to CASB for approval.
6. The CASB shall consider and recommend the Application Guidance to the Council for necessary approval.
7. The Council will approve the Application Guidance for issuance.

Authority attached to the application Guidance

The Application Guidance will be explanatory to the corresponding Cost Accounting Standard and will not override the same.

Compliance with the Cost Accounting Standards

The Cost Accounting Standards issued / to be issued are to be principle based, dealing with cost accounting principles for preparation of the General Purpose Cost Statement which required to be attested by the Cost Accounting professionals wherever applicable.

As far as maintenance of cost accounting records under the Companies Act or any other statute is concerned, relevant matter covered under the standards, wherever applicable shall be followed. Cost Auditors shall report the deviations, if any, in the Cost Audit Report or attestation required by any statute.



CAS-1 COST ACCOUNTING STANDARD ON “CLASSIFICATION OF COST”

The following is the text of the COST ACCOUNTING STANDARD 1 (CAS 1) issued by the Council of the Institute of Cost and Works Accountants of India on “**Classification of Cost**”. The standard deals with the principle of classifying costs in the cost statements. In this Standard, the standard portions have been set in ***bold italic*** type. These should be read in the context of the background material which has been set in normal type.

1. Introduction

The standard on classification of costs deals with the basis of classification of costs and the practice to be adopted for classification of cost elements in regard to its nature and management objective. The statement aims at providing better understanding on classification of cost for preparation of various cost statements required for statutory obligations or cost control measures.

2. Objective

- 2.1 The objective of this Standard is to prescribe the classification of costs for ascertainment of cost of a product or service and preparation of cost statements on a consistent and uniform basis with a view to effect the comparability of the same of an enterprise with that of previous periods and of other enterprises.
- 2.2 The classification and its disclosure are aimed at providing better transparency in the cost statement.
- 2.3 The standard is also for better adoption of Uniform Costing and Inter-firm Comparison.

3. Scope

- 3.1 The standard on classification of cost should be applied in assessment of cost of a product or service, application of costing technique and in case of management decision making by the manufacturing industries in India.
- 3.2 The standard is to be followed by an enterprise, whether covered under section 209(1)(d) of the Companies Act, 1956 or not, to classify cost in order to prepare cost statement on uniform basis to make it relevant and understandable for effective cost management.
- 3.3 The standard has also to be followed for the purpose of assessment of cost of production or valuation of product or the valuation of stock to be certified for calculation of duties and taxes, tariffs and other purposes as the case may be. The cost statement prepared based on standard will be used for assessment of excise duty and other taxes, anti-dumping measures, transfer pricing etc.



4. Definitions:

4.1 Cost : *Cost is a measurement, in monetary terms, of the amount of resources used for the purpose of production of goods or rendering services.*

4.2 Manufacturing of goods or rendering services involves consumption of resources. Cost is measured by the sacrifice made in terms of resources or price paid to acquire goods and services. The type of cost is often referred in the costing system depends on the purpose for which cost is incurred. For example material cost is the price of materials acquired for manufacturing a product.

4.3 Cost Centre : *Any unit of Cost Accounting selected with a view to accumulating all cost under that unit. The unit may be a product, a service, division, department, section, a group of plant and machinery, a group of employees or a combination of several units. This may also be a budget centre.*

4.4 Cost Centre or Cost Object is the logical sub-unit for collection of cost. Cost Centre may be of two types – personal and impersonal cost centers. Personal cost centre consists of a person or a group of persons. Cost centres which are not personal cost centres are impersonal cost centers. Again Cost centers may be divided into broad types i.e. Production Cost Centres and Service Cost Centres. Production Cost Centres are those which are engaged in production like Machine shop, Welding shop, Assembly shop etc. Service Cost centers are for rendering service to production cost centre like Power house, Maintenance, Stores, Purchase office etc.

4.5 Cost unit is a form of measurement of volume of production or service. This unit is generally adopted on the basis of convenience and practice in the industry concerned.

4.6 Examples of Cost Units :

Power - MW

Cement - MT

Automobile - Number etc

5. Basic Rules for Classification of Costs

5.1 Classification of cost is the arrangement of items of costs in logical groups having regard to their nature (subjective classification) or purpose (objective classification).

5.2 Items should be classified by one characteristic for a specific purpose without ambiguity.

5.3 Scheme of classification should be such that every item of cost can be classified.

**5.4 Basis of classification :**

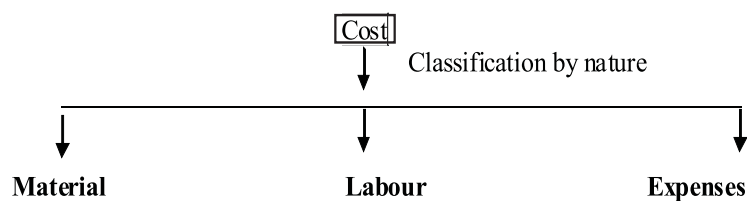
- i) Nature of expense**
- ii) Relation to object – traceability**
- iii) Functions / activities**
- iv) Behaviour fixed, semi-variable or variable**
- v) Management decision making**
- vi) Production Process**
- vii) Time period**

5.5 Classification of cost is the process of grouping the components of cost under a common designation on the basis of similarities of nature, attributes or relations. It is the process of identification of each item and the systematic placement of like items together according to their common features. Items grouped together under common heads may be further classified according to their fundamental differences. The same costs may appear in several different classifications depending on the purpose of classification.

5.6 Cost is classified normally in terms of a managerial objective. Its presentation normally requires sub-classification. Such sub-classification may be according to nature of the cost elements, functional lines, areas of responsibility, or some other useful break-up. The appropriate sub-classification depends upon the uses to be made of the cost report.

6. Classification of Costs**6.1 By Nature of expense:**

6.1.1 Costs should be gathered together in their natural groupings such as material, labour and other expenses. Items of costs differ on the basis of their nature. The elements of cost can be classified in the following three categories : i) Material ii) Labour iii) Expenses



6.1.2 Material Cost is the cost of material of any nature used for the purpose of production of a product or a service.

6.1.3 Material cost includes cost of procurement, freight inwards, taxes & duties, insurance etc directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks, refunds on account of modvat, cenvat, salex tax and other



similar items are deducted in determining the costs of material.

6.1.4. Labour Cost means the payment made to the employees, permanent or temporary, for their services.

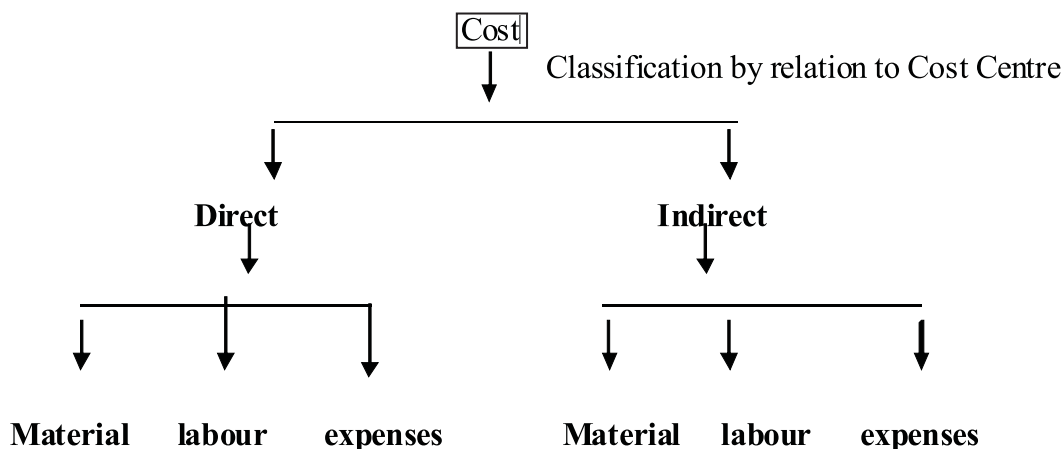
6.1.5 Labour cost include salaries and wages paid to permanent employees, temporary employees and also to employees of the contractor. Here, salaries & wages include all fringe benefits like Provident Fund contribution, gratuity, ESI, overtime, incentives, bonus , ex-gratia, leave encashment, wages for holidays and idle time etc.

6.1.6 Expenses are other than material cost or labour cost which are involved in an activity.

6.1.7 Expenditure on account of utilities, payment for bought out services, job processing charges etc. can be termed as expenses.

6.2 By Relation to Cost Centre

6.2.1 Classification should be on the basis of method of allocation of cost to a cost unit. If an expenditure can be allocated to a cost centre or cost object in an economically feasible way then it is called direct otherwise the cost component will be termed as indirect. According to this criteria for classification, material cost is divided into direct material cost and indirect material cost, labour cost into direct labour cost and indirect labour cost and expenses into direct expenses and indirect expenses. Indirect cost is also known as overhead.



6.2.2 Direct cost has three components – direct material cost, direct labour cost and direct expenses and indirect cost has three components- indirect material, indirect labour cost and indirect expenses. Sum of all direct costs is called prime cost .



6.2.3 *Direct material Cost is the cost of material which can be directly allocated to a cost centre or a cost object in a economically feasible way.*

6.2.4 Raw materials consumed for production for a product or service which are identifiable in the product or service form the direct material cost. Direct Material cost includes cost of procurement, freight inwards, taxes & duties, insurance etc directly attributable to the acquisition. Trade discounts, rebates, duty drawbacks, refunds on account of modvat, cenvat, salex tax and other similar items are deducted in determining the costs of direct material.

6.2.4 *Direct Labour Cost is the cost of wages of those workers who are readily identified or linked with a cost centre or cost object.*

6.2.5 Here, the wages of the workers include the fringe benefits include all fringe benefits like Provident Fund contribution, gratuity, ESI, overtime, incentives, bonus , ex-gratia, leave encashment, wages for holidays and idle time etc. for the purpose of calculation of direct labour cost.

6.2.6 *Direct Expenses are the expenses other than direct material or direct labour which can be identified or linked with the cost centre or cost object.*

6.2.7 Examples of direct expenses are

- expenses for special moulds required in a particular cost centre
- hiring charges for tools and equipments for a cost centre
- royalties in connection to a product
- Job processing charges etc

6.2.8 *Indirect Material is the cost of material which can not be directly allocable to a particular cost centre or cost object.*

6.2.9 Materials which are of small value and can not be identified in or allocated to a product/service are classified as indirect materials. Examples :

- Consumable spares and parts
- Lubricants etc.

6.2.10 *Indirect labour cost is the wages of the employees which are not directly allocable to a particular cost centre.*

6.2.11 Examples of indirect labour :

- Salaries of staff in the administration and accounts department
- Salaries of security staff etc

6.2.12 Indirect expenses are the expenses other than of the nature of material or labour and can not be directly allocable to a particular cost centres.



6.2.13 Indirect expenses are not be allocable to a particular cost centre. Examples – insurance, taxes and duties,

6.3 By functions/activities:

6.3.1 Costs should be classified according to the major functions for which the elements are used into the following four major functions :

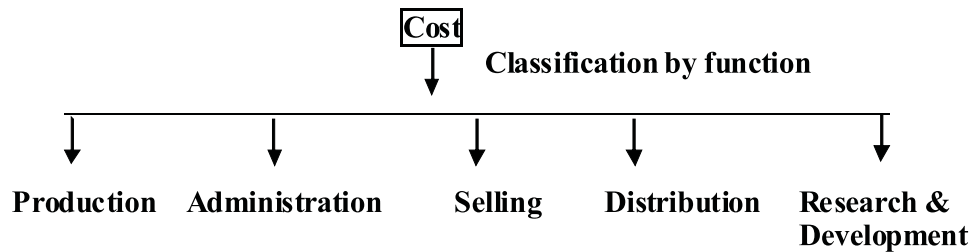
Production;

Administration;

Selling;

Distribution; and

Research & Development Expenditure.



6.3.2 Production Cost is the cost of all items involved in the production of a product or service. It includes all direct costs and all indirect costs related to the production.(Exhibit 1)

6.3.3 Production overhead is the indirect costs involved in the production process.

6.3.4 Production overhead is also termed as factory overhead or manufacturing overhead. Examples of Production overhead :

- Salaries for staff for production planning, technical supervision, factory administration etc
- normal idle time cost
- expenses for stores management
- security expenses in the factory
- labour welfare expenses
- dispensary and canteen expenses
- depreciation of plant and machineries
- repair and maintenance of factory building and plant & machineries
- insurance
- quality control etc.



6.3.5 Administration costs are expenses incurred for general management of an organization. These are in the nature of indirect costs and are also termed as administrative overhead.

6.3.6 Examples of items to be included in Administrative overhead :

- Salaries of administrative and accounts staff
- general office expenses like rent, lighting, rates and taxes, telephone, stationery, postage etc
- bank charges
- audit fees
- legal expenses
- depreciation & repair and maintenance of office building etc.

6.3.7 Selling costs are indirect costs related to selling of products or services and include all indirect cost in sales management for the organization.

6.3.8 Selling Costs include all costs relating to regular sales and sales promotion activities. Examples of expenses which are included in selling cost are :

- Salaries, commission and traveling expenses for sales personnel
- advertisement cost
- Legal expenses for debt realization
- market research cost
- royalty on sale
- after sales service cost etc

6.3.9 Distribution Costs are the cost incurred in handling a product from the time it is completed in the works until it reaches the ultimate consumer.

6.3.10 Distribution costs are the costs incurred for distribution of product to customers. Examples of distribution costs :

- Transportation cost
- cost of warehousing salable products
- cost of delivering the products to customers. etc

Note

1. Primary packaging cost is included in production cost whereas secondary packaging cost is distribution cost.
2. In exceptional cases, for example in case of heavy industries equipment supply, installation cost at delivery site for heavy equipments which involves assembling of parts, testing etc is included in production cost but not distribution cost. For example. installation cost of a gas turbine at plant site is included in the cost of production of gas turbine.



6.3.11 Research & Development Costs are the cost for undertaking research to improve quality of a present product or improve process of manufacture, develop a new product, market research etc and commercialization thereof.

6.3.12 Research Cost comprises the cost of development of new product and manufacturing process; improvement of existing products, process and equipment; finding new uses for known products; solving technical problem arising in manufacture and application of products etc. Development cost includes the cost incurred for commercialization / implementation of research findings.

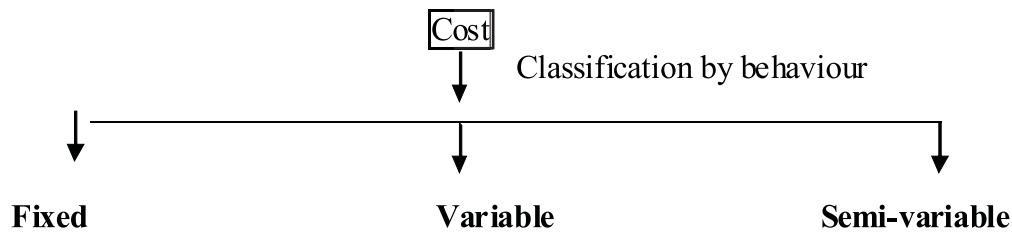
Exhibit 1

	(1) Direct Material Cost (a)
	(2) Direct Labour Cost
	(3) Direct Expenses
(1)+(2)+(3) =	(4) Prime Cost
	(5) Production Overhead
	(6) Administrative Overhead
	(7) Research & Development Cost (apportioned)
(4)+(5)+(6)+(7)=	(8) Cost of Production (b)
	(9) Selling Cost
	(10) Distribution Cost
(8)+(9)+(10) =	(11) Cost of Sales
Note :	
To arrive at value at different points as indicated above adjustment with opening and closing stock is necessary at following different points :	
(a) opening and closing stock of raw materials	
(b) opening and closing stock of work-in-progress & finished goods	



6.4 By Behaviour

6.4.1 ***Costs are classified based on behaviour as fixed cost, variable cost and semi-variable cost depending upon response to the changes in the activity levels.***



6.4.2 ***Fixed Cost is the cost which does not vary with the change in the volume of activity in the short run. These costs are not affected by temporary fluctuation in activity of an enterprise. These are also known as period costs.***

6.4.3 Examples for fixed cost : salaries, rent, audit fees, depreciation etc.

6.4.4 ***Variable Cost is the cost of elements which tends to directly vary with the volume of activity. Variable cost has two parts – (a) Variable direct cost; and (b) Variable indirect costs. Variable indirect costs are termed as variable overhead.***

6.4.5 Examples of variable cost are materials consumed, direct labour, sales commission, utilities, freight, packing, etc.

6.4.6 ***Semi Variable Costs contain both fixed and variable elements. They are partly affected by fluctuation in the level of activity.***

6.4.7 Examples of semi-variable cost : Factory supervision, maintenance, power etc.

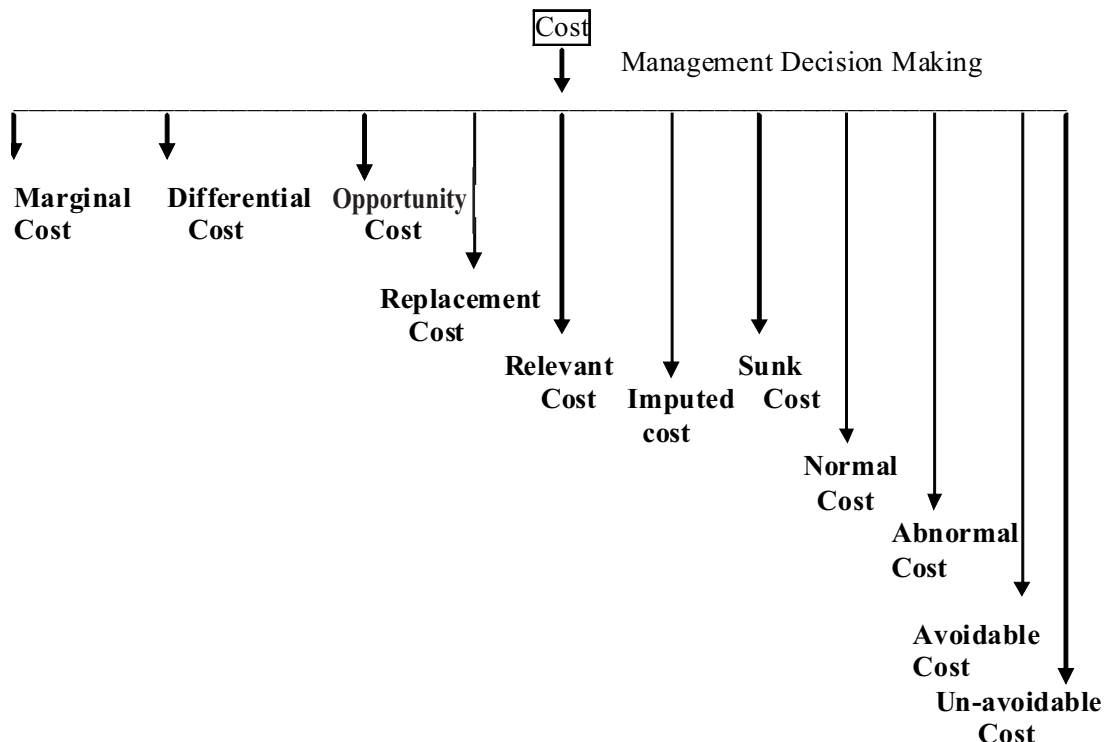
Note :

1. The characteristics of fixed costs are (1) fixed amount within an output range (2) fixed cost per unit decreases with increased output
2. The characteristics of variable Cost: (1) The variable cost varies directly with volume of activities or production (2) variable cost remains constant per unit within a range of activity .



6.5 For Management Decision Making

6.5.1 *Costs are classified for the purpose of management decision making under different circumstances as under :*



6.5.2 *Marginal cost is the aggregate of variable costs, i.e. prime cost plus variable overhead. Marginal cost per unit is the change in the amount at any given volume of output by which the aggregate cost changes if the volume of output is increased or decreased by one unit.*

6.5.3 Marginal cost is used in Marginal Costing system. For determining marginal cost, semi-variable costs, if any, are segregated into fixed and variable cost. Then, variable costs plus the variable part of semi-variable costs is the total marginal cost for the volume of production in consideration.



Example :

A. Production		45,000 units	
B. Cost	Fixed Cost Rs lakhs	Variable Cost Rs lakhs	
1. Material cost		4.50	
2. Labour cost		2.45	
3. Fixed Cost	4.80	-	
4. Variable Production & Selling overhead	2.30		
5. Semi-variable Cost (after segregation fixed and variable part)	3.20	2.00	
C. Total Marginal Cost		11.25	
D. Marginal cost per unit		Rs 25.00	

6.5.4. Differential Cost is the change in cost due to change in activity from one level to another.

6.5.5 Differential Cost is found by using the principle which highlights the points of differences in costs by adoption of different alternatives. This technique is used in export pricing, new products and pricing goods sought to be promoted in new markets, either within the country or outside.

6.5.6 The algebraic difference between the relevant cost at two levels of activities is the differential cost. When the level of activity is increased, the differential cost is known as incremental cost and when the level of activity is decreased, the decrease in cost is known as decremental cost.

Output Unit in Lakhs	Differential Unit in Lakhs	Total Cost (Rs lakhs)	Differential cost (Rs lakhs)	Differential cost per unit(Rs)
(a) 1.00	—	30.00	—	—
(b) 1.20	0.20 (b) – (a) –	35.00	5.00	25.00
(c) 0.80	0.20 (a) – (c)	26.00	- 4.00	- 20.00

(+) Incremental cost
(-) Decremental cost



6.5.7 Opportunity Cost is the value of the alternatives foregone by adopting a particular strategy or employing resources in specific manner.

6.5.8 It is the return expected from an investment other than the present one. The opportunity cost is considered for selection of a project or justification of investment, studying viability of an investment option.

Example : A machine is currently being used to produce product P. It can also be used to produce product Q which can fetch Rs 60,000 profit. Then the opportunity cost of using the machine is Rs 60000.

6.5.9 Replacement Cost is the cost of an asset in the current market for the purpose of replacement.

6.5.10 Replacement cost is generally used for determining the optimum time of replacement of an equipment or machine in consideration of maintenance cost of the existing one and its productive capacity.

6.5.11 Relevant Costs are costs relevant for a specific purpose or situation.

6.5.12 In the context of decision making relating to a specific issue, only those costs which are relevant are considered. A particular cost item may be relevant in a decision making and may be irrelevant in some other decision making situation. For example, present depreciated cost of machine is relevant in case of decision of its sale but it is irrelevant in case of decision of its replacement.

6.5.13 Imputed Costs are hypothetical or notional costs, not involving cash outlay, computed only for the purpose of decision making.

6.5.14. In economics, 'imputed' indicates an ascribed or estimated value when there is no criteria of absolute monetary value for such purpose. In national income estimation wages of housewives are imputed. Similarly, in farming operations, the wages or salaries of owner are imputed. Imputed costs are similar to opportunity costs. Interest on internally generated fund, which is not actually paid is an example of imputed cost.

6.5.15 Sunk Costs are historical costs which are incurred i.e. 'sunk' in the past and are not relevant to the particular decision making problem being considered.

6.5.16 Sunk costs are those that have been incurred for a project and which will not be recovered if the project is terminated. While considering the replacement of a plant, the depreciated book value of the old asset is irrelevant as the amount is a sunk cost which is to be written off at the time of replacement.

6.5.17 Normal Cost is a cost that is normally incurred at a given level of output in the conditions in which that level of output is achieved.



6.5.18 Normal cost includes those items of cost which occur in the normal situation of production process or in the normal environment of the business. The normal idle time is to be included in the ascertainment of normal cost.

6.5.19 Abnormal Cost is an unusual or a typical cost whose occurrence is usually irregular and unexpected and due to some abnormal situation of the production.

6.5.20 Abnormal cost arises due to idle time for some heavy break down or abnormal process loss. They are not considered in the cost of production for decision making and charged to profit & loss account.

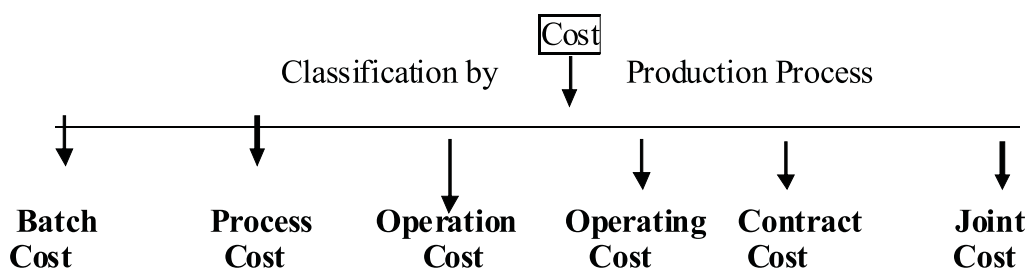
6.5.21 Avoidable Costs are those costs which under given conditions of performance efficiency should not have been incurred.

6.5.22. Avoidable costs are logically associated with some activity or situation and are ascertained by the difference of actual cost with the happening of the situation and the normal cost. When spoilage occurs in manufacture in excess of normal limit, the resulting cost of spoilage is avoidable cost. Cost variances which are controllable may be termed as avoidable cost.

6.5.23 Unavoidable Costs are inescapable costs which are essentially to be incurred, within the limits or norms provided for. It is the cost that must be incurred under a programme of business restriction. It is fixed in nature and inescapable.

6.6. By nature of production process

6.6.1 Costs are also classified on the basis of nature of production or manufacturing process.



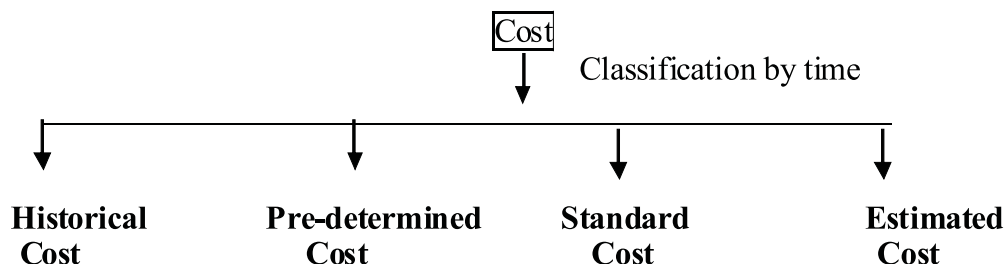
6.6.2 Batch Cost is the aggregate cost related to a cost unit which consist of a group of similar articles which maintain its identity throughout one or more stages of production.



- 6.6.3** *Process cost : When the production process is such that goods are produced from a sequence of continuous or repetitive operations or processes, the cost incurred during a period is considered as process cost. The process cost per unit is derived by dividing the process cost by number of units produced in the process during the period.*
- 6.6.4. Accounts are maintained for cost of a process for a period. The average cost per unit produced during the period is process cost per unit.
- 6.6.5** *Operation Cost is the cost a specific operation involved in a production process or business activity.*
- 6.6.6. When there are distinctly separate operations involved in a process, cost for each operation is found out for effective control mechanism.
- 6.6.7** *Operating Cost is the cost incurred in conducting a business activity. Operating costs refer to the cost of undertakings which do not manufacture any product but which provide services.*
- 6.6.8** *Contract cost is the cost of a contract with some terms and condition of adjustment agreed upon between the contractee and the contractor.*
- 6.6.9 Contract cost usually implied to major long term contracts as distinct from short term job costs. Escalation clauses are sometimes provided in the contract in order to take care of anticipated change in material price, labour cost etc.
- 6.6.10** *Joint Costs are the common cost of facilities or services employed in the output of two or more simultaneously produced or otherwise closely related operations, commodities or services.*
- 6.6.11 When a production process is such that from a set of same input, two or more distinguishably different products are produced together, products of greater importance are termed as joint products and products of minor importance are termed as by-products and the costs incurred prior to the point of separation of the products are termed as Joint Costs. For example, in a petroleum refinery industry, petrol, diesel oil, kerosene oil, naptha, tar etc are produced jointly in the refinery process.
- 6.6.12** *By-Product Cost is the cost assigned to the by-products.*

6.7 *Classification by time*

- 6.7.1** *A cost item is related to a specific period of time and cost can be classified according to the system of assessment and specific purpose as indicated in the following ways:*



6.7.2 Historical Costs are the actual costs of acquiring assets or producing goods or services.

6.7.3 They are 'postmortem' costs ascertained after they have been incurred and they represent the cost of actual operational performance. Historical costing system follows a system of accounting to which all values (in revenue and capital accounts) are based on costs actually incurred or as relevant from time to time.

6.7.4 Pre-determined Costs for a product are computed in advance of production, on the basis of a specification of all the factors affecting cost and cost data. Pre-determined costs may be either standard or estimated.

6.7.5 Standard Costs : 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 of deviation placed.

6.7.6. 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.

6.7.7 Estimated Costs of a product are prepared in advance prior to the performance of operations or even before the acceptance of sale orders.

6.7.8 Estimated cost is found with specific reference to product in question, and activity level of the plant. It has no link with actual and hence it is assumed to be less accurate than the standard cost.

7. Presentation and Disclosure:

7.1 The classification of cost item should be done on ' basis of classification' chosen with pre-determined objective.



- 7.2** *The classification of cost item should be followed consistently from period to period and preparation of cost statements should be made with reference to a period of time.*
- 7.3** *A change in classification should be made only if it is required by law or for compliance with a Cost Accounting Standard or the change would reset in a more appropriate preparation or presentation of cost statements of an enterprise.*
- 7.4.** *Any change in classification of cost which has a material effect on the cost of the product should be disclosed in the cost statements. Where the effect of such change is not ascertainable wholly or partly, the fact should be indicated in the cost statement.*



(CAS-2)

COST ACCOUNTING STANDARD ON CAPACITY DETERMINATION

The following is the COST ACCOUNTING STANDARD 2 (CAS 2) issued by the Council of the Institute of Cost and Works Accountants of India on "**CAPACITY DETERMINATION**". The standard deals with determination of capacity of a unit. In this Standard, the standard portions have been set in ***bold italic*** type. These are to be read in the context of the background material which has been set in normal type.

1. Introduction

Better utilization of capacity means better utilization of resources. It is an important consideration for cost determination and cost reduction. Thus, it is essential to establish the capacity of the plant. Cost Accounting Records Rules under section 209(1) (d) of Companies Act, 1956 and Cost Audit Report Rules, 2001 under section 233B of the said Act specify that comparative statement of installed capacity and actual capacity utilization is to be recorded and furnished in order to assess the operating level.

2. Objective

- 2.1 The objective of the standard is to prescribe the method of determination of capacity to be applied uniformly and consistently.
- 2.2 The standard is to help the management to identify the bottlenecks, imbalances and idle capacity for effective use of various resources.
- 2.3 The standard is to help in proper allocation, apportionment and absorption of cost.

3. Scope

- 3.1 ***The standard should be followed for capacity determination required to be carried out for any purpose or under provisions of any Act, Rules or Regulations except where capacity determination has been prescribed otherwise.***
- 3.2 ***The standard shall also be followed for maintaining cost records under the Cost Accounting Records Rules or for furnishing information on Capacity Utilization under the Cost Audit Report Rules issued pursuant to Section 209(1) (d) and section 233B of Companies Act, 1956 respectively.***
- 3.3 The standard is applicable for an undertaking, whether existing or new, where there is expansion of more than 5% of the existing capacity due to introduction of new machines or productive resources. Similarly, the standard is also applicable where there is more than 5% reduction of the existing capacity due to disposal or withdrawal or impairment of old machines or productive resources.



4. Definitions

4.1 ***'Licensed Capacity' is the production capacity of the plant for which license has been issued by an appropriate authority.***

4.2 ***'Installed Capacity' is the maximum productive capacity according to the manufacturers' specification of machines / equipment. Installed capacity of the unit/plant is determined after taking into account imbalances in different machines/ equipment in the various departments / production cost centres in the unit / plant and number of working shifts.***

4.3 ***'Practical or Achievable Capacity' is the maximum productive capacity of a plant reduced by the predictable and unavoidable factors of interruption pertaining to internal causes.***

Thus, practical capacity is the installed capacity minus the inevitable interruptions due to time lost for preventive maintenance, repairs, set ups, normal delays, weekly off-days and holidays etc. Practical capacity does not consider the external factors causing reduction in production e.g. lack of orders.

4.4 ***'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.***

Normal capacity is practical capacity minus the loss of productive capacity due to external factors.

4.5 ***'Actual Capacity Utilization' is the volume of production achieved in relation to installed capacity.***

4.6 ***'Idle Capacity' is the difference between installed capacity and the actual capacity utilization when actual capacity utilization is less than installed capacity.***

4.7 ***'Excess Capacity Utilization' is the difference between installed capacity and the actual capacity utilization when actual capacity utilization is more than installed capacity.***

4.8 ***'Abnormal idle capacity' is the difference between practical capacity and normal capacity or actual capacity utilization whichever is higher.***

5. Determination of Installed Capacity

5.1 ***Installed capacity is determined based on :***

- i) ***Manufacturers' Technical specifications***
- ii) ***Capacities of individual or interrelated production centres.***
- iii) ***Operational constraints / capacity of critical machines***



- iv) **Number of shifts**
 - v) **Any other factor**
- 5.2 ***In case of manufacturers' technical specifications are not available, the estimates by technical experts on capacity under ideal conditions may be considered for determination of installed capacity.***
- 5.3 ***In case a product passes through different production processes and each process is having different capacity then the process which brings effective or ultimate production shall be considered for deciding installed capacity.***
6. **Determination of Practical / Achievable Capacity**
- 6.1 ***Practical capacity or achievable capacity should be determined after adjustment of the following with the installed capacity.***
- (i) ***Available production hours taking into consideration holidays, normal shut down days and normal idle time.***
 - (ii) ***Normal time loss in batch change over, break downs of machines, repairs etc.***
 - (iii) ***Loss in efficiency due to ageing of the machines/ equipment***
 - (iv) **Number of shifts**
 - (v) **Any other factor**
7. **Determination of Normal Capacity**
- 7.1 ***Normal capacity is determined based on the productive capacity achieved over a period of time, say average of three normal years out of preceding five years or expected to be achieved over a period of time, say next three to five years.***
- 7.2 ***This capacity is determined after adjustment of external factors with practical capacity.***
- 7.3 ***Normal capacity of production process involved in the production of a product or the productive capacity of the plant as a whole should be taken into account to arrive at normal capacity for a product or plant, as the case may be.***
- 7.4 ***The periods influenced by abnormalities should be excluded for this purpose.***
- Explanation:
1. In case the same products with different specifications and of different ranges in terms of size, type, variety etc. are manufactured, then there is a need to determine equivalence among them in order to determine the capacity.



2. In case some intermediate products / components etc are also produced, they should be taken into consideration for determining equivalent capacity.
3. In case some machines are leased out/let out or some machines are taken on lease, resulting decrease / increase in capacity should also be considered.
8. **Disclosure**
 - 8.1 ***The details of basis for arriving at the capacity, variables used and assumptions made should be disclosed.***
 - 8.2 ***Any change in the installed capacity due to modifications in the machines/ equipment or addition of balancing equipment or disposal or impairment of some machines / equipment should be disclosed.***
 - 8.3 ***The licensed capacity and installed capacity should be disclosed in absolute term of production whereas practical capacity, normal capacity and actual capacity utilization should be disclosed in absolute term as well as in percentage of installed capacity.***
 - 8.4 ***In case the same products with different specifications and of different ranges in terms of size, type, variety etc. are manufactured, then there is a need to determine equivalence among them and capacity should be established in terms of equivalent units.***
 - 8.5 ***In case some machines are taken on lease or some machines are leased out, their impact in terms of increase/ decrease in capacity should be disclosed separately.***
 - 8.6 ***In case of low capacity utilization as compared to the installed capacity, reasons for the same should be disclosed. Comments on the shortfall in production should also specify the factors which are controllable and uncontrollable in short term or in long term.***
 - 8.7 ***In case of excess capacity utilization, the same should be disclosed separately in absolute terms and in terms of percentage with reasons.***

**Exhibit 1****Illustration**

Manufacturers' Specifications -

capacity per hour = 500 units

No of shifts (each shift 8 hours) = 3 shifts

Holidays in a year:

Sundays = 52 days

Other holidays = 13 days

Annual maintenance is done

within these 3 holidays

Preventive Weekly Maintenance

for the machine on Sunday.

Normal idle capacity for batch

change over, Lunch, personal need etc = 1 hr per shift

Production based on sales expectancy

in past 5 years = 30.1, 26.9, 29.7 24.4 and 30.2 lakh units

Actual Production for the year = 30.1

Calculation

Installed Capacity for the machine = $365 * 8 * 3 * 500$

= 43.8 lakh units

Practical Capacity = $(365 - 52 - 13)$

$* (8 - 1) * 3 * 500$

= 31.5 lakh units

Out of the past five years, normal

capacity is average of 3 normal years.

Normal Capacity = $(30.1 + 29.7 + 30.2) / 3 = 30.0$ lakh units

Actual Capacity Utilization = 30.1 lakh units = 68.7 %

Idle Capacity = $(43.8 - 30.1) = 13.7$ lakh unit = 31.3 %

Abnormal idle capacity = $31.5 - 30.1 = 1.4$ lakh units



CAS – 2 (REVISED 2012)

COST ACCOUNTING STANDARD ON CAPACITY DETERMINATION

The following is the Cost Accounting Standard - 2 (Revised 2012) issued by the Cost Accounting Standards Board of the Institute of Cost Accountants of India on “**Capacity Determination**”. In this Standard, the standard portions have been set in ***bold italic*** type. These are to 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 capacity of a manufacturing facility of an entity.
- 1.2 Capacity is determined for assignment of overheads to cost objects. Principles of assignment of overheads have been stipulated in Cost Accounting Standard – 3 (Revised 2011) on Overheads.
- 1.3 This standard deals with the principles and methods of classification and determination of capacity of a plant of an entity for ascertainment of the cost of product, and 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 determination of capacity with reasonable accuracy.

3. Scope:

This standard shall be applied to the cost statements, including those requiring attestation, which require determination of capacity for assignment of overheads.

4. Definitions:

The following terms are being used in this standard with the meaning specified.

- 4.1 *Abnormal Idle Capacity: Abnormal idle capacity is the difference between normal capacity and actual capacity utilization where the actual capacity is lower than the normal capacity.***
- 4.2 *Actual Capacity Utilization: Actual Capacity Utilization is the volume of production achieved in a specified period, expressed as a percentage of installed capacity.***



- 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 finally ascertained.¹*
- 4.4 Installed Capacity:** *Installed Capacity is the maximum productive capacity, according to the manufacturer's specifications or determined through an expert study.*
- 4.5 Normal Capacity:** *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.*
- Normal capacity is sometimes referred to as practical or achievable capacity.
- 4.6 Normal Idle Capacity:** *Normal Idle Capacity is the difference between installed capacity and normal capacity.*
- 5. Determination of Capacity:**
- 5.1 Capacity shall be determined in terms of units of production or equivalent machine or man hours.**
- 5.2 Installed Capacity:**
- Installed capacity is determined based on:*
- i) Manufacturers' Technical specifications*
 - ii) Capacities of individual or interrelated production centres.*
 - iii) Operational constraints / capacity of critical machines*
 - iv) Number of shifts*

In case manufacturers' technical specifications are not available, the estimates by technical experts on capacity under ideal conditions shall be considered for determination of installed capacity.

In case any production facility is added or discarded the installed capacity shall be reassessed from the date of such addition or discard. In case the same is reassessed as per direction of the Government, it shall be in accordance with the principles laid down in the said directives.

In case of improvement in the production process, the installed capacity shall be reassessed from the date of such improvement.



5.3 Normal Capacity:

Normal capacity shall be determined vis-a-vis installed capacity after carrying out following adjustments:

- (i) Holidays, normal shut down days and normal idle time,*
- (ii) Normal time lost in batch change over,*
- (iii) Time lost due to preventive maintenance and normal break downs of equipments,*
- (iv) Loss in efficiency due to ageing of the equipment,*
- (v) Number of shifts.*

5.4 Capacity utilization:

Capacity utilization is actual production measured as a percentage of installed capacity.

Actual production refers to in-house production.

6. Presentation:

6.1 Cost Statements shall present Installed capacity in absolute terms.

6.2 Actual Capacity utilization shall be presented in absolute terms and as a percentage of installed capacity.

7. Disclosure:

7.1 The cost statements shall disclose the following:

- 1. Basis for arriving at different types of capacity.**
- 2. Change in the installed capacity or normal capacity with reasons thereof.**
- 3. Increase or decrease in capacity due to equipments taken on lease or leased out.**
- 4. Details of production**
 - a) Self Manufactured**
 - b) Produced under leasing arrangements**
 - c) Produced on loan license / by third party on job work**
- 5. Reasons for low capacity utilization.**
- 6. Abnormal cost due to under-utilization of capacity.**



- 7.2** *Disclosures shall be made only where material, significant and quantifiable.*
- 7.3** *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*
- 7.4** *Any change in the principles and methods applied for capacity determination and its impact during the period covered by the cost statement which has a material effect on the capacity determination. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*



CAS-3

COST ACCOUNTING STANDARD ON "OVERHEADS"

The following is the text of the COST ACCOUNTING STANDARD 3 (CAS- 3) issued by the Council of the Institute of Cost and Works Accountants of India on "**Overheads**". The standard deals with the method of collection, allocation, apportionment and absorption of overheads" In this Standard, the standard portions have been set in ***bold italic*** type. These should be read in the context of the background material which has been set in normal type.

1. Introduction

- 1.1 In Cost Accounting the analysis and collection of overheads, their allocation and apportionment to different cost centres and absorption to products or services plays an important role in determination of cost as well as control purposes. A system of better distribution of overheads can only ensure greater accuracy in determination of cost of products or services. It is, therefore, necessary to follow standard practices for allocation, apportionment and absorption of overheads for preparation of cost statements.

2. Objective

- 2.1 The standard is to prescribe the methods of collection, allocation, apportionment of overheads to different cost centres and absorption thereof to products or services on a consistent and uniform basis in the preparation of cost statements and to facilitate inter-firm and intra-firm comparison.
- 2.2 The standardization of collection, allocation, apportionment and absorption of overheads is to provide a scientific basis for determination of cost of different activities, products, services, assets, etc.
- 2.3 The standard is to facilitate in taking commercial and strategic management ` decisions such as resource allocation, product mix optimization, make or buy decisions, price fixation etc.
- 2.4 The standard aims at ensuring better disclosure requirement and transparency in the cost statement.

3. Scope

- 3.1 ***The standard should be followed for treatment of overheads by all enterprises including companies covered under Cost Accounting Records Rules issued in pursuant to Sec 209(1)(d) of the Companies Act, 1956 or under the provisions of any other Act, Rules and Regulations.***
- 3.2 The standard shall be applied in Cost and Management Accounting practices relating to
- (a) Cost of products, services or activities
 - (b) Valuation of stock



- (c) Transfer pricing
- (d) Segment Performance
- (e) Excise / Custom duty, VAT, Income Tax, Service Tax and other levies, duties and abatement fixation
- (f) Cost statements for any other purpose

4. Definitions:

4.1 **Overheads - *Overheads comprise of indirect materials, indirect employee costs and indirect expenses which are not directly identifiable or allocable to a cost object in an economically feasible way.***

Overheads are to be classified on the basis of functions to which the overheads are related (Refer to 'Classification of cost' - CAS-1), viz

- ***Production overheads***
- ***Administrative overheads***
- ***Selling overheads***
- ***Distribution overheads***

Overheads may also be classified on the basis of behaviour such as variable overheads, semi-variable overheads and fixed overheads.

Variable overheads comprise of expenses which vary in proportion to the change of volume of production. For example, cost of utilities etc.

Fixed overheads comprise of expenses whose value do not change with the change in volume of production such as salaries, rent etc.

Semi-variable overheads are partly affected by change in the production volume. They are further segregated into variable overheads and fixed overheads

Any items of overheads arising out of abnormal situation in business activity should not be treated as overheads. They are charged to Costing Profit and Loss Account. Items not related to business activities such as donation, loss / profit on sale of assets etc are also not to be treated as overheads.

Borrowing cost and other financial charges including foreign exchange fluctuations will not form the part of overheads.

4.2 **Collection of Overheads - *Collection of overheads means the pooling of indirect items of expenses from books of account and supportive/corroborative records in logical groups having regards to their nature and purpose.***

Overheads are collected on the basis of pre-planned groupings, called cost pools. Homogeneity of the cost components in respect of their behaviour and character is to be considered in developing the cost pool. Variable and fixed



overheads should be collected in separate cost pools under a cost centre. A great degree of homogeneity in the cost pools are to be maintained to make the apportionment of overheads more rational and scientific. A cost pool for maintenance expenses will help in apportioning them to different cost centres which use the maintenance service.

4.3 Allocation of overheads - *Allocation of overheads is assigning a whole item of cost directly to a cost centre.*

An item of expense which can be directly related to a cost centre is to be allocated to the cost centre. For example, depreciation of a particular machine should be allocated to a particular cost centre if the machine is directly attached to the cost centre.

4.4 Apportionment of overhead - *Apportionment of overhead is distribution of overheads to more than one cost centre on some equitable basis.*

When the indirect costs are common to different cost centres, these are to be apportioned to the cost centres on an equitable basis. For example, the expenditure on general repair and maintenance pertaining to a department can be allocated to that department but has to be apportioned to various machines (Cost Centres) in the department. If the department is involved in the production of a single product, the whole repair & maintenance of the department may be allocated to the product.

4.5 Primary and Secondary Distribution of Overheads :

In case of multi-product environment, there are common service cost centres which are providing services to the various production cost centres and other service cost centres. The costs of services are required to be apportioned to the relevant cost centres. First step to be followed is to apportion the overheads to different cost centres and then second step is to apportion the costs of service cost centres to production cost centres on an equitable basis. The first step is termed as primary distribution and the second step is termed as secondary distribution of overheads.

4.6 Absorption of overheads - *Absorption of overheads is charging of overheads from cost centres to products or services by means of absorption rates for each cost center which is calculated as follows :*

$$\text{Overhead absorption Rate} = \frac{\text{Total overheads of the cost centre}}{\text{Total quantum of base}}$$

The base (denominator) is selected on the basis of type of the cost centre and its contribution to the products or services, for example, machine hours, labour hours, quantity produced etc.



Overhead absorbed = Overhead absorption rate x units of base in product or service

4.7 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. (CAS-2)

5. Apportionment and absorption of Production Overheads

5.1 Overheads are to be apportioned to different cost centres based on following two principles :

- i) Cause and Effect - Cause is the process or operation or activity and effect is the incurrence of cost. Apportionment of overheads based on this criterion ensures better rationality as it is guided by the relationship between cost object and cost.**
- ii) Benefits received - overheads are to be apportioned to the various cost centres in proportion to the benefits received by them.**

5.2 Primary Distribution of overheads :

Basis of primary apportionment of items of production overheads is to be selected to distribute them among the cost centres following the above two principles as given above in 5.1.

Basis of apportionment must be rational to distribute overheads. Once the base is selected, the same is to be followed consistently and uniformly. However, change in basis for apportionment can be adopted only when it is considered necessary due to change in circumstances like change in technology, degree of mechanization, product mix, etc. In case of such changes, proper disclosure in cost records is essential.

Examples of basis of primary distribution of some items of production overheads

Item of Cost	Basis of Apportionment
Power	(H.P. rating of Machines x hours x LF*
Fuel	Consumption rate x hour
Jigs, tools & fixtures	Machine hours or Man hours
Crane hire charges	Crane hours or weight of materials handled
Supervisors' salary & fringe benefits	Number of employees
Labour welfare cost	Number of employees
Rent & rates	Floor or Space area
Insurance	Value of fixed asset
Depreciation	Value of fixed asset

*LF = Motor Load Factor



5.3 Secondary Distribution of Overheads:

Secondary distribution 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 production cost centre(s).

5.4 Secondary Apportionment of Overheads on Reciprocal Basis

The services rendered by certain service cost centres are also utilized by other service cost centres. In reciprocal secondary distribution, the cost of service cost centres are apportioned to production cost centres as well as other service cost centres. In such case, any one of the following three methods may be followed:

- I. *Repeated Distribution Method*
- II. *Trial & Error Method*
- III. *Simultaneous Equation Method*

5.4.1 Repeated Distribution Method

Steps to be followed under this method are:

- i) *The proportion at which the costs of a service cost centres are to be distributed to production cost centres and other service cost centres are determined.*
- ii) *Costs of first service cost centres are to be apportioned to production cost centres and service cost centres in the proportion as determined in step (i).*
- iii) *Similarly, the cost of other service cost centres are to be apportioned.*
- iv) *This process as stated in (ii) and (iii) are to be continued till the figures remaining undistributed in the service cost centres are negligibly small. The negligible small amount left with service centre may be distributed to production cost centres.*

For example, refer to Exhibit 1

5.4.2 Trial and Error Method

This method is to be followed when the question of distribution of costs of service cost centres which are interlocked among themselves arises. In the first stage, gross costs of services of service cost centres are determined and then in the second stage, costs of service centres are apportioned to production cost centres. Steps to be followed:



- i) *The proportion at which the costs of a service cost centre to be distributed to production cost centres and other service cost centres is determined.*
- ii) *Cost of first service cost centre is distributed to the other service centres in the proportion of service they received from the first as assessed in step (i).*
- iii) *In the next step, total cost of second service cost centre so arrived has to be distributed to the other service centres in the proportion of service they received from the second as assessed in step (i).*
- iv) *Similarly, the cost of other service cost centres are to be apportioned to the service cost centres.*
- v) *This process as described in (iii) and (iv) is to be continued till the figures remaining undistributed in the service cost centres are negligibly small.*
- vi) *At the last, total cost of service cost centres to be distributed to production cost centres.*

For example, refer to Exhibit 2

5.4.3 Simultaneous Equation Method

The simultaneous equation method is to be adopted to take care of secondary distribution of cost of service cost centres to production cost centres with the help of mathematical formulation and solution. Steps to be followed :

- i) *Proportion of service benefits received by different cost centres from a cost centre are assessed on the basis of records*
- ii) *The same ratios are used as coefficients in the equations framed for apportionment of cost of service cost centres to production cost centres.*
- iii) *Solution of the equations gives the cost of service cost centres.*
- iv) *Cost of service cost centres to be distributed to production cost centres*

For example, refer to Exhibit 3

5.5 Secondary Apportionment of Overheads on Non-Reciprocal basis *In non-reciprocal secondary distribution, the costs of service cost centres are apportioned to the production cost centres. Steps involved are :*

- i) *The cost of first service cost centre is apportioned on a suitable basis to production cost centres.*



- ii) *The next step is to apportion the cost of second service centre to the production cost centres as indicated in stage (i).*
- iii) *The process is to be continued till the costs of all service cost centres are apportioned.*

For example, refer to Exhibit 4

5.6 Common bases for absorption of Production overheads from production cost centres to products or services :

Bases of denominator	Applicability
<i>Unit of Production</i>	<i>When single product is produced or various products are similar in specification.</i>
<i>Direct labour cost</i>	<i>When conversion process is labour intensive and wage rates are substantially uniform</i>
<i>Direct labour 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 base</i>

5.7 Absorption of Production Overheads and production capacity

Overheads shall be analysed into variable overheads and fixed overheads.

The variable production overheads shall be absorbed to products or services based on actual capacity utilisation.

The fixed production overheads and other similar item of fixed costs such as quality control cost shall be absorbed in the production cost on the basis of the normal capacity or actual capacity utilization of the plant, whichever is higher.

In case of less production than normal, under-absorption of overheads shall be adjusted with Costing Profit & Loss Account. In case of higher production than normal, the over-absorption of overheads shall also be adjusted with Costing Profit & Loss Account.

5.8 Absorption of Production overheads :

Production Overheads absorption rate for each cost centre is to be determined with the help of quantum base as indicated in 5.6 above and the formula as indicated below :

$$\text{Fixed overheads absorption rate} = \frac{\text{Fixed overheads}}{\text{Normal or actual quantum of base, whichever is higher}}$$



$$\text{Variable overheads absorption rate} = \frac{\text{Variable overheads}}{\text{Actual quantum of base}}$$

- 5.9** *A pre-determined rate may be used on a provisional basis for internal management decision making such as cost estimates for quotation, fixation of selling price etc. These rates are to be calculated for each cost centre for a particular period. Budgeted overheads for the respective cost centres for the period concerned are to be taken as numerator and budgeted normal base for the period as denominator for determining the rate.*

$$\text{Pre-determined overhead Rate} = \frac{\text{Budgeted Overheads for the period}}{\text{Budgeted normal base for the period}}$$

The amount of total overheads absorbed by a product, service or activity will be the sum total of the overheads absorbed from individual cost centres on pre-determined basis. The difference between overheads absorbed on pre-determined basis and the actual overheads incurred is the under- or over-absorption of overheads.

The under- or over- absorption of overheads is mainly due to variation between the estimation and actual.

6. Apportionment and absorption of Administrative Overheads

- 6.1** Administrative overheads include the following items of cost :

Printing and stationery, other office supplies

Employees cost - salaries of administrative staff

Establishment expenses - Office rent & rates, insurance, depreciation of office building and other assets, legal expenses, audit fees, bank charges etc.

- 6.2** Administrative overheads are to be collected in different cost pools such as :

- General Office
- Personnel department
- Accounts department
- Legal department
- Secretarial department etc

- 6.3** *Administrative overheads are to be further analysed into two - one for production activities and other for sales and distribution activities. Costs collected under the cost pools indicated in 6.2 above are to be distributed to administrative overheads relating to production activities and administrative overheads relating to selling and distribution activities on rational basis for each cost pool.*



- 6.4** *Administrative overheads relating to production activities are to be apportioned to different production cost centres on the basis conversion costs of production cost centres. The apportioned overheads are absorbed to products on the basis of the normal capacity or actual capacity, whichever is higher.*

In case of under-absorption or over-absorption of administrative overheads relating to production, the same shall also be adjusted with Costing Profit & Loss Account.

- 7.** **Apportionment and absorption of Selling overheads and Distribution overheads**

- 7.1** *The selling overheads and distribution overheads are collected under different cost pools such as :*

Selling Overheads :

- (i) *Sales Employees cost*
- (ii) *Rent*
- (iii) *Traveling expenses*
- (iv) *Warranty claim*
- (v) *Brokerage & Commission*
- (vi) *Advertisement relating to sales and sales promotion*
- (vii) *Sales incentive*
- (viii) *Bad debt etc*

Distribution Overheads :

- (i) *Secondary Packaging*
- (ii) *Freight & forwarding*
- (iii) *Warehousing & storage*
- (iv) *Insurance etc.*

- 7.2** *Some items of selling overheads and distribution overheads are directly identified and absorbed to products or services and remaining part of selling and distribution overhead along with the with share of administration overheads relating to selling and distribution activities are to be apportioned to various products or jobs or services on the basis of net actual sales value (i.e. Gross sales value less excise duty, sales tax and other government levies).*

- 8.** **Presentation and Disclosure:**

- 8.1** *Once the basis of collection, allocation, apportionment and absorption for different production cost centres are selected, the same shall be followed consistently and uniformly*

- 8.2** *Change in basis for collection, allocation, apportionment and absorption can be adopted only when it is compelled by the change in circumstances like change in technology, refinement and improvement in the basis etc*



and the change would provide more scientific approach. In case of such changes, proper disclosure in cost records is essential.

- 8.3** *Any change in basis for collection, allocation, apportionment and absorption which has a material effect on the cost of the product should be disclosed in the cost statements. Where the effect of such change is not ascertainable wholly or partly, the fact should be indicated in the cost statement.*

Exhibit 1

Reciprocal Overheads Apportionment : Repeated Method

	Production Department			Service Department	
	Machine	Assembly	Finishing	Stores	Repair
Ratio of apportionment from Stores	50%	20%	15%		15%
Ratio apportionment from Repair	40%	35%	15%	10%	
Distribution from Primary Distribution	35500.00	31900.00	14800.00	5000.00	6000.00
Stores Dept.	2500.00	1000.00	750.00	-5000.00	750.00
Total	38000.00	32900.00	15550.00	0.00	6750.00
Repairs & Maintenance Dept.	2700.00	2362.50	1012.50	675.00	-6750.00
Total	40700.00	35262.50	16562.50	675.00	0.00
Stores Dept.	337.50	135.00	101.25	-675.00	101.25
Total	41037.50	35397.50	16663.75	0.00	101.25
Repairs & Maintenance Dept	40.50	35.44	15.19	10.13	-101.25
Total	41078.00	35432.94	16678.94	10.13	0.00
Stores Dept.	5.06	2.03	1.52	-10.13	1.52
Total	41083.06	35434.96	16680.46	0.00	1.52
Repairs & Maintenance Dept	0.61	0.53	0.23	0.15	-1.52
Total	41083.67	35435.49	16680.68	0.15	0.00
Stores Dept.	0.10	0.03	0.02	-0.15	0.00
Total	41083.77	35435.52	16680.71	0.00	0.00



Exhibit 2

Reciprocal Overhead Apportionment : Trial & Error Method

	Production Machine	Department Assembly	Service Finishing	Department Stores	Repair
Ratio of apportionment from Stores	50%	20%	15%		15%
Ratio of apportionment from Repair	40%	35%	15%	10%	
Distribution from Primary Distribution	35500.00	31900.00	14800.00	5000.00	6000.00
Distribution between service centres					
Stores Dept.				0.00	750.00
Total				5000.00	6750.00
Repairs & Maintenance To stores				675.00	0
Stores Dept. to Repair & Maint				0.00	101.25
Repairs & Maintenance To stores				10.13	0.00
Stores Dept. to Repair & Maint				0.00	1.52
Repairs & Maintenance To stores				0.15	0.00
Stores Dept. to Repair & Maint				0.00	0.02
Gross cost of service cost centres				5685.28	6852.79
Stores to Production cost centres		2842.63	1137.06	852.79	-5685.28
Repairs & Maint to Production centres		2741.14	2398.46	1027.92	-6852.79
Total	41083.77	35435.52	16680.71	0	0

Exhibit 3

Reciprocal Overhead Apportionment: Simultaneous Equation Method

	Production Machine	Department Assembly	Service Finishing	Department Stores	Repair
Ratio of apportionment from Stores	50%	20%	15%		15%
Ratio of apportionment from Repair	40%	35%	15%	10%	
Distribution from Primary Distribution	35500.00	31900.00	14800.00	5000.00	6000.00

Let x, y be Store Dept and Repair & Maintenance Dept expenses respectively.

$$x - 0.10y = 5000$$

$$-0.15x + y = 6000$$

Solving $x = 5685.28, y = 6852.79$



Now, distribution of expenses will be as follows:

	Production Machine	Department Assembly	Service Finishing	Department Stores	Repair
Ratio of apportionment from Stores	50%	20%	15%		15%
Ratio of apportionment from Repair	40%	35%	15%	10%	
Amounts from Primary Distribution	35500.00	31900.00	14800.00	5685.28	6852.79
Stores to Production cost centres	2842.63	1137.06	852.79	-5685.28	
Repairs & Maint to Production centres	2741.14	2398.46	1027.92		-6852.79
Total	41083.77	35435.52	16680.71	0	0

Exhibit 4 Non-Reciprocal Overheads Apportionment

Primary Distribution

			Production Departments			Service Departments	
Expenses	Basis of allocation / apportionment	Total (Rs.)	Machine Shop	Assembly Shop	Finishing Dept	Stores	Repairs & Maint.
Consumable stores	Direct Materials	15,400	5,200	6,000	2,000	600	1,600
Supervision	Direct Wages	22,800	7,900	5,100	6,100	2,200	1,500
Rent & Rates	Area	10,000	3,000	2,000	2,500	1,000	1,500
Insurance	Asset Value	2,000	800	900	200	50	50
Depreciation	Asset Value	30,000	12,000	13,500	3,000	750	750
Power	H.PxHoursx LF	9,000	5,400	3,600	-	-	-
Light & Heat	Area	4,000	1,200	800	1,000	400	600
Total		93,200	35,500	31,900	14,800	5,000	6,000

Secondary Distribution

			Production Departments			Service Departments	
Expenses	Basis of allocation / apportionment	Total (Rs.)	Machine Shop	Assembly Shop	Finishing Dept	Stores	Repairs & Maint.
Primary dist. (earlier Table)		93,200	35,500	31,900	14,800	5,000	6,000
Stores	Direct Material (9 : 6 : 5)		2,050	1,500	1,200	-5,000	-6,000
Repairs & Maint	Direct (2: 3:1)		2,000	3,000	1,000		
		93,200	39,750	36,400	17,050	0	0



CAS-3
(Revised 2011)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 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.*²

4.2 *Absorption of overheads: Absorption of overheads is charging of overheads to Cost Objects by means of appropriate absorption rate.*

Overhead Absorption Rate = Overheads of the Cost object / Quantum of base.

4.3 *Administrative Overheads: Cost of all activities relating to general*

¹ This revised Cost Accounting Standard comes into force w.e.f. 1st April 2012 and supersedes the Cost Accounting Standard - 3 on Overheads issued by the Council on 3rd January 2003.)

² Adapted from CAS 1 paragraph 6.5.19



management and administration of an organisation.

Administrative overheads shall exclude production overheads, marketing overheads and finance cost. Production overheads include administration costs relating to production, factory, works or manufacturing.³

4.4 *Cost Centre: It is an organisational unit, in relation to which costs are accumulated.*

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.*⁴

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.*⁵

Examples of Distribution Overheads are Cost towards Secondary Packing, Transportation of Finished Goods, Warehousing of Finished Goods, Delivering the Finished Products to Customers, Clearing & Forwarding and Mending or Replacing Packing Materials at Distribution Point.

4.7 *Imputed Cost: Hypothetical or notional cost, not involving cash outlay, computed for any purpose.*⁶

4.8 *Indirect Employee Cost: The employee cost, which cannot be directly attributed to a particular cost object.*⁷

³From CAS 11 paragraph 4.3

⁴Adapted from CIMA Terminology

⁵From CAS 9 paragraph 4.7

⁶Adapted from CAS 1 paragraph 6.5.13

⁷Adapted from CAS 1 paragraph 6.2.10



- 4.9 Indirect Expenses: Expenses, which cannot be directly attributed to a particular cost object.⁸**
- 4.10 Indirect Material Cost: Materials, the cost of which cannot be directly attributed to a particular cost object.⁹**
- 4.11 Marketing Overheads: Marketing Overheads comprises selling overheads and distribution overheads.¹⁰**
- 4.12 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.¹¹**
- 4.13 Overheads: Overheads comprise costs of indirect materials, indirect employees and indirect expenses which are not directly identifiable or allocable to a cost object in an economically feasible manner.**

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

- Production Overheads
- Administrative Overheads
- Marketing Overheads

In addition Overheads shall also be classified on the basis of behaviour such as variable overheads, semi-variable overheads and fixed overheads.

- Variable overheads comprise of expenses which vary in proportion to the change of volume of production. For example, cost of utilities etc.
- Semi-variable overheads are partly affected by change in the production volume. They are further segregated into variable overheads and fixed overheads
- Fixed overheads comprise of expenses whose value does not change with the change in volume of production. For example, salaries, rent etc.

⁸Adapted from CAS 1 paragraph 6.2.12

⁹Adapted from CAS 1 paragraph 6.2.8

¹⁰ From CAS 9 paragraph 4.10

¹¹Adapted from CAS 2 paragraph 4.4



4.14 *Production Overheads: Indirect cost involved in the production process or in rendering service.*¹²

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.

4.15 *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.*¹³

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.¹⁴

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 5.1 shall be determined on the basis of cost 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.

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

¹² From CAS 9 paragraph 4.13

¹³ From CAS 9 paragraph 4.14

¹⁴ From CAS 7 paragraph 4.15



- 5.4** *Finance costs incurred in connection with procured or self generated resources referred to in paragraph 5.1 and 5.2 shall not form part of overheads.*
- 5.5** *Overheads shall not include imputed cost.*
- 5.6** *Overhead variances attributable to normal reasons shall be treated as part of overheads. Overhead 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. Where the recovery exceeds the total overheads, the balance recovery shall be treated as other income.*
- 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 Absorption of Production Overheads shall be as follows:**
- 6.3.1 The variable production overheads shall be absorbed to products or services based on actual capacity utilisation.**
- 6.3.2 The fixed production overheads shall be absorbed based on the normal capacity.**
- 6.4 Assignment of Administration Overheads shall be in accordance with CAS-11.**
- 6.5 Assignment of Marketing Overheads shall be as follows:**
- 6.5.1 Marketing Overheads that can be identified to a product or service shall be assigned to that product or service.**
- 6.5.2 Marketing Overheads that cannot be identified to a product or service shall be assigned to the products or services on the most appropriate basis.**
- 7. Presentation**
- 7.1 Overheads shall be presented as separate cost heads like production, administration and marketing.**
- 7.2 Element wise and behaviour wise details of the overheads shall be presented, if material.**
- 7.3 Any under-absorption or over-absorption of overheads shall be presented in the reconciliation statement.**
- 8. Disclosures**
- 8.1 The cost statements shall disclose the following:**
- 1. The basis of assignment of overheads to the cost objects.**
 - 2. Overheads incurred in foreign exchange.**
 - 3. Overheads relating to resources received from or supplied to related parties¹⁵.**
 - 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 cost not forming part of the overheads.**
 - 7. Any unabsorbed overheads.**

¹⁵ 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.*



CAS-4

COST ACCOUNTING STANDARD ON COST OF PRODUCTION FOR CAPTIVE CONSUMPTION

The following is the text of the COST ACCOUNTING STANDARD 4 (CAS-4) issued by the Council of the Institute of Cost and Works Accountants of India on “**Cost of Production for Captive Consumption**”. The standard deals with determination of cost of production for captive consumption. In this Standard, the standard portions have been set in ***bold italic*** type. These should be read in the context of the background material which has been set in normal type.

1. Introduction

The Cost Accounting principle for determination of cost of production is well established. Similarly, rules for levy of excise duty on goods used for captive consumption are also well defined. Captive Consumption means the consumption of goods manufactured by one division and consumed by another division(s) of the same organization or related undertaking for manufacturing another product(s). Liability of excise duty arises as soon as the goods covered under excise duty are manufactured but excise duty is collected at the time of removal or clearance from the place of manufacture even if such removal does not amount to sale. Assessable value of goods used for captive consumption is based on cost of production. According to the Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000, the assessable value of goods used for captive consumption is 115% (110% w.e.f. 05-08-2003) of cost of production of such goods, and as may be prescribed by the Government from time to time.

2. Objective

- 2.1 The purpose of this standard is to bring uniformity in the principles and methods used for determining the cost of production of excisable goods used for captive consumption.
- 2.2 The cost statement prepared based on standard will be used for determination of assessable value of excisable goods used for captive consumption.
- 2.3 The standard and its disclosure requirement will provide better transparency in the valuation of excisable goods used for captive consumption.

3. Scope

- 3.1 The standard is to be followed for determining the cost of production to arrive at an assessable value of excisable goods used for captive consumption.
- 3.2 Cost of production will include various cost components. They are already defined in Cost Accounting Standard-1 (‘Classification of Cost’ – CAS-1). Thus, this standard has to be read in conjunction with CAS-1.



4. Definitions:

4.1 Cost of Production: *Cost of production shall consist of Material Consumed, Direct Wages and Salaries, Direct Expenses, Works Overheads, Quality Control cost, Research and Development Cost, Packing cost, Administrative Overheads relating to production.*

To arrive at cost of production of goods dispatched for captive consumption, adjustment for Stock of work-in-Process, finished goods, recoveries for sales of scrap, wastage etc shall be made.

4.2 Captive Consumption: *Captive Consumption means the consumption of goods manufactured by one division or unit and consumed by another division or unit of the same organization or related undertaking for manufacturing another product(s).*

4.3 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. (CAS-2)*

5. Determination of Cost of Production for Captive Consumption

To determine the cost of production for captive consumption, calculations of different cost components and adjustments are explained below:

5.1 Material Consumed

Material Consumed shall include materials directly identified for production of goods such as:

- (a) Indigenous materials*
- (b) Imported materials*
- (c) Bought out items*
- (d) Self manufactured items*
- (e) Process materials and other items*

Cost of material consumed shall consist of cost of material, duties and taxes, freight inwards, insurance and other expenditure directly attributable to procurement. Trade discount, rebates and other similar items will be deducted for determining the cost of materials. Cenvat credit, credit for countervailing customs duty, Sales Tax set off, VAT, duty draw back and other similar duties subsequently recovered/ recoverable by the enterprise shall also be deducted.

5.2 Direct wages and salaries

Direct wages and salaries shall include house rent allowance, overtime and incentive payments made to employees directly engaged in the manufacturing activities.



Direct wages and salaries include fringe benefits such as:

- (i) Contribution to provident fund and ESIS
- (ii) Bonus/ ex-gratia payment to employees
- (iii) Provision for retirement benefits such as gratuity and superannuation
- (iv) Medical benefits
- (v) Subsidised food
- (vi) Leave with pay and holiday payment
- (vii) Leave encashment
- (viii) Other allowances such as children's education allowance, conveyance allowance which are payable to employees in the normal course of business etc.

5.3 Direct Expenses

Direct expenses are the expenses other than direct material cost and direct employees costs which can be identified with the product.

Direct expenses include:

- (i) Cost of utilities such as fuel, power, water, steam etc
- (ii) Royalty based on production
- (iii) Technical Assistance / know –how fees
- (iv) Amortized cost of moulds, patterns, patents etc
- (v) Job charges
- (vi) Hire charges for tools and equipment
- (vii) Charges for a particular product designing etc

5.4 Works Overheads

Works overheads are the indirect costs incurred in the production process.

Works overheads include the following expenses:

- (i) Consumable stores and spares
- (ii) Depreciation of plant and machinery, factory building etc
- (iii) Lease rent of production assets
- (iv) Repair and maintenance of plant and machinery, factory building etc
- (v) Indirect employees cost connected with production activities
- (vi) Drawing and Designing department cost.
- (vii) Insurance of plant and machinery, factory building, stock of raw material & WIP etc



- (viii) Amortized cost of jigs, fixtures, tooling etc
- (ix) Service department cost such as Tool Room, Engineering & Maintenance, Pollution Control etc

5.5 Quality Control Cost

The quality control cost is the expenses incurred relating to quality control activities for adhering to quality standard. These expenses shall include salaries & wages relating to employees engaged in quality control activity and other related expenses.

5.6 Research and Development Cost

The research and development cost incurred for development and improvement of the process or the existing product shall be included in the cost of production.

5.7 Administrative Overheads

Administrative overheads need to be analysed in relation to production activities and other activities. Administrative overheads in relation to production activities shall be included in the cost of production. Administrative overheads in relation to activities other than manufacturing activities e.g. marketing, projects management, corporate office expenses etc. shall be excluded from the cost of production.

5.8 Packing Cost

If product is transferred/dispached duly packed for captive consumption, cost of such packing shall be included.

Packing cost includes both cost of primary and secondary packing required for transfer/ dispatch of the goods used for captive consumption.

5.9 Absorption of overheads

Overheads shall be analysed into variable overheads and fixed overheads.

Variable Overheads are the items which change with the change in volume of production, such as cost of utilities etc.

Fixed overheads are the items whose value does not change with the change in volume of production such as salaries, rent etc.

The variable production overheads shall be absorbed in production cost based on actual capacity utilisation.

The fixed production overheads and other similar item of fixed costs such as quality control cost, research and development costs, administrative overheads relating to manufacturing shall be absorbed in the production cost on the basis of the normal capacity or actual capacity utilization of the plant, whichever is higher.

**5.10 Valuation of Stock of work-in-progress and finished goods**

Stock of work-in-progress shall be valued at cost on the basis of stages of completion as per the cost accounting principles. Similarly, stock of finished goods shall be valued at cost. Opening and closing stock of work-in-progress shall be adjusted for calculation of cost of goods produced and similarly opening and closing stock of finished goods shall be adjusted for calculation of goods despatched.

In case the cost of a shorter period is to be determined, where the figures of opening and closing stock are not readily available, the adjustment of figures of opening and closing stock may be ignored.

5.11 Treatment of Joint Products and By-Products

A production process may result in more than one product being produced simultaneously. In case joint products are produced, joint costs are allocated between the products on a rational and consistent basis. In case by-products are produced, the net realisable value of by-products is credited to the cost of production of the main product.

For allocation of joint cost to joint products, the sales values of products at the split off point i.e. when the products become separately identifiable may become the basis. Some other basis may be adopted. For example, in case of petroleum products, each product is assigned certain value based on its certain properties, may be calorific value and these values become the basis of apportionment of joint cost among petroleum products.

5.12 Treatment of Scrap and Waste

The production process may generate scrap or waste. Realized or realizable value of scrap or waste shall be credited to the cost of production.

In case, scrap or waste does not have ready market and it is used for reprocessing, the scrap or waste value is taken at a rate of input cost depending upon the stage at which such scrap or waste is recycled. The expenses incurred for making the scrap suitable for reprocessing shall be deducted from value of scrap or waste.

Illustration

A production process has three stages.

Stage	Input material cost (Rs/ MT)	Processing cost (Rs/MT)	Total (Rs/MT)
1	2000	500	2500
2	2500	1000	3500
3	3500	1000	4500



If during the production process at stage3, the scrap is produced and the same is recycled at stage2 after making an expenditure of Rs 200 per MT to make it suitable for re-processing at stage2, then scrap will be valued @ Rs (2500 – 200) i.e Rs 2300. If no expenditure is involved to make scrap re-usable, the scrap value will be @ Rs 2500. The scrap value for the scrap produced during a period calculated at the rate as explained above may be deducted to find out the cost of production for the period.

5.13 Miscellaneous Income

Miscellaneous income relating to production shall be adjusted in the calculation of cost of production, for example, income from sale of empty containers used for despatch of the captively consumed goods produced under reference.

5.14 Inputs received free of cost

In case any input material, whether of direct or indirect nature, including packing material is supplied free of cost by the user of the captive product, the landed cost of such material shall be included in the cost of production.

5.15 Moulds, Tools, Dies & Patterns etc received free of cost

The amortization cost of such items shall be included in the cost of production.

5.16 Interest and financial charges

Interest and financial charges being a financial charge shall not be considered to be a part of cost of production.

5.17 Abnormal and non-recurring cost

Abnormal and non-recurring cost arising due to unusual or unexpected occurrence of events, such as heavy break down of plants, accident, market condition restricting sales below normal level, abnormal idle capacity, abnormal process loss, abnormal scrap and wastage, payments like VRS, retrenchment compensation, lay-off wages etc. The abnormal cost shall not form the part of cost of production.

6. Cost Sheet

The cost sheet should be prepared in the format as par Appendix – 1 or as near thereto as possible. The manufacturer will be required to maintain cost records and other books of account in a manner, which would facilitate preparation and verification of the cost of production. For manufacturers covered under the ambit of Section 209(1)(d) of the Companies Act, 1956, i.e., where Cost Accounting Records are statutorily required to be maintained, the Cost Accountant certifying the cost of production for captive consumption shall verify the correctness of the cost from these records. However, for manufacturers not covered under



Section 209(1)(d) of the Companies Act, 1956, it is desirable that they also maintain cost accounting records in line with the records so prescribed as to facilitate determination and certification of cost of production.

7. Disclosure

- (i) *If there is any change in cost accounting principles and practices during the concerned period which may materially affect the cost of production in terms of comparability with previous periods, the same should be disclosed.***
- (ii) *If opening stock and closing stock of work -in-progress and finished goods are not readily available for certification purpose, the same should be disclosed.***



Cost of Production for Captive Consumption

Appendix – 1

Name of the Manufacturer:

Address of the Manufacturer:

Registration No of Manufacturer:

Description of product captively consumed:

Excise Tariff Heading:

Statement of Cost of Production of.....manufactured / to be manufactured during the period.....

	Qty	
Q1 Quantity Produced (Unit of Measure)		
Q2 Quantity Despatched (Unit of Measure)		
Particulars	Total Cost(Rs)	Cost unit(Rs)
1. Material Consumed		
2. Direct Wages and Salaries		
3. Direct Expenses		
4. Works Overheads		
5. Quality Control Cost		
6. Research & Development Cost		
7. Administrative Overheads (relating to production activity)		
8. Total (1 to 7)		
9. Add : Opening stock of Work - in -Progress		
10. Less : Closing stock of Work -in- Progress		
11. Total (8+9-10)		
12. Less : Credit for Recoveries/Scrap/By-Products / misc income		
13. Packing cost		
14. Cost of production (11 - 12 + 13)		
15. Add: Inputs received free of cost		
16. Add: Amortised cost of Moulds, Tools, Dies & Patterns etc received free of cost		
17. Cost of Production for goods produced for captive consumption (14 + 15 + 16)		
18. Add : Opening stock of finished goods		
19. Less : Closing stock of finished goods		
20. Cost of production for goods despatched (17 + 18 - 19)		

Seal & Signature of Company's Authorised Representative

I/We, have verified above data on test check basis with reference to the books of account, cost accounting records and other records. Based on the information and explanations given to me/us, and on the basis of generally accepted cost accounting principles and practices followed by the industry, I /We certify that the above cost data reflect true and fair view of the cost of production.

Date:

Place:

Seal & Signature of Cost Accountant

Membership No.....



GUIDANCE NOTE ON COST ACCOUNTING STANDARD ON COST OF PRODUCTION FOR CAPTIVE CONSUMPTION (CAS-4)

The Council of the Institute of Cost and Works Accountants of India has issued the Cost Accounting Standard 4 (CAS-4) for Determination of Cost of Production for Captive Consumption. This standard lays down the principles and methods for determining the cost of production of excisable goods used for captive consumption, presentation and disclosure in the cost sheet.

This Guidance Note deals with the principles and methods as provided in CAS-4 and practical aspects in connection with the determination of cost of production of excisable goods used for captive consumption.

In the preparation of cost sheet including those requiring attestation, cost of production of excisable goods used for captive consumption shall be determined as per CAS-4. The Cost Accounting Standards have been set in ***bold italic*** type and reference number has been retained as in CAS-4 for ready reference.

CAS 4 refers to Central Excise Act and Rules framed there under for determination of assessable value of goods used for captive consumption. Therefore, this Guidance note refers to relevant sections of Central Excise Act, 1944, Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, other relevant rules thereto, case laws on the subject and provides methodology for determination of assessable value of captively consumed goods on cost construction method as a measure of simplification.

Circular No. 692/08/2003-CX dated 13th February, 2003 issued by Department of Revenue (CBEC) inter alia provides “that for valuing goods which are captively consumed, the general principles of costing would be adopted for applying Rule 8. The Board has interacted with the Institute of Cost & Works Accountants of India (ICWAI) for developing costing standards for costing of captively consumed goods.” Paragraph 3 of the above circular further provides:

“cost of production of captively consumed goods will henceforth be done strictly in accordance with CAS-4.....”

The above circular is reproduced as Annexure I.

In view of above, CAS-4 is applicable from 13th February, 2003. The Department has, however, clarified that though CAS-4 was approved by the Government of India on 13.2.2003, cases pending finalization for the period earlier to this may be considered in line with costing principles laid down in CAS-4, issued by the Institute of Cost and Works Accountants of India. Assessments finalized prior to 13th February, 2003 not to be opened.



Cost of Production for Captive Consumption

CAS-4 applies to following type of organizations registered with Excise Department if goods manufactured are for captive consumption:

1. Proprietorship concern
2. Partnership Firms
3. Cooperative Societies
4. Private/Public Limited Companies.

SSI units registered with Excise Department are exempt from payment of excise duty as per registration conditions.

**Chapter 1****Introduction**

The scheme of valuation of excisable goods is contained in Sec. 3A, Sec. 4 and Sec. 4A of the Central Excise Act, 1944. The goods manufactured have to be valued in a prescribed manner as per above provisions to determine the excise duty payable by the assessee. Section 3 provides that excise duties shall be levied and collected on all excisable goods which are produced or manufactured in India at the rates set forth in Schedule to the Central Excise Tariff Act, 1985. Section 4 provides the mechanism to determine the value of goods subject to duty for the purpose of assessment. Section 4 was replaced by new Section 4 w.e.f 1-07-2000 and concept of 'transaction value' has been introduced under Section 4(3)(d). Section 4A provides for valuation of excisable goods with reference to retail sale price and applicable to commodities as notified by the Government from time to time and on which retail price is required to be indicated under the provision of the Standard of Weights & Measures Act, 1976 and the Rules made there under.

Section 4(1) (a) of Central Excise Act, 1944 deals with the Valuation of excisable goods when following requirements are satisfied:

1. Goods are sold at the time and place of removal from factory/warehouse;
2. The assessee and the buyer of the goods are not related; and
3. The price is the sole consideration of sale.

Each transaction is treated as a separate transaction for valuation purposes.

If any one of the above requirements is not satisfied, assessable value shall be determined under the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 notified on 30.6.2000, as provided under Section 4(1)(b) of the Act. For ready reference extract of Section 4 of the Central Excise Act, 1944 and the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 are annexed as **Annexure II and III**. Rules 8 and 9 deal with the valuation of goods captively consumed.

Meaning of Captive Consumption:

"Captive Consumption" means that the goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles in the same premises or elsewhere.

When goods manufactured are supplied to a related party who does not sell the goods but consumes the same in manufacture of another product(s), such goods are also deemed to be "captively consumed" for the purpose of valuation under Excise Laws.

In some cases during the manufacture, certain intermediate goods emerge and are used in manufacture/production of other goods. The use of such intermediate product within the factory is also termed as "Captive Consumption".



Cost of Production for Captive Consumption

Sometimes the goods are not removed from the factory but are used in the further manufacture/production of goods and in such cases also, duty is payable as soon as the goods are manufactured/produced within the factory unless exempted. Goods captively consumed in the same factory of the manufacturer are exempted from duty as per Notification No. 67/95-CE dt.16.03.1995, if duty is payable on the final product. For example, the manufacturer of motor vehicles manufactures various parts of the motor vehicles like brakes, panels etc. These parts are also excisable goods and have separate entry in the schedule to Central Excise Tariff Act, 1985. If these parts are removed from the factory, duty is payable but if these parts are used in the same factory of the manufacturer in the assembly / further manufacture of motor vehicles then the use of parts and components is called as captive consumption, and is not subject to excise duty in view of above notification.

Type of Goods:

Following type of goods are covered under CAS-4:

1. Goods manufactured not sold but captively consumed
2. Goods manufactured partly sold and partly captively consumed
3. Goods manufactured sold to related party for captive consumption

Goods manufactured, not sold but captively consumed:

Rule 8 of the Central Excise Valuation Rules provides that where the excisable goods are not sold but are used for consumption by assessee or on his behalf in the production or manufacture of other articles, the value shall be 110% (as of now) of the cost of production or manufacture of such goods. (115% was substituted by 110% vide notification no. 60 / 2003 – CE (NT) dated 05-08-2003) In other words, when goods are captively consumed, the assessable value will be 110% of cost of production. The earlier concept of deemed profit / notional profit has been done away and margin of 10% by way of profit etc is prescribed in the rule itself for ease of assessment of goods used for captive consumption. The cost of production is to be determined as per CAS-4 vide Government of India, Ministry of Finance & Company Affairs (Department of Revenue's Circular dated 13th February, 2003 (refer Annexure I)).

Judgement of Supreme Court dated 1.8.2006 :

In a landmark judgment dated 1.8.2006 in case No. Appeal (civil)2947-2948 of 2001 Commissioner of Central Excise, Pune vs M/s Cadbury India Ltd.(Refer Annexure IV), Hon'ble Supreme Court of India, observed :

“The Institute of Cost and Works Accountants of India (ICWAI) has laid down the principles of determining cost of production for captive consumption and formulated the standards for costing: CAS-4. According to CAS-4 the definition of “cost of production” is as under:

“4.1 Cost of Production : Cost of Production shall consist of Material consumed, Direct wages and salaries, Direct expenses, Works overheads, Quality Control



cost, Research and Development cost, Packing cost, Administrative Overheads relating to production.”

“The cost accounting principles laid down by ICWAI have been recognized by the Central Board of Excise and Customs vide Circular No.692/8/2003 CX dated 13.2.2003. The circular requires the department to determine the cost of production of captively consumed goods strictly in accordance with CAS-4. “

The Tribunal in the case of BMF BELTINGS LTD. vs. CCE : 2005 (184) E.L.T. 158 (Tri. Bang.) for the period 1995 to 2000 has directed the department to apply CAS-4 for the determination of the cost of production of the captively consumed goods. In ITC vs. CCE (190) ELT 119 the Tribunal held that the department has to calculate the cost of production in terms of CAS-4. Other decisions of the Tribunal, wherein it has directed that CAS-4 be applied for determination of the cost of production, are Teja Engineering v/s CCE 2006 (193) ELT 100 (Tri-Chennai), Ashima Denims v/s CCE 2005 (191) ELT 318 (Tri-Mumbai), and Arti Industries vs. CCE 2005 (186) ELT 208 (Tri-Chennai). This is therefore a consistent view taken by the Tribunal. The department has not filed any appeal in these cases and accepted the legal position. Apart from this, in the light of several decisions of this Court, the Department is also bound by the said circular No.692/9/2003 CX dated 13th February, 2003 issued by the CBEC.”

In view of the above judgement also, the cost of production for captively consumed goods is to be determined as per CAS-4.

Valuation of Goods Partly Captively Consumed And Partly Sold:

Where the goods to be valued are captively consumed in one's own factory, valuation will be done on the basis of 110% of the cost of production of goods. If the goods are partially sold by the assessee and partially captively consumed, the goods sold would be assessed on the basis of transaction value under section 4 and the goods captively consumed would be valued under rule 8 i.e. 110% of the cost production of goods, states the Board's circular no.643/32/2002-CE dt. 1-7-2002.

There can be situations where an assessee may manufacture an intermediate product (which is excisable) which requires be processing or using for further production in another unit of the same manufacturer located at a different place. In such a situation also, the principle of rule 8 is applicable. The cost of production of good manufactured plus 10% thereof is to be adopted for determining the assessable value.

Valuation of Goods sold to related party:

Rule 9 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 deals with sale to related person. Related person has been defined in Section 4(3)(b) of the Excise Act (Refer **Annexure II**). If a manufacturer sells goods to any of the related person, it will be treated as goods sold to related person. Rule 9 specifies that the goods can be sold to related persons for two purposes, one for onward sale when the related person is dealer/ distributor of the assessee and secondly



Cost of Production for Captive Consumption

the related person buys goods from the assessee for consumption in the production or manufacture of articles. In case, the related person does not sell the goods but uses or consumes such goods in the production or manufacture of the articles, the value shall be determined in the manner specified in rule 8, i.e. assessable value to be 110% of cost of production as per proviso to Rule 9.

Rule 10(a) of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, also provides that where excisable goods are sold to the related party/inter connected undertaking who does not sell the goods but uses or consumes such goods in the production or manufacture of articles, the value of goods shall be determined in the manner specified in Rule 8. The details of persons who shall be deemed to be related are prescribed under Section 4(3) (Refer Annexure II).

Valuation of capital goods manufactured and captively consumed:

Capital goods manufactured in a factory and used within the factory of manufacturer for manufacture/production of excisable goods, are exempt from payment of excise duty as per Notification No.67/1995-CE dated 16th March, 1995. This exemption is also available in case capital goods are manufactured by third party in the factory of manufacturer.

Free sample

CBEC vide its circular No.643/34/2002 CX dated 1.7.2002 had clarified that for excisable goods removed as free sample, provision of Rule 4 will not apply but excise duty will be paid on 110% of cost of production as per Rule 8. However on reconsideration, the CBEC has modified the above circular. As per revised circular No. 813/10/2005 CX dated 25.4.2005, value of free samples should be determined under Rule 4 of the Valuation Rules. The revised circular thus provides that valuation should be on the basis of value of identical goods cleared at or around the same time. However, in case of new or improved product, price of similar goods may not be available. Therefore for such goods, valuation should be on the basis of cost of production plus 10%, under Rule 11 read with Rule 8, in the absence of any other mode available for valuation.

Goods removed for test/trial outside the factory:

In above case Rule 4 is invoked as soon as assessee removes the manufactured goods for trial outside the factory. Since similar goods have been sold, the assessable value will be determined based on sale of such goods after making adjustment on account of difference in dates of delivery and the specification of goods.



Chapter 2

Definitions

The following terms are used in this guidance note with the meaning specified.

Cost of Production: *Cost of production shall consist of Material Consumed, Direct Wages and Salaries, Direct Expenses, Works Overheads, Quality Control cost, Research and Development Cost, Packing cost, Administrative Overheads relating to production. To arrive at cost of production of goods dispatched for captive consumption, adjustment for Stock of work-in-Process, finished goods, recoveries for sales of scrap, wastage etc shall be made.*

Captive consumption: *Captive Consumption means the consumption of goods manufactured by one division or unit and consumed by another division or unit of the same organization or related undertaking for manufacturing another product(s).*

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. (CAS-2)*



Chapter 3

**Principles for Determination of Cost of
Production for Captive Consumption**

5.1 Material Consumed

Material Consumed shall include materials directly identified for production of goods such as:

- (a) indigenous materials**
- (b) imported materials**
- (c) bought out items**
- (d) self manufactured items**
- (e) process materials and other items**

Cost of material consumed shall consist of cost of material, duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement. Trade discount, rebates and other similar items will be deducted for determining the cost of materials. Cenvat credit, credit for countervailing customs duty, Sales Tax set off, VAT, duty draw back and other similar duties subsequently recovered/ recoverable by the enterprise shall also be deducted.

Various types of materials used for production of goods have been indicated. It depends on the type of product and process of manufacture involved. For example for production of engineering product both indigenous and imported raw materials may be used besides bought out items. In process industry, it may be indigenous/imported raw materials and other item of materials.

Materials are also classified as direct material and indirect material. Direct materials identified to finished product is a part of material cost while indirect material is part of overheads.

The cost elements to be considered for determining the cost of material consumed have been indicated above. The cost of material should be measured 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. The method of valuation of material consumed shall be as per financial accounts, i.e., First in First out (FIFO) or weighted Average Rate.

LC charges/ Bank charges will not form part of material cost.

Normal loss or spoilage of material prior to reaching the factory will be absorbed in the cost of materials, after reducing the amounts chargeable to suppliers and recovery as scrap. Losses due to shrinkage or evaporation and gain due to elongation or absorption of moisture before the material is received will be absorbed in material cost to the extent they are normal.



Records relating to of material cost such as purchase, receipt, storage, issued for manufacture, sales or delivery of goods, including inputs and capital goods as the case may be, are required to be maintained under the Central Excise Law besides excise records for daily production report, daily stock account, CENVAT credit account for inputs, and the like . In brief it is to be ensured that there is effective material management system, properly documented, correctly accounted for to arrive at quantity and cost of material consumed for different types of products produced/manufactured. The item-wise material consumption for major item is reconciled with financial account.

The cost of material consumed is determined with respect to (i) the source / type of material consumed, and (ii) the method of valuation followed for issue of goods to production.

Any subsidy/grant/incentive and any such payment received /receivable with respect to any material shall be reduced from the cost of material consumed.

In case raw material is imported through advance license/DEPB or under any other scheme and used for manufacture of goods for captive consumption, adjustment for import duty shall be made to bring the raw material cost to the level of duty paid import. However, Duty Drawback refund benefit shall not be reduced from the input cost. Other export benefits like DEPB and DFRC will not be adjusted for calculation of cost of production.

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

Bought out components:

Landed cost of indigenous / imported / bought out items shall be calculated on the above basis.

Illustrations of calculation of landed cost of indigenous and imported material are at Annexure VA and VB.

Self manufactured Items:

These will include any goods manufactured with raw material, indigenous or imported bought out material etc. by the manufacturer in the same factory for further use in manufacture of final product. For this purpose, the cost of production of such self manufactured items shall be considered as material cost for the subsequent product, after considering inward freight, octroi, etc., as applicable. Intermediate products/ goods transferred by another unit of the same manufacturer etc. shall be based on cost of production as per CAS-4.

Process material, colour and chemicals, packing materials: The cost of these shall be calculated on the same lines as above. In some cases, these items may get manufactured on job work basis from outside parties. In such cases, cost should consist of the cost of material supplied plus job work charges/processing charges paid to the job worker/processor. The incidental charges like freight, insurance, handling charges etc, if any, shall also form cost of material.



Cost of Production for Captive Consumption

In case of certain process materials like catalysts having longer process useful life, the cost of catalyst should be spread over its useful life.

Quantity of Material consumed:

The quantity of material consumed is to be worked out from material issue records from stores for each product. Such consumption in quantity may be derived by two methods.

Method (i): Based on actual issues for batch, unit or job - This method is preferred as it establishes direct relationship of actual material usage for the product.

Method (ii): Based on any method other than actual e.g. Standard

Under this method material is issued at Standard Bill of material. The standard cost for each direct material is defined at the beginning of the year. The variances from standard on account of price/usage and the like are adjusted to consumption at the end of the period. Some organizations follow "Back flush Costing" system for issue of material. As soon as a finished good is ready for stock, material is back flushed (issued) as per the bill of material for that product. Any variation between the actual issues (both quantity and value) and the standard as accumulated over the period is charged off to consumption at the end of the period. Abnormal consumption, if any, shall not form part of material consumption on products.

This method is to be used in case of goods, where the direct link of actual consumption for product is not available. The manufacturer using this method should certify the quantitative requirement considered for calculation of material consumption as per Bill of Material. It may be ensured that usage variance is within reasonable limit and it should be adjusted in calculation of cost of production.

Reconciliation of cost of material consumed - It is advisable that cost of the material consumed for working out cost of production is reconciled with financial books. For major direct materials, reconciliation is to be ensured both in quantity and value.

5.2 Direct Wages and Salaries:

Direct wages and salaries shall include house rent allowance, overtime and incentive payments made to employees directly engaged in the manufacturing activities.

Direct wages and salaries include fringe benefits such as:

- I. Contribution to provident fund and ESIS
- II. Bonus/ ex-gratia payment to employees
- III. Provision for retirement benefits such as gratuity and superannuation
- IV. Medical benefits
- V. Subsidised food
- VI. Leave with pay and holiday payment
- VII. Leave encashment
- VIII. Other allowances such as children's education allowance, conveyance allowance which are payable to employees in the normal course of business etc.



Direct wages and salaries are also termed as Employee cost. Employee cost are classified as direct employees cost and indirect employees cost. Direct employee cost is assigned to or linked with a cost centre or cost object. Indirect Employee Cost is treated as Overhead as dealt later.

Employee cost shall include the employee benefits as detailed above. If fringe benefits have not be identified with relevant cost centre, these should be allocated in the ratio of direct salaries and wages of the cost centres. Where an employee has worked in more than one departments/cost centres, it may be assigned on the basis of time spent.

The manufacturer shall prepare a detailed statement indicating Direct Employee Cost to different products and basis of allocation. Total Employee Cost shall be reconciled with financial accounts.

VRS payment, if any, shall not form part of cost of production.

5.3 Direct Expenses

Direct expenses are the expenses other than direct material cost and direct employee's costs which can be identified with the product.

Direct Expenses Include:

- I. Cost of utilities such as fuel, power, water, steam, etc
- II. Royalty based on production
- III. Technical Assistance/ know –how fees
- IV. Amortized cost of moulds, patterns, patents etc
- V. Job charges
- VI. Hire charges for tools and equipment
- VII. Charges for a particular product designing etc.

Utilities include Power, water, steam, compressed air, Effluent Treatment etc. Some of the utilities are generated within the plant and others are purchased from outside source. Actual cost of utilities should be accumulated through utility cost centres and charged to user cost centres/departments on actual or technical estimates. In case meters have been installed, allocation of power/steam shall be as per actual reading. If any utility is supplied by a sister concern, the same shall be at landed cost. In case a utility cannot be identified with a product or service cost centre, the same may be treated as part of works overhead.

If a utility is partly produced and partly purchased, it shall be charged on weighted average rate.

A separate cost sheet for each of the utilities is to be prepared by the manufacturer. illustrations of power and steam utility cost sheet are given at **Annexure VI and VII**.



Royalty:

Royalty is payable either in relation to production or sales. If royalty payment is in respect of production of the goods captively consumed, then the same should be added as the cost element. Royalty for Marketing and Distribution, if paid, will be excluded from cost of production. Sometimes, royalty payments are one time payment at the time factory is established and are identified with the plant cost. It is capitalized and depreciated/ amortized with the plant cost.

Technical Assistance/Know-how fees:

Technical Assistance/know-how fees should be apportioned to products for which it is payable based on the payment/ provision for the relevant period as per agreement with the supplier and its impact shall be determined with reference to planned production.

Amortized cost of moulds, dies, patterns, designs, drawings etc.:

The cost of moulds, dies, patterns, patents etc should be apportioned to products for which such moulds, patterns, patents are used which are directly identifiable with the products, based on the useful life of the item.

Based on the representation received from foundry manufacturer, the department has clarified treatment of pattern cost vide MF (DR) Circular No. 170/4/96-CX 1(F.No.6/14/94-CX 1) dated 23.1.1996 (Annexure VIII) as under:

“the proportionate cost of pattern has to be included in the assessable value of the castings even in cases where such patterns are being supplied by the buyers of the castings or are prepared / manufactured by the job worker at the cost of the buyer. In cases where there is a difficulty in apportioning the cost of pattern, apportionment can be made depending on the expected life and capability of the pattern and the quantity of castings that can be manufactured from it and thus working the cost to be apportioned per unit. For this purpose a certificate from a Cost Accountant may be accepted.”

Job / Processing charges:

Job Work Charges / Processing Charges which are directly identified or linked with the products will form part of direct expenses.

Hire charges for tools and equipment:

Hire charges in respect of tools and equipments which can be directly identified with a particular product will form part of direct expenses. Hire charges for tools and equipment for general use is in the nature of indirect expenses and is to be included in works overheads.

Charges for a particular product designing etc:

Product design charges to the extent charged or amortized in the books of account in respect of tools and equipments which can be directly identified with a particular product will form part of direct expenses.



5.4 Works Overheads:

Works overheads are the indirect costs incurred in the production process.

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

Works overheads include the following expenses:

- I. Consumable stores and spares.
- II. Depreciation of plant and machinery, factory building etc.
- III. Lease rent of production assets
- IV. Repair and maintenance of plant and machinery, factory building etc
- V. Indirect employees cost connected with production activities
- VI. Drawing and Designing department cost.
- VII. Insurance of plant and machinery, factory building, stock of raw material & WIP etc
- VIII. Amortized cost of jigs, fixtures, tooling etc
- IX. Service department cost such as Tool Room, Engineering & Maintenance, and Pollution Control etc.

These expenses are incurred in the production process or in rendering service. These are used for a type of cost that cannot be directly assigned to a cost centre or product, but can only be apportioned to cost units/ cost object. Cost Accounting Standard 3, which deals with the methods of accumulation, allocation, apportionment of overheads to different cost centres and absorption thereof to products or services, should be followed.

A reconciliation statement showing the amount incurred under different heads of overheads and amount absorbed by different products used for captive consumption and for sale should be prepared by the assessee. The reconciliation will help in ensuring accuracy of cost statements.

List of items of expenses for works overheads, as indicated above, are illustrative and their treatment is indicated below. Other expenses such as Security, dispensary, canteen, staff welfare and the like will also form part of works overhead.

Consumable stores are items used in the maintenance of plant for example lubricant, cotton waste, paint and the like. Spares are purchased items used for replacement of worn out part of machinery and the like. Other indirect materials are items of small value such as bolt, nut nails, and the like which cannot be directly identified economically with a product and are treated as indirect material. These form part of the works overhead.

The depreciation on the fixed assets shall be as per the method of depreciation followed for the purpose of financial accounts as per rates specified under Companies Act, 1956. Depreciation on idle fixed assets shall be excluded from cost of production. Further, depreciation should not be calculated based on the replacement value or



notional value on revaluation of the assets. As per CAS-4 Depreciation of plant and machinery, factory building and the like is part of works overhead.

Insurance premium for various assets and risk connected with production activity should be included in works overheads. However, insurance on loss of profit policy and finished goods in transit policy should not be part of works overhead. Lease rental on fixed asset shall be also considered under this head.

5.5 Quality Control Cost:

The quality control cost is the expenses incurred relating to quality control activities for adhering to quality standard. These expenses shall include salaries & wages relating to employees engaged in quality control activity and other related expenses.

Quality control cost shall include various costs related to Quality Control, Quality Assurance Department functions and activities such as inspection of incoming material, inspection during progressive stages of manufacture of product on completion of finished product, Testing, Analysis Charges, Fees / Charges paid to IS / QS/Quality certification expenses etc. Expenses shall be identified under major heads such as salaries and wages, ISO certification etc.

CAS-4 provides that the quality control cost is to be shown separately in the cost sheet.

5.6 Research and Development Cost:

The research and development cost incurred for development and improvement of the process or the existing product shall be included in the cost of production.

Research and Development costs are the cost of undertaking research to improve quality of the present product or improve process of manufacture, develop a new product, etc.

The R & D cost for the existing product/ process shall be included in the cost of production. In case the company has followed a policy to treat a part of the R & D cost of existing product/process as deferred cost, share applicable for the year/period will be included in cost of production.

R & D cost incurred for developing a new product should be excluded from calculation of cost of production.

R&D cost is to be shown separately in the cost sheet as per Appendix I to CAS-4.

5.7 Administrative Overheads:

Administrative overheads need to be analyzed in relation to production activities and other activities. Administrative overheads in relation to production activities shall be included in the cost of production. Administrative overheads in relation to activities other than manufacturing activities e.g. marketing, projects management, corporate office expenses etc. shall be excluded from the cost of production.



The role of administration is to facilitate the manufacturing, general policy making and marketing activities. The administrative overheads shall be included in the cost of production only to the extent they are attributable to the factory. Administrative overheads in relation to activities other than manufacturing activities e.g. marketing, selling, depot/branches etc. shall be excluded from the cost of production.

Administrative Overheads for production may include share from:

- Salaries of staff for administrative and other departments relating to production such as Accounts, Purchase, HRD, Production Planning, Security etc.
- General office expenses - like rent, lighting, rates & taxes, telephone, stationery, postage etc.
- Depreciation of office building, office equipment, furniture, vehicles, etc
- Repairs & Maintenance of office building, office equipment, furniture, vehicles, etc.
- Legal expenses in relation to factory.

Treatment of Head Office/Corporate Office Expenses:

A company may have a number of factories with a head office. In a multi-locational/multi-product company, there are common activities carried out at Head Office like purchase, inventory management, finance, personnel, R & D, Quality Assurance, security etc. These activities sometimes, are centralized at one place i.e. Head Office for business convenience and scale of economy and booked as head office expenses along with other activities like secretarial, project, treasury, investment, trading, etc. They do not form part of the Administration overheads. For example: Industrial relation Department; Material management; Operation/production planning Department; Human Resources, System Design & Development Set Up and the like are production related activities. Nomenclature or place where the activity takes place is not relevant. In such a situation, activities at Head Office/Corporate level are to be clearly demarcated and segregated so as to distinguish activities that contribute clearly and directly to production activities from general management and administration activities. It is necessary to properly analyze the expenses of such activities of head office and allocate these to plants/products on rational basis.

Freight and forwarding charges on dispatch of goods for captive consumption:

In case goods for captive consumption are dispatched from one factory premises to another factory premises, the cost of transportation incurred by sender of the goods is to be treated as cost of transportation under Rule 5 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, hence excluded from calculation of cost of production for CAS.

5.8 Packing Cost:

If product is transferred/dispatched duly packed for captive consumption, cost of such packing shall be included.



Packing cost includes both cost of primary and secondary packing required for transfer/dispatch of the goods used for captive consumption.

Packing Cost includes:

- I. Cost of Packing Material used
- II. Job charges paid for manufacture of packing material, if any.
- III. Packing charges including salaries & wages of the persons involved in packing activity.
- IV. Other expenses relating to packing activity.

Landed cost of the packing material should be calculated as per the guidelines given in para related to material cost. If product for captive consumption is transferred without packing (unpacked), packing cost need not be included in the cost of production. In case, captive product is transferred on returnable/ durable packing container, pro-rata cost shall be estimated and charged based on the life of the container. In case packed goods are sent to job worker, the cost of packing will form part of cost of production, unless these are returned to buyer for re-use.

Packing cost includes both cost of primary and secondary packing required for transfer/dispatch of the goods used for captive consumption.

5.9 Absorption of overheads:

Overheads shall be analyzed into variable overheads and fixed overheads.

Variable Overheads are the items which change with the change in volume of production, such as cost of utilities etc.

Fixed overheads are the items whose value do not change with the change in volume of production such as staff salaries, rent etc.

The variable production overheads shall be absorbed in production cost based on actual capacity utilization.

The fixed production overheads and other similar items of fixed costs such as quality control cost, research and development costs, administrative overheads relating to manufacturing shall be absorbed in the production cost on the basis of the normal capacity or actual capacity utilization of the plant, whichever is higher.

Absorption of overheads:

Based on behaviour, overheads are classified as variable overhead and fixed overhead. Variable Overheads comprise of expenses which vary in proportion to the change in the volume of production e.g. cost of utilities, royalty, job charges, etc.

Fixed overheads comprise of expenses which do not vary with the change in volume of production such as of rent, insurance, technical assistance/know-how fees, amortized cost of moulds, patterns, patents, hire charges for tools and equipments, charges for a particular design, and the like.



The principles laid down in CAS-3, relating to the methods of accumulation, allocation, apportionment of overheads to different cost centers and absorption thereof to products or services on a consistent and uniform basis in the preparation of cost sheet should be followed for the purpose of allocation and absorption of overheads.

The variable production overheads shall be absorbed in cost of product, based on actual capacity utilization. The fixed production overheads shall be absorbed on normal capacity basis or actual capacity utilization whichever is higher. 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. Normal capacity for a defined period is the practical capacity minus the loss of productive capacity due to external factors. Whereas Practical or Achievable capacity as “the maximum productive capacity of a plant reduced by the predictable and unavoidable factors of interruption pertaining to internal causes such as inevitable interruptions due to time lost for preventive maintenance, repairs, set ups, normal delays, weekly off days and holidays etc.

An illustration on absorption of overheads based on normal capacity utilisation is at Annexure IX.

A reconciliation statement showing the amount incurred under different heads of overheads and amount absorbed by different products should be prepared for this purpose. The reconciliation will help in ensuring accuracy of cost of production in cost statements.

5.10 Valuation of Stock of work-in-progress and finished goods

Stock of work-in-progress shall be valued at cost on the basis of stages of completion as per the cost accounting principles. Similarly, stock of finished goods shall be valued at cost. Opening and closing stock of work-in-progress shall be adjusted for calculation of cost of goods produced and similarly opening and closing stock of finished goods shall be adjusted for calculation of goods dispatched.

For determining the cost of production for captive consumption, adjustment for opening and closing stock of work-in-progress shall be made. The valuation of opening stock and closing stock of WIP is valued at cost on the basis of stages of completion. Similarly for calculation of cost of finished goods dispatched, adjustment for opening and closing stock of finished goods, if any, is to be made. In case the cost of a shorter period is to be determined, where the figures of opening and closing stock are not readily available, the adjustment of figures of opening and closing stock may be ignored.

Adjustment of opening and closing stock of WIP/finished goods will arise only when the cost of production is to be determined for historical cost and due consideration shall be given for above adjustment in determining the cost of production. However, if cost of production is to be determined for a future period, it will be based on projected cost and projected capacity utilisation. In such cases, adjustment of opening and closing WIP/finished goods and valuation thereof does not arise.

5.11 Treatment of Joint Products and By-Products

A production process may result in more than one product being produced simultaneously. In case joint products are produced, joint costs are allocated



between the products on a rational and consistent basis. In case by-products are produced, the net realisable value of by-products is credited to the cost of production of the main product.

For allocation of joint cost to joint products, the sales values of products at the split off point i.e. when the products become separately identifiable may be the basis. It may be allocated based on a measure of the number of units, weight or volume. Some other basis may be adopted. For example, in case of petroleum products, each product is assigned certain value based on its certain properties, may be calorific value and these values become the basis of apportionment of joint cost among petroleum products.

The joint cost shall be allocated to the cost of production of Joint Products as per the generally accepted cost accounting principles.

By-product:

By product is a product recovered incidentally from the material used in the manufacture of main products. It has lower importance compared to the main product(s). It is difficult to determine the cost of by-product. By products are sold:

- (1) Either In original form without further processing; or
- (2) or processed in order to be saleable. In such case, the main product is credited with the sale realization (gross/net) as the case may be. In other words expenses incurred to bring by-product to marketable conditions shall be adjusted from the sale of by product and net realizable value of by-product shall be credited to cost of production of main product.

In case sale realization is not available, credit to main product at substitute value of by product may be given.

5.12 Treatment of Scrap and Waste:

The production process may generate scrap or waste. Realized or realizable value of scrap or waste shall be credited to the cost of production.

In case, scrap or waste does not have ready market and it is used for reprocessing, the scrap or waste value shall be taken at a rate of input cost depending upon the stage at which such scrap or waste is recycled. The expenses incurred for making the scrap suitable for reprocessing shall be deducted from value of scrap or waste.

Illustration

Stage	Input material cost	Processing cost	Total
	(Rs/MT)	(Rs/MT)	(Rs/MT)
1	2000	500	2500
2	2500	1000	3500
3	3500	1000	4500



If during the production process at stage 3, the scrap is produced and the same is recycled at stage 2 after making an expenditure of Rs 200 per MT to make it suitable for re-processing at stage 2, then scrap will be valued @ Rs (2500 - 200) i.e. Rs 2300. If no expenditure is involved to make scrap re-usable, the scrap value will be @ Rs 2500. The scrap value for the scrap produced during a period calculated at the rate as explained above may be deducted to find out the cost of production for the period.

The above illustration refers to recycled waste or inferior/ sub-standard production. Normal process loss is ignored for the sake of simplicity. If the cost calculation is done for the past period and the actual sales realization of scrap is available, the same shall be deducted after adjustment for opening and closing stock of scrap (to arrive at the realizable value of scrap generated) from the cost of production for the relevant period. In case the scrap is not disposed off/sold during the period and lying in the stock, the realizable value of scrap can be calculated from the quotations/market rate.

5.13 Miscellaneous Income:

Miscellaneous income relating to production shall be adjusted in the calculation of cost of production, for example income from sale of empty containers used for dispatch of the captively consumed goods produced under reference.

The miscellaneous income needs to be analyzed in detail for its nature (capital / revenue) and if not related to production activities, the same may be ignored. The income arising out of sale of used empty containers of the input materials shall be adjusted in the cost of production.

5.14 Inputs received free of cost:

In case any input material, whether of direct or indirect nature, including packing material is supplied free of cost by the user of the captive product, the landed cost of such material shall be included in the cost of production.

Landed cost of inputs received free of cost should be calculated as per the guidelines given in para related to material cost. The cost of inputs received free of cost shall be included in the cost of production for captive consumption.

5.15 Moulds, Tools, Dies & Patterns etc received free of cost:

The amortization cost of such items shall be included in the cost of production.

Amortization should be done on the basis of estimated production that can be achieved during the life of the Mould, Tool, Die or Pattern. After the estimated life, if the moulds, dies are still in use and if the full cost has already been amortized, then amortization cost need not be considered for the purpose of cost of production. However, for this purpose, proper record needs to be maintained. The estimated life / estimated production may be certified by technical person. Where the dies, moulds etc are supplied by the customer, the necessary details may be obtained from the customer.

In case of dies, moulds etc purchased / manufactured in-house, its cost should be ascertained and amortised over its useful life.



5.16 Interest and Financial Charges:

Interest and financial charges being a financial charge shall not be considered to be a part of cost of production.

Interest and financial charges can be on bank borrowings, amortization of discounts or premium related to borrowings, amortization of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs.

Interest and financial charges are finance cost and do not form part of cost of production for captive consumption. Logic for excluding interest from captive consumption is that for purpose of assessable value a margin of 10% of cost of production is added to take care of return on capital employed. (Normally return on capital employed takes care of return on owners' equity and interest on borrowed fund). To make the calculation simple above approach of 110% of cost of production of captively consumed good is taken as assessable value.

5.17 Abnormal and Non-recurring Cost

Abnormal and non-recurring cost arises due to unusual or unexpected occurrence of events, such as heavy break down of plants, accident, market condition restricting sales below normal level, abnormal idle capacity, abnormal process loss, abnormal scrap and wastage, payments like VRS, retrenchment compensation, lay-off wages etc. The abnormal cost shall not form the part of cost of production.

Loss due to fire, natural calamities and the like (as indicated above) are treated as abnormal and non-recurring cost, and excluded from cost of production. Further, expenses which are not related to manufacturing activity and which do not form part of the cost as per the generally accepted cost accounting principles may be excluded for this purpose e.g. - donations, loss on sale of fixed assets, etc.



The cost sheet should be prepared in the format as per Appendix-1 to the Standard or as near thereto as possible. The manufacturer will be required to maintain cost records and other books of account in a manner, which would facilitate preparation and verification of the cost of production. For manufacturers covered under the ambit of Section 209(1) (d) of the Companies Act, 1956, i.e., where Cost Accounting Records are statutorily required to be maintained, the Cost Accountant certifying the cost of production for captive consumption shall verify the correctness of the cost from these records. However, for manufacturers not covered under Section 209(1) (d) of the Companies Act, 1956, it is desirable that they also maintain cost accounting records in line with the records so prescribed as to facilitate determination and certification of cost of production.

Separate cost sheet shall be prepared for each type / variety / description of product used for captive consumption. The cost sheet may be suitably modified to cover the special features, if any, of the industry. Where goods of different variety / type / size of a group of products are manufactured and the manufacturing process is the same, the cost of production may be worked out for main product / variety and the cost of other type / variety of the product may be worked out by applying above cost per unit and adjustment made for addition / deletion of items required for a particular product. Separate cost statement is to be prepared for each size and variety of goods on the above basis.

In case of multi-location units, the cost of production should be worked out separately for each unit as per CAS-4.

The Cost Accountant certifying the cost sheet of cost of production for captive consumption shall verify and reconcile the product cost arrived at for the certification with that worked out to comply with provisions of Section 209(1)(d) of the Companies Act, 1956.

In case where the product is covered under The Companies (Cost Accounting Records) Rules 2011 issued in pursuant to Section 209(1)(d) of the Companies Act, 1956, the system for cost calculation would be in place and the relevant information will be readily available for such calculations. If the product is not covered under above provision, maintenance of cost accounting records as per the generally accepted costing principles read with Cost Accounting Standards shall be useful for the purpose.

Manufacturers following standard costing system should adjust the variances to the various products as per generally accepted cost accounting principles for calculation of product wise cost of production.

Two illustrations of Cost Sheet are annexed as Annexure X (a) and X (b).

Attestation/Certification:

The responsibility of preparation of cost sheet is that of the management. After cost sheet has been authenticated by company's authorized representative, cost accountant



Cost of Production for Captive Consumption

in practice has to certify the same as per certificate appended below the cost sheet. Cost accountant shall carry out test checks with reference to books of account, cost records and other records required for the purpose. Records required under Excise relating to receipt, purchases, manufacture storage, sales or delivery of goods inputs, etc may be scrutinized. He should ensure that cost data reflect true and fair view of the cost of production. Suggested list of test check to be carried out are given below.

Test checks will depend upon the type of organization i.e. covered under maintenance of cost accounts records as required under Section 209(1) (d) and cost audit thereof under section 233B of the Companies Act 1956. Cost accounting records and cost report may be examined and other organisations. In case of organisations covered under above provisions, the Cost Accountant certifying the cost sheet of cost of production for captive consumption shall verify and reconcile the product cost arrived at for certification with that worked out to comply with provisions of Section 209(1)(d) of the Companies Act, 1956 and cost audit report thereof.

Other organizations are:

1. Not covered under statutory maintenance of cost accounting records but have goods cost accounting system and proper records are maintained. In such cases cost records should be reviewed and information shall be called for the purpose.
2. Organisation do not maintain cost records at all: Organization shall submit the relevant records and data on the basis of which cost sheet has been prepared with reference to financial and excise records relating to production. With computerized accounting system, organization can supply the necessary data required for the purpose.

Test Checks:

Test checks required may be decided keeping in view the type of organisations detailed above. Examine the material accounting systems from purchase to issue of material. Compare the norms of consumption of input of materials as mentioned in ER 4, 5 and ER 6. If the product is already being produced, consumption shall be compared with previous period. Test check some issue vouchers relating to raw material and process material. If breakup of material cost is not indicated in the cost statement, ask for separate details item-wise. The basis of valuation shall be as per financial accounts. If the method of valuation is changed, it should be ensured that it does not result in undervaluation of cost of material.

Compare consumption of major raw material as shown in annual accounts. Check whether by product waste is being properly accounted for and credit is given to the main raw material.

Review procedure of employee cost booking, direct expenses and other overheads relating to classification and allocation and absorption. (Breakup of Overhead into fixed and variable overheads).



Check that the expenses as exhibited in the cost sheet have been properly worked out as provided under CAS-4.

Authentication on cost sheet, workings and/or declaration shall, preferably obtained from the professional accountant of the company.

However, when the normal capacity utilization is not quantifiable and /or actual capacity utilization is likely to be low, as compared to previous period; It is advisable that the manufacturer shall go for Provisional Assessment under rule 7 of Central Excise Rules, 2002. After the end of the year annual certification should be done based on the finalized books of account and if the cost of production is found different than the provisional costs, differential duty shall be paid by the manufacturer.

In case of multi-location units, the cost of production should be worked out separately for each unit as per CAS-4.

Periodicity of cost sheet/certification:

The basic purpose of CAS-4 is to determine the cost of production for goods capitively consumed and calculate deemed transaction value thereof. Therefore, valuation is required at the time of removal of the goods. If costing is for the future period, it will be done at projected costs, projected capacity utilisation. In such cases, valuation of opening and closing stock of WIP and finished stock is to be ignored. In case, when the normal capacity utilization is not quantifiable and / or actual capacity utilization is likely to be low, as compared to previous period; it is advisable that the manufacturer shall go for Provisional Assessment under rule 7 of Central Excise Rules, 2002. After the end of the year annual certification should be done based on the finalized books of account and if the cost of production is found different than the provisional costs, differential duty shall be paid by the manufacturer.



- (i) If there is any change in cost accounting principles and practices during the concerned period which may materially affect the cost of production in terms of comparability with previous periods, the same should be disclosed.***
- (i) If opening stock and closing stock of work -in-progress and finished goods are not readily available for certification purpose, the same should be disclosed.***

The cost accounting principles and methods adopted for determining the cost of production to be followed consistently from one period to subsequent period. If there is any change in the cost accounting principles and methods during the period resulting in material effect on the cost of production, the same shall be disclosed indicating its impact in the cost statement.

Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule or below the certificate relating to above items or any other matter.



Annexure I

Circular No. 692/08/2003-CX 13th February, 2003

F.No.6/29/2002-CX.I

Government of India

Ministry of Finance and Company Affairs

Department of Revenue

Subject: Valuation of goods captively consumed.

I am directed to say that on introduction of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, w.e.f. 1.7.2000, it was clarified by the Board vide Circular No.354/81/2000TRU dated 30.6.2000 (para 21) that for valuing goods which are captively consumed, the general principles of costing would be adopted for applying Rule 8. The Board has interacted with the Institute of Cost & Works Accountants of India (ICWAI) for developing costing standards for costing of captively consumed goods.

The Institute of Cost & Works Accountants of India [ICWAI] has since developed the Cost Accounting Standards, CAS 2, 3 and 4, on capacity determination, overheads & cost of production for captive consumption, respectively, which were released by the Chairman, CBEC on 23.1.2003.

It is, therefore, clarified that cost of production of captively consumed goods will henceforth be done strictly in accordance with CAS-4. Copies of CAS-4 may be obtained from the local Chapter of ICWAI.

Board's Circular No. 258/92/96-CX dated 30.10.96, may be deemed to be modified accordingly so far as it relates to determination of cost of production for captively consumed goods.

This Circular may be brought to the notice of the field formations.

Suitable Trade Notices may be issued for the benefit of the Trade.

Hindi version will follow.

Receipt of these instructions may be acknowledged



EXTRACT OF SECTION 4 OF CENTRAL EXCISE ACT, 1944

4. Valuation of excisable goods for purposes of charging of duty of excise.

- 1) Where under this Act, the duty of excise is chargeable on any excisable goods with reference to their value then, on each removal of the goods, such value shall:
 - a. In a case where the goods are sold by the assessee, for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value;
 - b. In any other case, including the case where the goods are not sold be the value determined in such manner as may be prescribed.
- 2) The provisions of this section shall not apply in respect of any excisable goods for which a tariff value has been fixed under sub-section (2) of section 3.
- 3) For the purposes of this section, -
 - a. "assessee" means the person who is liable to pay the duty of excise under this Act and includes his agent;
 - b. persons shall be deemed to be "related" if –
 - I. they are inter-connected undertakings;
 - II. they are relatives;
 - III. amongst them the buyer is a relative and a distributor of the assessee, or a sub-distributor of such distributor; or
 - IV. they are so associated that they have interest, directly or indirectly, in the business of each other.

Explanation: In this clause:

- (i) "inter-connected undertakings" shall have the meaning assigned to it in clause (g) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969; and
 - (ii) "relative" shall have the meaning assigned to it in clause (41) of section 2 of the Companies act, 1956;
- a) "Place of removal" means-
- I. a factory or any other place or premises of production or manufacture of the excisable goods;
 - II. A warehouse or any other pace or premises wherein the excisable goods have been permitted to be deposited without payment of duty; from where such goods are removed;



Guidance Note - 4

- b) “transaction value” means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, Or on behalf of, the assessee, by reason of , or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.



**CENTRAL EXCISE VALUATION (DETERMINATION OF PRICE OF
EXCISABLE GOODS) RULES, 2000**

Notification No. 45/2000-C.E. (N.T.) dated 30-6-2000 [Effective from 1-7-2000].

Amended by

Notification No. 11/2003-C.E. (N. T.), dated 1-3-2003

Notification No. 60/2003-C.E. (N.T.), dated 05-08-2003

Notification No. 09/2007-C.E. (N. T.), dated 1-3-2007

[Issue by the Ministry of Finance (Department of revenue) vide F. No. 354/81/2000-TRU;

Published in the Gazette of India Extraordinary Part II, Section 3, sub-section (i) dated

30.6.2000]. NOTIFICATION [NO. 45/2000- Central Excise (N.T.)]

G.S.R.575 (E):- In exercise of the powers conferred by section 37 of the Central Excise Act, 1944 (1 of 1944), and in supersession of the Central Excise (Valuation) Rules, 1975 except as respect things done or omitted to be done before such supersession, the Central Government hereby makes the following rules, namely:-

1. (1) These rules may be called the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.
- (2) They shall come into force on and from the 1st day of July, 2000.

**CHAPTER I
PRELIMINARY**

2. In these rules, unless the context otherwise requires:
 - a) “Act” means the Central Excise Act, 1944 (1 of 1944)
 - b) “normal transaction value” means the transaction value at which the greatest aggregate quantity of goods are sold ;
 - c) “value” means the value referred to in section 4 of the Act;
 - d) words and expressions used in these rules and not defined but defined in the Act shall have the meanings respectively assigned to them in the Act.

**CHAPTER II
DETERMINATION OF VALUE**

3. The value of any excisable goods shall, for the purposes of clause (b) of sub-section (1) of section 4 of the Act, be determined in accordance with these rules.
4. The value of the excisable goods shall be based on the value of such goods sold by the assessee for delivery at any other time nearest to the time of the time of the removal of goods under assessment, subject, if necessary, to such adjustment on



account of the difference in the dates of delivery of such goods and of the excisable goods under assessment, as may appear reasonable.

5. Where any excisable goods are sold in the circumstances specified in clause (a) of sub-section (1) of section 4 of the Act except the circumstance in which the excisable goods are sold for delivery at a place other than the place of removal, then the value of such excisable goods shall be deemed to be the transaction value, excluding the actual cost of transportation from the place of removal upto the place of delivery of such excisable goods.

Explanation 1: "Cost of transportation includes"

- I. the actual cost of transportation, and
- II. In case where freight is averaged, the cost of transportation calculated in accordance with generally accepted principles of costing.

Explanation 2: For removal of doubts, it is clarified that the cost of transportation from the factory to the place of removal, where the factory is not the place of removal, shall not be excluded for the purposes of determining the value of excisable goods.

6. Where the excisable goods are sold in the circumstances specified in clause (a) of sub section (1) of section 4 of the Act except the circumstance in where the price is not the sole consideration for sale, the value of such goods shall be deemed to be the aggregate of such transaction value and the amount of money value of any additional consideration flowing directly or indirectly from the buyer to the assessee.

Explanation 1: For removal of doubts, it is hereby clarified that the value, apportioned as appropriate, of the following goods and services, whether supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale of such goods, to the extent that such value has not been included in the price actually paid or payable, shall be treated to be the amount of money value of additional consideration flowing directly or indirectly from the buyer to the assessee in relation to sale of the goods being valued and aggregated accordingly, namely:-

- I. Value of materials, components, parts and similar items relatable to such goods;
- II. Value of tools, dies, moulds, drawings, blue prints, technical maps and charts and similar items used in the production of such goods;
- III. Value of materials consumed, including packaging materials, in the production of such goods;
- IV. Value of engineering, development, art work, design work and plans and sketches undertaken elsewhere than in the factory of production and necessary for the production of such goods.

Explanation 2: Where an assessee receives any advance payment from the buyer against delivery of any excisable goods, no notional interest on such advance shall be added to the value unless the Central Excise Officer have evidenced to the effect that



Cost of Production for Captive Consumption

the advance received has influenced the fixation of price of the goods by way of charging a lesser price from or by offering a special discount to the buyer who has made the advance deposit.

Illustration 1: X an assessee, sells his goods to Y against full advance payment at Rs 100 per piece. However, X also sells such goods to Z without any advance payment at the same price of Rs 100 per piece. No notional interest on the advance received by X is includible in the transaction value.

Illustration 2: A an assessee manufactures and supplies certain goods as per design and specification furnished by B at a price of Rs 10 lakhs. A takes 50% of the price as advance against these goods and there is no sale of such goods to any other buyer. There is no evidence available with the Central Excise Officer that the notional interest on such advance has resulted in lowering of the prices. Thus, no notional interest on the advance received shall be added to the transaction value.

7. Where the excisable goods are not sold by the assessee at the time and place of removal but are transferred to a depot, premises of a consignment agent or any other place or premises (hereinafter referred to as "such other place") from where the excisable goods are to be sold after their clearance from the place of removal and where the assessee and the buyer of the said goods are not related and the price is the sole consideration for the sale, the value shall be the normal transaction value of such goods sold from such other place at or about the same time and, where such goods are not sold at or about the same time, at the time nearest to the time of removal of goods under assessment.
8. Where the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles. The value shall be one hundred and ten per cent of the cost of production or manufacture of such goods.
9. When the assessee so arranges that the excisable goods are not sold by an assessee except to or through a person who is related in the manner specified in either of sub clauses (ii) or (iii) or (iv) of clause (b) of sub-section (3) of section 4 of the Act, the value of the goods shall be the normal transaction value at which these are sold by the related person at the time of removal, to buyer (not being related person); or where such goods are not sold to such buyers, to buyers (being related person), who sells such goods in retail:

Provided that in a case where the related person does not sell the goods but uses or consumes such goods in the production or manufacture of articles, the value of goods shall be determined in the manner specified in rule 8.

10. When the assessee so arranges that the excisable goods are not sold by him except to or through an inter-connected undertaking, the value of goods shall be determined in the following manner, namely:-



- a) If the undertakings are so connected that they are also related in terms of sub-clause (ii) or (iii) or (iv) of clause (b) of sub-section (3) of Section 4 of the Act or the buyer is a holding company or subsidiary company of the assessee, then the value shall be determined in the manner prescribed in rule 9.

Explanation: In this clause “holding company” and “subsidiary company” shall have the same meanings as in the Companies Act, 1956 (1 of 1956).

- b) In any other case, the value shall be determined as if they are not related persons for the purpose of sub-section (1) of section 4.

10A. Where the excisable goods are produced or manufactured by a job-worker, on behalf of a person (hereinafter referred to as principal manufacturer), then, -

- (i) in a case where the goods are sold by the principal manufacturer for delivery at the time of removal of goods from the factory of job-worker, where the principal manufacturer and the buyer of the goods are not related and the price is the sole consideration for the sale, the value of the excisable goods shall be the transaction value of the said goods sold by the principal manufacturer;
- (ii) In a case where the goods are not sold by the principal manufacturer at the time of removal of goods from the factory of job-worker, but are transferred to some other place from where the said goods are to be sold after their clearance from the factory of job-worker and where the principal manufacturer and buyer of the goods are not related and the price is the sole consideration for the sale, the value of the excisable goods shall be the normal transaction value of such goods sold from such other place at or about the same time and, where such goods are not sold at or about the same time, at the time nearest to the time of removal of said goods from the factory of job-worker;
- (iii) In a case not covered under clause (i) or (ii), the provisions of foregoing rules, wherever applicable, shall mutatis mutandis apply for determination of the value of the excisable goods:

Provided that the cost of transportation, if any, from the premises, wherefrom the goods are sold, to the place of delivery shall not be included in the value of excisable goods.

Explanation: For the purposes of this rule, job-worker means a person engaged in the manufacture or production of goods on behalf of a principal manufacturer, from any inputs or goods supplied by the said principal manufacturer or by any other person authorized by him.

11. If the value of any excisable goods cannot be determined under the foregoing rules, the value shall be determined using reasonable means consistent with the principles and general provisions of these rules and sub-section (1) of section 4 of the Act.



CASE NO.: Appeal (civil) 2947-2948 of 2001
PETITIONER: Commissioner of Central Excise, Pune
RESPONDENT: M/s. Cadbury India Ltd.
DATE OF JUDGEMENT: 01/08/2006
BENCH: Ashok Bhan & Markandey Katju

JUDGEMENT: (with Civil Appeal Nos.1856-1857/2002, 5232-5233/2003, 1425/2005 and 2878-2879/2005) MARKANDEY KATJU, J. Civil Appeals Nos. 2947-2948/2001 have been filed against the impugned final order dated 28.9.2000 passed by the Customs Excise and Gold (Control) Appellate Tribunal, West Regional Bench at Mumbai in Appeal No. E/1021, 1022/2000-MUN.

Heard learned counsel for the parties.

The question involved in these appeals is about the valuation of milk crumbs, refined milk chocolate and four other products manufactured by the respondent - M/s. Cadbury India Limited, in its factory at Induri, Pune and captively consumed in that factory and other factories of the respondent in the manufacture of chocolate. No part of these products are sold by the respondent.

The respondent had sought valuation of these goods under Rule 6(b)(ii) of the Central Excise (Valuation) Rules, which provides for basing the valuation on such goods on the "cost of production on manufacture including profits, if any, the assessee would have earned in the sale of such goods."

The assessee had showed the price of these goods supported by a statement verified by a chartered accountant. The statement indicated the cost of edible and packing material used in the manufacture including its overheads. A separate statement in support of the profit added was formulated and these assessments were provisionally approved.

At the time of the finalization of the assessment, the department took the view that the value of the goods should include the labour cost, direct expenses, total factory expense, administration expenses, travelling expense, insurance premium, advertising expense and interest. The Assistant Commissioner added these elements to the declared value. He added the total expenses of the company as shown in the balance sheet and deducted the cost material. A percentage of this cost of the remaining figure was treated as the factor by which the assessable value should be increased.

In appeal the Commissioner (Appeals) upheld the order of the Assistant Commissioner. He held that since Rule 6(b)(ii) itself specified including the profit on the goods captively consumed hence this indicated the intention in the rule that the valuation should be brought to the level of the sale value of the goods and hence this includes all expenses referred to above. The Commissioner (Appeals) also relied on the circular dated



30.10.1996 issued by the Board relating to captively consumed goods. He has also relied upon paragraph 49 of the Supreme Court's judgment in Union of India vs. Bombay Tyres International AIR 1984 SC 420. In further appeal the Tribunal set aside the orders of the Commissioner and the Assistant Commissioner. The Tribunal held that sub-rule (ii) of Rule 6(b) can be invoked only in a situation where the goods are not sold and there are no comparable goods. The Tribunal held that the expenses other than the cost of manufacture, cost of raw materials and the profit would not be includible in the assessable value.

The issue in the present case is about the value of the goods captively consumed by the respondent. The assessee has contended that there is no dispute that these intermediate goods are not marketable and are not bought and sold in the market. Hence the valuation of these intermediate goods has to be done according to Rule 6(b)(ii) of the Central Excise (Valuation) Rules, 1975.

Rule 6(b)(ii) reads as follows: "Rule 6 If the value of the excisable goods under assessment cannot be determined under Rule 4 or Rule 5, and a) (b) (i) (ii) if the value cannot be determined under sub-clause (i), on the cost of production or manufacture including profits, if any, which the assessee would have normally earned on the sale of such goods; "

According to settled principles of accountancy only the elements that have actually gone into the manufacture/production of these intermediates i.e. sum total of the direct labor cost, direct material cost, direct cost of manufacture and the factory overheads of the factory producing such intermediate products are included in the cost of production. The Appellant produced alongwith the reply to the Show Cause Notice the following authoritative texts: Wheldon's Cost Accounting and Costing Methods, Cost Accounting methods by B K Bhar, Principles of Cost Accounting by N.K. Prasad, Glossary of Management Accounting Terms by ICWAI.

In CCE v. Dai Ichi Karkaria Ltd., (1999) 7 SCC 448, at page 459 it has been held that the normal principles of accountancy shall be applied to determine the cost. In this decision this Court observed:

"Learned Counsel for the respondents drew our attention to the judgment of this Court in Challapalli Sugar Ltd. v. CIT. The Court was concerned with "written-down value". The "written-down value" had to be taken into consideration while considering the question of deduction on account of depreciation and development rebate under the Income Tax Act.

"Written-down value" depended upon the "actual cost" of the assets to the assessee.

The expression "actual cost" had not been defined in the Income Tax Act, 1922 and the question was whether the interest paid before the commencement of production on the amount borrowed for the acquisition and installation of the plant and machinery could be considered to be a part of the "actual cost" of the assets to the assessee. As the expression "actual cost" had not been defined, this Court was of the view that it should be construed "in the sense which no commercial man would misunderstand. For this purpose, it could be necessary to ascertain the connotation of the above expression



Cost of Production for Captive Consumption

in accordance with the normal rules of accountancy prevailing in commerce and industry". Having considered authoritative books in this regard, this Court said that the accepted accountancy rule for determining the cost of fixed assets was to include all expenditure necessary to bring such assets into existence and to put them in a working condition. That rule of accountancy had to be adopted for determining the "actual cost" of the assets in the absence of any statutory definition or other indication to the contrary."

Subsequent to the filing of these appeals, the Institute of Cost and Works Accountants of India (ICWAI) has laid down the principles of determining cost of production for captive consumption and formulated the standards for costing: CAS-4. According to CAS-4 the definition of "cost of production" is as under:

"4.1. Cost of Production: Cost of Production shall consist of Material consumed, Direct wages and salaries, Direct expenses, Works overheads, Quality Control cost, Research and Development cost, Packing cost, Administrative Overheads relating to production." The cost accounting principles laid down by ICWAI have been recognized by the Central Board of Excise and Customs vide Circular No.692/8/2003 CX dated 13.2.2003. The circular requires the department to determine the cost of production of captively consumed goods strictly in accordance with CAS-4.

The Tribunal in the case of BMF BELTINGS LTD. vs. CCE : 2005 (184) E.L.T. 158 (Tri. Bang.) for the period 1995 to 2000 has directed the department to apply CAS-4 for the determination of the cost of production of the captively consumed goods. In ITC vs. CCE (190) ELT 119 the Tribunal held that the department has to calculate the cost of production in terms of CAS-4. Other decisions of the Tribunal, wherein it has directed that CAS-4 be applied for determination of the cost of production, are Teja Engineering v/s CCE 2006 (193) ELT 100 (Tri-Chennai), Ashima Denims v/s CCE 2005 (191) ELT 318 (Tri-Mumbai), and Arti Industries vs. CCE 2005 (186) ELT 208 (Tri-Chennai). This is therefore a consistent view taken by the Tribunal.

The department has not filed any appeal in these cases and accepted the legal position. Apart from this, in the light of several decisions of this Court, the Department is also bound by the said circular No.692/8/2003 CX dated 13.2.2003 issued by the CBEC. As such it cannot now take a contrary stand. It may be noted that in the present case the intermediate products (milk crumbs, refined milk chocolate and four other intermediate products) are captively consumed in the Respondent's own factory. These Intermediate products are not sold nor are marketable.

Hence there can be no question of including the expenses of the factory which produces the final product namely the chocolate e.g. advertising, insurance and another expenses in their valuation as was sought to be added by the Commissioner (Appeals) and the Assistant Commissioner. For the reasons given above, we find no merit in these appeals and they are dismissed. No costs. Civil Appeal Nos. 1856-1957/2002, 5232-5233/2003, 1425/2005 & 2878-2879/2005) In view of the decision in Civil Appeal Nos. 2947-2948/2001, these appeals are accordingly dismissed. No costs.



Annexure VA & VB
Illustration of Landed Cost of Indigenous/Imported Material

Annexure VA
Indigenous Material:

The landed cost of indigenous material shall be calculated in the following manner:

1.	Basic Material Cost (after deducting discounts, if any)	
2.	Add:	Excise Duty
		VAT/Sales Tax
		Turnover Tax
		Surcharge such Education cess and the like
		Octroi/Entry Tax
		Other levies, if any
		Total
3.	Less	Cenvat credit
		Sales Tax/VAT set off
		Other set offs direct attributable to the material
4.		Total (1+2-3)

Above Duties /levies are indicative and actual may vary with reference to type of material.

Illustration of the Landed Cost of indigenous material:

Sl.	Particular of goods	Qty	Rate	Amount
1	ABC goods	11700	11.00	1,28,700
2	Basic Excise duty @ 16%			20,592
3	Cess on BED @ 2%			412
4	SHE Cess @ 1%			206
5	Total (1+2+3+4)			1,49,910
6	VAT 4%			5,996
7	Freight			15,600
8	Total (5+6+7)			1,71,506
9	Less : Cenvat (2+3+4)			21,210
10	Less : VAT (6)			5,996
11	Net Cost (8-9-10)			1,44,300



Annexure VB
Landed Cost of Imported Material

Imported Material

The landed cost of imported material shall be calculated in the following manner:

1.	CIF Value of material	
2.	Add	Custom Duty
		Surcharge
		Additional Duty/Countervailing Duty
		Special Additional Duty
		Protective Duty
		Anti Dumping Duty
		Octroi/Entry Tax
		Other levies
		Other Expenses directly attributable to procurement (freight inwards, Local freight, transit insurance, local insurance)
		Other charges such as Customs clearance etc
3.	Less:	Cenvat Credit (including CVD)
		Other rebates, benefits recovered/recoverable
4.		Total (1+2-3)

Above Duties /levies are indicative and actual may vary with reference to type of material imported.

Illustration of landed cost of imported material:

Sl.	Particular	Rate	Amount
1.	Basic Value		100.00
2.	Basic Custom Duty	5%	5.00
3.	Sub Total (1 + 2)		105.00
4.	CVD	8%	8.40
5.	ED Cess on CVD	2%	0.17
6.	SHE Cess on CVD	1%	0.08
7.	Sub Total (3 to 6)		113.65
8.	Custom Edu Cess	2%	2.27
9.	Custom SHE Cess	1%	1.14
10.	SAD(on7+8+9)	4%	4.68
11	Total Landed Cost		121.74
12	Cenvat Available (4+5+6+10)		13.33



Annexure VI

Name of the unit XYZ
 Name and address of the factory ABC, New Delhi
 STATEMENT SHOWING THE COST OF Power produced and Consumed during the year

S.No	PARTICULARS	QTY (Kwh)
1	Installed Capacity	215136000
2	Quantity Produced	13,60,73,501
3	Capacity Utilisation	63
4	Quantity Re-circulated	
5	Quantity purchased, if any	
6	Internal consumption in power plant	1,21,46,703
7	Net unit available	12,39,26,798

SR.	PARTICULARS	UNIT	QUANTITY RS/UNIT	RATE RS	AMOUNT	RATE/ KwH 2008-09
A.						
1.	Material cost					
	a. Furnace Oil	MT	66064	4878.03	32,22,62,370	2.60
	b. High Speed Diesel	KL	76	37,393	28,41,893	0.02
	c. Natural Gas	SCM	7,26,460	12	87,95,457	0.07
	d. Coal	MT	66,064	3,596.58	23,76,04,281	1.92
	e. Lube Oil				39,94,651	0.03
2.	Process Material / Chemicals				-	-
3.	Direct Wages & Salaries				1,55,56,852	0.13
4.	Utilities				-	-
5.	Other direct expenses				-	-
6.	Consumable Stores & Spares				38,41,898	0.03
7.	Repairs and Maintenance				82,74,080	0.07
8.	Depreciation				4,27,45,759	0.34
9.	Insurance				61,99,660	0.05
10.	Fly Ash Disposal Cost				11,28,241	0.01
11.	Other Works Overhead				28,75,377	0.02
12.	Sub-total (1 to 10)				65,61,20,519	5.29
13.	Less : Credit, if any				-	-
14.	Total Cost				65,61,20,519	5.29



Cost of Production for Captive Consumption

SR.	PARTICULARS	UNIT	QUANTITY RS/UNIT	RATE RS	AMOUNT	RATE/ KwH 2008-09
B.	Apportioned to product					
			Units		Amount	
	Product A		12,15,22,526		64,33,01,484	
	Product B		4,35,029		23,02,905	
	Product c		19,34,644		1,02,41,388	
	Product D		34,600		1,83,161	
	Service Dept		17,300		91,581	
	Total		12,39,44,099		65,61,20,519	



Annexure VII

Name of the unit		ABC				
Address		P Road				
Steam Cost Sheet for the year ending 31.3.2008						
Quantitative Information						
Steam Generated		135000 MT				
Cost						
Particulars		Unit	Quantity	Rate	Amount	Rs/M.T.
A.	Variable Expenses					
1.	Furnance oil	KL	4500	22500	101250000	750.00
2.	Power	KWH	1636500	5.2	8509800	63.04
3.	Treated Water	KL	4350	36	156600	1.16
4.	Other fuel	Ncum	16552500	7.4	122488500	907.32
	Total –A				232404900	1721.52
B.	Fixed Cost					
1.	Personnel	Rs			1202500	8.91
2.	Stores	Rs			2564500	19.00
3.	Repairs & Maintenance	Rs			454650	3.37
4.	Others	Rs			39000	0.29
5.	Depreciation	Rs			226050	1.67
	Total - B				4486700	33.23
	Total cost (A+B)				236891600	1754.75
	Steam utilized		QTY MT		Amount Rs	
	Department A		35000		61416341	
	Department B		87000		152663476	
	Department C		13000		22811784	
	Total		135000		236891600	



Circular: 170/4/96-CX dated 23-Jan-1996
Valuation of Castings — Patterns supplied by the buyers
required to be included

Circular No. 170/4/96-CX, dated 23-1-1996

[From F.No. 6/14/94-CX.1]

Government of India

Ministry of Finance (Department of Revenue)

New Delhi

Subject: Foundry Industries - Calculation of assessable value of castings -
Addition of value of patterns supplied by the buyers in the assessable value.

It has been brought to the notice of the Board by Maharashtra Chambers of Commerce & Industry that there is difficulty in determination of value of patterns used in foundry industry to be added in the cost of castings for arriving at the assessable value of the castings as the quantity of casting to be made out of a pattern cannot be anticipated and sometimes some modifications or repairs are also made in the pattern after some period of use.

A survey was floated to ascertain the actual position in the field formations. From the reports received, it is observed that generally Commissioners are of the view that cost of the pattern should be added in the assessable value of the castings. However, in some Commissionerates, the proportionate value of the pattern is not being added in the assessable value of the casting if such patterns are supplied by the buyers of the castings. Generally Commissionerates find that there is no difficulty in apportioning the cost of pattern in the assessable value of the casting. However, a few Commissioners have expressed difficulty in apportionment of the cost in cases where old patterns are supplied by the buyers of the castings to the job worker and when patterns are returned back to the buyers.

The matters has been examined and it is hereby clarified that the proportionate cost of pattern has to be included in the assessable value of the casting even in cases, where such patterns are being supplied by the buyers of the casting or are got prepared / manufactured by the job worker at the cost of the buyer. In cases where there is difficulty in apportioning the cost of pattern, apportionment can be made depending on the expected life and capability of the pattern and the quantity of castings that can be manufactured from it and thus working the cost to be apportioned per unit. For this purpose, a certificate from a Cost Accountant may be accepted.



Annexure IX
Absorption of Overheads Cost

Illustration of overhead absorption	
Installed capacity	150 Nos. Bulk Carrier
Normal Capacity fixed after accounting for normal unavoidable interruptions	130 Nos. Bulk Carrier
Production during :	
2005-06	110 Nos. Bulk Carrier
2006-07	125 Nos. Bulk Carrier
2007-08	53 Nos. Bulk Carrier
Production during 2007-08 was lower due to strike by contract labour for 5 months which resulted in loss of production. Therefore it was decided by the management to remove portion of fixed overheads incurred during the strike period and the same was shown as a reconciliation item (Abnormal Overhead) in the Profit Reconciliation Statement for Profit as per Cost Accounts and Profit as per financial Account. Detailed working is as under:	
Variable Overheads for 53 Bulk carriers	Rs 5,30,000
Variable Overhead per Bulk Carrier	Rs 10,000
(A) Fixed Overheads for the year based on Normal Capacity of 130 Bulk Carriers	Rs 13,26,000
(B) Abnormal Fixed Overhead due to unutilized capacity	Rs 7,85,400
(C) Share of Fixed Overhead for Actual Production	Rs 5,40,600
(D) Fixed Overhead per Bulk Carrier	Rs 10,200
Overheads Absorbed	
(a) Variable Overhead	Rs 5,30,000
(b) Fixed Overhead	Rs 5,40,600
(c) Total	Rs 10,70,600
Fixed Overhead unabsorbed (treated as an item of reconciliation between Costing P&L A/c & Financial A/c)	Rs 7,85,400



Cost of Production for Captive Consumption

Annexure X A

Name of the Manufacturer	ABC Ltd
Address of the Manufacturer	GT Road, Ghaziabad
Registration No of Manufacture	ABB75
Description of product captive	Component
Excise Tariff Heading:	XK7

Statement of Cost of production of Component A manufactured of during the period of 1st April

		QTY	
Q1	Quantity Produced (Unit of Measure)	250	
Q2	Quantity Despatched (Unit of Measure)		
	Particulars	Total cost (Rs)	Cost /unit (Rs)
1.	Material consumed	35,000	140.00
2.	Direct Wages and Salaries	9,500	38.00
3.	Direct Expenses	350	1.40
4.	Works Overheads	1,500	6.00
5.	Quality Control Cost	750	3.00
6.	Research & Development Cost	90	0.36
7.	Administrative Overheads (relating to production activity)	35	0.14
8	Total (1 to 7)	47,225	188.90
9	Add : Opening stock of Work – in – progress	-	0.00
10	Less : Closing stock of work –in –progress	-	0.00
11	Total (8+9+10)	47,225	188.90
12	Less : Credit for Recoveries /Scrap/ By-products/misc income	-	0.00
13	Packing cost	-	0.00
14	Cost of production	47,225	188.90
15	Add :Inputs received free of cost	-	0.00
16	Add : Amortised cost of Moulds, Tools, Dies & Patterns etc received free of cost	-	0.00

**Guidance Note - 4**

17	Cost of Production for goods produced for captive consumption (14+15+16)	47,225	188.90
18	Add : Opening stock of finished goods	-	0.00
19	Less : Closing stock of finished goods	-	0.00
20	Cost of production for goods dispatched (17+18-19)	47,225	188.90

Note: Breakup of material cost is to be verified in terms of quantity and type of material used in the component. Above cost sheet is for future projections, it is to be checked that estimates are based on realistic data such as project report or any previous period data available. Other expenses related to the product are to be considered after proper scrutiny of the relevant records.



Cost of Production for Captive Consumption

Annexure X B

Name of the Manufacturer	XYZ
Address of the Manufacturer	ABC Nagar Kanpur
Description of product captively consumed	Processed cloth
Excise Tariff Heading	

Statement of Cost of production of xyz manufactured of during the period of 1 Apt -31 March 2008

QTY			
Q1	Quantity Produced (Unit of Measure)	3400	
Q2	Quantity Despatched (Unit of Measure)	34150	
	Particulars Cost details	Total cost(Rs)	Cost / unit(Rs)
1.	Material consumed :		
	Grey cloth	827560	24.34
	Colours & Chemicals	100182	2.95
2.	Direct Wages and Salaries :	6460	0.19
3.	Utility:		
	Power	27200	0.80
	Steam Cost	44604	1.31
	Heat Cost	14620	0.43
4.	Works Overheads	60825	1.79
	Depreciation	19040	0.56
5.	Quality Control Cost	-	-
6.	Research & Development Cost	-	-
7.	Administrative Overheads	5780	0.17
8.	Total (1 to 7)	1106271	32.54
9.	Add : Opening stock of Work – in – progress	22703	
10.	Less : Closing stock of work –in –progress	33711	
11.	Total (8+9+10)	1095263	32.07
12.	Less : Credit for Recoveries /Scrap /By-products/misc income	37719	1.10
13.	Packing cost	-	-
14.	Cost of production	1057544	30.97



Guidance Note - 4

15.	Add :Inputs received free of cost	-	-
16.	Add : Amortised cost of Moulds, Tools, Dies & Patterns etc received free of cost	-	-
17.	Cost of Production for goods produced for captive consumption (14+15+16)		
18.	Add : Opening stock of finished goods	6558	0.19
19.	Less : Closing stock of finished goods	6176	0.18
20.	Cost of production for goods dispatched (17+18-19)	1057926	30.98



CAS-5 COST ACCOUNTING STANDARD ON DETERMINATION OF AVERAGE (EQUALIZED) COST OF TRANSPORTATION

The following is the text of the Cost Accounting Standard 5 (CAS-5) issued by the Council of the Institute of Cost & Works Accountants of India on “**Determination of Average (Equalized) Cost of Transportation**”. This standard deals with the determination of average transportation cost of a product. In this standard the standard portions have been set in ***bold italic*** type. These are to be read in the context of the background material which has been set in the normal type.

1. Introduction

- 1.1 The cost accounting principles for tracing/identifying an element of cost, its allocation/apportionment to a product or service are well established. Transportation cost is an important element of cost for procurement of materials for production and for distribution of product for sale. Therefore, Cost Accounting Records should present transportation cost separately from the other cost of inward materials or cost of sales of finished goods. The Finance Act 2003 also specifies the certification requirement of transportation cost for claiming deduction while arriving at the assessable value of excisable goods cleared for home consumption/export. There is a need to standardize the record keeping of expenses relating to transportation and computation of transportation cost.

2. Objective

- 2.1 To bring uniformity in the application of principles and methods used in the determination of averaged/equalized transportation cost.
- 2.2 To prescribe the system to be followed for maintenance of records for collection of cost of transportation, its allocation/apportionment to cost centres, locations or products.
- For example, transportation cost needs to be apportioned among excisable, exempted, non-excisable and other goods for arriving at the average of transportation cost of each class of goods.
- 2.3 To provide transparency in the determination of cost of transportation.

3. Scope

- 3.1 This standard should be applied for calculation of cost of transportation required under any statute or regulations or for any other purpose. For example, this standard can be used for:
- (a) Determination of average transportation cost for claiming the deduction for arriving at the assessable value of excisable goods



- (b) Insurance claim valuation
- (c) Working out claim for freight subsidy under Fertilizer Industry Coordination Committee
- (d) Administered price mechanism of freight cost element
- (e) Determination of inward freight costs included or to be included in the cost of purchases attributable to the acquisition.
- (f) Computation of freight included in the value of inventory for accounting on inventory or valuation of stock hypothecated with Banks / Financial Institution, etc.

4. Definitions

The following terms are used in this standard with the meaning specified :

4.1 *Cost of Transportation comprises of the cost of freight, cartage, transit insurance and cost of operating fleet and other incidental charges whether incurred internally or paid to an outside agency for transportation of goods but does not include detention and demurrage charges.*

Explanation: Cost of transportation is classified as inward transportation cost and outward transportation Cost.

4.2 *Inward Transportation cost is the transportation expenses incurred in connection with materials/goods received at factory or place of use or sale/removal.*

4.3 *Outward Transportation cost is the transportation expenses incurred in connection with the sale or delivery of materials or goods from factory or depot or any other place from where goods are sold /removed.*

4.4 *Freight is the charges paid or payable to an outside agency for transporting materials/goods from one place to another place.*

4.5 *Cartage is the expenses incurred for movement of goods covering short distance for further transportation for delivery to customer or storage.*

4.6 *Transit insurance cost is the amount of premium to be paid to cover the risk of loss/damage to the goods in transit.*

4.7 *Depot is the bounded premises /place managed internally or by an agent, including consignment agent and C & F agent, franchisee for storing of materials/goods for further dispatch including the premises of Consignment Agent and C&F Agent for the purpose.*

Depot includes warehouses, go-downs, storage yards, stock yards etc.

4.8 *Equalized transportation cost means average transportation cost incurred during a specified period.*

4.9 *Equalized freight means average freight.*



- 5. Maintenance of records for ascertaining Transportation Cost**
- 5.1** *Proper records shall be maintained for recording the actual cost of transportation showing each element of cost such as freight, cartage, transit insurance and others after adjustment for recovery of transportation cost. Abnormal costs relating to transportation, if any, are to be identified and recorded for exclusion of computation of average transportation cost.*
- 5.2** *In case of a manufacturer having his own transport fleet, proper records shall be maintained to determine the actual operating cost of vehicles showing details of various elements of cost, such as salaries and wages of driver, cleaners and others, cost of fuel, lubricant grease, amortized cost of tyres and battery, repairs and maintenance, depreciation of the vehicles, distance covered and trips made, goods hauled and transported to the depot.*
- 5.3** *In case of hired transport charges incurred for despatch of goods, complete details shall be recorded as to date of despatch, type of transport used, description of the goods, destination of buyer, name of consignee, challan number, quantity of goods in terms of weight or volume, distance involved, amount paid, etc.*
- 5.4** *Records shall be maintained separately for inward and outward transportation cost specifying the details particulars of goods despatched, name of supplier/recipient, amount of freight etc.*
- 5.5** *Separate records shall be maintained for identification of transportation cost towards inward movement of material (procurement) and transportation cost of outward movement of goods removed/sold for both home consumption and export.*
- 5.6** *Records for transportation cost from factory to depot and thereafter shall be maintained separately.*
- 5.7** *Records for transportation cost for carrying any material / product to job-workers place and back should be maintained separately so as include the same in the transaction value of the product.*
- 5.8** *Records for transportation cost for goods involved exclusively for trading activities shall be maintained separately and the same will not be included for claiming any deduction for for calculating assessable value excisable goods cleared for home consumption.*
- 5.9** *Records of transportation cost directly allocable to a particular category of products should be maintained separately so that allocation in appendix –3 can be made.*
- 5.10** *For common transportation cost, both for own fleet or hired ones, proper records for basis of apportionment should be maintained.*



- 5.11** *Records for transportation cost for exempted goods, excisable goods cleared for export shall be maintained separately.*
- 5.12** *Separate records of cost for mode of transportation other than road like ship, air etc are to be maintained in appendix –2 which will be included in total cost of transportation.*

6. Treatment of cost

- 6.1** *Inward transportation costs shall form the part of the cost of procurement of materials which are to be identified for proper allocation/ apportionment to the materials/products.*
- 6.2** *Outward transportation cost shall form the part of the cost of sale and shall be allocated / apportioned to the materials and goods on a suitable basis.*

Explanation: Outward transportation cost of a product from factory to depot or any location of sale shall be included in the cost of sale of the goods available for sale.

- 6.3** *The following basis may be used, in order of priority, for apportionment of outward transportation cost depending upon the nature of products, unit of measurement followed and type of transport used:*

- (i) Weight*
- (ii) Volume of goods*
- (iii) Tonne-Km*
- (iv) Unit / Equivalent unit*
- (v) Value of goods*
- (vi) Percentage of usage of space*

Once a basis of apportionment is adopted, the same should be followed consistently.

- 6.4** *For determining the transportation cost per unit, distance shall be factored in to arrive at weighted average cost.*
- 6.5** *Abnormal and non recurring cost shall not be a part of transportation cost.*

Explanation: Penalty, detention charges, demurrage and cost related to abnormal break down will not be included in transportation cost.

7. Cost Sheet

The cost sheets shall be prepared and presented in a form as per Appendices 1, 2 and 3 or as near thereto. Appendix 1 and Appendix 2 show the details of information to be maintained for compilation of transport cost for own fleet and hired transportation charges respectively. Appendix 1 is applicable where the organization is having its own fleet.



The directly allocable cost of own fleet (outward) shall be identified against different categories of products as shown in Appendix 3 and same shall be indicated there. Similarly, total common cost of own fleet (outward) shall be apportioned to different categories of products as shown in Appendix 3 on a basis which should be specified. The basis of apportionment may be adopted depending on the nature of product as indicated in para 6.3. Similar approach shall also be applied for hired outward transport charges.

More columns may be required to be shown in Appendix 3 specifying different types of transactions. For example: Sale on specific rate basis, sale of waste, scrap, return from customer, goods sent for job work, goods received after job work etc.

Unit of Measurement (UM) may vary depending upon the nature of the product. For example, Number, MT, Meter, Litre etc.

Proper records shall be maintained to show separately the Transportation Cost relating to sending of jobs to job contractors/convertors and receipt back of processed jobs/converted materials.

An enterprise shall be required to maintain cost records and other books of account in a manner which would facilitate preparation and verification of cost of transportation and other related charges and its apportioning to various products.

8. Transaction value:

‘Transaction value’ shall have the meaning assigned to it in Section 4 of The Central Excise Act, 1944 or Section 14 of The Customs Act, 1962 or as defined in any other Act or Regulations as the case may be.

9. The standard will be operative from the date of issue.

Finalized by CASB-WTO Committee on 20July2005 and circulated to the Council at its meeting on 21July 2005 (1st draft was published in June 2002 journal)



Appendix 1

Name of the Manufacturer:

Address of the Manufacturer:

Statement of Operating Cost of own Fleet for the period.....

Sl No		
A	QUANTITATIVE INFORMATION	
A1	Number of Vehicles	
A2	Number of trips	
A3	Goods Transported – inward (UM)	
A4.	Goods transported – outward (UM)	
A5.	Goods transported – inward – Km	
A6.	Goods transported – outward – Km	
A7.	Total Goods transported inward – basis of apportionment (Specify)	
A8.	Total Goods transported outward – basis of apportionment (Specify)	
A9	Total (A7+A8)	
B	COST INFORMATION	(Rs)
	Cost of Operation	
	Variable Cost	
B1.	Salaries & Wages of Drivers, Cleaners and others	
B2.	Fuel & Lubricants	
B3.	Consumables	
B4.	Amortized cost of Tyre, Tube & Battery	
B5.	Spares	
B6.	Repair & Maintenance	
B7.	Other Variable Cost (specify)	
B8.	Total Variable Cost (B1 to B7)	
	Fixed Cost	
B9.	Insurance	
B10.	Licence Fee, Permit Fee and Taxes	
B11.	Depreciation	
B12.	Other Fixed Costs (Specify)	
B13.	Total Fixed Cost (B9 to B12)	
B14.	Total Operating Cost (B8+B13)	
C	APPORTIONMENT (Basis to be specified) - usage	
C1.	Inward Transport Cost (B14 *A7/ A9)	
C2.	Outward Transport Cost (B14 *A8/A9)	
C3.	Transit insurance for inward movement	
C4.	Transit insurance for outward movement	
C5.	Total transportation cost for inward movement (C1+C3)	
C6.	Total transportation cost for outward movement (C2+C4)	

Note:

1. Cost of Battery, and Tyres and Tubes shall to be amortised over its useful life.
2. Asset Register shall be maintained for determination of depreciation and amortization cost.
3. Separate Cost Sheet shall be prepared for different types of vehicles.



Name of the Manufacturer:

Address of the Manufacturer:

Statement of Hired Outward Transportation Cost for the period ending

A	Quantitative Information	
A1	Quantity of goods transported – outward (UM)	
B	COST INFORMATION) (Rs)	
B1	Hired Transport Charges	
B2	Transit Insurance	
B3	Other (specify)	
B4	Total Transportation cost (B1 to B3)	



Appendix -3

Name of the Manufacturer:

Address of the Manufacturer:

Statement of apportionment of Outward Transportation Cost to different goods and Determination of Averaged Outward Transport Cost for the period ending.....

A	Quantitative Information	Total	Excisable goods		Specific Rated goods Export	Goods Cleared for	Exempted goods	Goods Cleared on MRP Basis	Goods cleared from factory to customer	Others (specify)
			Product group 1	Product group 2	Product group 3					
A1	Goods transported Outwards(UM*)									
A2	Goods Transported Outward (KM)									
B	Outward Transport Cost (Rs)									
B1	Directly allocated own fleet transportation cost (Rs)									
B2	Basis of Apportionment of own fleet cost (Specify)									
B3	Common own fleet transport cost to be apportioned									
B4	Directly allocated hired transportation charges (Rs)									
B5	Basis of Apportionment of hired transportation cost (Specify)									
B6	Common hired transport charges to be apportioned									
B7	Total Transport Cost (B1+ B3+B4+B6)									
B8	Averaged transport cost per unit (Rs) (B7/A1)									

UM is the Unit of measurement

Seal and signature of Company's authorized representative

I /We, have verified above data and calculation in the appendix 1, 2 and 3 on test check basis with reference to the books of account, cost accounting records and other records. Based on the information and explanations given to me/us, and on the basis of generally accepted cost accounting principles and practices followed by the industry, I /We certify that the above cost data reflect true and fair view of averaged transport cost.

Date:

Place :

Seal & Signature of Cost Accountant
Membership No.



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 operation¹.*
- 4.2 Administrative overheads:** *Expenses in the nature of indirect costs, incurred for general management of an organization².*
- 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.³*
- 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 making⁴.*
- 4.6 Materials:**
- 4.6.1 Direct Materials:** *Materials the costs of which can be attributed to a cost object in an economically feasible way⁵.*
- 4.6.2 Indirect Materials:** *Materials, the costs of which cannot be directly attributed to a particular cost object⁶.*
- 4.7 Material Cost:** *The cost of material of any nature used for the purpose of production of a product or a service⁷.*

¹Adapted from CAS-1 Para 6.5.19

²Adapted from CAS-1 Para 6.3.5

³Adapted from CIMA Terminology

⁴CAS 1- Para 6.5.13

⁵Adapted from CAS 1-6.2.3

⁶Adapted from CAS 1- 6.2.8

⁷CAS-1-6.1.2



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

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*⁹.

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.¹⁰ 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*¹¹.

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.*

⁸Adapted from CAS-1 Para 6.3.3 and 6.3.4.

⁹Adapted from Glossary of Management Accounting Terms- Page 62.

¹⁰Adapted from CAS 1_ Para 6.7.5.

¹¹Adopted from Glossary of Management Accounting Terms page 70.



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 parties¹² 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.*

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



GUIDANCE NOTE ON COST ACCOUNTING STANDARD ON MATERIAL COST (CAS-6)

The Council of the Institute of Cost and Works Accountants of India (ICWAI) has issued the Cost Accounting Standard 6 (CAS-6) on Material Cost which lays down a set of 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 the cost statements.

CAS-6 does not deal with Packing Materials as a separate Cost Accounting Standard on Packing Material Cost (CAS-9) has been issued on the subject.

The Guidance Note deals with principles and methods as provided in the CAS-6 and practical aspects in connection with the determination of material cost of a product or service.

In the preparation of cost statements including those requiring attestation, material cost shall be determined as per CAS-6. The Cost Accounting Standards have been set in **bold italic** type and reference number of the standard has been retained as in CAS-6 for ready reference.

The Companies (Cost Accounting Records) Rules, 2011 provide that every company, including a foreign company defined under section 591 of the Companies Act, 1956 which is engaged in production, processing, manufacturing or mining activities have to maintain cost accounting records in accordance with the Generally Accepted Cost Accounting principles (GACAP) and Cost Accounting Standards issued by the ICWAI, to the extent these are found to be relevant and applicable. The above Rules further provide that these will be applicable to companies wherein aggregate value of net worth as on the last date of the immediately preceding financial year exceeds five crores of rupees; or wherein the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds twenty crores of rupees; or wherein the company's equity or debt securities are listed or are in the process of listing on any stock exchange whether in India or outside India.

The Companies (Cost Audit Report) Rules, 2011 cast a duty for a Cost Auditor appointed under Section 233B of the Companies Act, 1956 to certify inter alia that books and records maintained by the company are in conformity with the Cost Accounting Standards issued by the ICWAI to the extent these are found to be relevant and applicable.

**Chapter 1****Introduction**

Materials constitute one of the important elements of production. Types of materials covered under CAS-6 are raw materials, process materials, additives, manufactured / bought out components, sub-assemblies, accessories, semi finished goods, consumable stores, spares and other indirect materials.

Raw Materials:

Raw material is a basic /main material used in the manufacture of product. For example sugar cane is the raw material for production of sugar. Cotton is the raw material for production of cotton yarn.

An illustrative list of industries and raw materials used is annexed at Annexure 1.

Process Materials:

Process materials/additives are materials used in the process of manufacture in addition to raw material. It varies from industry to industry. Process material for sugar industry is lime, sulphur; in cement industry pozzallana and gypsum are additive materials; and in paper industry clay/china clay is additive material.

Bought Out Components:

Bought out component means a manufactured (industrial) product, which forms part of the finished product (for example fastener, fan belt and the like) and is fitted to the product without any further processing. In other words bought components are purchased items used in the assembly of main product. These items are developed by the supplier as per specifications of manufacturer. Bought out component when used in the main product are called “Original Equipment Supplies (O.E.S)”. These items are also available in the market for replacement of worn out parts and is called as spare /bought out parts.

Sub-assemblies:

“Sub-assembly” (also sometimes called as “aggregates”) means an assembly of various components with a distinct identity, and forms part of the finished product, for example engine, steering in an automobile.

“Accessory” may be either a component or sub-assembly, which is not essential for the basic functioning of the product, but supplied as an optional item (for example an air conditioner or music system in an automobile). However, in the case of mining, earthmoving drilling equipment and other similar items of machinery, accessories are supplied with the basic equipment, depending upon the operating conditions in the field as standard equipment.

Consumable Stores:

Consumable stores are items used in the maintenance of plant for example lubricant, cotton waste, paint and the like. Spares are purchased items used for replacement of worn out part of machinery and the like.



Other indirect materials are items of small value such as bolt, nut nails, and the like which cannot be directly identified economically with a product and are treated as indirect material.

Material acquired in exchange of other material:

When material is acquired in exchange for other material or service supplied, the cost of material acquired is taken as cost of material supplied or services provided plus other applicable cost such as freight.

In paper industry where bagasse from sugar mill is obtained by the paper mill by supplying coal to the sugar mills, in the cost statement, the cost of coal supplied is included in the cost of bagasse procured.

All the above items are identifiable with a product and are classified as direct material cost.

Materials are classified under a common designation on the basis of similarities of nature, attribute or relations, source of supply and the like. Materials are classified according to nature such as raw material, consumable stores, spares and the like. In terms of relationship, materials are classified as direct material and indirect material. On the basis of source of supply, materials are classified as indigenous materials / imported materials. Indigenous materials are manufactured within the country and imported materials are purchased from other countries.

For purpose of identification and convenience, each item of material is given a distinct name. Similar items are classified under sub-groups and number of such group is classified under the main or major groups. For example, items of brass may be classified under sub-head 'non-ferrous metals' and under the main head 'metals'.

The objective of the CAS-6 is to bring uniformity and consistency in the principles and methods of determination of cost of material of a product / service. The principles and methods adopted shall be applied consistently from one period to another and for reasonable uniformity between different products / units. For example if FIFO method is used for valuation of issue of materials, the same shall be followed consistently from one period to another.



The following terms are used in this guidance note with the meaning specified.

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.*

Administrative overheads: *Expenses in the nature of indirect costs, incurred for general management of an organization.*

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.*

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

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

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

Imputed Costs: *Hypothetical or notional costs, not involving cash outlay, computed only for the purpose of the decision making.*

Direct Materials: *Materials, the costs of which can be attributed to a cost object in an economically feasible way.*

Indirect Materials: *Materials, the costs of which cannot be directly attributed to a particular cost object.*

Material Cost: *The cost of material of any nature used for the purpose of production of a product or a service.*

Production overheads: *Indirect costs involved in the production process or in rendering service.*

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.*

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

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.*

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.*

**Chapter 3****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.*

The valuation of receipt of materials is to be based on the terms and conditions stated in the purchase order depending upon source of supply i.e. indigenous or imported.

Indigenous Material:

The purchase order inter alia states:

- (1) Specification of material being purchased
- (2) Purchase price
- (3) Quantity of supply
- (4) Time of supply
- (5) Place of supply
- (6) Payment terms
- (7) Other commercial conditions regarding inspection, rejection, trade discount and similar item.

If purchase price is ex-works of purchaser, inward freight is inbuilt in the price structure. If purchase price is ex-works of supplier, inward freight is to be paid by the purchaser and it is to be included in the valuation of receipt. Other terms used in this regard are F.O.R destination / F.O.R of supplier's place (F.O.R – means free on rail). If it is F.O.R destination, loading at the place of supplier and railway freight is inbuilt in the material purchase price. Unloading and transportation from railway station to works is to be incurred by the purchaser and is to be charged to the material purchase value. In case of F.O.R supplier's place, railway freight is to the account of purchaser.

In addition to basic purchase price, duties and taxes, freight inwards, insurance and other expenditure directly attributable to procurement are to be taken into account while valuing the receipt if these can be quantified with reasonable accuracy at the time of receipt. If any of these items of expenditure cannot be quantified with reasonable accuracy, these shall be treated as material handling cost. Trade discount, rebates, taxes and duties refundable (or to be credited by the taxing authorities) are to be set off. Examples of taxes to be deducted from cost are:



- Cenvat Credit
- Countervailing/custom duty credit
- Vat credit
- Any other tax

Illustration on valuation of receipt of indigenous supply is at Annexure II.

The cost of the material is determined as per invoice. If supply of material is ex-works of purchaser, there will be no freight and cartage charges in the invoice. In case inward freight is incurred, it shall form part of the cost of procurement of materials and is to be apportioned to the items purchased on rational basis such as weight / number and the like.

Imported Material:

Following points are to be considered while valuing imported material:

- a) Actual customs duty paid on the basis of classification by the Customs Authorities will be assigned, net of any credits.
- b) Material imported free of duty or at concessional rate of duty under export incentive scheme will be accounted for at the actual rate of duty applicable so long as there is reasonable expectation that the entity will satisfy the conditions for the duty exemption or concession. In case the material is used for a purpose other than the intended purpose, provision for import duty should be made. This entry may be offset when the material is available for export purposes at the imported parity rate of material.
- c) Harbour dues, stevedoring charges, congestion charges, and the like on the basis of actual, if imported singly should be accounted. If imported as part of a basket of other material, then proportionate charges will be allocated on import value.
- d) Intermediate storage – actual charged by the storage provider should form part of the cost of material.
- e) Clearing Agent's Charges will be added to cost of materials. Where other services are also provided by the commission agent besides procurement of orders, for example arranging for LC, the charges for such services will also be assigned to the materials covered on a suitable basis.
- f) Adjustment of CENVAT /VAT as per applicable regulation.
- g) Duty drawback and other similar duties subsequently recovered shall also be deducted from the cost of material.
- h) Bank Charges are in the nature of administrative overheads and will not form part of material cost.

Illustrations on FOB and CIF basis of import of material are at Annexure III a & III b.

Preparatory Cost:

All traceable costs to the extent possible for bringing the material up to the place of manufacture are to be reckoned. This may include preparatory costs in some industries.



In case of procurement of cane considerable efforts and resources are involved, which can be directly identified and classified as sugar cane development costs. This would include cost incurred for dressing of sugar cane before crushing and the like. Similarly, in mining industry raw ore undergoes changes through many stages and cost up to each stage is considered separately and added to the next stage cost.

In paper industry bamboo, hardwood, wood waste (Veneer waste, Rulla and the like from Plywood Industry) are used as raw material. Before these materials can be used, various preparatory operations such as cutting, debarking, chipping and screening to make proper size of wood chips are performed to make the material fit for use. This preparatory cost forms part of the raw material cost.

Wood requires seasoning and the cost of cutting, seasoning should be treated as material cost. Seasoning of raw material for wine is another example of preparatory cost.

Handling costs up to works / factory gate:

If handling cost is specific and handled singly, it is to be assigned to the material handled. If employees are used for handling the material, it is to be apportioned on the basis of time taken by them.

Incoming Inspection:

If the material calls for inspection by a third party, specific cost will be assigned to the material inspected. If the Inspection is carried out internally and its cost is significant, it is to be apportioned on the basis of time spent on inspection or other suitable measure of effort. In case the material is supplied by the supplier at his cost and risk with regard to quantity etc, there will be no cost for inspection to the buyer.

Other cost incurred for material acquisition is insuring of material. If insurance premium is specific and insured singly, it is to be assigned to the specific material insured. In case it is part of a comprehensive policy then the assignment of the insurance premium will be on the basis of the proportionate value insured. If insurance becomes part of the carrier's responsibility no separate cost will be assigned in this regard.

Treatment of containers for materials purchased:

Treatment of container cost in the cost of material purchased is as under:

Container is non returnable and for which no cost is charged in the invoice:

The container cost is included in the material cost. An estimated residual value of the container may be reduced for ascertainment of material cost, if sold for some value, from time to time. If the value is not so significant, it may be credited to manufacturing overheads.

Container is returnable, but charged in invoice and refunded, when returned:

As refunds are made, the cost of material will be net of the charge for returnable container. Necessary physical controls will be operative. Containers not returned in time may be charged to the entity. The amount so charged by the supplier should be aggregated with manufacturing overheads.



The cost borne by the entity will only be added to the cost of material. If charged value is Rs 100/- per container and return credit is for Rs 40/-, balance Rs 60/- is the cost to be included in material cost.

Container is charged separately in the invoice and not returnable:

This will be included in material cost.

Container sold as scrap:

The value may be reduced from material cost if material is significant, otherwise sale value of scrap be adjusted against manufacturing overheads.

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

Finance costs are interest and the like, on borrowed funds. Finance costs are excluded from cost of material. The letter of credit charges are for credit risk or a transaction risk (demand bill) and are part of bank charges which form part of administrative overheads.

Sometimes goods are kept in bonded warehouse and clearance of goods is delayed. This may happen due to any financial stringency delaying the payment to the bank. Such payments of storage are to be excluded from cost of material calculation and are dealt with in the financial accounts.

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.

Self manufactured materials include components assemblies and subassemblies, accessories and the like manufactured internally for making the final product. For example, gear box assembly, steering system assemblies and the like are made separately and used in the final product assembly. Many products like TV, Switchgear, Computers and the like have innumerable small components either bought or self manufactured. Self manufactured material used in the assembly of main product are also classified as intermediate products.

Cost of self manufactured material is to be determined taking into account the cost of direct material, direct employee cost, direct expenses, share of factory overhead and share of administrative overheads relating to production. Overheads comprise of indirect materials, indirect employee costs and indirect expenses which are not directly identifiable or allocable to a cost object in an economically feasible way.

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

Factory Overheads are the indirect costs incurred in the production process or in rendering service. These are used for a type of cost that cannot be directly assigned to a cost centre or product, but can only be apportioned to cost units.



Administrative Overheads are the cost of all activities relating to general management and administration of an organization. These are to be analyzed and distributed between administrative overheads relating to production activities and administrative overheads relating to selling and distribution activities on rational basis. Administrative Overheads relating to production activities will form part of self-manufactured materials.

Self manufactured components, if captively consumed and are subject to levy of excise duty, its valuation is to be determined as per CAS-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.

The spares which are specific to any equipment procured at the time of purchase are capitalized. The spares are to be depreciated as per the Accounting Policies of the entity. Sometimes, capital spares are not separately invoiced but merged with the cost of equipment supplied. These are depreciated with the cost of machinery over its useful life. It may be charged to cost based on machine hours utilized.

Spares which are termed as insurance spares are stored to meet a contingency such as failure of a critical part in order to have insurance against stoppage of production. Such spares may be used for replacing a defective part. These are special purpose spares specific to a specific machinery or group. These are also to be amortized over the useful life of the machinery.

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.

Sometimes materials are lost in transit or spoiled. Treatment of such a loss will depend upon the terms and conditions of purchase order. If the purchase order does not specify any level of loss and supplier is responsible to supply good quantity, in such cases, the loss is to be borne by the supplier or the insurer as the case may be.

The normal loss is to be absorbed by the good units. Abnormal loss of material is charged to Profit and Loss Account and does not form part of the cost of material. In case of spoiled material if there is any significant realizable value, loss is to be accounted net of such value.

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.



In case of certain materials before its receipt, losses due to shrinkage /evaporation and gain due to elongation or absorption of moisture arises. An anticipated level for such losses or gains for each type of material is to be predetermined. Unit price of material is reduced or inflated to cover the cost of the normal percentage of loss or gain. An illustration is given below:

1000 units of material X purchased @ Rs 4/- per unit = Rs 4000

Anticipated loss on shrinkage: 4% i.e. 40 units

Receipt will be 960 units and price inflated = Rs 4000/(1000-40 Units) = Rs 4.17 per unit

If there is gain in the quantity, issue rate will be reduced.

Certain materials contain moisture at the time of purchase which may evaporate during summer, thereby losing some weight or moisture may be absorbed during monsoon thereby gaining some weight. One of the methods of dealing with such material is to record the material as dry weight after deducting the moisture percentage which is considered normal. For any variation in moisture, suitable adjustment shall be made to record weight in term of dry weight. Loss in quantity due to excess moisture over the normal percentage will not form part of the material cost.

Illustration showing the treatment of driage loss in sugar industry is at Annexure IV.

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.

FOREX conversion has to be on the date of transaction. The cost and financial accounts will have the same basis for alignment. The date on which the property in goods passes is adopted as the date of transaction. The difference between the actual payment and the amount taken as material cost of goods received is taken to a separate account to show the exchange rate variations (not becoming part of material cost calculations.)

Illustration on treatment of FOREX component is at Annexure V.

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.

Demurrage and penalties are levied by the Transporters /Custom Authorities for delay in clearance of wagon/vessel and the like.

Illustrations are:

- Demurrages levied by transporter for not removing goods,
- Penalties for keeping hazardous goods in unauthorized places in transit without proper safeguards.
- Penalties levied by Customs Authorities for delayed clearance.

Demurrage and penalties are abnormal cost and are not part of the material cost. It is charged to Profit & Loss Account.



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.

Subsidy and grant received should be recognized on a systematic basis. These should be matched with the related cost for which these are intended to compensate. Subsidy received for any material is to be reduced from the material cost.

There can be some subsidy for using materials produced by a specific priority industry or energy saving device and the like. Such subsidy is to be adjusted from the material cost.

Incentives received should be reduced from the material cost of the products in respect of which the incentives are received. There can be some difficulty to match incentive with the cost of production due to possible timing differences between the period of production, and the period of receipt of the incentives. Incentives are sometimes recorded on the basis of receipt. In such a situation matching becomes difficult. It will be desirable that accounting entries relating to incentives are passed on accrual basis to reflect the true and fair position of the cost of the product in the cost statements.

5.2. Principle of valuation of issue of material

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

The CAS-6 provides for adopting any of the following three methods for valuation of issues of material:

- a) First in First out (FIFO)
- b) Last in First out (LIFO)
- c) Weighted Average Rate

Method of valuation of issue of material once adopted shall be followed consistently. If method of valuation is changed, its impact on costs of material shall be disclosed.

The FIFO formula assumes a cost flow that the items of materials that were purchased or produced first are issued first, while LIFO assumes the exactly opposite cost flow charging the current price to cost. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each fresh shipment is received.

Accounting Standard AS-2 provides for cost formulae, viz. Specific identification, FIFO (First-in-First-out) and Weighted Average cost method. Most of the organizations are adopting one of above cost formulae for the purpose. If any other cost formula is adopted, the difference between financial accounts and cost accounts shall be disclosed in the reconciliation of profit as per cost records and the financial accounts.

LIFO method can be gainfully applied while estimating /projection of cost as it reflects current price cost.

Illustration on FIFO/LIFO/Weighted average method of issue of material is at Annexure VI.



Any accepted method of pricing of issue may be used. However, whatever method of pricing is adopted, the same should be specified and followed consistently.

In case of some bulky/volumetric materials such as coal, limestone, gypsum, salt, slag and the like, it is not always possible to weigh the same and therefore the quantities of receipts and issues of materials are mostly determined by volumetric measurements. Such volumetric measurements are also validated by the actual weight of the stocks at random from time to time. However, it is necessary to check the stock of materials regularly and if any variation in the book stock and physical stock is found, the method of adjustment of such shortage shall be identified with the relevant product(s). Normally, adjustment in the variation of the book stocks and physical stocks are accounted in consumption of such material because of the approximation involved in the receipt and issue of the same.

Another material which requires special mention is petroleum product when issued for further processing. For example Fuel oil is supplied in KL (volume) and its price is also in terms of Rs/KL. This price is related to at a volume measured at 29.5° C (All India ambient temperature) and a temperature variance allowance is given if the item is considered at a higher temperature at the time of issue, particularly bulk loading.

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

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. 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. In some process industries like refractory, pharma, formulations and the like, standard mix of raw materials is used to determine the cost of material and variance between standards and actual is adjusted periodically.

Standard Price Method can also be applied for valuation of issue of material. In this method price of issues is predetermined for a stated period taking into account all the factors affecting price such as anticipated market trends, transportation charges and normal quantity of purchase. Standard prices are determined for each material and material requisitions are valued at standard price irrespective of the actual purchase price. Any difference between the standard and actual prices of purchase results in material price variance. The material price variance is to be treated as part of material cost.

When standard costing system is in vogue, there can be other variances relating to usage during the course of production which may be due to normal or abnormal reasons. Variances due to normal reasons should be treated as cost, while the variances due to abnormal / reasons are treated outside the cost of production.

Illustration of material cost variance (price, use, mix and yield) is at Annexure VII.

The variance account enables management to observe the extent to which actual materials costs are differing from planned objectives or predetermined estimates.



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

Abnormal cost is not considered in the cost of production and excluded from cost of material. The rationale of exclusion is that inclusion of such items in the cost will make the cost not comparable with a normal situation. Such an aberration is avoided to understand the cost in a better perspective for any purpose. For instance, the cost of material cannot be loaded with losses due to an earthquake which is an abnormal event. Similarly, loss of production due to major fire accident or a major shutdown due to sudden and long machine breakdown for days together for want of a special part may be treated as Abnormal Cost.

Material lost due to major fire accident, burglary, obsolescence, if significant, material and quantifiable shall not form part of cost of the production as not to distort the cost due to abnormal reasons. It is dealt with in the costing Profit and Loss Account.

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.

Inward freight shall form the part of the cost of material. In case inward freight charges are indicated in the invoice, which is for more than one material, inward freight shall be allocated to different materials indicated in the invoice on reasonable and appropriate basis such as weight, volume, numbers and the like.

If the material is carried by a special carrier, it will be assigned to the specific material transported.

5.2.5 Material cost may include imputed costs not considered in financial accounts.

In economics, 'imputed' indicates an ascribed or estimated value when there is no criteria of absolute monetary value for such purpose. In national income estimation, wages of housewives are imputed. Similarly, in farming operations, the wages or salaries of owner are imputed. Imputed costs are similar to opportunity costs. Interest on internally generated fund, not actually paid is an example of imputed cost for a project evaluation.

As such there is an imputed cost in all the resources of a business if they are applied to another profitable activity. For example in caustic soda plant hydrogen is produced as by product. If the unit has a captive power plant, it is used as fuel. Its cost is to be imputed based on the fuel substituted such as coal/ furnace oil, based on equivalent calorific value.

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.

Self manufactured components are valued at cost including production overheads. This is dealt with under standard 5.1.3 of the Standard.



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.

Scrap results from the processing of material. It is unavoidable residue material arising in the process of manufacture. It may have some value. Example of scrap is border material from stamping, shavings, filing, boring, turning operations and the like. The scrap is accumulated in storage yard so that it can be sold to scrap dealers.

In some cases scrap can be reprocessed into useful raw material for subsequent production of basic products. For example the scrap material from sheets of metal from which parts have been stamped, may be melted and again formed into sheets from which more units may be stamped. Similarly scrap generated in steel foundry is put into furnace to melt and form steel castings. Another example is runners and risers generated in the course of dressing up of castings in foundry. Runners and risers are valued at weighted average cost at pouring stage (i.e. raw material cost plus conversion cost of molten metal). The material cost of abnormal scrap will not form part of the material cost.

Normal scrap generated during process of manufacture is to be treated as a part of material cost. Scrap have generally low recovery value as in the case of steel but it may have significant value as in the case of gold. Thus its recovery value depends upon the type of material. There are several methods of accounting of scrap as detailed below:

1. Scrap sales credited to revenue
2. Scrap sales credited to production overhead
3. Scrap identifiable with a job, and its realizable value is credited to the job.

Defective/Spoiled material arises when the material does not meet the exact specification of the material required. Normal Defective/spoilage of material is to be absorbed by good production and abnormal spoilage is to be charged to Profit and Loss Account.

For Example:

Metal poured, due to time lost in pouring, is incomplete on account of loss of temperature. This has to be disposed off as such by re-melting or sold as scrap.

In certain types of processes and operations, some material physically disappears on account of shrinkage, evaporation and the like with the result that the quantity of output is less than the quantity of input. In other cases residue such as smoke, dust, gases, slag and the like arises in the course of operation and has practically no measureable value or utility. In some cases, disposal of waste results in further cost to comply with regulatory requirements. In some cases waste may have value.

**Chapter 4****Assignment of Cost****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.*

Assignment of material cost involves establishing a suitable procedure to identify and record the resources consumed by the cost object.

Cost Object or Cost Centre is the logical sub-unit for accumulation of cost. Cost Centre may be classified in different ways like function-wise and nature wise:

Function wise	Production / Process Cost Centres: for example Machine Shop, Welding shop, Assembly shop and the like. Service Cost Centre: for rendering service to Power house, Maintenance, stores and the like.
Nature wise	Personal: for example Works manager, maintenance crew. Impersonal: for example machine shop.

Cost Object may be any customer, product service, contract, project, activity or other work unit for which a separate cost measurement is desired. For example, if it is desired to determine what it costs to produce a car, then the cost object is car. If it is desired to determine the operating cost of maintenance department within a plant, the cost object is maintenance department.

Different costs can be assigned to the same cost object, depending on the purpose. For example, costs from all parts of the value chain may be assigned to a product for pricing decisions. The direct cost of one cost object may be the indirect cost of another cost object.

For assigning direct material cost to a cost object, the source document is material requisition. Details of material issued for manufacturing a cost object/ product are recorded in it. It records the job number, type of material, and items listed are priced as per the method of valuation adopted for issues. Thus material requisition represents the source of information for assigning the cost of material to cost object.

The quantity of material consumed is to be worked out from material issue records of stores for a product and return of unused material, if any. Such consumption in quantity may be derived by two methods.

Method (i): Based on actual issues for batch, unit or job:

This method is preferred as it establishes direct relationship of actual material usage for the product.



Method (ii): Based on any method other than actual, for example, Standard:

Under this method material is issued as Standard Bill of material. The standard cost for each direct material is defined at the beginning of the year. The variances from standard on account of price / consumption and the like are adjusted to consumption at the year end. Some organizations follow “Back flush Costing” system. It eliminates detailed accounting transaction. It focuses first on the output of the organization and then works backwards when allocating cost between goods sold and inventories. As soon as a finished good is ready for stock, material is Back flushed (issued) as per the bill of material for that product. Any variation between the actual issues (both quantity and value) and the standard as accumulated over the period is charged off to consumption.

Standard Bill of material method is to be used in case of goods, where the direct link of actual consumption for product is not available. The manufacturer using this method should certify the quantitative requirement considered for calculation of material consumption as per Bill of Material. It may be ensured that usage variance is within reasonable limit and it should be adjusted in calculation of cost of production.

For tracing of material cost direct to a cost object, concept of “to the extent economically feasible” is also to be taken into account. This requires an exercise to analyse the cost involved, benefit to accrue and over-riding requirement to identify material with the object. In other words material cost if not directly identified with the cost object on economic feasibility consideration, it shall not result in misstatement of material cost of cost object.

It is advisable to reconcile the cost of the material consumed as per cost records is reconciled with financial books. For major direct materials, reconciliation is to be ensured both in quantity and value.

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.

Materials which are not directly traceable to cost object, are to be assigned on some rational basis consistently. Technical estimates help in arriving at such rational basis. For Example, Grease or lubricants used for maintenance work may be consumed by all the departments. It may not be economical to issue individual requisition to charge each time. It may be decided to take the total consumption per month and divide the cost between all the user cost centres based on a technical estimate on a sample survey of usage during a selected period. Such studies may be reviewed periodically to correct for changes taking place affecting the consumption.

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.



It relates to a production operation outsourced. The material undergoes change and enters the work in process stage or semi finished goods stage. A part of the production operation is outsourced. The outsourcing charges paid to third party is treated as part of material cost.

Example (1): Casting requires trimming, machining and polishing, heat treatment after pouring and the like. One of these operations is subcontracted. The activity subcontracted and its cost is part of the material cost.

Example (2): A metal sheet is given to another unit for conversion into specific measurement for use in a press; the material cost is increased to take care of the change in shape done before using in production. Such cost is part of the material cost, as the material is made fit for the operation.

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.

This provision covers a situation where the manufacturer gets part of the manufacturing operation subcontracted. For example steel strip is sent to slitter for smaller size, slitting charges paid to subcontractor is to be treated as direct expenses and assigned directly to 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.

The cost of indirect materials shall be directly assigned to the cost centre where possible under suitable heads as may be economical to aggregate and report under heads like lubricants, tools, consumable stores (building stores, mechanical stores and electrical stores) spares and the like. All the costs under different heads for the cost centres aggregated and accumulated shall be distributed to the production cost centres on a rational basis.

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.

Indirect materials like cost of catalysts, dies, tools, patterns and the like have longer service life. Some special patterns are charged to the cost of the specific jobs and such indirect materials shall be amortized over the production units benefited by such cost.

In a steel plant, indirect materials like refractory, rolls and other process materials are in the nature of catalysts and their useful life is determined by many parameters like production, quality, metallurgical requirement and many other techno operational parameters. In such cases these may be charged off as and when issued for consumption.



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.*

It gives a general principle where the life of any indirect material is estimated beyond a year, (life of the material should be estimated on technical basis) to amortise its cost over the estimated life.

**Chapter 5****Presentation****7.1 Direct Materials shall be classified in the cost statement under suitable heads.**

Cost Statements shall depict Direct Material costs as detailed below:

- a. Raw materials,
- b. Components,
- c. Semi finished goods and
- d. Sub-assemblies

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

Direct Materials should be presented in the Cost statement by types of material - raw material, components, semi-finished goods and sub-assemblies. It further specifies classification of material on the basis of source of supply viz. indigenous, imported and self manufactured. For example raw material used may be indigenous, imported material or self manufactured. Raw Material cost is to be indicated separately for indigenous and imported raw material consumed. This requirement of presentation by source wise also applies to other types of material viz. components, semi-finished and sub-assemblies also. In process industry direct material is classified as raw material, additives / filler, process chemicals and dyes.

Illustration of the manner in which material cost should be presented is in Annexure VIII a to VIII c.

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

Indirect material consumed should be grouped under major heads like tools, stores and machinery spares, jigs and fixtures, consumable stores, and the like. These items are to be presented in the cost statement under the above broad groups, if they are significant.



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.

Major items of raw materials indicating quantity and rates are to be disclosed in the cost statement which constitutes more than 5% of the total cost of materials. An item of cost is considered as major and significant if that item forms at least 5 % of the total cost of materials. Criteria of 5% of disclosure of material has been prescribed taking into account total items to be disclosed in the cost statement shall not exceed 20 items. For instance, imported direct materials is say 4 % of the total direct material cost, it is not material and significant to warrant a separate disclosure. Significant items should be classified and disclosed separately while the other items could be aggregated.

Illustrations of presentation and disclosure of material cost under major items for Engineering industry and Process industry are Annexure VIII a, VIII b and VIII c.

In the *Annexure VIII b*, Process Industry, Material Broke, Filler, sizing, alum dyes has been indicated separately which are individually less than 5% of the total material cost, but considering their significance these items have been presented and disclosed separately. Other chemicals which were not significant have been grouped under item B-5 of the above Annexure.

Each major item of material which forms 5% of the cost of materials is considered material and should be disclosed in the cost statement; whereas items below 5% of the cost of materials should be aggregated preferably under respective classification of materials. If any item of material is less than 5 % of the total cost of materials, and warrants a separate disclosure due to its significance / nature, same shall be disclosed separately.

8.2 The basis of valuation of materials shall be disclosed.

The standard provides various methods of valuation of issues of material such as FIFO/ LIFO/ Weighted Average. Method adopted for valuation of material cost shall be disclosed in the cost statement.

Example

Periodic quarterly Weighted Average is used for pricing the issues of material. In the Cost accounting records, all major and significant items are included in the direct materials identified with the product. Direct materials forming more than 5 % of the total material cost have been separately classified. Items forming less than 5 % of the total material cost have been suitably grouped and shown under others direct material. Components which are individually small but collectively form more than 5 % of the



material cost are classified as components. Direct materials constitute 75 % of the total material cost.

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.

The cost accounting principles and methods adopted for determining the material cost is to be followed consistently from one period to subsequent period. If there is any change in the cost accounting principles and methods during the period resulting in material effect on the cost, the same shall be disclosed indicating its impact in the cost statement.

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

Abnormal cost arises due to idle time for some heavy break-down or abnormal process loss. They are not considered in the cost of production and charged to Profit & Loss Account.

Materials lost / damaged due to fire and natural calamities which are not considered fit for use are examples of abnormal cost, hence excluded from cost of material.

Example:

Abnormal cost of Rs. 3 lacs has been excluded in calculating the material cost. This cost is considered abnormal due to a fire accident which took place on 12.02.20XX due to which materials issued for production was lost. The loss of material has been assessed by a surveyor. As the position of allowable claim has not yet been ascertained no credit has been taken for claims recoverable.

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

As discussed in earlier para, any demurrage, detention, penalty is to be excluded from material cost.

Example

Demurrage of Rs 6.5 lacs have been paid to the Railways in view of the delay in clearing the goods. This was an exceptional cost due to heavy rains and non availability of cranes for moving the goods.

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

Any subsidy / grant / incentive received relating to materials is to be reduced from the cost of materials and disclosure made accordingly. The State Government has been subsidizing the transport cost of moving the goods in view of the location for a period of five years. Such subsidies received and receivable are reduced from transport cost of the materials specified by the Government.



8.7 Cost of Materials procured from related parties shall be disclosed.

If any material is procured from related parties, (as defined under the Companies Act, 1956) its relationship, nature of transaction viz. quantity, rate, other terms / conditions of procurement are to be disclosed. The objective of disclosure is to ascertain that the transaction is at arm's length and on purely commercial terms.

Example:

Related Party → XYZ Ltd

Nature of Relationship → *Company and associates own 51 percent of their Equity.*

Nature of transactions: XYZ Ltd supplies the engines for the assembly of equipments manufactured by the Company. The engines are specially designed for this purpose and engines of four specific hp are supplied. There are no other parties supplying similar engines.

Volume of transaction: During this year 2500 engines valuing Rs 215 lacs were supplied by XYZ Ltd. Of these, 2200 engines valuing Rs 198 lacs were consumed and they are shown under the bought out components in the direct material cost in the cost statement. The price fixed is based on the assessable value for Excise duty plus 10 % mark-up on that. This valuation has been consistent and considered as reasonable by the management.

There are no other related party transaction relating to purchase of material.

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

As defined in the standard, imputed cost is a notional cost. It does not involve any cash outlay. It is computed only for the purpose of decision making. If any cost is imputed in arriving at material cost, it is to be disclosed to provide information that there is no cash outlay and it is only for decision making.

For example:

In the production of caustic soda, Hydrogen is produced as by-product. It is used as fuel to be burnt in the boiler besides sales. For the quantity burnt as fuel, hydrogen is priced after converting the quantity to thermal equivalent quantity of LSD oil and valued at the price of the LSD Oil.

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

Standard provides that any item of materials forming 5% of the total cost of material is to be disclosed both in quantity, rate and value. Further materiality and significance of information depends on nature, size and complexity of manufacturing operation. An item of material for use in the production of a product may have significance considering the nature of the product. For example, a critical part has been imported under export incentive scheme. It is to be used in the products to be exported. Though its value is less than 5% of the total cost of material, it is to be disclosed in terms of export requirement. Hence it is significant in the context of cost statement. Materiality is to be



judged in terms of quantity and nature of material and in particular context of its omission. Information is material, if its non-disclosure could influence the decision of the user.

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

Disclosures may be made in the body of the cost statement as foot note. If there are many items of disclosures, the same may be included in Schedule of Notes to the cost statement.



ILLUSTRATIVE LIST OF INDUSTRIES AND RAW MATERIALS USED

S.No.	Description	Names of important raw materials
1.	Sugar	Sugarcane and/or Beetroot
2.	Milk powder	Whole fresh milk/skimmed milk as the case may be
3.	Tea	Green Tea leaves
4.	Motor Spirit	Crude Oil
5.	Diesel oil	Crude Oil
6.	Furnace Oil	Crude oil
7.	Bitumen	Crude oil/coal
8.	Soda Ash	Common salt
9.	Caustic soda	Common salt
10.	Sodium silicate	Soda Ash and Soluble glass
11.	Sulphuric acid	Sulphur and/pyrite
12.	Urea	Raw naphtha/ammonia/lignite/coal
13.	Rayon and Synthetic Fibre & Yarn	Wood pulp/staple fibre
14.	Cotton Yarn	Cotton
15.	Wollen Fabrics	Woollen Yarns
16.	Cement	Lime stone and gypsum
17.	Zinc	Zinc ore
18.	Aerated water	Concentrate
19.	Coffee powder	Coffee beans
20.	Gear, Pinion, shaft	Rough forging for such items



Annexure II

ILLUSTRATION ON VALUATION OF RECEIPT OF INDIGENOUS SUPPLY

XYZ co

Faridabad

Inv.No.KKM/29[2009

To

M/s KLM, Noida

Item	Quantity Nos	Rate Rs/Unit	Amount (Rs.)
1. Bottom Cap	2200	2.79	6138
2. Top Cap	2200	2.26	4972
Total Assessable value			11110
Excise Duty		8%	889
Education Cess		2%	18
Secondary and Higher Education Cess		1%	9
Taxable Value			12026
Vat		4%	481
Freight & Cartage			0
Total			12507

Accounting entries in regard to above procurement will be as under:

Accounting Entries		Amount (Rs.)	
Purchases – Material	Dr	11110	
Basic Excise Duty Receivable A/c	Dr	889	
Education Cess Receivable A/c	Dr	18	
Secondary and Higher Education Cess Receivable A/c	Dr	9	
Vat recoverable	Dr	481	
To Supplier	Cr		12507
On Payment			
Supplier	Dr	12507	
To Bank	Cr		12507



Material Cost

On manufacture, excise duty payable will be adjusted against the above account viz. Excise Duty payable will be debited and Basic Excise Duty receivable account will be credited to discharge the payment liability of excise.

In certain purchases there may be no excise duty and the like and only VAT is paid. Entry will be in regard to purchase price and VAT paid will be adjusted against VAT payment liability.

VAT is a state subject. Provisions, rules and regulations governing this tax differ from state to state. A registered dealer can set-off VAT paid on inputs such as raw-materials and other supplies, (VAT credit) against VAT payable on outputs such as finished goods or traded goods (Vat liability). The underlying principle is similar to, CENVAT Scheme. In certain situation VAT credit is not available. These include:

- Dealers who are not registered under VAT.
- Dealers having a turnover below the threshold limit as fixed under the State Laws on VAT.
- Dealers engaged in works contract and option to pay tax by way of composition.
- Purchase of goods from unregistered dealers.
- Goods purchased in the course of inter-state trade where VAT is disallowed.



Annexure III a

LANDED COST OF IMPORTED MATERIAL ON FOB BASIS

Calculation of landed cost of Imported material on FOB Basis

Party's name	XYZ			
Invoice No.	49			
MRR Date	15.9.2009			
LC/TT No.	XXX			
FOB/CIF	FOB			
Bill of Entry No. and date	XXX dated 8.10.2009			
Item	Qty (Kg)	Rate per unit	Bill Value	(\$ = Rs 50.55)
P. Black	10800	\$3.00	\$ 32,400	1637820
			Amount (Rs.)	
a. Assessable value B/E (101% of value)			1654198	
b. Basic Custom Duty (BCD)	7.50%		124065	
c. Education Cess on BCD	2%		2481	
d. Secondary and Higher Education Cess on BCD	1%		1241	
e. CVD (on AV+BCD)	8%		142261	
f. Education Cess on CVD	2%		2845	
g. Secondary and Higher Education Cess on CVD	1%		1423	
h. Custom Edn cess (CVD+EC)	2%		2902	
i. Custom Higher Edn cess (CVD+EC)	1%		1451	
j. Special Addl. Duty (on a to i)	4%		77315	
TOTAL CUSTOM DUTY				355984
Other duty, if any				
Freight				23751
Insurance				124035
Clearing & Forwarding expenses				6801
Total Purchase value	10800 kg			2148391



Material Cost

Less CVD			142261	
Less Education Cess on CVD			2845	
Less Secondary and Higher Education Cess on CVD			1423	
Less Special Addl.Duty**			77315	(-)223844
Net Purchase Value				1924547
**applicable to manufacturer only and not service provider				
Landed Cost per unit				178



Annexure III b

LANDED COST OF IMPORTED MATERIAL ON CIF BASIS

Calculation of landed cost of Imported material on CIF Basis

Party's name		XYZ		
Invoice No.		49		
MRR Date		5 th April, 2009		
LC/TT No.		XXX		
FOB/CIF		CIF		
Bill of Entry No. and date		XXX Dated		
Item	Qty (Kgs)	Rate per unit	Bill Value \$	(\$ = Rs 51.15)
H Melt	300	\$ 7.70	\$2310	118157
			Amount (Rs.)	
Assessable value B/E (101% of value)			119338	
Basic Custom Duty	20.00%		23868	
Education cess on BCD	2%		477	
Secondary and Higher Education cess on BCD	1%		239	
CVD (on AV +BCD)	8%		11456	
Education cess on CVD	2%		229	
Secondary and Higher Education Cess on CVD	1%		115	
Education cess on Custom (CVD + EC)	2%		234	
Secondary and Higher Education Cess on Custom	1%		117	
Special Addl. Duty	4%		6243	
TOTAL CUSTOM DUTY				42978
Freight				0
Insurance				0
Clearing & Forwarding expenses				5530
Total Purchase value	300kg			166665



Material Cost

Less CVD			11456	
Less Education Cess on CVD			229	
Less Secondary and Higher Education Cess on CVD			115	
Less Special Addl. Duty			6243	(-)18043
Net Purchase Value				148622
Landed Cost per unit	300 KG			495



Annexure IV

**ILLUSTRATION SHOWING THE TREATMENT OF DRIAGE LOSS
IN SUGAR INDUSTRY**

				Quantity (Tonnes)	
	Sugarcane	Purchased	Received	Loss	% of loss
(a)	Own farm	0	0	0	0
(b)	Gate	609073	609073	0	0
(c)	Road	362593	360548	2045	0.564
(d)	Rail	0	0	0	0
(e)	Other means of transport	0	0	0	0
		971666	969621	2045	0.210
	Particulars	Unit	Quantity	Rate (Rs)	Amount (Rs)
1.	Total sugarcane purchased incl. from own farm	MT	971666		
	Less—normal losses such as driage	MT	2045		
	Actual	MT	969621	555.522	538645797
2.	Commission paid			17.193	16670694
3.	Other expenditure at cane collecting Center				
	(a) Salaries and wags			7.257	7036539
	(b) Stores and stationery			1.128	1093732
	(c) Repairs and maintenance			0.609	590499
	(d) Other expenses			3.187	3090182
4.	loading and unloading charges			3.922	3802853
5.	Net harvesting charges			0	0
6.	Taxes and levies				
	(a) Cane cess/purchases tax			17.537	17004243
	(b) Octroi			0	0
	(c) Other levies			0	0
	Total	MT	969621	606.355	587934541
7.	Transport charges				
	(a) Transport cost			0	0
	(b) Others			12.765	12377212



Material Cost

8.	Cane development expenses				
	(a) Salaries and wages of cane dev. Staff			1.429	1385588
	(b) Others			2.378	2305758
	Total	MT	969621	622.927	604003100
9.	Stock Adjustment if any				
	Add- opening stock	MT	156	476.692	74364
	Less- closing stock	MT	294	584.844	171944
10.	TOTAL	MT	969483		603905520



ILLUSTRATION ON TREATMENT OF FOREX COMPONENT

XYZ imported Quantity 5000 kilos @ US \$ 30 per kilo.

Total contracted rate US \$ 150000 CIF Chennai

Letter of credit established demand bill basis documents against payment.

Date of dispatch of goods 1st Dec XXXX.

(Conversion rate per US Dollar = Rs 44) Market rate published by RBI,

Date of dispatch of Documents 2nd Dec XXXX (Rs 45 per \$ as per market rate published by RBI)

Date of receipt of Documents 6th Dec XXXX (Rs 43 per \$)

Date of payment by the Bank 8th Dec XXXX (Rs 42 per \$ used by the Bank in India)

The cost of materials will be taken @ Rs 45 per US\$ being the date of dispatch of documents. The rate used by their bank for debit is the market rate at the time of conversion within a day which need not tally with the published rate.

The difference between Rs 45 and Rs 42 per \$ will be considered in financial accounts as under:

US \$ 150000 @ 45 per \$ = Rs. 6750000

US \$ 150000 @ 42 per \$ = Rs 6300000

The short / (gain) of Rs 450000 will be credited to exchange rate fluctuations / adjustment account. It does not form part of material cost.

The bank charges are in the nature of Administrative Overheads and will not form part of material cost.



Annexure VI

Illustration on FIFO/LIFO/Weighted average method of issue of material

The following is the receipts and issues of January 2009:

Date	Receipts		Date	Issue (Qty)
	Units(tonnes)	Rupees/unit		
2-1-2009	300	4	7-1-2009	200
16-1-2009	500	6	18-1-2009	400
23-1-2009	450	5	29-1-2009	100

FIFO method:

Date	Qty	Receipt Rate (Rs)	Amt (Rs)	Qty	Issue Rate (Rs)	Amt (Rs)	Qty (Rs)	Balance Rate (Rs)	Amt (Rs)
1-1-09							-	-	-
2-1-09	300	4	1200				300	4	1200
7-1-09				200	4	800	100	4	400
16-1-09	500	6	3000				100	4	400
							500	6	3000
							600		3400
18-1-09				100	4	400	200	6	1200
				300	6	1800			
23-1-09	450	5	2250				200	6	1200
							450	5	2250
							650		3450
29-1-09				100	6	600	100	6	600
							450	5	2250
							550		2850



LIFO method:

Date	Qty	Receipt Rate (Rs)	Amt (Rs)	Qty	Issue Rate (Rs)	Amt (Rs)	Qty	Balance Rate (Rs)	Amt (Rs)
1-1-09							-	-	-
2-1-09	300	4	1200				300	4	1200
7-1-09				200	4	800	100	4	400
16-1-09	500	6	3000				100	4	400
							500	6	3000
							600		3400
18-1-09				400	6	2400	100	4	400
							100	6	600
							200		1000
23-1-09	450	5	2250				100	4	400
							100	6	600
							450	5	2250
							650		3250
29-1-09				100	5	500	100	4	400
							100	6	600
							350	5	1750
							550		2750

Weighted average method:

Date	Qty	Receipt Rate (Rs)	Amt (Rs)	Qty	Issue Rate (Rs)	Amt (Rs)	Qty	Balance Rate (Rs)	Amt (Rs)
1-1-09							-	-	-
2-1-09	300	4	1200				300	4	1200
7-1-09				200	4	800	100	4	400
16-1-09	500	6	3000				600	5.667*	3400
18-1-09				400	5.667	2000	200	5.667	1133
23-1-09	450	5	2250				650	5.2**	3380
29-1-09				100	5.2	520	550	5.2	2860

Weighted average method:

*issue on 18-1-09 → $(3400/600=5.667)$ **issue on 29-1-09 'a' $(1133+2250)/650=5.2$



Annexure VII

Illustration of material cost variance (price, use, mix and yield)

Examples of material cost variance (price, use, mix and Yield):Material 'A' and 'B' are mixed in the proportion of 60% and 40% respectively and a standard loss of 5% is fixed. Standard and actual cost for a period is as under:

Item	Standard Cost			Actual Cost		
	Qty (KG)	Rate per unit	Total	Qty (KG)	Rate per unit	Total
Material A	6000	6.00	36000	5000	6.50	32500
Material B	4000	4.00	16000	4500	3.50	15750
Total	10000	5.20	52000	9500	5.08	48260
Loss 5%	500					
Output	9500			9000		
Variances calculation:						
Material price variance: Actual qty (Standard Price –Actual price)						(Rs.)
Material A :5000x(6.00-6.50) = 2,500					(Adverse)	(2500)
Material B 4500x(4.00-3.50) = 2250					Favourable	2250
					Total	(250)
Material Usage variance:						
(Actual production x standard material per unit – actual material) x standard price per unit						
{(9000x0.6)/0.95 – 5000} x Rs 6.00 = 4105					Favourable	4105
{9000x.0.4)/0.95 - 4500} x Rs 4.00 = 2842					Adverse	(2842)
					Total	1263
Material Mix Variance						
(Actual quantity of material – quantity of material based on total material quantity split in standard proportion)x (weighted average cost per unit (Kg) – standard cost per unit(Kg))						
A(5000 – 5700) x (5.079 – 6.00) = 644						644
B((4500 -3800) x (5.079 - 4.00) = 755						755
						1399
Material Yield Variance						
Standard material quantity allowed for actual output – actual material quantity input)x standard weighted average cost per unit (Kg)						
(9000/0.95 - 9500) x 5.08 = (136)						(136)

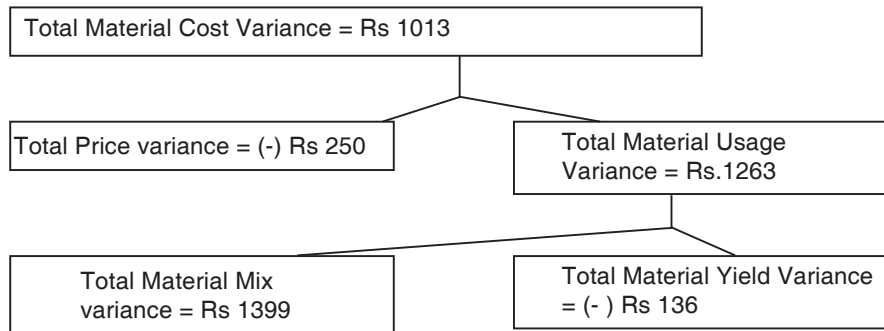




**ILLUSTRATION OF PRESENTATION OF MATERIAL
COST – ENGINEERING INDUSTRY**

S. No.	Description	Unit	Qty	Rate	Amount
A	Direct Material			Rs	Rs
1.	Sheet	Kg.	10	200	2000
2.2(a)	Bought out components Imported				
	Crank shaft	No.	1	6900	6900
	Cylinder block	No	1	12500	12500
	Hydraulic lift valve	No.	1	7200	7200
	Wheel Assembly Rear	No.	2	3230	6460
2b)	Indigenous				
	Injection pump	No.	1	18500	18500
	Tyres	No.	5	3000	15000
	Battery	No.	1	7500	7500
3.	Others constituting less than 5% of the Total material cost				175000
4	Total				251060



Annexure VIII b

**ILLUSTRATION OF PRESENTATION OF MATERIAL COST -
PROCESS INDUSTRY (PAPER)**

S. No.	Description	Unit	Qty	Rate	Amount
A	Direct Material - Raw material				
1.	Wood pulp (self manufactured)	MT	250	20000	5000000
2.	Imported pulp	MT	10	35000	350000
3.	Broke	MT	10	12000	120000
B	Process chemicals/additives				
1	Filler	MT	12	8500	102000
2	Sizing	MT	3	19000	57000
3	Alum	MT	10	9400	94000
4	Dyes Fluorescent	KG	13	150	1950
5	Other chemicals				105210
	Total				5830160



Annexure VIII c

ILLUSTRATION OF PRESENTATION OF MATERIAL COST - CAUSTIC SODA

(Power used for electrolysis process is treated as part of material cost)

S. No.	Particulars	Unit	Qty	Rate	Amount
A.	Materials consumed				
1	Direct Material				
	a) Purchased				
	- Indigenous Salt (Industrial Grade)	MT	997500	750	748125000
	- Imported	0	0	0	0
	b) Self Manufactured - Power consumed in electrolyser	KWH	15250000	5	76250000
	Total Direct Material				824375000
2.	Process material				
	a) Barium Carbonate	KG	876600	19	16655400
	b) Sodium Sulphite	KG	94300	16	1508800
	c) Soda Ash	KG	42850	12	51420
	d) Alpha Cellulose	KG	6750	96	648000
	e) Flocculent	KG	1700	315	535500
	Total process material				19861900



CAS-7

COST ACCOUNTING STANDARD ON EMPLOYEE COST

The following is the COST ACCOUNTING STANDARD 7 (CAS - 7) issued by the Council of The Institute of Cost and Works Accountants of India on "**EMPLOYEE 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 the principles and methods of determining the Employee cost.
- 1.2 ***This standard deals with the principles and methods of classification, measurement and assignment of Employee cost, for determination of the Cost of product or service, and 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 Employee cost with reasonable accuracy.

3 Scope

This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Employee cost 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.¹***
- 4.2 ***Abnormal Idle time: An unusual or atypical employee idle time occurrence of which is usually irregular and unexpected or due to some abnormal situations.***
E.g.: Idle time due to a strike, lockout or an accident
- 4.3 ***Administrative overheads: Expenses in the nature of indirect costs, incurred for general management of an organization².***

¹Adapted from CAS 1 paragraph 6.5.19

²Adapted from CAS 1 paragraph 6.3.5



- 4.4 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 finally ascertained.*³
- 4.5 Distribution Overheads:** *Distribution overheads, also known as Distribution Cost, are the costs incurred in handling a product from the time it is ready for despatch until it reaches the ultimate consumer.*⁴
- The cost of any non manufacturing operations such as packing, repacking, labelling, etc. at an intermediate storage location will be part of distribution cost.
- 4.6 Direct Employee Cost:** *The cost of employees which can be attributed to a Cost Object in an economically feasible way.*⁵
- 4.7 Employee cost:** *The aggregate of all kinds of consideration paid, payable and provisions made for future payments for the services rendered by employees of an enterprise (including temporary, part time and contract employees). Consideration includes wages, salary, contractual payments and benefits, as applicable or any payment made on behalf of employee. This is also known as Labour Cost.*⁶

Explanation:

1. Contract employees include employees directly engaged by the employer on contract basis but does not include employees of any contractor engaged in the organisation.
2. Compensation paid to employees for the past period on account of any dispute / court orders shall not form part of Employee Cost.
3. Short provisions of prior period made up in current period shall not form part of the employee cost in the current period.

Employee cost includes payment made in cash or kind.

For example:

- **Employee cost**
 - o Salaries, wages, allowances and bonus / incentives.
 - o Contribution to provident and other funds.
 - o Employee welfare
 - o Other benefits
- **Employee cost – Future benefits**
 - o Gratuity.
 - o Leave encashment.

³Adapted from CIMA Terminology

⁴Adapted from CAS 1 paragraph 6.3.9

⁵Adapted from CAS 1 paragraph 6.2.4 (Direct labour cost)

⁶Adapted from CAS 1 paragraph 6.1.4



- o Other retirement/separation benefits.
- o VRS/ other deferred Employee cost.
- o Other future benefits

Benefits generally include

- Paid holidays.
- Leave with pay.
- Statutory provisions for insurance against accident or health scheme.
- Statutory provisions for workman's compensation.
- Medical benefits to the Employees and dependents.
- Free or subsidised food.
- Free or subsidised housing.
- Free or subsidised education to children.
- Free or subsidised canteen, crèches and recreational facilities.
- Free or subsidised conveyance.
- Leave travel concession.
- Any other free or subsidised facility.
- Cost of Employees' stock option.

4.8 Idle time: *The difference between the time for which the employees are paid and the employees' time booked against the cost object.*

The time for which the employees are paid includes holidays, paid leave and other allowable time offs such as lunch, tea breaks.

4.9 Imputed Costs: *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.*⁷

4.10 Indirect Employee Cost: *The cost which can not be directly attributed to a particular cost object.*⁸

4.11 Marketing overheads: *Marketing Overheads are also known as Selling and Distribution Overheads.*

4.12 Overtime Premium: *Overtime is the time spent beyond the normal working hours which is usually paid at a higher rate than the normal time rate. The extra amount beyond the normal wages and salaries paid is called overtime premium.*

⁷ Adapted from CAS 1 paragraph 6.5.13

⁸ Adapted from CAS 1 paragraph 6.2.10



4.13 Production Overheads: *Indirect costs involved in the production process or in rendering service.*⁹

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

4.14 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.*¹⁰

4.15 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 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. Standard costs are also used for estimation.

5 Principles of Measurement

5.1 *Employee Cost shall be ascertained taking into account the gross pay including all allowances payable along with the cost to the employer of all the benefits.*

5.2 *Bonus whether payable as a Statutory Minimum or on a sharing of surplus shall be treated as part of employee cost. Ex gratia payable in lieu of or in addition to Bonus shall also be treated as part of the employee cost.*

5.3 *Remuneration payable to Managerial Personnel including Executive Directors on the Board and other officers of a corporate body under a statute will be considered as part of the Employee Cost of the year under reference whether the whole or part of the remuneration is computed as a percentage of profits.*

Explanation: Remuneration paid to non executive directors shall not form part of Employee Cost but shall form part of Administrative Overheads.

5.4 *Separation costs related to voluntary retirement, retrenchment, termination etc. shall be amortised over the period benefitting from such costs.*

5.5 *Employee cost shall not include imputed costs.*

⁹Adapted from CAS 1 paragraph 6.3.3

¹⁰Adapted from CAS 1 paragraph 6.3.7



- 5.6** *Cost of Idle time is ascertained by the idle hours multiplied by the hourly rate applicable to the idle employee or a group of employees.*
- 5.7** *Where Employee cost is accounted at standard cost, variances due to normal reasons related to Employee cost shall be treated as part of Employee cost. Variances due to abnormal reasons shall be treated as part of abnormal cost.*
- 5.8** *Any Subsidy, Grant, Incentive or any such payment received or receivable with respect to any Employee cost shall be reduced for ascertainment of cost of the cost object to which such amounts are related.*
- 5.9** *Any abnormal cost where it is material and quantifiable shall not form part of the Employee cost.*
- 5.10** *Penalties, damages paid to statutory authorities or other third parties shall not form part of the Employee cost.*
- 5.11** *The cost of free housing, free conveyance and any other similar benefits provided to an employee shall be determined at the total cost of all resources consumed in providing such benefits.*
- 5.12** *Any recovery from the employee towards any benefit provided e.g. housing shall be reduced from the employee cost.*
- 5.13** *Any change in the cost accounting principles applied for the determination of the Employee cost should 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 enterprise.*
- 6** **Assignment of Costs**
- 6.1** *Where the Employee services are traceable to a cost object, such Employees' cost shall be assigned to the cost object on the basis such as time consumed or number of employees engaged etc or similar identifiable measure.*
- 6.2** *While determining whether a particular Employee cost is chargeable to a separate cost object, the principle of materiality shall be adhered to.*
- 6.3** *Where the Employee costs are not directly traceable to the cost object, these may be assigned on suitable basis like estimates of time based on time study.*
- 6.4** *The amortised separation costs related to voluntary retirement, retrenchment, and termination etc. for the period shall be treated as indirect cost and assigned to the cost objects in an appropriate manner. However unamortised amount related to discontinued operations, shall not be treated as employee cost.*



- 6.5 Recruitment costs, training cost and other such costs shall be treated as overheads and dealt with accordingly.**
- 6.6 Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime.**
- 6.7 Idle time cost shall be assigned direct to the cost object or treated as overheads depending on the economic feasibility and the specific circumstances causing such idle time.**

Cost of idle time for reasons anticipated like normal lunchtime, holidays etc is normally loaded in the Employee cost while arriving at the cost per hour of an Employee/a group of Employees whose time is attributed direct to cost objects.

7 Presentation

- 7.1 Direct Employee costs shall be presented as a separate cost head in the cost statement.**
- 7.2 Indirect Employee costs shall be presented in cost statements as a part of overheads relating to respective functions e.g. manufacturing, administration, marketing etc.**
- 7.3 The cost statement shall furnish the resources consumed on account of Employee cost, category wise such as wages salaries to permanent, temporary, part time and contract employees piece rate payments, overtime payments, Employee benefits (category wise)etc wherever such items form a material part of the total Employee cost.**

8 Disclosures

- 8.1 The cost statements shall disclose the following:**
- 1. Employee cost attributable to capital works or jobs in the nature of deferred revenue expenditure indicating the method followed in determining the cost of such capital work.**
 - 2. Separation costs payable to employees.**
 - 3. Any abnormal cost excluded from Employee cost.**
 - 4. Penalties and damages paid etc excluded from Employee cost.**
 - 5. Any Subsidy, Grant, Incentive and any such payment reduced from Employee cost**
 - 6. The Employee cost paid to related parties¹¹.**
 - 7. Employee cost incurred in foreign exchange.**

¹¹Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement



- 8.2** *Any change in the cost accounting principles and methods applied for the measurement and assignment of the Employee Cost during the period covered by the cost statement which has a material effect on the Employee Cost. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*
- 8.3** *Disclosures shall be made only where material, significant and quantifiable.*
- 8.4** *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*



Guidance Note on Cost Accounting Standard on Employee Cost (CAS-7)

The Council of the Institute of Cost and Works Accountants of India (ICWAI) has issued the Cost Accounting Standard 7 (CAS-7) on Employee Cost which lays down a set of principles and methods of classification, measurement and assignment of Employee cost, for determination of the cost of product or service and the presentation and disclosure in the cost statements.

The Guidance Note deals with principles and methods as provided in the CAS-7 and practical aspects in connection with the determination of employee cost of a product or service.

In the preparation of cost statements including those requiring attestation, employee cost shall be determined as per CAS-7. The Cost Accounting Standards have been set in bold italic type and reference number of the standard has been retained.

Further, The Companies (Cost Accounting Records) Rules, 2011 provide that every company, including a foreign company defined under section 591 of the Companies Act, 1956 which is engaged in production, processing, manufacturing or mining activities have to maintain cost accounting records in accordance with the Generally Accepted Cost Accounting Principles (GACAP) and Cost Accounting Standards issued by the ICWAI, to the extent these are found to be relevant and applicable. The above Rules further provide that these will be applicable to companies wherein:

- a) aggregate value of net worth as on the last date of the immediately preceding financial year exceeds five crores of rupees; or
- b) the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds twenty crores of rupees; or
- c) the company's equity or debt securities are listed or are in the process of listing on any stock exchange whether in India or outside India.

The Companies (Cost Audit Report) Rules, 2011 cast a duty on a Cost Auditor appointed under Section 233B of the Companies Act, 1956 for a company to certify inter alia that books and records maintained by the company are in conformity with the Cost Accounting Standards issued by the ICWAI to the extent these are found to be relevant and applicable.

**Chapter 1****Introduction**

Employee cost is a significant factor of cost of production. But, its significance is decreasing due to automation in production. However in knowledge based industry such as software industry, employee cost is the single most important factor of cost of product / service.

The term “employee costs” refers to the expenditure incurred by an entity towards the services performed by the employees of such an entity. In normal parlance employee costs include wages/ salaries, allowances and bonuses, paid by an employer in cash or in kind to employee in return for the work done. However such costs also include employer contribution to social saving schemes, payments for days not worked and remunerations in kind such as provision of free or concessional food, drink, fuel and other amenities. There are a number of other costs which do not appear in the payroll but are employee related cost such as: recruitment costs, training costs, relocation costs, support / social costs, and personnel administration costs. The employee cost is also sometimes termed as “Labour cost”.

Type of Employees:

Employees in an entity may be categorized as:

- a. Daily rated worker / badli worker, piece rated worker,
- b. Monthly paid worker,
- c. Contract basis,
- d. Temporary or regular,
- e. Skilled or unskilled,
- f. Executive / non executive.

The employees are paid remuneration as per their terms of employment. Employees may be paid on monthly, weekly or piece rate basis. In case of piece work employees’ quality and quantity is ensured. Payments made to employees are classified as casual labour cost, supervisory employee cost and the like. The attendance of employees is closely monitored by various methods for example biometric / clocking system / manually.

Payments made in cash or kinds to employees are categorized as:

- (i) Salaries / wages
- (ii) Allowances: Dearness allowance, House Rent allowance, Education Allowance, transport allowance,
- (iii) Bonus: Remuneration packages often include profit sharing or production bonus plans subject to fulfilment of certain pre-conditions. Payments under this head are:
 - a. Statutory minimum bonus / sharing in surplus profit. The Payment of Bonus Act, 1965 deals with profit sharing bonus. It represents an additional payment.



- b. Productivity linked or other efficiency related bonus including bonus payment based on agreement with trade unions (not linked to profits)
 - c. Incentives: quality incentive, merit incentive, service loyalty incentive, etc. An incentive is a monetary inducement for better performance in addition to regular and overtime wages. It is an extra pay for extra performance. Scheme of incentives varies from entity to entity. However incentive payments made to employees form part of employee cost.
- (iv) Contribution to provident and other funds: Entity covered under Provident fund and Employee's State Insurance scheme has to deduct specified contribution from the employee's wages and salaries. Such deductions are to be deposited with the Government agencies accompanied by corresponding contribution from the employer. For example if total deduction from employees during a period is Rs 1.20 lakhs, the entity has to deposit Rs 2.40 lakhs (Rs 1.20 lakhs from employees and corresponding contribution from employer of Rs 1.20 lakhs) within the specified time.
- (v) Instead of depositing the contribution with Provident Fund Commissioner, many large and medium enterprises operate their own Provident Funds, by establishing an independent Trust for managing the assets as per provisions of the Employees Provident Fund & Misc Provision Act 1952. It is a statutory requirement that the employees covered by such PF scheme should derive a specified return on the contribution made. If the actual yield on funds deployed happened to be lower than the notified rate, the shortfall is met by the employer. Thus an obligation is cast on employers to bear the difference, if any, between the notified rate, and the return generated by assets of such PF. Such shortfall forms part of employee cost.
- (vi) Employee welfare: These include facilities like subsidized canteen, cooperative stores, laundry and washing services, sports, housing schemes, transport and educational facilities. These facilities are as good as higher wages offering incentive to the workers to stay with the entity.
- (vii) Other benefits: Payment to employees for the following items also form part of the employees cost:
- Paid holidays.
 - Leave with pay / maternity leave.
 - Statutory provisions for insurance against accident or health scheme:
 - a) **E.S.I. (Employees State Insurance) Scheme** is a contributory scheme for the employees in the factories or establishments to which the Act applies. The employees are insured in a manner provided by the Employees' State Insurance Act 1948. The contribution payable to the E.S.I Corporation in



respect of an employee shall comprise of employer's contribution and employee's contribution at a specified rate. The rates are revised from time to time. Presently, the employees' contribution is 1.75% of the wages and that of employers' is 4.75% of the wages paid or payable in respect of the employees in every wage period. The Scheme covers employees engaged on a monthly remuneration not exceeding Rs. 6500 (**enhanced to Rs 15000 w.e.f. 1st May 2010**) in a factory / establishment to which the Act applies. The employees so covered are entitled to benefits such as periodical payments in case of a sickness, periodical payments to women in case of confinement or miscarriage or sickness arising out of pregnancy etc., periodical payments for suffering from disablement as a result of an employment injury and medical treatment etc. Dependents of the employees are also entitled to the benefits provided under the Act.

b) Statutory provisions for workman's compensation:

In case a personal injury is caused to a workman by an accident arising out of and in the course of his employment, the employer is liable to pay compensation in accordance with the provision of the Workmen's Compensation Act, 1923. The amount paid towards such compensation also form part of employee cost.

- Medical benefits to the employees and dependents.
- Free or subsidised food.
- Free or subsidised housing.
- Free or subsidised education to children.
- Free or subsidised canteen, crèches and recreational facilities.
- Free or subsidised conveyance.
- Leave travel concession.
- Any other free or subsidised facility.
- Cost of Employees' stock option: The employees in case of certain entities are given a right to acquire shares in the entity at a future date at a predetermined price. The offer may be free of cost, or at concessional rates. Such benefit is in the form of:
 - a) shares, share options and other equity instrument issued to employee at less than fair value at which these instruments are issued to third parties; and
 - b) Cash payment, the amount of which will depend on the future market price of enterprise shares.

The aggregate amount of such expenditure which would form part of the Employee cost on account of Employee stock option plan as ascertained at the year end is carried forward as Deferred Employee Compensation Benefit to be written off over the related vesting period of individual options.



- Future Benefits Employee Cost: Employer has to provide for certain future benefits payable to employees, such as Gratuity, Superannuation benefits and the like.
 - √ **Gratuity:** It is a lump sum payment made based on the total service of an employee either on retirement or death. The gratuity is paid on the basis of the employee's basic plus dearness allowance if any. As per the Payment of Gratuity Act 1972, the gratuity amount is 15 days' wages multiplied by the number of years service put in. It is calculated based on last salary drawn divided by 26 to work out per day rate. An employee should have minimum service of 5 years' service to earn gratuity. The maximum gratuity payable is 16 ½ months emoluments for the maximum of 33 years of service and for lesser service it is proportionately paid.

For employees who do not fall under the Gratuity Act, the amount due for them is half of the average ten months' salary multiplied by the number of years of service or as per term of employment.

To meet its liabilities towards gratuity, a company funds the money, or opens a trust. This fund is then managed either by an insurer or on actuarial basis. The gratuity liability at the end of the year is determined on the basis of actuarial valuation.

The superannuation liability is also assessed and provided on the above basis.
- Short term compensated absence (such as paid annual leave and paid sick leave) Employee is entitled for leave as per his term of employment. A part of leave lapses during the year and other part of leave is accumulated over a period as per policy of the entity. Leave may also be encashed during the service. Employee is also entitled for leave encashment at the time of termination of employment. It is the amount payable for the employee's leave period, depending upon the leaves to his credit and his salary at the time of termination of employment.
- Voluntary Retirement Scheme (VRS): To reduce the surplus strength, Voluntary retirement scheme is introduced providing a lump sum payment for the remaining year of service on seeking voluntary retirement besides other terminal benefits.

The various employee benefits are to be provided in the accounts as per AS-15. These benefits form part of employee cost and their treatment is required to be indicated in the Cost Accounting Records.

Classification of Employee cost:

Employee cost, on the basis of relation with a cost centre / cost object is classified direct employee cost, or indirect employee cost of product / service.



Direct employee cost is that portion of wages and salaries which can be identified with and charged to a cost object. It may be classified as direct when:

1. There is a direct relationship to the product through a process or a costing unit;
2. The cost may be measured in light of this relationship; and
3. The cost is significant in amount.

The general rule is that direct employee cost is the labour spent in the actual production of the finished product which is economically identifiable with product costs. "Economically" means cost benefit ratio be looked into before going into a detailed exercise ascertaining direct employee cost.

All factory employees cost other than for direct employees are classified as indirect employee costs. The distinction between direct and indirect employee is sometime difficult to establish. Early stages of technology witnessed a major role for the workmen in the manufacturing process with output being controlled mainly by the workmen's efforts. Hence elaborate systems were built to log workmen's time for an individual jobs or products and operations and employee cost was assigned on the basis of time booking and identified as direct employee cost. As technology developed, the importance of machines in production grew with decreasing nexus between workmen's efforts and production. Work men were assigned to more than one machine producing more than one product with their role being reduced to attending to controls.

However, in case where technology is at an early stage, it is still common for direct employee cost to be assigned to products and operations on the basis of time booked for the job. This is applicable for engineering shops with conventional machines such as lathes, drilling machines, milling machines etc., and simple processing shops.

In case where fully automatic machinery is used, the worker becomes in effect a machine tender. The machine alters the size or shape of the product, while the worker merely feeds the machine at intervals and makes minor adjustments. A question may arise a machine adjuster is a direct employee or an indirect employee. A distinction is to be made that if a man is tending a productive machine, his labour is as direct as the labour of an employee producing goods manually. But if the he is repair man or set-up man, he may be classified as indirect employee.

Further, in certain cases employee may be direct in nature, but for practical reasons, may not be charged directly to a given product, being prorated as direct employee cost over several products or even treated as indirect employee cost. Instances of such border line cases are spray painting, inspection and short operations e.g. buffing, polishing, etc. Spray painting can, in some instances, be easily identified with and charged to specific jobs but in many cases the spraying is done on a conveyor belt with items from various jobs being sprayed as needed. In the latter case, to charge the paint spraying employee cost directly to the separate job may entail too much clerical detail and the employee cost may be allocated to various jobs on some equitable basis.

Inspection employee may be considered direct employee or indirect employee depending upon the circumstances. It is often considered direct employee in cases



Employee Cost

where each unit must be tested or measured to ascertain that the product meets predetermined specification as in the case of manufacture of drugs where each item must be tested to guard against error. Inspection should, in other cases be considered as indirect employee if inspection is done on an intermittent or selective basis. If inspector divides his time between two or more departments or jobs, proration of his wages may be accomplished more easily by treating them as indirect employee cost than by attempting to make a direct allocation through time tickets or time cards.

The distinction between direct and indirect employee is necessary because direct employee efficiency is measured by the number of acceptable units completed, while the efficiency of other type of employee frequently has little relationship to the number of units produced. Therefore in the measurement of the efficiency of a particular worker, group of workers or a department, their employees must be divided, so far as practicable, into direct and indirect employee. Measurement of Employee Cost involves determining the basis of cost measurement method and establishing criteria for use of alternative cost measurement techniques.

Examples of cost measurement are:

- Use of historical cost,
- Use of actual or standard cost,
- Designation of items of cost which must be included or excluded from the Employee Cost,
- Employee Cost is measured in terms of time (man hours / man days) and rate of payment.

Measurement of Employee Cost is detailed under Chapter 3.

Assignment is tracing the employees cost to a product or service and is dealt in Chapter 4.

The principles and methods adopted for computation of employee cost in a cost statement shall be applied consistently from one period to another and for reasonable uniformity between different products / units. For example Employees working on machining operation are to be classified as Direct Employee from one period to another and those engaged in repair to be classified as indirect.



Chapter 2

Definitions

The following terms are used in this guidance note with the meaning specified:

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.

Abnormal Idle time: An unusual or atypical employee idle time occurrence of which is usually irregular and unexpected or due to some abnormal situations.

Administrative overheads: Expenses in the nature of indirect costs, incurred for general management of an organization.

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.

Direct Employee Cost: The cost of employees which can be attributed to a Cost Object in an economically feasible way.

Distribution Overheads: Distribution overheads, also known as Distribution Cost, are the costs incurred in handling a product from the time it is ready for despatch until it reaches the ultimate consumer.

Employee cost: The aggregate of all kinds of consideration paid, payable and provisions made for future payments for the services rendered by employees of an enterprise (including temporary, part time and contract employees). Consideration includes wages, salary, contractual payments and benefits, as applicable or any payment made on behalf of employee. This is also known as Labour Cost.

Idle time: The difference between the time for which the employees are paid and the employees' time booked against the cost object.

Imputed Costs: Hypothetical or notional costs, not involving cash outlay, computed for any purpose.

Indirect Employee Cost: The cost which cannot be directly attributed to a particular cost object.

Marketing overheads: Marketing Overheads are also known as Selling and Distribution Overheads.

Overtime Premium: Overtime is the time spent beyond the normal working hours



which is usually paid at a higher rate than the normal time rate. The extra amount beyond the normal wages and salaries paid is called overtime premium.

Production Overheads: Indirect costs involved in the production process or in rendering service.

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.

Standard Cost: A predetermined cost of resource inputs for the cost object computed with reference to set of technical specifications and efficient operating conditions.

**Chapter 3****Principles of Measurement****5.1 Employee Cost shall be ascertained taking into account the gross pay including all allowances payable along with the cost to the employer of all the benefits.**

The gross pay and allowances payable to an employee are indicated in the pay slip of an employee. The payroll department computes the gross pay, including gross amount earned and the net amount payable to employees after deductions (for PF, FPS, ESI and so on) based on the attendance details received from HRD / Time Office. Pay slip contains inter alia the personal details of an employee besides payment details. An illustration of pay slip is at **Annexure I**.

Based on Pay slips (which indicate department code), summary of gross earnings, deductions, working days and the like are prepared department wise / cost centre wise. Gross earning of an employee is the employee cost to the entity. An illustration of summary of gross earnings of employees cost centre wise is indicated at **Annexure II**.

Gross Employees costs generally exceed the cost of gross wages or salaries paid to employees. Employers are required to match the employee's contribution to PF, FPS, ESI, Workmen Compensation, paid holidays, leave, pension gratuity and the like.

Employer's contribution to PF, FPS and ESI are identifiable with each employee. Contribution to Provident fund is to be made as per the PF Rules and the same is paid to a PF Commissioner or fund administered through a separate trust. Thus contribution to Provident Fund, Employee State Insurance Scheme and FPS are charged as incurred.

Share of employers' contribution to PF, FPS and ESI shall be identified to cost centre / department where the employee is working. In cases where it is not feasible, it shall be allocated based on employees gross earning.

To cover the cost of worker's compensation under Workmen Compensation Act for injury to employees on the job, Accident Insurance policy is taken resulting in additional employee cost. It shall be treated as Production overhead as it is not specific to any cost centre.

Non financial benefits are offered to employees in several ways.

These are the benefits in the form of amenities or facilities which do not offer cash reward to the employee for any specific or measured work done. Such non monetary benefits make the working conditions and terms of employment lucrative so as to induce the employee to increase his efforts/productivity. The benefit goes to all the employees in the undertaking and is not limited to any individual, class, or group.

For example:

- Free or subsidised food.
- Free or subsidised housing.
- Free or subsidised education to children.
- Free or subsidised canteen, crèches and recreational facilities.



- Free or subsidised conveyance.
- Leave travel concession.
- Any other free or subsidised facility.
- Recreational facilities
- Protective clothing, liveries, uniforms etc.
- Tea milk etc

They are non-financial only so far as the employee is concerned, but the employer has to incur expenditure to provide for the incentives. The above payments to employees are ascertainable at the end of each month. In case of subsidized benefits, token money recovered from the employee is credited to the relevant benefit scheme. Net cost of benefits is allocated to the departments / cost centre on the basis of gross earning / number of employee or may be treated as overhead.

There are group benefits extended to employees such as Group Personal Accident Insurance, Group Medical Insurance Scheme etc. It is difficult to relate such costs to individual employees and therefore to cost centres or objects. These can only be allocated to cost centres or cost objects on the basis of no. of employees or employee cost of each cost centre or cost object.

Cost Object or Cost Centre is the logical sub-unit for collection of cost. Cost object may be any customer, product service, contract, project, activity or other work unit for which a separate cost measurement is desired. For example, if it is desired to determine what it costs to produce a car, then the cost object is car. If it is desired to determine the operating cost of maintenance department within a plant, the cost object is maintenance department. Different costs can be assigned to the same cost object, depending on the purpose.

Employee welfare expenses similarly represent a motley of benefits including canteen facilities, recreation facilities, gifts to individual employees on birthdays / marriage, dispensary facilities etc., These are legitimately treated as part of employee cost and allocated to cost centres or cost objects on the basis of no. of employees or employee cost of each centre or cost object.

Post-employment benefit schemes can take any two forms:

- a. Fixed contribution to a fund by the employer with varying benefits to employees.
- b. Variable contribution to a fund by the employer to assure given benefit to the employees.

The fixed contribution plans involves a defined cost per employee and can be readily assigned to cost centres or objects. The contribution under variable contribution plans are generally determined on an actuarial valuation. The treatment of such benefits in Cost Accounts will be on the same basis as in financial accounts which is governed by AS-15 in India.

The allocation of the cost of such employee benefits to cost centres / Cost objects will be on the basis of no. of employees or employee cost.



Provision for gratuity, leave encashment, superannuation, termination benefit, medical benefits and the like are provided in the accounts as per AS-15 and these will form part of employee cost. The allocation of the cost of above employee benefits to cost centre / cost object shall be on the basis of number of employees or employee cost.

Employee Rate per Hour

The measure of cost to keep an employee at work an hour or a day must include all of these elements where they exist. Hourly rates are to be calculated using the available hours as the denominator. Normal health breaks or rest allowances are excluded from available hours.

In brief Employee cost includes remuneration paid or payable and provisions made for future payments. However the following payments to employees will not form part of employee cost:

As per CAS-7.4.7, the employee cost will not include the compensation paid to employees for the past period on account of any dispute / court orders for the reason that there is no contribution by the concerned employee to the production activity of the entity during the current period. Such payments for past period are items of reconciliation between cost and financial accounts.

Similarly as per explanation 3 of CAS-7.4.7, under provisions of prior period made up in current period shall not form part of employee cost in the current period and will be an item of reconciliation between cost and financial accounts.

Employee cost does not include workers hired through contractor or agents as they are not on the roll of the entity and payments are made to the contractor and not to such workers.

5.2 Bonus whether payable as a Statutory Minimum or on a sharing of surplus shall be treated as part of employee cost. Ex gratia payable in lieu of or in addition to Bonus shall also be treated as part of the employee cost.

Remuneration packages often include profit sharing or production bonus plans subject to fulfilment of certain pre-conditions. Payments under this head are:

- a) Statutory minimum bonus / sharing in surplus profit. The Payment of Bonus Act, 1965 deals with profit sharing bonus. It represents an additional payment.
- b) Productivity linked or other efficiency related bonus including bonus payment based on agreement with trade unions (not linked to profits)
- c) Incentives: quality incentive, merit incentive, service loyalty incentive, and the like. An incentive is a monetary inducement for better performance in addition to regular and overtime wages. It is an extra pay for extra performance. Scheme of incentives varies from entity to entity. However incentive payments made to employees form part of employee cost.

Bonus under the Payment of Bonus Act must be distinguished from performance



incentives which are generally related to output and not profits. These may take the form of incentives at

- Individual employee level – based on his or her performance.
- Group of employees level – based on performance of a group of employees or team
- Unit level – where the incentives are paid on the basis of performance of the factory or other unit.

In some cases, incentives are paid to production employees based on sales as cost of production. Such incentive payment either computed on sales value of production or payable only on sales of the product shall form part of the employee cost if such payment was originally conceived as an incentive for higher production.

Any payment of bonus either as a Statutory Minimum or on a sharing of surplus / incentive shall form part of the employee cost. The bonus paid to employees shall be identified with each cost centre / department. For determining labour hour rate, bonus shall be estimated on the basis of past results and future forecast.

5.3 Remuneration payable to Managerial Personnel including Executive Directors on the Board and other officers of a corporate body under a statute will be considered as part of the Employee Cost of the year under reference whether the whole or part of the remuneration is computed as a percentage of profits.

Remuneration to officers, managers and executive director of a corporate body paid as a fixed amount or paid whole or part of the remuneration as percentage of profits will be treated as employee cost. Remuneration covers fixed salary, PF contribution, leave, superannuation and severance payment, and other benefits, besides commission, etc. Other benefits include free furnished residential accommodation or house rent allowance, leave travel concession, reimbursement of medical expenses for self and family, personal accident insurance, fully maintained company's car with driver, gardener, watchmen, electricity.

Remuneration paid to managerial personnel will be identified as production, administrative or selling overhead on the basis of services provided by them. However remuneration paid to non-executive directors will be treated as Administrative Overheads.

Salary paid to an owner in the case of sole proprietorships, and fixed salary paid to a working partner in the case of a partnership shall be treated as cost to be identified as production, administrative or selling overhead on the basis of services provided by them.

5.4 Separation costs related to voluntary retirement, retrenchment, termination etc. shall be amortized over the period benefitting from such costs.

These benefits are amortized over the period benefitting from such additional cost



resulting in reduction of current employee cost. Lump sum payment under the above scheme shall be amortized normally over 5 years and will form part of employee cost. The accounting for the unamortised is an issue, since there is no Costing Balance Sheet available for carrying forward the amount in the future periods. Memoranda account shall be maintained for the purpose.

5.5 Employee cost shall not include imputed costs.

In economics, 'imputed' indicates an ascribed or estimated value when there is no criteria of absolute monetary value for such purpose. In simple words, it is a cost which does not involve at any time any outright expenses or cash outlay. As such it does not appear in the financial books. In farming operations, the wages or salaries of owner are imputed. Imputed costs are similar to opportunity costs.

Imputed cost of an employee shall not form part of the employee cost as there is no cash payment and it is being used for the purpose of decision making.

5.6 Cost of Idle time is ascertained by the idle hours multiplied by the hourly rate applicable to the idle employee or a group of employees.

Idle time happens due to various causes for which an employee is not responsible but full payment may be required to be made. Idle time may arise due to:

Time lost between gate and place of work, break for tea, personal needs, time interval between one job and another, time for tool setting, adjustment of machine, and the like is treated as normal idle time. Normal idle time is built in the labour hour rate and forms part of the cost object. It is to be measured on the basis of the hourly rates of individual employee or at an average rate for closely associated group of employees or some statistical basis such as factor hours. Use of individual pay rates is the most accurate but requires more clerical effort.

In addition to above, there is loss of time due to breakdown of machinery, power failures, non-availability of material, lock out, atmosphere conditions, flood etc. It is abnormal idle time lost and is not part of the cost object. However, it shall be analysed cause wise as per Annexure III for corrective action, if any. Payment for such abnormal idle time is not included in costs and is charged to Costing Profit and Loss account.

5.7 Where Employee cost is accounted at standard cost, variances due to normal reasons related to Employee cost shall be treated as part of Employee cost. Variances due to abnormal reasons shall be treated as part of abnormal cost.

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. 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.

When standard costing system is in vogue, there can be employee cost variance, besides material cost and other variances relating to usage of resources during the



course of production. Variance is the difference between an actual amount and a target or planned amount. Variances may be due to normal or abnormal reasons. Variances due to normal reasons shall be treated as cost while the variances due to abnormal reasons are treated outside the cost of production. Direct employee cost standard consists of two phases:

- 1) Fixation of employee time (i.e. quantity); and
- 2) Setting of the employee wage rate standards for each product manufactured.

The standard time for each operation multiplied by the standard employee wage rate gives the standard employee cost for the operation. Employee time standards may be set up in any of three ways:

- a. Using past records of performance
- b. Time and motion study
- c. Taking trial runs.

Employee rate standard

The operations to be performed; the grades of employee required to perform the various operations and the rates of pay expected to be paid to the employee is taken into consideration for fixation of employee rate standards. In case of piece work system of payment, the setting of rate standard is simple because the piece rate fixed itself form the standard rate. In case of day work system, an hourly rate of pay is fixed for each grade of employee with reference to the standard employee rate.

Direct employee cost variance is the difference between standard direct employee cost specified for the activity achieved and the actual direct employee wages paid.

Examples of employee cost variance are at **Annexure IV**.

5.8 Any Subsidy, Grant, Incentive or any such payment received or receivable with respect to any Employee cost shall be reduced for ascertainment of cost of the cost object to which such amounts are related.

Subsidy, grant or incentives are provided for specific purpose. For example, generation of employment in specified areas, subsidy, grant or incentives are given by government to attract setting up units in those areas. Any subsidy, grant received / receivable relating to employee cost shall be reduced from the employee cost.

5.9 Any abnormal cost where it is material and quantifiable shall not form part of the Employee cost.

Abnormal cost arises due to major breakdown of equipment for considerable period, non-availability of raw materials, lack of business, faulty supervision, abnormal process loss, strike, or lock-outs, fire, flood, storm, or other similar causes. Payment made to employees for time lost due to fire and natural calamities are abnormal employee cost.

It not considered in the cost of production and charged to Costing profit & loss account. It is the cost that is not normally associated with a level of activity in existing circumstances. It is to be excluded if it is material and quantifiable. The materiality has



not been defined in the standard. It will depend upon situation to situation. The rationale of exclusion is that inclusion of such items in the cost will make the cost not comparable with a normal situation. It shall not form part of cost of the production as not to distort the cost due to abnormal reasons. It is dealt with in the costing profit and loss account.

5.10 Penalties, damages paid to statutory authorities or other third parties shall not form part of the Employee cost.

Penalties / damages are levied by statutory authorities or third parties for failure to comply or for late compliance with statutory / contractual requirements, such as non-payment of PF contribution in time, non-compliance with any labour legislation, and the like. Since penalties / damages are abnormal items of expense, it will not form part of the employee cost and will be an item of reconciliation with financial accounts.

5.11 The cost of free housing, free conveyance and any other similar benefits provided to an employee shall be determined at the total cost of all resources consumed in providing such benefits.

Free housing accommodation is provided to certain staff. Accommodation may be on lease or owned by the entity total expenses incurred for maintenance, repairs , depreciation, lease rent paid and any other related cost of housing is be assessed and form part of employee cost.

The above treatment is also applicable for free conveyance provided which may be leased or owned. For leased vehicle hire charges and for owned vehicles, related expenses such as petrol / diesel, maintenance and repair, depreciation of vehicles will form part of free conveyance provided to the employees.

5.12 Any recovery from the employee towards any benefit provided e.g. housing shall be reduced from the employee cost.

Amount recovered from employee towards housing, supply of electricity, water, or for any other subsidized benefits such as canteen facility and the like shall be adjusted against the relevant cost of the benefit. Net cost of benefits provided will form part of the employee cost.

5.13 Any change in the cost accounting principles applied for the determination of the cost should 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 enterprise.

Principles applied for determining the employee cost should be followed consistently. For example profit sharing bonus paid to employees was required to be separately disclosed in the cost audit Proforma, after “Total cost of Sales” under previous Cost Audit Report Rules 1996. This principle was being followed consistently but due to change in the principle with the notification of Cost Audit Report Rules, 2011 bonus is now part of the employee cost and no separate disclosure is required. Thus change in cost accounting principle / law for determining the cost can be made when required by any law as illustrated above or for compliance with cost accounting standards or it results in appropriate presentation of cost statement.

**Chapter 4****Assignment of Cost**

6.1 Where the Employee services are traceable to a cost object, such employees' cost shall be assigned to the cost object on the basis such as time consumed or number of employees engaged etc. or similar identifiable measure.

Documents commonly used for assignment of employee cost are the “**time card**” and the “**Employee job ticket**”.

A time card (clock card) is inserted in a time clock by the employee several times each day: upon arrival, going to lunch, taking a break, and when leaving for the day. By mechanically / biometrically keeping a record of total hours worked each day by employees, this procedure provides a reliable source for computing and recording total payroll costs by employee wise and cost centre wise.

Depending upon process of production, employee job tickets are prepared daily by employees for each job worked on. Employee job tickets indicate the number of hours worked, a description of the work performed, and the employee's wage rate (inserted by the payroll department). The sum of the employee cost and hours for different jobs (as shown on employee job tickets) should be equal to the total employee cost and employee hours for the period (as shown on time cards).

Time booked as Job tickets when multiplied by employee hour rate indicate the cost against jobs or production order or standing order Number as the case may be. (Standing order number is the sub-division of overhead cost for purpose of accounting and control). Valuation of the time tickets is done on the basis of the current hourly rates when a group or a number of employees work interchangeably on similar operations. In this method, an average hourly wage rate of all such workers or of the group is computed and hours in the time tickets are valued with this rate without reference to the hourly rate of the particular workers who actually perform the work.

Another method which is applicable where a worker runs several automatic machines is known as the Factor Hours Method. Each machine is known as a factor and the hours for which is referred to as factor hours. Under this method, a standard factor hour cost worked as under:

Worker's wage rate	Rs. 300 per day
Working hours per day	8
Machine or factors handled	3
Factor hours per day (3 x 8)	24
Standard cost rate per factor hour	$300/24 = \text{Rs. } 12.5$

In brief, for job costing, time records are arranged according to production, job order or standing order no. Thus Information from time tickets, time sheets and daily production records are used as a basis for distributing the payroll cost to products, processes or to indirect labour accounts.



In process industry, there is no job card system, as employees are identified with each process and their employee cost is assigned accordingly.

It is usual for employee cost, particularly direct employee cost, to be converted to hourly rates for ease of assignment to jobs or products. Such hourly rate may reflect only payroll costs i.e., only basic + dearness allowance + allowances or be comprehensive and include all benefits. The ultimate objective is to reflect the Cost to Company (CTC). Where the rate excludes some elements of employee cost, these will be treated as overheads and absorbed in cost.

Where direct workmen are expected to carry out maintenance on the machines attended by them, it is usual to log such time separately against maintenance work orders and treat the same as Repairs and Maintenance Cost.

6.2 While determining whether a particular Employee cost is chargeable to a separate cost object, the principle of materiality shall be adhered to.

CAS 7 provides that the principle of materiality shall be kept in view while assigning a particular cost to a separate cost object. Materiality and significance of a piece of information depends on nature, size of operation and the like. For example Employee Cost for generation of solar power is not significant in terms of product cost and forms part of overhead, but for subsidy requirement, it may be indicated separately.

6.3 Where the Employee costs are not directly traceable to the cost object, these may be assigned on suitable basis like estimates of time based on time study.

Some employees work in such a manner that it is not possible to identify them with any cost centre or department. Their employee cost is to be assigned on technical estimates, such as factor hours for machine operator attending to more than one machine/ work study and the like.

For example:

In bulk drug industry workers attend to different equipments in a sequence. Degree of attention devoted to different process equipment varies and is therefore not in constant ratio to equipment hours. For this purpose some weights are pre-determined for different equipment. Allocations of employee cost are made on the basis of equipment hours after adjustments are made with such predetermined weights.

Another example is of group benefits extended to employees such as Group Personal Accident Insurance, Group Medical Insurance Scheme etc. It is difficult to relate these costs to individual employees and therefore to cost centres or objects. These can only be allocated to cost centres or cost objects on the basis of no. of employees or employee cost of each cost centre or cost object.



6.4 The amortised separation costs related to voluntary retirement, retrenchment, and termination etc. for the period shall be treated as indirect cost and assigned to the cost objects in an appropriate manner. However unamortised amount related to discontinued operations, shall not be treated as cost.

Voluntary retirement, retrenchment and termination cost are to be incurred, resulting in reduction in labour force and consequential reduced current employee cost. However this separation cost benefit is to accrue in future. It is therefore desirable that such payments shall be pro-rated over the years to be benefited by such payment, amortize the separation cost over a period, say five years, to cost objects on suitable basis, such as, direct employee hours or direct employee cost. However, unamortized separation cost shall not be amortized over the remaining period, if the relevant production operation has been discontinued. For example in a textile mill Dyeing activity has been discontinued after one year of the voluntary retirement scheme. Thus portion of unamortized separation cost relating to Dye activity is to be charged to Costing Profit and Loss account and will not be amortized for the balance period.

6.5 Recruitment costs, training cost and other such costs shall be treated as overheads and dealt with accordingly.

For recruiting employee, various activities are to be carried out such as:

- (i) Pre-recruitment –
 - (a) job specification; and
 - (b) briefing personnel department setting up recruitment process search;
- (ii) Advertising
- (iii) Candidates evaluation
- (iv) Interviewing, including travel and substance
- (v) Placement agency cost
- (vi) Induction training /orientation programme etc.

Cost incurred in regard to above activities is to be treated as overhead and assigned to the cost object on appropriate basis, such as number of employee recruited department wise.

6.6 Overtime premium shall be assigned directly to the cost object or treated as overheads depending on the economic feasibility and the specific circumstance requiring such overtime.

Overtime premium is the time spent beyond the normal working hours which is usually paid at a higher rate than the normal time rate.

The overtime premium is to be assigned in one of the following ways:

- Where the overtime working is caused by a “rush order” of the customer or other special requirement of a job, the overtime premium is assigned to the job or product.
- In all other cases, it is usual to treat the overtime premium as overheads and absorb the same as part of overheads.



6.7 Idle time cost shall be assigned direct to the cost object or treated as overheads depending on the economic feasibility and the specific circumstances causing such idle time.

The Idle time is the difference between the time for which the employees are paid and the employees' time booked against the cost object.

Idle time for reasons such as lunchtime, holidays, personal needs etc. are built in the cost per hour of an employee and it is a part of the employee cost for an object.

Idle time cost (other than stated above) should be recorded as separate time on time ticket and standing code numbers established for this purpose.

Idle time is to be assigned to the cost object to the extent economically feasible. In other cases it may be treated as overhead.

**7.1 Direct employee costs shall be presented as a separate cost head in the cost statement.**

Direct employees are those who work on a product directly, either manually or by using machines. They are directly involved in the production of a finished product, that can be easily traced to the product. Examples are assembly-line workers in an automobile factory or employee working on spindle / loom in textile industry. Direct Employee cost is to be presented as a separate item in the cost statement.

7.2 Indirect employee costs shall be presented in cost statements as a part of overheads relating to respective functions e.g. manufacturing, administration, marketing etc.

Indirect employee cost is not directly traceable to a cost object / product and forms part of overheads. The word 'overheads' is used for a type of cost that cannot be directly allocated to a cost object or product, but can be assigned to cost objects.

Employees whose services are indirectly related to production include product designers, job supervisors, foreman, product inspectors, and the like. Employee cost of such employees is considered part of Production overheads. Salaries of employees working on administrative activities such as administration, personnel, accounts, and the like are classified as part of administrative overheads. Similarly, salaries of employees engaged in marketing / selling activities and distribution activities are part of Selling and Distribution Overheads.

7.3 The cost statement shall furnish the resources consumed on account of Employee cost, category wise such as wages salaries to permanent, temporary, part time and contract employees, piece rate payments, overtime payments, employee benefits (category wise) etc wherever such items form a material part of the total employee cost.

Direct employee cost is to be exhibited as a separate item in the cost statement as per CAS 7.

**Chapter 6****Disclosures**

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

8.1 The cost statements shall disclose the following:

1. ***Employees cost attributable to capital works or jobs in the nature of deferred revenue expenditure indicating the method followed in determining the cost of such capital work. The concept of deferred revenue expenditure will be obsolete as per new accounting standard.***
2. ***Separation costs payable to employees.***
3. ***Any abnormal cost excluded from employee cost.***
4. ***Penalties and damages paid etc excluded from Employee cost.***
5. ***Any Subsidy, Grant, Incentive and any such payment reduced from Employee cost.***
6. ***The Employee cost paid to related parties. Related Party should be defined in the guidance note for appropriate disclosure***
7. ***Employee cost incurred in foreign exchange.***

The above paragraph requires following disclosures to be made:

If an entity undertakes any capital works or job internally, the cost of such jobs is to be capitalized. It includes material consumed, employee cost and overhead. Employee cost attributable to such jobs is to be capitalized and will not form part of cost of production.

For example:

During the current year, modernization of assembly line was carried out departmentally amounting to Rs 50 lakhs, out of which Rs 2 lakhs is for employee cost.

Separation costs paid / payable during the period is to be disclosed indicating the basis adopted for charging off the cost. As detailed under paragraph 6.4, amortized separation cost is to be treated as indirect cost and will form part of the overhead cost. A disclosure shall be made about the amount amortised during the period and remaining unamortized amount indicating the period to be written off.

For example:

Under the Employee Separation Scheme of the Company, the net present value of the future liability for pension payable is amortized equally over five years. The increase in the net present value of the future liability for pension payable to employees who have opted for retirement under Employees Separation Scheme of the company is charged to the profit account. During the current year amount charged to Profit & Loss account is Rs 15 lakhs.



Employee Cost

Abnormal cost has been dealt with in paragraph. If there is abnormal cost relating to employee during period of cost statement, the same is to be disclosed.

For example:

Due to major breakdown in the plant, abnormal idle employee cost of Rs 4 lakhs has been excluded from the cost of production.

Disclosure of Penalties and damages paid etc excluded from employee cost is to be disclosed in the cost statement.

For example:

Penalty of Rs 50,000/- has been levied for delayed deposit of PF contribution with the concerned authority and the same has been excluded from the employee cost.

Any subsidy / grant / incentive and any such payment is to be reduced from the employee cost.

For example:

The State Government has given grant for training locally employed man power of Rs 3 lakhs. The same has been excluded from the employee cost.

Disclosure is to be made for employee cost paid to related parties. The related parties have been defined under various Acts viz. Companies Act, 1956, Central Excise Act 1944, Income Tax Act 1961. If any employee cost is paid to related parties, its relationship, nature of transaction viz. amount and other terms / conditions relating to employee cost are to be disclosed. The objective of disclosure is to ascertain that the transaction is at arm's length and on purely commercial terms.

For example:

A is holding company of B Company. Employees of B Company attended training programme conducted by A Company. Share of training cost paid to A is Rs 1 lakh.

Employee cost incurred in foreign exchange: Any paid in foreign exchange relating to employee cost is to be disclosed in foreign currency.

For example:

A sum of US\$ 500000/- has been paid as salary to staff posted in USA branch.

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

The cost accounting principles and methods applied for the measurement and assignment of employee cost is to be followed consistently from one period to subsequent period and applied uniformly for different products and divisions. If there is any change in the cost accounting principles and methods during the period resulting



in material effect on the cost, the same shall be disclosed indicating its impact in the cost statement.

For example:

Indirect employee cost was being assigned on the basis of direct labour hours to the products. During the year, the indirect employee cost has been identified by activity wise and assigned to the product on the basis of relevant activity drivers. Material handling employee cost has been assigned on the basis of material handled for each product.

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

Standard provides that disclosure shall be made only where it is material significant and quantifiable. The materiality and significance of a piece of information depends on nature, size and complexity of operation. An item of employee cost of a product may have significance considering the nature of the product. For example, an employee working on critical operation at special machine is to be indicated in the cost statement as per contract agreement, it is to be disclosed to ensure compliance with the terms of contract.

In the context of cost statement, Materiality is to be judged in terms of quantity and nature of employee cost and in particular context of its omission. A piece of information is material, if its non-disclosure could influence the decision of the user.

For example:

Prior period employee cost amounting to Rs 1.56 lakh has been excluded.

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

Disclosures may be made in the body of the cost statement or as a foot note. If there are many items of disclosures, the same may be in schedule of Notes to the cost statement.

Example of Employee cost resource wise	Rs / Lakhs
Direct employee cost (Time basis)	125
Piece Rate Wages	12



Illustration of Pay Slip

Personnel	Attendance	Monthly rate	Earning	Deductions
Department Code	Total working days	Basic	Basic	Provident Fund
Employee Number	No. of days present	Dearness allowance	Dearness allowance	E.S.I.
Employee Name	Weekly off	House rent allowance	House rent allowance	L.I.C.
Father's Name	Holidays	Transport allowance	Transport allowance	Income tax
Grade	Casual Leave	Wash allowance	Wash allowance	House rent
Bank Account Number	Earned leave / PL	Medical allowance	Medical allowance	Provident Fund Loan
PF Number	Medical Leave	Special Site allowance	Special Site allowance	Others
FPS Number	Special leave	Education allowance	Education allowance	Total Deductions
ESI Number	Absent			
Date of birth	Late deduction	Gross earning	Gross earning	
Date of joining	Pay days			

Reasons for variance are:



XYZ COMPANY																					
STATEMENT SHOWING EMPLOYEE EARNINGS																					
PERIOD FROM 01/04/2009 TO 30/04/2009																					
DEPT T.	HAN D	BASI C	DA	PL BAS IC	PL D A	S.S. ALLO W	CONV	HRA	S PL A LL	WA SH. ALL	OTH ER	CASH CMP.	INCE NTIVE	GWR	SHIFT -ALL	DUT Y_A LL.	MED ALL.	SPL _PA Y	SPL _HR A	R. OFF	GROSS EARNIN G
2101	12	63600	38600	0	0	3500	10300	9500	0	500	0	3500	7400	9300	1400	0	1550	0	0	24	149174
2111	15	66000	41000	0	0	3800	11000	10000	0	520	0	7100	7600	15000	1800	0	1400	0	0	30	165250
2125	12	64200	38000	0	0	3500	11000	9700	0	500	0	4850	7150	18200	1600	0	1700	0	0	30	160430
2155	31	16052 0	98250	0	0	8900	26500	24400	0	1250	0	18700	14500	30300	4000	0	4200	0	0	90	391610
2260	28	14940 0	88600	0	0	8050	23700	22800	0	1100	500	13500	13700	32500	3650	0	4200	0	0	60	361760
6505	20	10720 0	63900	0	0	5800	17900	16200	0	800	0	11200	12500	49700	2500	0	2500	0	0	50	290250
TOTAL	118	61092 0	368350	0	0	33550	100400	92600	0	4670	500	58850	62850	155000	14950	0	15550	0	0	284	1518474
GROSS EARNING OF THE EMPLOYEES COST CENTER WISE ARE IN THE ABOVE STATEMENT.																					
SIMILAR STATEMENT OF DEDUCTIONS FROM EMPLOYEE COST CENTRE WISE IS ALSO PREPARED.																					



Analysis of Idle time

Department	Idle time due to								
	Total	Productive		Maintenance		No material		Transport	
	DLH	DLH	%	DLH	%	DLH	%	DLH	%
A	1000	800	80	150	15			50	5
B	1900	1710	90			85	4.5	105	5.5
C	850	765	90	45	5			40	4.7
D	300	255	85	15	5	15	5	15	5
DLH = Direct labour hour									
Maintenance = waiting for maintenance									
No Material = waiting for material									
Transport = Waiting for transport									



Annexure IV

Examples of employee cost variance (rate, efficiency and mix): Standard and actual employee cost for a period is as under:-

	Standard Cost			Actual Cost		
Item	hours	Rate per hr	Total	Hours	Rate per hr	Total
Hours produced	2000	40	80000	2800	28.00	78400
Direct employee cost	(Actual hrs x actual rate) – (standard hrs x standard rate)					
Variance						
Variances calculation:						
Direct Employee cost variance: (Actual hrs x actual rate) – (standard hrs x standard rate) = (2800x 28) –(2000x 40)				Rs. 1600	Favourable	
Employee Rate Variance: Actual hours (Standard rate –Actual rate) 2800 x (40 -28)				Rs. 33600	Favourable	
Employee Efficiency Variance Standard rate x(Standard hours – Actual hours) 40 x (2000 – 2800)				Rs. 32000	Adverse	
Total employee Variance: (Employee Rate variance – Efficiency Variance) (Rs. 33600 Favourable – Rs. 32000 Adverse)				Rs. 1600	Favourable	
Employee Mix Variance: The variance arises due to change in the composition of labour force.						
Standard Gang 2 men @ Rs. 20 per hour 5 men @ Rs. 16 per hour 1 men @ Rs. 25 per hour				Actual Gang worked 4 men @ Rs. 20 per hour 2 men @ Rs. 16 per hour 2 men @ Rs. 25 per hour		
Standard cost per hour = (2xRs20+5xRs 16+ 1x Rs25) = Rs. 145 per hour				Actual cost per hour = (4 x Rs 20 + 2 x Rs 16 +2 x Rs 25)= Rs. 162 per hr		
Hours worked 48 hrs Standard employee cost 48 X Rs 145 = Rs. 6960				Hours worked 48 hrs Actual employee cost 48 x Rs162 = Rs. 7776		
Mix variance = Standard mix cost – actual mix cost Rs. 6960 – Rs. 7776 = Rs. 816 Adverse Variance						

Employee (wage) rate variance:

This is the portion of the wage variance which is due to the difference between the actual wage rate paid and the standard rate of pay specified.

Reasons for wage rate variances are:

- Change in basic wage structure or change in piece rate
- Engagement of workers of grades and rates of pay different from those specified due to shortage of labour of the proper category



Employee Cost

- c) Payment of guaranteed wages to works that are unable to earn their normal wages, if such guaranteed wages form part of direct labour cost.
- d) Overtime and night shift work in excess of or less than the standard
- e) Composition of a gang as regards the skill and rates of wages being different from that laid down in the standard.

Wage rate variance are uncontrollable except for the portion which arises due to deployment of wrong grade of employee or overtime work and such other controllable factors for which the departmental executive may be held responsible.

Employee Efficiency variance: It is the portion of the direct wages variances which is due to the difference between the standard employee hours specified and the actual employee hours expended. The employee efficiency variance is the result of taking more or less time than the standard for the performance of an operation or process

Reasons for variance are:

- a) Lack of proper supervision
- b) Poor working conditions
- c) Delays due to waiting for materials, tools, instructions etc if not treated as idle time.
- d) Defective machines, tools and other equipment
- e) Work on new machines requiring less time than provided.
- f) Basic inefficiency of works due to low morale, insufficient training, faulty instructions etc.
- g) Use of non-standard material requiring more or less operation time.

Variances are to be analyzed. Normal variances will form part of the employee cost and abnormal variance will not form part of the employee cost.

For example: Abnormal employee cost variance may be due to slow down tactics or waiting for material or breakdown of machinery.



CAS-8

COST ACCOUNTING STANDARD ON COST OF UTILITIES

The following is the COST ACCOUNTING STANDARD - 8 (CAS-8) issued by the Council of The Institute of Cost and Works Accountants of India on “**COST OF UTILITIES**”, for comments. 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 the principles and methods of determining the cost of utilities.*

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

3. Scope

3.1 *This standard shall be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of cost of utilities including those requiring attestation.*

3.2 *For determining the cost of production to arrive at an assessable value of excisable utilities used for captive consumption, Cost Accounting Standard 4 on Cost of Production for Captive Consumption (CAS 4) shall apply.*

3.3 This standard shall not be applicable to the organizations primarily engaged in generation and sale of utilities.

3.4 *This standard does not cover issues related to the ascertainment and treatment of carbon credits, which shall be dealt with in a separate standard.*

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.¹*

¹Adapted from CAS 1 paragraph 6.5.19



- 4.2 Committed Cost:** *The cost of maintaining stand-by utilities shall be the committed cost.*
- 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.²*
- 4.4 Finance Costs:** *Costs incurred by an enterprise in connection with the borrowing of funds.* This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs³. The terms Finance costs and Borrowing costs are used interchangeably.
- 4.5 Imputed Costs:** *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.⁴*
- 4.6 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.⁵*
- In case of any standby utility the normal capacity will be the same as actual production of the utility.
- The normal capacity of a utility meant for captive consumption would be based on the normal capacity for the production facility of the end product of the consuming unit.
- 4.7 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 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. Standard costs are also used for estimation.
- 4.8 Utilities:** *Significant inputs such as power, steam, water, compressed air and the like which are used for manufacturing process but do not form part of the final product.*

²Adapted from CIMA Terminology

³Adapted from CIMA Terminology

⁴Adapted from CAS 1 paragraph 6.5.13

⁵Adapted from CAS 2 paragraph 4.4



- 4.9 Stand-by utilities: Any utility created to safeguard against the failure of the main source of inputs.**
- 5. Principles of measurement**
- 5.1 Each type of utility shall be treated as a distinct cost object.**
- 5.2 Cost of utilities purchased shall be measured at cost of purchase including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified with reasonable accuracy at the time of acquisition.**
- 5.3.1 Cost of self generated utilities for own consumption shall comprise direct material cost, direct employee cost, direct expenses and factory overheads.**
- 5.3.2 In case of Utilities generated for the purpose of inter unit transfers, the distribution cost incurred for such transfers shall be added to the cost of utilities determined as per paragraph 5.3.1.**
- 5.3.3 Cost of Utilities generated for the inter company transfers shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost and share of administrative overheads.**
- 5.3.4 Cost of Utilities generated for the sale to outside parties shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost, share of administrative overheads and marketing overheads.**
- The sale value of such utilities will also include the margin.
- 5.4 Finance costs incurred in connection with the utilities shall not form part of cost of utilities.**
- 5.5 The cost of utilities shall include the cost of distribution of such utilities.**
- The cost of distribution will consist of the cost of delivery of utilities up to the point of consumption.
- 5.6 Cost of utilities shall not include imputed costs.**
- 5.7 Where cost of utilities is accounted at standard cost, the price variances related to utilities shall be treated as part of cost of utilities and the portion of usage variances due to normal reasons shall be treated as part of cost of utilities. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.**
- 5.8 Any Subsidy/Grant/Incentive or any such payment received/receivable with respect to any cost of utilities shall be reduced for ascertainment of the cost to which such amounts are related.**



- 5.9** *The cost of production and distribution of utilities shall be determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, shall be treated as abnormal cost⁶. Cost of a Stand-by Utility shall include the committed costs of maintaining such a utility.*
- 5.10** *Any abnormal cost where it is material and quantifiable shall not form part of the cost of utilities.*
- 5.11** *Penalties, damages paid to statutory authorities or other third parties shall not form part of the cost of utilities.*
- 5.12** *Credits/recoveries relating to the utilities including cost of utilities provided to outside parties, material and quantifiable, shall be deducted from the total cost of utility to arrive at the net cost of utility.*
- 5.13** *Any change in the cost accounting principles applied for the measurement of the cost of utilities should 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 organisation.*
- 6. Assignment of costs**
- 6.1** *While assigning cost of utilities, traceability to a cost object in an economically feasible manner shall be the guiding principle.*
- 6.2** *Where the cost of utilities is not directly traceable to cost object, it shall be assigned on the most appropriate basis.*
- 6.3** *The most appropriate basis of distribution of cost of a utility to the departments consuming services is to be derived from usage parameters.*
- 7. Presentation**
- 7.1** *Utilities costs shall be presented as a separate cost head for each type of utility in the cost statement, if material.*
- 7.2** *Where separate cost statements are prepared for utilities, cost of utilities shall be classified as purchased or generated. Such statement shall also include cost of utilities consumed along with quantitative information by individual consuming units, inter unit transfers, inter company transfers and sale to outside parties wherever applicable.*
- 8. Disclosures**
- 8.1** *The cost statements shall disclose the following:*
- 1.** *The basis of distribution of Cost of Utility to the consuming centres.*
 - 2.** *The cost of purchase, production, distribution, marketing and price with reference to sales to outside parties.*

⁶Adapted from paragraph 5.7 of CAS 3



3. *Where cost of utilities is disclosed at standard cost, the price and usage variances.*
 4. *The cost and price of Utility received from/supplied to related parties⁷.*
 5. *The cost and price of Utility received from/supplied as inter unit transfers and inter company transfers*
 6. *Cost of utilities incurred in foreign exchange.*
 7. *Any Subsidy/Grant/Incentive and any such payment reduced from Cost of utilities.*
 8. *Credits/recoveries relating to the Cost of utilities.*
 9. *Any abnormal cost excluded from Cost of utilities.*
 10. *Penalties and damages paid etc excluded from cost of utilities.*
- 8.2 *Any change in the cost accounting principles and methods applied for the measurement and assignment of the Cost of utilities during the period covered by the cost statement which has a material effect on the Cost of utilities. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*
- 8.3 *Disclosures shall be made only where material, significant and quantifiable.*
- 8.4 *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*

⁷ Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement



GUIDANCE NOTE ON COST ACCOUNTING STANDARD ON COST OF UTILITIES (CAS-8)

The Council of the Institute of Cost Accountants of India has issued Cost Accounting Standard 8 (CAS-8) on Cost of Utilities which lays down a set of principles and methods of classification, measurement and assignment of Cost of Utilities for determination of the cost of product and presentation and disclosure of such costs in the cost statement. The Guidance Note deals with practical aspects in connection with the determination of Cost of Utilities of a product. In this Guidance Note the Cost Accounting Standards have been set in bold italic type and reference number of the standard has been retained”.

Further The Companies (Cost Accounting Records) Rules, 2011 provides that every company, including a foreign company defined under section 591 of the Companies Act, 1956 which is engaged in production, processing, manufacturing, or mining activities has to maintain cost accounting records in accordance with the generally accepted cost accounting principles and cost accounting standards issued by the ICAI, to the extent these are found to be relevant and applicable. The above Rules further provides that these will be applicable to companies wherein:

- (a) aggregate value of net worth as on the last date of the immediately preceding financial year exceeds five crores of rupees; or
- (b) the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds twenty crores of rupees; or
- (c) the company's equity or debt securities are listed or are in the process of listing on any stock exchange whether in India or outside India.

**Chapter 1****Introduction**

Production processes need several inputs other than raw material in the form of water, steam, electricity, and the like. These inputs are known as utilities. Utilities are classified according to the nature of utility, such as power, steam, water, compressed air and so on.

A distinction is to be made whether an input is a utility or production input. For example in case of manufacture of Caustic Soda, electricity is a principal input for electrolysis of brine. If there are multiple connections/source of supply of electricity and in production of Caustic soda one of the source is directly connected, it is to be treated as production input and not as utility. For other connection where utility power is distributed to one or more end users, it is to be treated as utility.

For example, one of the manufacturing processes requires heating. The heat can be generated and applied with help of steam or a stand alone thermic fluid heater attached to the process equipment. In such a case, if heat is applied to a given process with the help of stand-alone thermic fluid heater which is a part of process equipment and there is only single end user - this should be treated as a part of a process and not as a utility cost.

When different activities are required to be carried out on given input(s) to make it distributable and usable by one or more consuming sections, it should be recognized as a distinct utility.

Sub-set of a particular Utility:

A given utility may have more than one distinct utilities. For example supplier of electricity may be providing electricity at 11 KVA and thereafter it is converted to 460 V and given to different users. One of such user may employ step down process and bring the voltage level to 230 V. Depending upon the relevancy, the electricity in this case may be treated as two distinct utilities viz. 460 V (High Voltage) and 230 V (Low voltage) electricity. If there is variation in supply rate.

Sub-set of utility is also applicable for generating of steam. If steam is raised in a boiler at 48 Kg/cm² at 1800oC temperature with 0% humidity (Superheated steam) given to certain process and in other boiler steam is raised at 18 Kg/cm² with 2% moisture at 1000oC (saturated steam) which is given to different processes or to the same process and at different point of time, two different utilities shall be considered for steam viz High Pressure steam (48 Kg/cm²) and Low Pressure steam (18 Kg/cm²).

The above two examples highlight the importance of selection of appropriate sub sets of a given utility considering the special feature of a sub-set.

Sometimes an entity may have centralised utility or utility at department level. For example a manufacturing process may need some form of compressed air, whether for running a simple air tool or for more complicated tasks such as the operation of pneumatic control. Compressed Air Utility may be centralized services or it may be that



individual air compression units are provided for each department depending upon the requirement. In case individual air compression units are provided it may be possible to merge the cost of operating the air compressor with the respective departmental expenses. But where centralized air compression and supply is made, a separate air compressed utility is to be accounted.

Classification of utility:

“Various types of utilities are used in manufacturing process as indicated in **Annexure-1**. These are classified according to the nature of utility, such as power, steam water, compressed air and the like”.

Examples of cost measurement are:

- Use of historical cost;
- Use of actual or standard cost;
- Designation of items of cost which must be included or excluded from the utility cost.

Unit of Measurement of Utility:

Each utility has a different measurement unit considering its nature and cost is expressed in per unit of the related utility. Details of measurement of unit of different utility is given below:

Utility	Measure	Unit	Category
Power	Units per hr	KWH or MWH	H.T 440V L.T220V
Steam-Super Low Heat Steam Super Hear Steam	Kg per tonne	KG/ Cm2 at — oC	Kg/sq.cm
Water- Chilled water Treated water Demineralised	Volume	Ltrs/K.Ltrs	
Heating	Thermal Unit	K cal or BTU	Output Temp 300 to 400 Deg C
Air- Compressed air	Pressure Volume	M ³	Kg/sq.cm

Assignment is tracing the cost of utility to a product or service and dealt in Chapter 4. The principles and methods adopted should be applied consistently from one period to another and for reasonable uniformity between different products/units. For example inputs of utility such as coal, furnace oil, etc are valued on the basis of FIFO (First-in-First out) method, the same should be followed consistently from one period to another and for different type of utility for valuing the inputs.



Guidance Note - 8

CAS-8 is applicable to the organization which is producing utilities for use in their manufacturing process. It is not applicable to the organizations which are primarily engaged in generation and sale of utilities. For example it is not applicable to organizations producing utilities, such as, NTPC, TATA power, NHPC etc.

As per Para 3.4 of CAS -8, the issues related to ascertainment and treatment of carbon credit are not covered under this standard.



Chapter 2

Definitions

The following terms are used in this guidance note with the meaning specified:

Abnormal cost: An unusual or a typical cost whose occurrence is usually irregular and unexpected and/ or due to some abnormal situation of the production or operation.

Committed Cost: The cost of maintaining stand-by utilities shall be the committed cost.

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.

Finance Costs: Costs incurred by an enterprise in connection with the borrowing of funds.

Imputed Costs: Hypothetical or notional costs, not involving cash outlay, computed for any purpose.

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.

Standard Cost: A predetermined cost of resource inputs for the cost object computed with reference to set of technical specifications and efficient operating conditions.

Utilities: Significant inputs such as power, steam, water, compressed air and the like which are used for manufacturing process but do not form part of the final product.

Stand-by utilities: Any utility created to safeguard against the failure of the main source of inputs.

**Chapter 3****Principles of measurement****5.1 Each type of utility shall be treated as a distinct cost object.**

As each utility is a distinct cost object, cost of each utility is to be collected and measured separately. For example power, steam, water, compressed air, oxygen, nitrogen, coke oven gas and the like are distinct utilities, and the cost is collected and measured for each utility separately. The costs are booked to each utility through initial documents such as supplier's bill, if directly identifiable with utility, payroll analysis sheet, stores requisition, etc. A separate cost statement is to be prepared for each utility.

5.2 Cost of utilities purchased shall be measured at cost of purchase including duties and taxes, transportation cost, insurance and other expenditure directly attributable to procurement (net of trade discounts, rebates, taxes and duties refundable or to be credited) that can be quantified with reasonable accuracy at the time of acquisition.

There can be a mix source of supply for a given utility. For example, the entity may purchase electricity from electricity supplier and may also be receiving from its own stand-by facilities for generation of electricity.

For purchased power it will include all cost of purchase, maximum demand charges (which is payable irrespective of the actual power consumption), Load factor, local duties and other expenditure attributable to procurement. Credit is to be given for any discount, rebate, taxes and duties refundable.

The above treatment is also applicable to any other utility purchased, such as purchase of steam, coke oven gas from other unit, raw water from municipal sources and so on.

Cost of utility consists of direct employee cost, fuel, direct expenses, chemicals, stores and spares, repairs & maintenance, depreciation and inter utility transfer cost.

5.3.1 Cost of self generated utilities for own consumption shall comprise direct material cost, direct employee cost, direct expenses and factory overheads.

The cost of generating a utility may comprise water, fuel, power, direct expenses (such as boiler inspection fee) consumable stores, direct employee cost, repair and maintenance, depreciation, inter-utility transfer and factory overhead.

For example:

Cost of power generation will include cost of fuel such as furnace oil, coal, salaries and wages, consumable stores, repair and maintenance, depreciation and factory overhead.

Unit cost is arrived at on the basis of the net aggregate consumption in different departments after adjusting transmission losses. In case of cogeneration (power and steam) where waste heat from TG (Turbine Generation) is recovered in waste heat recovery unit and used for production of steam, due credit should be given to the Power plant and corresponding charge to SGP (Steam Generation Plant).



Charging of power to the consuming cost object is generally done at the weighted average of the cost of power purchased, generated and distribution cost at the consuming point.

Steam: A separate statement of cost of steam is prepared indicating the quantity of steam generated, cost of fuel, soft water, power, employee cost for operating staff, sundry supplies, chemical additives, depreciation and other works overhead. Unit cost of steam is arrived at on the basis of units consumed in different departments after adjusting distribution loss.

Steam may be of high pressure, low pressure and medium pressure with multiple paths by which the steam pressure is reduced according to the purpose of use. Steam costs are highly dependent on the path that steam follows in the generation and distribution system.

Raw water: Raw water is either purchased or obtained from ground wells/canal. The cost of water mainly consists of share of cost of power allocated through inter-utility transfer. The total cost of water should include employee cost, fuel, power, repair and maintenance of tube wells, depreciation, overhead. The total monthly cost of operating this department is divided by the quantity of K Ltr of water pumped during the month to determine the unit cost of water pumped.

Cost of Soft Water: Water, if hard, requires treatment. The cost of soft water will include the cost of raw water, chemicals, cost of maintenance of settling tanks, employees cost, depreciation and the like.

The cost of demineralised water is also arrived at on the above basis.

Inter Utility transfer

There is inter-utility transfer cost for a utility. For example water utility may be used in generation of steam and power. Power may be required for pumping water from tubewell. Inter-utility cost is to be determined by the following method:

- a) repeated distribution method;
 - b) matrix algebra through computer application
- (a) When Repeated Distribution Method is adopted, the utility costs are repeatedly allocated in the specified percentage until the figures become too small to be significant. Steps to be followed under this method are:
- I. The proportion at which the cost of a utility is to be distributed to production cost centres and other utilities centre is determined based on usage.
 - II. Cost of first utility is to be apportioned to production cost centres and other utilities in the proportion as determined in step (a) above.
 - III. Similarly cost of other utilities is to be apportioned.



IV. This process as stated above is to be continued till the figures remaining undistributed in the utility are too small to be significant. The small amount left with utilities may be distributed to the production cost centres.

- b) Matrix algebra through computer application: Spread sheet software such as Excel provides facility for inter-division cost ascertainment and reapportionment of inter utility. This application may be used for determining inter-utility transfer cost.

Quantitative records of production and distribution should be recorded for each utility to measure the unit cost of a utility.

An illustration of steam cost is at Annexure 2.

5.3.2 In case of Utilities generated for the purpose of inter unit transfers, the distribution cost incurred for such transfers shall be added to the cost of utilities determined as per paragraph 5.3.1.

If utilities generated are transferred to inter units of an entity, the cost of distribution of such utilities will be included in the cost of utility as determined under para 5.3.1. It will comprise cost of generating utility and cost of distribution facility. Distribution may be through a pipe line/transmission line. The cost of maintenance of pipe line/ Transmission line for transfer of utility will be added to the cost of utility.

5.3.3 Cost of Utilities generated for the inter company transfers shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost and share of administrative overheads.

In case of inter company transfer, cost of utility so transferred should comprise as para 5.3.2 viz. direct material (fuel and the like), direct labour, direct expenses, chemicals, share of factory overheads, distribution cost and share of administrative overhead. Cost of a utility determined as above plus share of administrative overhead is to be charged for inter company transfer. Transmission loss should be treated as per agreement between the parties.

5.3.4 Cost of Utilities generated for the sale to outside parties shall comprise direct material cost, direct employee cost, direct expenses, factory overheads, distribution cost, share of administrative overheads and marketing overheads.

The sale price of utilities sold to outside parties should include cost of utilities as computed under para 5.3.3. plus marketing overhead and margin, as illustrated in Annexure 3.

5.4 Finance costs incurred in connection with the utilities shall not form part of cost of utilities.

Finance Costs are incurred by an enterprise in connection with the borrowing of funds. While determining the cost of utility as para 5.3.1 to 5.3.4. above, finance cost i.e. interest related cost will not be considered as an item of cost.

5.5 The cost of utilities shall include the cost of distribution of such utilities. The cost of distribution will consist of the cost of delivery of utilities up to the point of consumption.



The utility is supplied to the user from the place of generating the utility. The cost incurred from the place of generating to the end users (i.e. setting of pipe line and the like) will form part of the cost of utility supplied. It will include the cost of transportation through pipe/ transmission line, stepping up/stepping down of power voltage, maintenance of distribution channels, etc.

5.6 Cost of utilities shall not include imputed costs.

Imputed cost does not involve any cash payment. It should not be included in the cost of utility.

5.7 Where cost of utilities is accounted at standard cost, the price variances related to utilities shall be treated as part of cost of utilities and the portion of usage variances due to normal reasons shall be treated as part of cost of utilities. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.

The cost of utility may be accounted on standard cost method. The standards are fixed for various inputs, such as material, fuel, direct employee cost, budgeted overhead expenses. Under this method, price of inputs of material fuel and the like is predetermined for a stated period taking into account all the factors affecting price such as anticipated market trends, transportation charges and normal quantity of purchase. Standard prices are determined for each input and material requisitions are valued at standard price irrespective of the actual purchase price. Any difference between the standard and actual prices of purchase results in input/ material price variance. The material price variance is to be treated as part of input/material cost. There may be also input/material usage variance (the difference between the quantity required as per standard and actual consumption). Normal variance will form part of the cost of input. Abnormal usage variance will not form part of the utility cost. There can be other variances relating to employee cost, overhead between actual and budgeted and the like. Variances due to normal reasons should be treated as cost while the variances due to abnormal reasons should not form part of the cost of production.

For other expenses and overhead, expenses budgeted and actual are compared at different level of activity.

5.8 Any Subsidy/Grant/Incentive or any such payment received/receivable with respect to any cost of utilities shall be reduced for ascertainment of the cost to which such amounts are related.

Subsidy, grant or incentives are provided for specific purpose. For example, generation of non-conventional energy. Any subsidy, grant received/receivable should be reduced from the utility cost.

5.9 The cost of production and distribution of utilities shall be determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, shall be treated as abnormal cost. Cost of a Stand-by Utility shall include the committed costs of maintaining such a utility.



Where utilities are created exclusively for captive consumption, utility plants are operated based on the production plan of end product. Normal capacity of end product is considered to be normal capacity for the utility.

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. There may be a situation when end product itself may be operated at below normal capacity in adverse market conditions and recession. In such a situation the normal capacity adopted for end product should be treated as normal capacity for the utility. The cost of production and distribution of utilities should be determined based on the normal capacity. The unabsorbed cost is to be treated as abnormal cost.

The committed cost of maintaining a stand-by utility should be included in the cost of stand by utility. All related cost of the standby utility is to be absorbed irrespective of its level of utilization.

There may be a different situation where a utility is purchased and generated also. For example in case of electricity, there is one subset called purchased electricity and another is a electricity generation through DG set.

Where utilities have capacity to cater to plant requirement and for sale to other parties, the cost of production and utilities is to be determined based on the normal capacity of the utility plant. If it is operating below normal capacity utilization, unabsorbed cost is to be treated as abnormal cost.

5.10 Any abnormal cost where it is material and quantifiable shall not form part of the cost of utilities.

Abnormal cost may arise for example due to plant break down, flood fire and the like. Such cost will not form, part of the utility cost. Another example of abnormal cost is due to low capacity utilization.

5.11 Penalties, damages paid to statutory authorities or other third parties shall not form part of the cost of utilities.

Penalties /damages are levied for non compliance of regulatory requirements. For example not complying with boiler inspection, not safeguarding hazardous utility. Penalty so levied should not form part of the cost of utilities.

5.12 Credits/recoveries relating to the utilities including cost of utilities provided to outside parties, material and quantifiable, shall be deducted from the total cost of utility to arrive at the net cost of utility.

The total cost of a utility is to be adjusted for the cost of utility supplied to outside parties if the its cost is material and quantifiable. Credit should also be given for the recovery made for the utility consumed by other units such as township and the like. The net cost arrived at, be then charged to the different units benefitted by the use of a utility.



Example:

- (1) Where a unit has a township/colony, electricity and water charges recovered for its use may be credited to the cost of these utilities and net cost distributed to production centres.
- (2) If utility is sold by Unit A to outside parties, credit is to be given to the cost of utility at price of utility sold to outside parties (i.e. cost of utility including distribution +administrative Overhead+ Marketing Overhead and Margin)

5.13 Any change in the cost accounting principles applied for the measurement of the cost of utilities 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 organisation.

Cost accounting principle applied for measurement of the cost of utilities should be followed consistently and uniformly among different utilities and period. Change in cost accounting principle should be made only if required by law or for compliance with requirement of law. If various inputs are valued on FIFO basis, it should be followed consistently.

**Chapter 4****Assignment of costs****6.1 While assigning cost of utilities, traceability to a cost object in an economically feasible manner shall be the guiding principle.**

The cost of utilities is to be assigned to the end user/ cost objects on the basis of traceability to a cost object. Cost Object as defined under paragraph 4.3 includes a product, service, cost centre, activity, sub-activity, project, contract, customer or distribution channel or any other unit in relation to which utility costs are to be ascertained. The meter installed for recording consumption of utility is the right source of traceability of cost of utility for a cost object. If no meters are provided, the cost of utilities is to be assigned on the basis of rated capacity, wattage, horse power of machines, area volume or on technical assessment. The basis adopted for assigning cost of utility should be economically feasible. Economic feasible means cost effectiveness in the sense that cost accounting is not too expensive in relation to expected benefits. Basis of assignment varies with each utility as detailed below:

Power: The power consumed by each cost object /activity/sub-activity is to be assigned on the basis of meter reading. Current period reading minus previous period reading indicates the units consumed by the cost object and multiplying with utility rate, total cost of the utility is assigned.

If no meters are provided, the cost is assigned on the basis of, kw or horse power of machines, as discussed earlier. This practice applies for other utilities

6.2 Where the cost of utilities is not directly traceable to cost object, it shall be assigned on the most appropriate basis.

The cost of utilities is to be assigned on the basis of meter reading which is more reliable. In case meters have not been installed, it should be assessed on technical estimate based on equipment rating, area, volume, and the like.

For example:

For Product A, in the absence of meter, utility required may be assigned based on product requirement as per technical estimate.

6.3 The most appropriate basis of distribution of cost of a utility to the departments consuming services is to be derived from usage parameters.

In the absence of meter, utility is to be distributed to the consuming departments based on usage parameters such as stated in the project report, technical estimates taking into account the equipment rating capacity, space, volume and the like. The project report of the plant lays down various usage requirement of utility, and the same should also be taken into account while assigning the utility consumption.

**Chapter 5****Presentation****7.1 Utilities costs shall be presented as a separate cost head for each type of utility in the cost statement, if material.**

The cost statement should indicate the details of each utility separately, if material, as detailed below:

Cost statement of A Product

Particulars	Unit	Qty	Rate/Per unit	Amount(Rs)
Material consumed	Xx	Xx		Xx
UtilitiesWater	KL	62500	1.50	93750
Dm Water	KL	3560	3.00	10680
Power	Kwh	615780	4.00	2463120
Steam	MT	2560	780.00	1996800

In the context of cost statement, Materiality is to be judged in terms of nature, quantity and cost of utility. A piece of information is material, if its omission/non-disclosure could influence the decision of the user. If a utility is not material, it may be shown under production overhead.

For utilities (such as steam, hot water, thermic fluid) produced with heat recovery system, separate cost statement shall be prepared giving details of cost elements.

7.2 Where separate cost statements are prepared for utilities, cost of utilities shall be classified as purchased or generated. Such statement shall also include cost of utilities consumed along with quantitative information by individual consuming units, inter unit transfers, inter company transfers and sale to outside parties wherever applicable.

If a utility is purchased and generated, purchase value of the units purchased and cost of units generated is to be indicated in the cost statement separately. Weighted average rate is to be used for assigning the cost of utility to the user departments. The cost statement should also furnish distribution of utility to users departments, inter unit transfers, inter company transfers and sale to outside parties. The information is to be furnished both in quantity and value. Cost of utility is to be assigned as provided under para 6 above.

**Chapter 6****Disclosures****8.1 The cost statements shall disclose the following:****8.1.1 The basis of distribution of Cost of Utility to the consuming centres.**

The basis of distribution of cost of utility to the consuming centre adopted is to be disclosed in the cost statement. Normally it will be based on meter readings of period/ technical estimates, area, etc as detailed in the table below

Power	Basis	Units (KWH)	Amount
Production Deptt A	Meter reading	5700	23370
Production Deptt B	Meter reading	3560	14596
Utility : Water	Meter reading	1000	4100
Air-conditioning	Meter reading	2300	9430
Other	Meter reading	1500	6150
	Total	14060	57646
Steam	Basis	M.tons	Amount
Power House	Meter reading		
Production Deptt A	Meter reading		
Production Deptt B	Meter reading		
	Total		
Production	Volume		
Design & Drawing	Volume		
Administration	Volume		
Sales Department	Volume		



8.1.2 The cost of purchase, production, distribution, marketing and price with reference to sales to outside parties.

If a utility purchased as well as generated is sold to outside parties, the utility cost statement should disclose the following details

Particulars	Units	Rate	Amount
POWER			
Purchased			
Generated			
Total			
Less Distribution loss			
Net units			
Distribution			
Deptt A			
Deptt B			
Other			
Outside parties			
Total			
Sale to outside parties			
Cost of generation & Distribution			
Add: Administrative Overhead			
Add: Marketing & Distribution cost			
Total			
Sale Price			

For Example

Disclosure: During the period, unit has sold 5680 KWH units to outside parties @ Rs 6.50 per KWH against cost of sales (including marketing and distribution cost) of Rs 5.10 per KWH.

8.1.3 Where cost of utilities is disclosed at standard cost, the price and usage variances.

In case standard costing technique is used, cost statement of a utility should disclose price and usage variance separately relating to various inputs. Variances should be indicated in the cost statement. Abnormal variance are to be excluded and indicated in the cost statement as a foot note.

A cost statement indicating the variance is at **Annexure 3**.

8.1.4. The cost and price of Utility received from/supplied to related parties.

If any utility is procured from or supplied to related parties(as defined under the Companies (Accounting Standards) Rules, 2006) its relationship, nature of transaction



viz quantity, rate, other terms/ conditions of procurement are to be disclosed. The objective of disclosure is to ascertain that the transaction is at arm's length and on purely commercial terms.

Example

Related party	→	XYZ Ltd
Nature of relationship	→	We and our subsidiaries own 51 percent of their Equity.
Nature of transactions:		XYZ Ltd supplies power
Volume of transaction:		During this year 2500 KWH units of power were supplied @ Rs. 4.50 per KWH for Rs 11250.

8.1.5 The cost and price of Utility received from/supplied as inter unit transfers and inter company transfers

Inter unit transfers/inter company transfers relating to utility received/supplied is to be disclosed in the cost statement or as a foot note. It should indicate cost of a utility supplied and price of a utility purchased. In case of inter-unit transfers, utility should be at cost. if inter utility transfer is at selling price, difference between cost and price to be indicated as a footnote in the cost statement of a product. In case of inter company transfers, if utility is charged at price in the cost statement, details of cost should be furnished by a footnote.

For Example:

- (1) Main Steel plant has supplied coke oven gas to Tubes Plant at cost of Rs xxx per cub meter.
- (2) Company A has sold power 6500 KWH to Company B at a selling price of Rs 5.00 per KWH against cost of sales of Rs 3.75 per KWH.

Cost of Production	per KWH		Rs 3.50
Selling & Distribution	per KWH		Rs 0.25
Cost of Sales	per KWH		Rs 3.75

8.1.6 Cost of utilities incurred in foreign exchange.

Cost of inputs for a utility incurred in foreign exchange is to be disclosed by way of footnote in the cost statement of the utility.

For Example:

Unit has captive thermal power plant. It has imported 1500 MT coke valued in foreign exchange US \$ xxxxx during the current year.

8.1.7 Any Subsidy/Grant/Incentive and any such payment reduced from Cost of utilities.

Any subsidy/grant/incentive received relating to utilities is to be reduced from the cost of utilities and disclosure made accordingly by way of a foot note.



Example

The State Government has been subsidizing setting up of non-conventional energy plant/ its use. Such subsidies received and receivable are to be reduced from the cost of utility.

Example: Unit has set up wind plant and received subsidy of Rs 10.0 lakhs. This has been reduced from the capital cost of the plant and resulting in lower depreciation of Rsxxxx.

8.1.8 Credits/recoveries relating to the Cost of utilities.

If any credit or recovery considered while determining the cost of utility, the same should be disclosed in the body of the cost statement.

8.1.9 Any abnormal cost excluded from Cost of utilities.

Abnormal cost is to be excluded from the cost of utilities as the same has not contributed to the production of utilities. Disclosure is to be made by way of foot note in the cost statement.

For example: During the year there was theft of 300 Tons of coal valued at Rs xxxx. The same has been excluded from the cost of the power generated. .

8.1.10 Penalties and damages paid etc. excluded from cost of utilities.

Penalties and damages paid are not an item of cost as these are levied for non compliance with regulatory /contractual requirements. These are to be excluded from cost and disclosure made as a footnote in the cost statement.

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

Cost Accounting principles, and methods applied for the measurement and assignment of cost of utilities are to be applied consistently between one period and uniformly applied for different utilities. If any change is made in these principles and methods results in material effect on the cost of utilities, the same should be disclosed in the cost statement or by a foot note. In case the impact of change in principles and methods of cost accounting is not ascertainable, the fact is to be disclosed by a note to the cost statements.

For Example:

- (1) Heat recovery steam partly used for drying process was charged at of the normal steam rate. It has been changed to charging Heat recovery steam at equivalent calorific value of furnace oil used resulting in higher charges to dry process of Rs xxx and higher credit to steam.
- (2) Steam to various cost centres was being assigned on technical estimates. During the current period, meters have been installed and the cost of steam has been assigned on the basis of meter reading.



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

Level of materiality and significance has not been stated in the standard. As stated in para 7.1 Material and significance of an information will be different from situation to situation. Materiality of cost information is to be judged from the perspective of the users of that information. If material, the same is to be disclosed.

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

Disclosure in the body of cost statement will depend on cost of each utility. If it forms material part of the cost of the utility, the same should be disclosed in the cost statement. Disclosures may also be by way of foot note.



CLASSIFICATION OF UTILITY

Power	Purchased Power Generated Power (stand alone) Co Generation
Water	Raw Water Treated water Demineralized water Distilled water/softening water Chilled/cold water Hot water
Steam	Low Pressure steam High pressure steam
Climatic control	Air conditioning Humidification Air Handling units
Air	Compressed Air Instrument Air (Vacuum) Oxygen Gas Nitrogen gas, Hydrogenation



Annexure 2

Illustration of Steam Cost

Raw Material	Unit	Qty	Rate	Amount	Cost Per MT
Coal	MT	9380	4386.25	411.43	742.85
Coal Handling Charges				3.5	6.32
Diesel Oil Expenses For Loader				5.5	9.93
Coal Cosumption\Ash Sale				6.28	-11.34
Siding Expenses				1.67	3.01
Entry Tax				6.25	11.28
Raw Mtrl Total				422.07	762.05
Chemicals					
Lime	MT	11.85	3460.21	0.41	0.74
Caustic Soda	MT	11.85	27512.87	3.26	5.89
H C L	MT	67.94	3694.60	2.51	4.53
Resin-FFIP	LT	118.50	151.91	0.18	0.32
Sulphuric Sulphate	LT	2.37	8438.82	0.2	0.36
Chlorine	LT	1.58	7594.94	0.12	0.22
Sodium Sulphate	KG	19.75	151.91	0.03	0.05
Other		0.00	1.00	1.65	2.98
Chemical Total				8.36	15.09
Power	KW	871172	2.79	24.3	43.87
Water	KL	49003	2.72	1.33	2.40
Total Variable Cost				456.06	823.41
Fixed Cost					
Employees				8.04	14.52
Depreciation				4.5	8.12
Other				1.2	2.17
Total Fixed Cost				13.74	24.81
Total Cost (Variable+Fixed)				469.80	848.24



Annexure 3

Examples of Steam cost – Transfer to Other units

Steam cost per tonne works out to Rs 471.09 as illustrated under Annexure 2. If steam is transferred to other unit, distribution cost will be in addition to the above cost as illustrated below

1	Steam generation cost as 5.3.1 above	Rs 471.09 Per MT
2	Distribution cost :	Per MT
	Operation & Main tenance cost of	Rs 1.00
	distribution line Depreciation	Rs 0.75
	Other	Rs 0.75
	Total Distribution cost	Rs 2.50
3.	Inter Unit transfer cost	Rs 473.59

Cost of a utility determined as per para 5.3.2 plus share of administrative overhead to be charged.

Example:

Inter Company transfer price

1.	Cost of steam generation as para 5.3.1.	Rs 471.09 per MT
2.	Distribution cost	Rs 2.50 per MT
3.	Share of Administrative Overheads	Rs 0.50 per MT
4.	inter company transfer, cost of utility	Rs 474.09 per MT

Example of Sale of Utility

1.	Cost of steam generation as para 5.3.1.	Rs 471.09 per MT
2	Distribution cost	Rs 2.50 per MT
3	Share of Administrative Overheads	Rs 0.50 per MT
4	Marketing overhead	Rs 0.75 per MT
5.	Cost of Sales	Rs 474.80 per MT
6	Margin	Rs 2.20 per MT
7	Sales to outside parties	Rs 477.00 per MT



Illustration : Determination of Abnormal Cost due to low capacity Utilisation

Installed capacity Power Plant	400,000 kwh
Normal Capacity fixed after accounting for normal unavoidable interruptions	366,000 kwh
Generation of Power:	
2007-08	370,000
2008-09	340,000

Generation during 2008-09 was low due to strike for 30 days.

Therefore it was decided by the management to remove cost portion of fixed overheads incurred during the strike period and the same was shown as a reconciliation item (Abnormal Overhead) in the Profit Reconciliation Statement for Profit as per Cost Accounts and Profit as per financial Account. Detailed working is as under:

(A) Variable Cost	Rs 11,90,000
(B) Fixed Overheads for the year based on Normal Capacity of	Rs 7,32,000
(C) Abnormal Fixed Overhead due to unutilised capacity	Rs 61,000
(D) Share of Fixed Overhead for Actual Production (B-C)	Rs 6,71,000
Cost of generation after excluding low utilisation cost	
(a) Variable cost	Rs 11,90,000
(b) Fixed Overhead for actual production	Rs 6,71,000
(c) Total	Rs 1,861,000
Units produced	340000kwh
Cost per unit (KWH) 340000	kwhRs5.53 kwh
Fixed Overhead unabsorbed (treated as an item of reconciliation between Costing P&L A/c & Financial A/c)	Rs 61,000



CAS-9

COST ACCOUNTING STANDARD ON PACKING MATERIAL COST

The following is the COST ACCOUNTING STANDARD -9 (CAS - 9) issued by the Council of The Institute of Cost and Works Accountants of India on “**PACKING MATERIAL COST**”, for comments. 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 the principles and methods of determining the Packing Material Cost.

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

1.3 ***Packing Materials for the purpose of this standard are classified into primary and secondary packing materials.***

2. Objective

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

3. Scope

This standard should be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of Packing Material Cost 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.***¹

For example: the cost of packing material which is rejected after issue due to abnormal causes such as misprinting, use of material of wrong specification etc. (net of realisable value) may be treated as abnormal cost.

4.2 ***Administrative Overheads: Cost of all activities relating to general management and administration of an organisation.*** Administrative overheads shall exclude any overhead relating to production, operations and marketing.

¹Adapted from CAS 1 Para 6.5.19



- 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.*²
- 4.4 Direct Employee Cost:** *The cost of employees which can be attributed to a Cost Object in an economically feasible way.*³
- 4.5 Direct Expenses:** *Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material or direct employee cost*⁴. Examples of Direct Expenses are royalties charged on production, job charges, hire charges for use of specific equipment for a specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling Expenses for a specific job.
- 4.6 Direct Materials:** *Materials the costs of which can be attributed to a cost object.*⁵
- 4.7 Distribution Overheads:** *Distribution overheads, also known as Distribution Cost, are the costs incurred in handling a product from the time it is ready for despatch until it reaches the ultimate consumer.*⁶
- 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.
- 4.8 Finance Costs:** *Costs incurred by an enterprise in connection with the borrowing of funds.* This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs⁷. The terms Finance costs and Borrowing costs are used interchangeably.

²Adapted from CIMA Terminology

³Adapted from CAS 7 Para 4.6

⁴Adapted from CAS 1 Para 6.2.6 and also proposed in the CAS on Direct Expenses

⁵Adapted from CAS 6 Para 4.6.1

⁶Adapted from CAS 1 Para 6.3.9

⁷Adapted from CIMA Terminology



4.9 Imputed Costs: *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.*⁸

For example: packing material supplied by the customer.

4.10 Marketing overheads: *Marketing Overheads comprises selling overheads and distribution overheads.*

4.11 Packing Materials: Materials used to hold, identify, describe, store, protect, display, transport, promote and make the product marketable and communicate with the consumer.

4.11.1 Defectives: *Packing materials that do not meet quality standards. This may include reworks or rejects.*⁹

4.11.1.1 Reworks: *Defectives which can be brought up to the standards by putting in additional resources.*¹⁰

Rework includes repairs, reconditioning and refurbishing.

4.11.1.2 Rejects: *Defectives which can not meet the quality standards even after putting in additional resources.*¹¹

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

4.11.2 Packing Material Cost: *The cost of material of any nature used for the purpose of packing of a product.*

4.11.3 Primary Packing Material: *Packing material which is essential to hold the product and bring it to a condition in which it can be used by or sold to a customer.*

For example:

- Pharmaceutical industry: Insertions related to product, Foils for strips of tablets/capsules, vials.
- Industrial gases: Cylinders / bottles used for filling the gaseous products
- Confectionary Industry: Butter paper and wrappers.

4.11.4 Reusable Packing Material: *Packing materials that are used more than once to pack the product.*

4.11.5 Scrap: *Discarded packing material having some value in a few cases and which is usually either disposed of without further treatment or reintroduced into the production of packing material.*¹²

⁸Adapted from CAS 1 Para 6.5.13

⁹Adapted from CAS 6 Para 4.4

¹⁰Adapted from CAS 6 Para 4.4.1

¹¹Adapted from CAS 6 Para 4.4.2

¹²Adapted from Para 4.9 of CAS 6



4.11.6 Secondary Packing Material: *Packing material that enables to store, transport, inform the customer, promote and otherwise make the product marketable.*

For example:

- Pharmaceutical industry: Cartons used for holding strips of tablets and card board boxes used for holding cartons.
- Textile industry: Card board boxes used for holding cones on which yarn is woven.
- Confectionary Industry: Jars for holding wrapped chocolates, Cartons containing packs of biscuits.

4.12 Packing Material Development Cost: *Cost of evaluation of packing material such as pilot test, field test, consumer research, feed back, and final evaluation cost.*

4.13 Production overheads: *Indirect costs involved in the production process or in rendering service*¹³.

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 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.*¹⁴

4.15 Standard Cost: *A predetermined cost of resource inputs for the cost object computed with reference to set of technical specifications and efficient operating conditions.*¹⁵

Standard costs are used as scale of reference 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. Standard costs are also used for estimation.

5. Principles of Measurement

5.1 Principle of valuation of receipts of packing material:

5.1.1 *The packing material receipts 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) that can be quantified at the time of acquisition.*

¹³Adapted from CAS-1 Para 6.3.3 and 6.3.4

¹⁴Adapted from CAS 1 Para 6.3.7

¹⁵Adapted from CAS 6 Para 4.15



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 directly incurred in connection with the acquisition of Packing Material shall not form part of Packing Material Cost.***
- 5.1.3 ***Self manufactured packing materials shall be valued including direct material cost, direct employee cost, direct expenses, job charges, factory overheads including share of administrative overheads comprising factory management and administration and share of research and development cost incurred for development and improvement of existing process or product.***
- 5.1.4 ***The valuation of captive consumption of packing materials shall be in accordance with paragraph 5 of Cost Accounting Standard 4.***
- 5.1.5 ***Normal loss or spoilage of packing material prior to receipt in the factory shall be absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal.***
- 5.1.6 ***The forex component of imported packing 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 packing 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.

- 5.1.7 ***Any demurrage, detention charges or penalty levied by the transport agency or any authority shall not form part of the cost of packing materials.***
- 5.1.8 ***Any Subsidy/Grant/Incentive or any such payment received/receivable with respect to packing material shall be reduced for ascertainment of the cost to which such amounts are related.***

5.2. Principle of valuation of issue of packing material

Issues shall be valued using appropriate assumptions on cost flow.

For example: First In First Out, Last In First Out, Weighted Average Rate.

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

- 5.3 ***Wherever, packing 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.***



- 5.4** *Packing Material Costs shall not include imputed costs. However in case of Cost of Production of Excisable Goods for Captive Consumption the computation of cost shall be as per CAS 4.*
- 5.5** *Where packing materials are accounted at standard cost, the price variances related to such materials shall be treated as part of packing material cost and the portion of usage variances due to normal reasons shall be treated as part of packing material cost. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.*
- 5.6** *The normal loss arising from the issue or consumption of packing materials shall be included in the packing materials cost.*
- 5.7** *Any abnormal cost where it is material and quantifiable shall be excluded from the packing material cost.*
- 5.8** *The credits/recoveries in the nature of normal scrap arising from packing materials if any, should be deducted from the total cost of packing materials to arrive at the net cost of packing materials.*
- 6. Assignment of Cost**
- 6.1** *Assignment of packing material costs to cost objects: Packing material costs shall be directly traced to a cost object to the extent it is economically feasible.*
- 6.2** *Where the packing material costs are not directly traceable to the cost object, these may be assigned on the basis of quantity consumed or similar measures like technical estimates.*
- 6.3** *The packing material cost of reusable packing shall be assigned to the cost object taking into account the number of times or the period over which it is expected to be reused.*
- 6.4** *Cost of primary packing materials shall form part of the cost of production.*
- 6.5** *Cost of secondary packing materials shall form part of distribution overheads.*
- 7. Presentation**
- 7.1** *Packing Materials shall be classified as primary and secondary and within this classification as purchased – indigenous, imported and self manufactured.*
- 7.2** *Where separate cost statements are prepared for packing costs, the cost of packing materials consumed shall be presented in terms of type of packing in which the materials are used (For example; Bale, Bag, Carton, Pallet). Such statements shall also include cost and quantitative information, wherever it is found material and quantifiable.*



8. Disclosures

8.1 The cost statements shall disclose the following:

- 1. The basis of valuation of Packing Materials.**
- 2. Where Packing Materials Cost is disclosed at standard cost, the price and usage variances.**
- 3. The cost and price of Packing Materials received from/supplied to related parties¹⁶.**
- 4. Packing Materials cost incurred in foreign exchange.**
- 5. Any Subsidy/Grant/Incentive and any such payment reduced from Packing Materials Costs.**
- 6. Credits/recoveries relating to the Packing Materials Costs.**
- 7. Any abnormal cost excluded from Packing Materials Costs.**
- 8. Penalties and damages paid etc. excluded from Packing Materials Costs.**

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

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

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

¹⁶Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement



Guidance Note on Cost Accounting Standard on Packing Material Cost (CAS-9)

The Council of the Institute of Cost Accountants of India has issued the Cost Accounting Standard on Packing Material Cost (CAS - 9) which lays down a set of principles and methods of classification, measurement and assignment of packing material cost for determination of the cost of product and the presentation and disclosure in the cost statement.

The Guidance Note deals with principles and methods as provided in the CAS-9 and practical aspects in connection with the determination of packing material cost of a product.

In the preparation of cost statement and its attestation if any packing material cost is required, the same shall be determined with reference to CAS-9.

Further The Companies (Cost Accounting Records) Rules, 2011 provides that every company, including a foreign company defined under section 591 of the Companies Act, 1956 which is engaged in production, processing, manufacturing or mining activities have to maintain cost accounting records in accordance with the generally accepted cost accounting principles and cost accounting standards issued by the Institute, to the extent these are found to be relevant and applicable. The above Rules further provides that these will be applicable to companies wherein aggregate value of net worth as on the last date of the immediately preceding financial year exceeds five crores of rupees; or wherein the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds twenty crores of rupees; or wherein the company's equity or debt securities are listed or are in the process of listing on any stock exchange whether in India or outside India.

The Companies (Cost Audit Report) Rules 2011 cast a duty on a Cost Auditor appointed under Section 233B of the Companies Act 1956 to certify inter alia that books and records maintained by the company are in conformity with the Cost Accounting Standards issued by the Institute to the extent these are found to be relevant and applicable.

The Cost Accounting Standards have been set in ***bold italic*** type. Numbering of standard has been retained as in CAS-9 for facility of reference.



Chapter 1

Introduction

Packaging is enclosing or protecting products for distribution, storage, sale, and use. Material used for packaging is termed as Packing Material.

Packing material is required for containment, protection, handling, presentation, delivery, transporting, warehousing, logistics, sale, and end use of the product as detailed below:

- **Physical protection** - The products enclosed in the package require protection from, among other things, shock, vibration, compression, temperature, and the like.
- **Barrier protection** - A barrier from oxygen, water vapour, dust, and the like, is often required. Packing Keeps the contents clean, fresh, sterile and safe for the intended shelf life
- **Containment or agglomeration** - Small objects are typically grouped together in one package for reasons of efficiency. For example, a single box of 1000 pencils requires less physical handling than 1000 single pencils. Liquids, powders, and granular materials need containment.
- **Information transmission** - Packages and labels communicate how to use, transport, recycle or dispose of the package or product. With pharmaceuticals, food, medical and chemical products, some types of information are required by regulatory authorities. Some packages and labels are used for track and trace purposes.
- **Marketing** - The packaging and labels are used by marketers to encourage potential buyers to purchase the product.
- **Security** - Packaging can play an important role in reducing the security risks of shipment. Packages can be made with improved tamper resistance to deter tampering.
- **Convenience** - Packages can have features that add convenience in distribution, handling, stacking, display, sale, opening, reclosing, use, dispensing and reuse.
- **Portion control** - Single serving or single dosage packaging has a precise amount of contents to control usage. Bulk commodities (such as salt) can be divided into packages that are more suitable for individual households. It also aids the control of inventory, selling sealed one-litre-bottles of milk, rather than people bringing their own bottles.

Type of packing material required depends on the type of product to be packed. Packing materials are of various types. Type of packing material required for a product depend upon the nature of the product to be packed. Illustrative list of packing material used is at Annexure

I. It varies from industry to industry as items to be packed will be different as indicated in **Annexure II**.



Packing Material is classified under a common designation on the basis of similarities of nature, attribute, source of supply and the like. For example Wooden crates, Aluminium foil, paper bag, gunny bags, HDPE bags, Glass, plastic bottles, closures (metal / plastic rubber) and the like.

On the basis of source of supply, packing materials are classified as indigenous materials / imported materials. Indigenous packing materials are manufactured within the country and imported packing materials are purchased from other countries.

For the purpose of this standard Packing Materials are classified into primary and secondary packing materials.

Primary Packing Material are for holding the product, keeping the contents clean, fresh, sterile and safe for the intended shelf life and sale. Primary packing material required for a product will depend upon the type of the product to be packed.

For example for pharmaceutical industry primary packing material will be insertion related to product, Blister strips for tablets / capsules, bottle, tubes and the like. For confectionary / food products, it may be butter paper, wrappers, box, tray, can, jar and so on.

Primary packing material may also be intended for shop display .But the function of primary packing material is essentially for holding a product. Depending upon use, the same material may be classified as secondary packing material. For example, a shrink wrap can be primary packaging when applied directly to the product, and secondary packaging when combining smaller packages.

Primary packing material cost is part of production cost of a cost object. In case two types of primary packing materials are used viz. plain and fancy, the difference in the plain and fancy packing material is to be treated as secondary packing. In such cases, differentiating between primary and secondary packaging will depend upon the specific facts and circumstances of a product to be packed and type of industry.

Secondary packing material is the term used to describe larger cases or boxes that are used to group quantities of primary packaged goods for distribution.

Secondary Packing material also include transit packaging such as wooden pallets, board and plastic wrapping and containers that are used to collate the groups into larger loads for transport, which facilitates loading and unloading of goods.

Some products such as sugar, fertilizers, cements, and the like are sold in bags and do not need any further packing. Such packing is to be treated as primary packing and will form part of cost of production.



Chapter 2

Definitions

- 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.
- 4.2 Administrative Overheads:** Cost of all activities relating to general management and administration of an organisation.
- 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.
- 4.4 Direct Employee Cost:** The cost of employees which can be attributed to a Cost Object in an economically feasible way.
- 4.5 Direct Expenses:** Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material or direct employee cost.
- 4.6 Direct Materials:** Materials the costs of which can be attributed to a cost object.
- 4.7 Distribution Overheads:** Distribution overheads, also known as Distribution Cost, are the costs incurred in handling a product from the time it is ready for despatch until it reaches the ultimate consumer.
- 4.8 Finance Costs:** Costs incurred by an enterprise in connection with the borrowing of funds.
- 4.9 Imputed Costs:** Hypothetical or notional costs, not involving cash outlay, computed for any purpose.
- 4.10 Marketing overheads:** Marketing Overheads comprises selling overheads and distribution overheads.
- 4.11 Packing Materials:** Materials used to hold, identify, describe, store, protect, display, transport, promote and make the product marketable and communicate with the consumer.
 - 4.11.1 Defectives:** Packing materials that do not meet quality standards. This may include reworks or rejects.
 - 4.11.1.1 Reworks:** Defectives which can be brought up to the standards by putting in additional resources.
 - 4.11.1.2 Rejects:** Defectives which cannot meet the quality standards even after putting in additional resources.
 - 4.11.2 Packing Material Cost:** The cost of material of any nature used for the purpose of packing of a product.
 - 4.11.3 Primary Packing Material:** Packing material which is essential to hold the



product and bring it to a condition in which it can be used by or sold to a customer.

- 4.11.4 Reusable Packing Material:** Packing materials that are used more than once to pack the product.
- 4.11.5 Scrap:** Discarded packing material having some value in a few cases and which is usually either disposed of without further treatment or reintroduced into the production of packing material.
- 4.11.6 Secondary Packing Material:** Packing material that enables to store, transport, inform the customer, promote and otherwise make the product marketable.
- 4.12 Packing Material Development Cost:** Cost of evaluation of packing material such as pilot test, field test, consumer research, feedback, and final evaluation cost.
- 4.13 Production overheads:** Indirect costs involved in the production process or in rendering service.
- 4.14 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.
- 4.15 Standard Cost:** A predetermined cost of resource inputs for the cost object computed with reference to set of technical specifications and efficient operating conditions.



Chapter 3

Principles of Measurement

5.1. Principle of valuation of receipt of packing material:

5.1.1 The packing material receipts 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) that can be quantified at the time of acquisition.

The valuation of receipt of packing materials is to be based on the terms and conditions stated in the purchase /supply order. It indicates the source of supply i.e. indigenous or imported and the like.

Purchase of indigenous Packing material:

The purchase / supply order inter alia states:

- (1) Specification of packing material being purchased
- (2) Purchase price
- (3) Quantity of supply
- (4) Time of supply
- (5) Place of supply
- (6) Payment terms
- (7) Other commercial conditions regarding inspection, rejection, cash / trade discount etc.

In addition to basic purchase price, duties and taxes, freight inwards, insurance and other expenditure directly attributable to procurement are to be taken into account while valuing the receipt of packing material if these can be quantified with reasonable accuracy at the time of receipt. If any of these items of expenditure cannot be quantified with reasonable accuracy, these are treated as material handling cost, an item of overhead.

Trade / cash discount, rebates, taxes and duties refundable (or to be credited by the taxing authorities) are to be set off. 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.

Imported Packing Material:

Packing Materials are imported from other countries depending upon the availability in the country / economics of import. Import license may be required in certain cases. Terms of Purchase inter alia may be FOB, CIF port/airport. FOB (Free on Board) means that goods are loaded on the ship and there is no additional charge relating to loading and the like. Purchaser has to pay transit insurance and freight from place of loading to its destination. In case of CIF (Cost, Insurance & Freight) price, price includes besides



basic price, transit insurance and freight. On receipt of packing material, bill of entry is prepared and other custom formalities are complied with for clearance of the goods.

Following points are to be considered while valuing imported packing material:

- a. Actual customs duty paid on the basis of classification by the customs authorities will be assigned, net of any credits. Higher duty paid under protest will not be included in cost if there is reasonable expectation that the entity will satisfy the conditions for the excess duty to be refunded.
- b. Packing Material imported free of duty or at concessional rate of duty under export incentive scheme will be accounted for at the actual rate of duty applicable so long as there is reasonable expectation that the entity will satisfy the conditions for the duty exemption or concession. In case the packing material is used other than the intended purpose, provision for import duty / penalty leviable, if any, shall be provided. This entry may be offset when the material is available for export purposes at the imported parity rate of material.
- c. Harbour dues, stevedoring charges, congestion charges, and the like on the basis of actual, if imported singly. If the packing material is imported as part of a basket, then a suitable basis such as proportionate weight, volume or value will become the basis for assigning the above charges
- d. If Intermediate storage is called by the nature of transport, the actual charges by the storage provider will be included in the cost.

For example transporting the material by different mode of transport due to certain transport constraint.

- e. Commission Agent's Charges will be added to cost of materials. Where other services are also provided by the commission agent besides procurement of orders, e.g. arranging for LC, the charges for such services will also be assigned to the materials covered on a suitable basis.
- f. Adjustment of CENVAT / VAT as per applicable regulation
- g. Duty drawback and other similar duties subsequently recoverable shall also be deducted from the cost of material
- h. Bank Charges are in the nature of borrowing cost or in the nature of administrative overheads will not form part of packing material cost.

Cost incurred for acquisition, inspection, storage, movement of materials and insurance is also to be assigned to packing material cost on rational basis.

Handling costs upto works / factory gate

If handling cost is specific and handled singly, it is to be assigned to the packing material handled. If employees are used for handling the packing material, it is to be treated as procurement overheads and not included in Packing Material Cost. In other cases where handling charges are included in the carrier's responsibility, there will be no assignable cost due to handling.



Incoming Inspection

If the packing material calls for inspection by a third party, specific cost will be assigned to the packing material inspected. If the inspection is carried out internally with own employees, it is to be treated as procurement overheads and not included in Packing Material Cost. If the inspection is part of the vendor's responsibility, no separate inspection cost will be assigned.

Other cost incurred for packing material acquisition is insuring of packing material. If insurance premium is specific and insured singly, it is to be assigned to the specific packing material insured. In case it is part of a comprehensive policy then the assignment of the insurance premium will be on the basis of the proportionate value insured. If insurance becomes part of the carrier's responsibility no separate cost will be assigned in this regard.

5.1.2 Finance costs directly incurred in connection with the acquisition of Packing Material shall not form part of Packing Material Cost.

Finance costs are interest and the like on borrowed funds. Finance costs are excluded from packing material cost. The letters of credit charges are for credit risk or a transaction risk (demand bill) and / or part of bank charges, which form part of administrative overheads. Such charges are not finance charges except where they are in the nature of borrowing costs.

Sometimes goods are kept in bonded warehouse and clearance of goods is delayed. This may happen due to any financial stringency delaying the payment to the bank. Such payments of storage are to be excluded from packing material cost and are dealt with in the financial accounts.

5.1.3 Self manufactured packing materials shall be valued including direct material cost, direct employee cost, direct expenses, job charges, factory overheads including share of administrative overheads comprising factory management and administration and share of research and development cost incurred for development and improvement of existing process or product.

The packing material may be manufactured by an entity. It is to be valued taking into account all the relevant cost incurred in manufacturing the packing material. For example it shall take into account the direct material cost, direct employee cost, direct expenses, share of factory overhead and share of administrative overheads relating to production.

In case any packing material development cost such as pilot test, field test consumer research, feedback and final evaluation cost is incurred, it will form part of the cost of self manufactured packing material.

Direct Material is the cost of material which can be attributed to a cost object. It is consumed for production of a product or service which is identifiable in the product and forms direct material cost.

Direct material consumed in the manufacture of packing material is to be valued at



purchase price including duties and taxes, freight inwards, insurance and other expenditure (net of trade discounts, rebate, taxes and duties refundable or to be credited) as detailed under paragraph 5.1.1.

Direct employee cost is that portion of wages and salaries which can be identified with and charged to a cost object. Direct Employees engaged in the manufacturing of packing material are to be identified. Remuneration paid to them and share of other employee related cost are to be determined as per Standard CAS-7 on Employee cost.

Direct Expenses specifically identifiable with the production of packing material (for example job charges, hire charges for use of specific equipment, cost of special designing of packing material or drawings etc.) shall form part of the cost of self manufactured packing material.

Factory overheads comprise of indirect materials, indirect employee costs and indirect expenses which are not directly identifiable or allocable to a cost object in an economically feasible way. these are the indirect costs incurred in the production process or in rendering service.

The Factory overheads includes administration cost relating to production, factory or manufacturing.

5.1.4 The valuation of captive consumption of packing materials shall be in accordance with paragraph 5 of Cost Accounting Standard 4.

Para 5 of the Cost Accounting Standard on Cost of Production for Captive Consumption (CAS-4) deals with the determination of cost production for captive consumption. While valuing the cost for captive consumption of packing material, the following elements of costs are to be considered:

- I. Material consumed (indigenous, imported, bought out items, self manufactured items, process material etc.)
- II. Direct employee cost (as per CAS-7)
- III. Direct expenses (for example cost of utilities, royalty, technical know-how charges for design)
- IV. Quality control Cost
- V. Research and Development
- VI. Share of factory overhead (including factory administration and management expenses)
- VII. Inputs received free
- VIII. Adjustment for misc income, if any.



5.1.5 Normal loss or spoilage of packing material prior to receipt in the factory shall be absorbed in the cost of balance materials net of amounts recoverable from suppliers, insurers, carriers or recoveries from disposal.

Sometimes packing materials are lost in transit or spoiled. Treatment of loss will depend upon the terms and conditions of purchase order. If the purchase order does not specify any level of loss, and supplier is responsible to supply good quantity, the loss is to be recovered from suppliers or insurers as the case may be.

The normal loss is to be absorbed by the good units. Abnormal loss of packing material is taken to reconciliation and does not form part of the packing material cost.

5.1.6 The forex component of imported packing 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 packing material cost.

Forex conversion has to be on the date of transaction. The cost and financial accounts will have the same basis for alignment. The date on which the transaction first qualifies for recognition in accounts is adopted as the date of transaction. The difference between the actual payment and the amount taken as packing material cost is taken to a separate financial account as exchange rate variations not being part of the packing material cost. Foreign Exchange difference shall be a reconciliation item.

5.1.7 Any demurrage, detention charges or penalty levied by the transport agency or any authority shall not form part of the cost of packing materials.

Demurrage and penalties are levied by the transport agency or any other authority such as custom authorities for delay in clearance of wagon/vessel and the like.

Illustrations are:

- Demurrages levied by transporter for not removing goods,
- Penalties for keeping hazardous goods in unauthorized places in transit without proper safeguards.
- Penalties or interest levied by custom authorities for delayed clearance.

Demurrage and penalties are abnormal cost and are not part of the packing material cost. It is taken to reconciliation.

5.1.8 Any Subsidy / Grant / Incentive or any such payment received / receivable with respect to packing material shall be reduced for ascertainment of the cost to which such amounts are related.

Subsidy and grant received should be recognized on a systematic basis. These should be matched with the related cost for which these are intended to compensate. Subsidy received for any packing material is to be reduced from the packing material cost.

Subsidy receivable for using specific packing materials produced on account of environmental reasons shall be adjusted against the packing material cost.



5.2. Principle of valuation of issue of packing material: Issues shall be valued using appropriate assumptions on cost flow.

The CAS-9 provides for adopting any one of the following three methods for valuation of issues of material:

- a) FIFO (First in First out)
- b) LIFO (Last in First out)
- c) Weighted Average Rate

Method of valuation of issue of packing material once adopted shall be followed consistently. If method of valuation is changed, its impact on costs of packing material shall be disclosed.

The FIFO formula assumes a cost flow that the items of packing materials that were purchased or produced first are issued first while LIFO assumes the exactly opposite cost flow charging the current price to cost. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each fresh shipment is received, depending upon the circumstances of the entity.

Accounting Standard AS-2 provides for cost formulae, viz. Specific identification, FIFO (First in First out) and Weighted Average cost method. Any of the above assumptions on cost flow can be used under CAS 6. In addition, LIFO assumption can also be used. CAS 6 does not preclude the use of specific identification of cost.

LIFO method can be gainfully applied while estimating or projection of cost as it reflects current price cost.

Any accepted method of pricing of issue may be used. However, whatever method of pricing is adopted under CAS 6, the same should be specified and followed consistently.

5.3 Wherever, packing 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.

Inward freight shall form the part of the packing materials cost. In case inward freight charges are indicated in the invoice which is for more than one material, inward freight shall be assigned to different materials indicated in the invoice on appropriate basis such as weight, volume, nos. and the like.

If the packing material is carried by special carrier, it will be assigned to the specific packing material transported.

5.4 Packing Material Costs shall not include imputed costs. However in case of Cost of Production of Excisable Goods for Captive Consumption the computation of cost shall be as per CAS 4.

Imputed cost does not involve any cash outlay and is relevant for decision making purpose viz whether to use reusable packing material or not. This will not form part of



the packing material cost. But if any excisable goods produced is used for captive consumption, its cost is to be determined as per CAS-4. Under CAS-4 in case packing material is supplied free of cost by the user of the captive product the landed cost of such material shall be included in the cost of production.

5.5 Where packing materials are accounted at standard cost, the price variances related to such materials shall be treated as part of packing material cost and the portion of usage variances due to normal reasons shall be treated as part of packing material cost. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.

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 variance is placed. Standard costs are used to compare the actual costs with the standard cost with a view to determine the variances, if any, analyse the causes of variances and take proper measure to control them.

Standard Cost method can also be applied for valuation of receipt and issue of packing material. In this method price of issues is predetermined for a stated period taking into account all the factors affecting price such as anticipated market trends, transportation charges and normal quantity of purchase. Standard price is determined for each packing material and material requisitions are valued at standard price irrespective of the actual purchase price. Any difference between the standard and actual prices of purchase results in packing material price variance. The packing material price variance is to be treated as part of packing material cost.

When standard costing system is in vogue, there can be other variances relating to usage during the course of packing the cost object which may be due to normal or abnormal reasons. Variances due to normal reasons shall be treated as cost while the variances due to abnormal reasons are treated outside the cost of production.

5.6 The normal loss arising from the issue or consumption of packing materials shall be included in the packing materials cost.

Certain losses are inherent in the use of packing material and cannot be eliminated. For example losses occur in cutting wood, cardboard to make box and crate. These losses occur even under efficient operating condition and are referred to as normal loss.

Normal loss arising from issue or consumption of packing materials shall be treated as a part of packing material cost.

5.7 Any abnormal cost where it is material and quantifiable shall be excluded from the packing material cost.

Abnormal cost arises due to some abnormal causes viz. heavy break-down in plant, theft, fire, material not according to required specification and the like. They are not



considered in the cost of production and charged to profit & loss account. In case of packing material which is rejected after issue due to abnormal causes such as misprinting, material of wrong specification, size and the like is to be treated as abnormal cost. It is to be excluded from cost of packing material cost of the product. Any realization from disposal of such rejected packing material is to be credited to the abnormal cost.

The rationale of exclusion of abnormal cost is that such items in the cost will make the cost not comparable with a normal situation. Such an aberration is avoided to understand the cost in a better perspective for any purpose. For instance, loss of packing material due to major fire accident is to be treated as Abnormal Cost. It shall not form part of cost of the packing material consumed as not to distort the cost due to abnormal reasons. It is dealt with in the reconciliation with financial accounts.

5.8 The credits / recoveries in the nature of normal scrap arising from packing materials if any, should be deducted from the total cost of packing materials to arrive at the net cost of packing materials.

Normal Loss occurs in use of different packing material such as in cutting wood and cardboard to make box and crate. Adjustment shall be made to the cost of packing material for credits / recoveries from sale of such scrap.



6.1 Assignment of packing material costs to cost objects: Packing material costs shall be directly traced to a cost object to the extent it is economically feasible.

Assignment of packing material cost involves establishing a suitable procedure to identify and record the packing material consumed by the cost object. Cost object 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. It is the logical sub-unit for collection of cost.

Material requisition is the source document indicating details of packing material issued for a product. It records the job number, quantity, type of packing material, and items listed are priced at their acquisition cost. Thus material requisition represents the source of information for assigning the cost of packing material to cost object. Based on actual issues, the cost of packing material is traced to cost object to the extent economically feasible.

Packing material cost may also be assigned on the basis of standard bill of packing material in place of actual issues. Under this method packing material is issued as Standard Bill of material. The standard cost for each item of packing material is defined at the beginning of the year. The variances from standard on account of price and consumption are adjusted to consumption at suitable interval. Any variation between the actual issues (both quantity and value) and the standard as accumulated over the period is charged off to consumption.

In many situations packing materials cannot be issued for the exact quantity required for packing the products produced. This may happen because the material is bulky e.g. wood used for making crates and they cannot be cut to the exact size in the stores. It may also happen that packing materials of small value like nails, glue etc. are issued in bulk as it is cumbersome to issue them for the exact quantity. In such cases, the quantity of packing materials issued cannot be taken as consumption.

In such cases, the material issued to the packing department is treated as departmental stock and the quantity of packing material required to pack the quantity of the product produced as per norms is relieved from the stock, on production being reported. The normative consumption so arrived at will be adjusted for excess or short consumption based on physical stock taking of packing materials in stock in the packing department at periodic intervals. Quantity of packing material consumed so arrived at can be valued either at standard rate or actual rate depending on the cost system in vogue in the Company.

The norms regarding the quantity of packing materials required for each product is stored either as part of the standard bill of materials relating to the product or in a separate bill of packing materials.

Packing material cost may also be assigned on the basis of standard bill of packing material in place of actual issues. Under this method packing material is issued as



Standard Bill of material. The standard cost for each item of packing material is defined at the beginning of the year. The variances from standard on account of price and consumption are adjusted to consumption at suitable interval. Any variation between the actual issues (both quantity and value) and the standard as accumulated over the period is charged off to consumption.

For tracing of packing material cost direct to a cost object, concept of “to the extent economic feasible” is also to be taken into account. This requires an exercise to analyse the cost involved, benefit to accrue and over-riding requirement to identify packing material with the object.

6.2 Where the packing material costs are not directly traceable to the cost object, these may be assigned on the basis of quantity consumed or similar measures like technical estimates.

Packing Material Costs which are not directly traceable to cost object, are to be assigned on some rational basis consistently. The basis could be on some factor linking to the utilization. Technical estimates help in arriving at such rational basis.

Illustration: Nails, adhesive, tapes, gums etc are consumed while packing the cost object. Such packing materials are used in small quantities and are not significant in value. In such cases it may not be economical to issue individual requisition to charge to cost object each time. It is desirable to take the total consumption of such packing material per month and divide the cost between costs objects packed based on a technical estimate or on a sample survey of usage during a selected period. Such studies may be reviewed periodically to correct for changes taking place affecting the consumption.

6.3 The packing material cost of reusable packing shall be assigned to the cost object taking into account the number of times or the period over which it is expected to be reused.

Certain packing materials are reusable. Assigning the cost of reusable packing material will depend on the number of times or period over which it is expected to be reused.

For example if the packing material costs ₹120 and it is expected to be reissued six times, the cost of reusable packing material to be assigned to the product will be taken to be ₹20.

Assuming further that, the returnable packing material (say container) is charged in the invoice and refunded for a part value of charged amount, when returned. If charged value for container is ₹75 and return credit is ₹40, ₹35 will be treated as recovery towards packing material cost. The Charge of ₹35 per returnable container is to be determined considering the number of times / period over which it is expected to be reused and the total recovery targeted over the entire period.

Another example is gas cylinder. These are returnable. Filled cylinders are supplied against a security deposit and user is charged rent. Cylinders are depreciated over its useful life and any repair and depreciation will form packing material cost.



While arriving at the cost of reusable packing material, the cost of freight and other costs attributable to activities associated to make the packing material reusable like minor repair cost, storage cost of these material, manpower dedicated for this activity shall identified and forms part of the packing material cost .

6.4 Cost of primary packing materials shall form part of the cost of production.

Primary packing material has been defined under paragraph 4.11 of the CAS-9. These materials are essential to hold the product and bring it to a condition in which it can be used by or sold to a customer. Primary packing materials are of various types and their use varies with industry to industry.

For example:

- Pharmaceutical industry: Insertions related to product, Foils for strips of tablets / capsules, vials.
- Industrial gases: Cylinders / bottles used for filling the gaseous products.

The cost of primary packing material used for a product shall form part of the cost of production.

6.5 Cost of secondary packing materials shall form part of distribution overheads.

Secondary Packing material has been defined under paragraph 4.11.6. These are:

- a) The packing material used for storing and transport from factory to customer / warehouse for further distribution to marketing agents.

For example

- I. Cartons holding strips of tablets and card board boxes used for holding cartons;
 - II. cartons containing packs of biscuits
 - III. card board boxes for holding packed cloth
 - IV. Strips are primary packing material and will form cost of production and whereas carton and card board boxes used for strips of tablets shall form part of the distribution overheads as these are used for storing transporting. Similarly cartons for pack of biscuits, card boxes for packed cloth will form part of secondary packing material.
- b) fancy packing material to attract customers;
- c) Product literature to inform the customers etc.

As per The Companies (Cost Audit Report) Rules, 2011 (para 5 of the Annexure to Form II) the cost of secondary packing materials is to be exhibited as a separate line item 23 in the Abridged Cost Statement.

The cost of secondary packing materials is generally to be treated as distribution overhead as these are used to make the product marketable.



Chapter 5

Presentation

7.1 Packing Materials shall be classified as primary and secondary and within this classification as purchased – indigenous, imported and self manufactured.

This paragraph specifies categories under which Packing Material Cost is to be exhibited in the Cost statement viz. by type of packing material – Primary packing material and Secondary packing material. It further specifies classification of packing material cost on the basis of source of supply viz. indigenous, imported and self manufactured. These items are to be exhibited separately as illustrated in **Annexure III**.

7.2 Where separate cost statements are prepared for packing costs, the cost of packing materials consumed shall be presented in terms of type of packing in which the materials are used (For example; Bale, Bag, Carton, Pallet). Such statements shall also include cost and quantitative information, wherever it is found material and quantifiable.

Separate cost statement for packing cost, if prepared, shall indicate the following details in regard to packing material:

S. No.	Item	Quantity	Rate (Nos.)	Amount	Cost Per unit
1	Packing material Cost				
1.A	Primary Packing Cost				
	Primary packing material				
	Wrapper				
	Boxes				
	Others	500	1.00	500	
	(Such as gum, tape, string etc).....	50	5.00	250	
1.B	Secondary Packing cost				
	Secondary Packing Material				
	Card Box	5	20	100	
	Others				

It is advisable to provide previous year's figures against cost per unit. Type of packing used, i.e. strips, bottle, container, Bags, bale, Box, carton and the like is to be indicated.

**Chapter 6****Disclosures****8.1 The cost statements shall disclose the following:****8.1.1 The basis of valuation of Packing Materials.**

The standard provides various methods of valuation of issues of Packing material such as FIFO, LIFO and weighted average. Method adopted for valuation of packing material cost shall be disclosed in the cost statement.

For example:

Basis of valuation of packing material cost:

Periodic quarterly weighted average is used for pricing the issues of packing material.

8.1.2 Where Packing Materials Cost is disclosed at standard cost, the price and usage variances.

In case issue of packing material is valued at standard cost, the cost statement shall disclose the standard cost and variance thereof.

8.1.3 The cost and price of Packing Materials received from / supplied to related parties.

If any packing material is procured from or supplied to related parties, (as defined under the Companies Act 1956) name & address of the party, name of the packing material, nature of transaction, quantity, transfer price, amount, normal price and basis adopted for determining normal price are to be disclosed. The objective of disclosure is to ascertain that the transaction is at arm's length and on purely commercial terms.

For example:

Name and address of Related Party	XYZ Ltd (address)
Nature of transactions:	XYZ Ltd supplies packing bags
Volume of transaction:	During the year 500 HDPE bags were supplied @ '5 per bag for '2500
Normal Price:	'5 per bag
Basis adopted for determining normal price: The above price is based on competitive quotes.	

8.1.4 Packing Materials cost incurred in foreign exchange.

Payment made in foreign exchange for importing packing material shall be indicated in the cost statement.

8.1.5 Any Subsidy / Grant / Incentive and any such payment reduced from Packing Materials Costs.

Any subsidy / grant / incentive received relating to packing material is to be reduced



from the cost of packing material and disclosure made accordingly by way of a foot note.

The State Government has been subsidizing using of jute / paper bags in place of pvc bags for environmental reasons. Subsidy received and receivable are reduced from the cost of packing material.

8.1.6 Credits/recoveries relating to the Packing Materials Costs.

If any credit or recovery is considered while determining the cost of packing material, the same shall be disclosed in the cost statement e.g. sale of empties returned by customers.

8.1.7 Any abnormal cost excluded from Packing Materials Costs.

Abnormal cost is to be excluded from the cost of packing material as the same has not contributed to the packing cost of the cost object. Disclosure is to be made.

For example: During the year there was fire resulting in loss of packing material valued at '2.5 lakhs. The same has been excluded from the cost of packing material.

8.1.8 Penalties and damages paid etc. excluded from Packing Materials Costs.

Penalties and damages paid are not an item of cost as these are levied for non compliance with regulatory /contractual requirements. These are to be excluded from cost and disclosure made.

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

Cost Accounting principles, and methods applied for the measurement and assignment of cost of packing material are to be applied consistently between one period to subsequent period and uniformly applied for different packing material. If any change is made in these principles and methods which results in material effect on the cost of packing material, the same shall be disclosed in the cost statement or by a foot note. In case the impact of change in principles and methods of cost accounting is not ascertainable, the fact is to be disclosed by a foot note to the cost statements.

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

Level of materiality and significance has not been stated in the standard. Material and significance of any information will be different from situation to situation. If material, the same is to be disclosed. The following criteria can be applied for determining the materiality. No one criterion is determinative in and of itself.

- The absolute amount – the larger the amount , the more likely that it is material
- The amount of cost of a cost object compared to the amount of packing material cost under consideration – the greater the proportion of the considered amount



of packing material cost versus the cost of object, the more likely it is material.

- The relationship of repairs and maintenance cost with cost object.
- The cumulative impact of individually immaterial items - do they offset one another or do they accumulate in one direction (increase or decrease)
- The cost of determining the repairs and maintenance cost

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

Disclosure may be made in the body of cost statement or as a footnote. If there are many items of disclosure, the same may be included in schedule of notes to the cost statement.



ANNEXURE I

TYPE OF PACKING MATERIALS USED

Wood Boxes/crates	Cheapest and commonly available material. Exports are generally preferred in white or silver coloured wood. softwood can be used instead of hardwood, which is heavier,
Cardboard/corrugated boxes	These are usually made out of corrugated fiberboard. If more protection is needed, double-walled boxes can be used. Cardboard / corrugated boxes are cheaper to manufacture and easier to handle than the traditional wooden crates.
Different types of material used for packaging :	Aerosols, Bottles. Cans, Foils, Lids, Bottle Caps, Closures Packaging Bags, Packaging Boxes, Packing & Sealing Tapes , Plastic Packaging Materials, Tear Tapes Thermocol, Tin can, tin Containers, Jumbo Bags, Gunny Bags, polythene bags. Bulk Bags and Sacks, Packaging Bags, Laminated Bags and Zip Bags Lids, Bottle Caps, Closures, Corks & Packaging Seals Other Miscellaneous Packaging and Lamination Material Packaging & Lamination Films, Foils, Sheets, Rolls & Wrappers, Packaging Boxes, Crates, Cartons, Pallets & Trays, Packaging Pouches, Sachets, Envelopes and Zipper Pouches, Packaging Tubes, Cans, Bottles, Jars & Containers, Box, Case, Tray and Carton, Box boards, Linerboards, Corrugated & Bleached Boards.
Plastic	Plastic is the most frequently used type of packaging material because of its low cost and light weight. It can be manufactured in a variety of sizes and shapes, allowing users to make convenient packages for the user of a particular item.
Plastic films- Wrapping with stretch film.	These wraps are water proof, moisture proof, dust proof and transparent.
Wrapping with shrink film	Shrink wrap is commonly used on commercial products where tamper-protection is a high priority, such as CDs or DVDs. After the item is wrapped, heat is applied to make the wrap shrink to fit. Because it creates such a tight seal and keeps moisture out, shrink wrap can also be used to package perishable food items.



Packing Material Cost

Bubble Wrap	Bubble wrap is common due to its effectiveness at protecting fragile items without adding significant weight or cost. For small items or those that require additional protection, the bubble wrap can simply be overlapped to provide several layers of cushioning.
Tissue Paper	Tissue paper is used inside a container to fill empty space so that the packed items do not shift in transit. Fragile contents like glass or porcelain are often wrapped in tissue paper before being placed inside another type of protective container for shipping.
Poly Bags, Tubes & Sheets	Poly Wrappers in custom Sizes & Thickness plastic wrappers, films and sheet
PVC- Polyvinyl chloride	Food trays, cling film, bottles for squash, mineral water and shampoo.
HDPE - High-density polyethylene	Bottles for milk and washing-up liquids.
Polyethylene terephthalate polyethylene	Fizzy drink bottles and oven-ready meal trays.
LDPE - Low density polyethylene	Carrier bags and bin liners, plastic goods and toys.
PP - Polypropylene	Margarine tubs, microwaveable meal trays.
PS – Polystyrene	pots, trays, food boxes and egg cartons, vending cups, plastic cutlery, protective packaging
Adhesives, Glue, Barcodes, Stickers & Label Sealants	Adhesive, Non-Adhesive & Pressure Sensitive Vacuum, Skin, Blister & Thermoform Packaging Banding & Bundling Material
Sticker	Labelling, Marking
Insertions	
Packing material may be classified as primary packing material or secondary packing material depending upon its use. But certain packing materials having a characteristics of primary packing material are classified as raw material based on industry practice. For example Primary enclosure of: • Sterile Injection • Home carry pack of ice cream/shri kand • Ink/colours for drawing Repellent liquid for mosquitoes and the like.	

**ANNEXURE II****Details of packing materials used in different industries**

Food Packaging	Bakery items, dairy products, confectionary, snacks, frozen items, ice creams- food packaging foils, food packaging laminates, flexible packaging foils, cookies packaging, cracker packaging, bread packaging material, chips packaging, chocolate packaging, wafer packaging, namkeen packaging, pastry packaging, toffee wrappers, lollipop wrappers, chewing gum wrappers, chocolate wrappers and many more.
Beverage Packaging	Beer, drinks, water bottle, juice, soft drinks bottles / can
Personal care cosmetic Packaging	Cosmetic, oral care, Toiletries, soap, shampoo, glass like clear polymer bottle / tubes / pouch etc
Pharmaceutical	Blister, Aluminium / cellophane / glassine paper foil for strip or blister packing of tablets / capsules, bottle (glass / plastic), closures, (metal / plastic / Rubber closures for vials) jars , tubes, aerosol etc
Heavy machinery packing	Wooden crates / boxes / pallets
Fertilizers, cement, sugar,	HDPE Bags
Paper/stationery	Wrapper, liner, strings, gum tape, wooden , bottle (for ink / gum), tubes, box for holding pens/pencils
Textiles	Yarn in hanks packed in burlap and bales; Yarn in cones packed in boxes/bags; Cloth packed in bales; fancy cloth in wooden/cardboard cases/ boxes; Other packing material used are hessian ,cloth, paper board, polythene paper, lining paper, iron/plastic hooks, nails, sewing thread etc.



Annexure III

Illustration of Presentation of Packing Material

Item	Quantity (Unit)	Rate (Unit)	Amount	Cost Per unit
Material Cost				
Employee cost				
Primary packing Cost				
a) Primary packing material				
• imported				
• indigenous				
b) Other expenses				
• Production Overhead				
Production cost (after adjustment of WIP)				
Secondary Packing Cost:				
Cartoons (indigenous)				
Card Boxes (imported)				
Selling Expenses				



CAS-10

COST ACCOUNTING STANDARD ON DIRECT EXPENSES

The following is the COST ACCOUNTING STANDARD - 10 (CAS-10) issued by the Council of The Institute of Cost and Works Accountants of India on “**DIRECT EXPENSES**”, for comments. 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 the principles and methods of determining the Direct Expenses.

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

3. Scope

This standard should be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of Direct Expenses 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.¹*

4.2 **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.²*

4.3 **Direct Employee Cost:** *The cost of employees which can be attributed to a cost object in an economically feasible way.³*

¹Adapted from CAS 1 paragraph 6.5.19

²Adapted from CIMA Terminology

³Adapted from CAS 1 paragraph 6.2.4 (Direct labour cost)



- 4.4 Direct Expenses:** *Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost⁴.* Examples of Direct Expenses are royalties charged on production, job charges, hire charges for use of specific equipment for a specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling Expenses for a specific job.
- 4.5 Direct Material Cost:** *The cost of material which can be attributed to a cost object in an economically feasible way⁵.*
- 4.6 Finance Costs:** *Costs incurred by an enterprise in connection with the borrowing of funds.* This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs⁶. The terms Finance costs and Borrowing costs are used interchangeably.
- 4.7 Imputed Costs:** *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.⁷*
- 4.8 Overheads:** *Overheads comprise of indirect materials, indirect employee costs and indirect expenses which are not directly identifiable or allocable to a cost object.⁸*
- 4.9 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 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. Standard costs are also used for estimation.

5. Principles of Measurement:

- 5.1 Identification of Direct Expenses shall be based on traceability in an economically feasible manner.**

⁴Adapted from CAS 1 paragraph 6.2.6

⁵Adapted from CAS 1-6.2.3

⁶Adapted from CIMA Terminology

⁷Adapted from CAS 1 paragraph 6.5.13

⁸Adapted from CAS 3 paragraph 4.1



- 5.2.1** *Direct expenses incurred for the use of bought out resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited.*
- 5.2.2** *Direct expenses other than those referred to in paragraph 5.2.1 shall be determined on the basis of amount incurred in connection therewith.*
- Examples:** in case of dies and tools produced internally, the cost of such dies and tools will include direct material cost, direct employee cost, direct expenses, factory overheads including share of administrative overheads relating to production comprising factory management and administration. In the case of research and development cost, the amount traceable to the cost object for development and improvement of the process for the existing product shall be included in Direct Expenses.
- 5.2.3** *Direct Expenses paid or incurred in lump-sum or which are in the nature of 'one – time' payment, shall be amortised on the basis of the estimated output or benefit to be derived from such direct expenses.*
- Examples:** Royalty or Technical know-how fees, or drawing designing fees, are paid for which the benefit is ensued in the future period. In such case, the production / service volumes shall be estimated for the effective period and based on volume achieved during the Cost Accounting period, the charge for amortisation be determined.
- 5.3** *If an item of Direct Expenses does not meet the test of materiality, it can be treated as part of overheads.*
- 5.4** *Finance costs incurred in connection with the self generated or procured resources shall not form part of Direct Expenses.*
- 5.5** *Direct Expenses shall not include imputed costs. In case of goods produced for captive consumption, treatment of imputed cost shall be in accordance with Cost Accounting Standard – 4 (CAS-4).*
- 5.6** *Where direct expenses are accounted at standard cost, variances due to normal reasons shall be treated as part of the Direct Expenses. Variances due to abnormal reasons shall not form part of the Direct Expenses.*
- 5.7** *Any Subsidy/Grant/Incentive or any such payment received/receivable with respect to any Direct Expenses shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.*
- 5.8** *Any abnormal portion of the direct expenses where it is material and quantifiable shall not form part of the Direct Expenses.*
- 5.9** *Penalties, damages paid to statutory authorities or other third parties shall not form part of the Direct Expenses.*



- 5.10 Credits/ recoveries relating to the Direct Expenses, material and quantifiable, shall be deducted to arrive at the net Direct Expenses.**
- 5.11 Any change in the cost accounting principles applied for the measurement of the Direct Expenses should 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 organisation.**
- 6. Assignment of Costs**
- 6.1 Direct Expenses that are directly traceable to the cost object shall be assigned to that cost object.**
- 7. Presentation**
- 7.1 Direct Expenses, if material, shall be presented as a separate cost head with suitable classification. e.g.**
- Subcontract charges
 - Royalty on production
- 8. Disclosures**
- 8.1 The cost statements shall disclose the following:**
- 1. The basis of distribution of Direct Expenses to the cost objects/ cost units.**
 - 2. Quantity and rates of items of Direct Expenses, as applicable.**
 - 3. Where Direct Expenses are accounted at standard cost, the price and usage variances.**
 - 4. Direct expenses representing procurement of resources and expenses incurred in connection with resources generated.**
 - 5. Direct Expenses paid/ payable to related parties⁹.**
 - 6. Direct Expenses incurred in foreign exchange.**
 - 7. Any Subsidy/Grant/Incentive and any such payment reduced from Direct Expenses.**
 - 8. Credits/recoveries relating to the Direct Expenses.**
 - 9. Any abnormal portion of the Direct Expenses.**
 - 10. Penalties and damages excluded from the Direct Expenses**
- 8.2 Disclosures shall be made only where material, significant and quantifiable.**

⁹Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement



- 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 Direct Expenses during the period covered by the cost statement which has a material effect on the Direct Expenses. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*



Guidance Note on Cost Accounting Standard on Direct Expenses (CAS-10)

The Council of the Institute of Cost Accountants of India has issued the Cost Accounting Standard -10 (CAS-10) on Direct Expenses which lays down a set of principles and methods of classification, measurement and assignment of Direct Expenses for determination of the cost of product or service and the presentation and disclosure in the cost statements. The Cost Accounting Standards have been set in bold italic type and reference number of the standard has been retained.

The Guidance Note deals with principles and methods as provided in the CAS-10 and practical aspects in connection with the determination of Direct Expenses for a product or service. In the preparation of cost statement and its attestation, Direct Expenses should be determined with reference to CAS-10.

The Companies (Cost Accounting Records) Rules, 2011 provide that every company, including a foreign company defined under section 591 of the Companies Act, 1956 which is engaged in production, processing, manufacturing or mining activities have to maintain cost accounting records in accordance with the Generally Accepted Cost Accounting Principles (GACAP) and Cost Accounting Standards issued by the Institute, to the extent these are found to be relevant and applicable. The above Rules further provide that these will be applicable to companies wherein:

- (a) aggregate value of net worth as on the last date of the immediately preceding financial year exceeds five crores of rupees; or
- (b) the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds twenty crores of rupees; or
- (c) the company's equity or debt securities are listed or are in the process of listing on any stock exchange whether in India or outside India.

The Companies (Cost Audit Report) Rules 2011 cast a duty on a Cost Auditor appointed under Section 233B of the Companies Act, 1956 to certify inter alia that books and records maintained by the company are in conformity with the Cost Accounting Standards issued by the Institute to the extent these are found to be relevant and applicable.



Chapter 1

Introduction

Direct Expenses are the expenses relating to manufacture of a product or rendering of a service which can be identified or linked with the cost object other than those incurred on direct material and direct employee cost.

Examples of Direct Expenses are royalties charged on the basis of production, job charges, hire charges for use of specific equipment for a specific product, cost of special designs or drawings for a product, software services specifically required for a job product, travelling expenses for a specific product. These are dealt below:-

- (i) **Royalty:** Royalty is to be paid to Collaborators or technology suppliers in terms of agreement entered with them. It is payable either in relation to production or sales during the accounting period. If royalty payment is to be computed on the basis of production the same should be treated as Direct Expenses. Royalty for Upgrading Technology for the product will be included in cost of production, irrespective of whether it is paid on production basis or sales basis. Royalty for Marketing and Distribution, if paid, will be excluded from cost of production.
- (ii) **Technical Assistance/Know-how fees:**
Technical Assistance/know-how fees are paid for acquiring Technical assistance /Know-how. Custom duty paid/payable at the time of import of technical knowhow is treated as part of cost of technical knowhow. This is to be reflected as a line item under paragraph 5 - Abridged Cost Statement of the Companies (Cost Audit Report) Rules, 2011.
- (iii) **Job/Processing charges for a product:** Job Work Charges/Processing Charges which are directly identified or linked with the products will form part of Direct Expenses. Job charges may be for a specific product or for job on contract basis for a product.
- (iv) **Hire charges for tools etc:** Hire charges in respect of tools and equipments which can be directly identified with a particular product will form part of Direct Expenses. Hire charges for tools for general use is in the nature of indirect Expenses and is to be included in production overheads.
- (v) **Charges for a particular product designing etc:** Product design charges in respect of tools which can be directly identified with a particular product will form part of Direct Expenses. For example, special design was to be developed for a tool as per customer requirements and such expenses incurred in designing of a tool for the product would be treated as Direct Expenses for the product.



4. Definitions

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.*¹

4.2 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.*²

4.3 Direct Employee Cost: *The cost of employees which can be attributed to a cost object in an economically feasible way.*³

4.4 Direct Expenses: *Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost*⁴.

4.5 Direct Material Cost: *The cost of material which can be attributed to a cost object in an economically feasible way*⁵.

4.6 Finance Costs: *Costs incurred by an enterprise in connection with the borrowing of funds.*

4.7 Imputed Costs: *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.*⁶

4.8 Overheads: *Overheads comprise of indirect materials, indirect employee costs and in Direct Expenses which are not directly identifiable or allocable to a cost object.*⁷

4.9 Standard Cost: *A predetermined cost of resource inputs for the cost object computed with reference to set of technical specifications and efficient operating conditions.*

¹ Adapted from CAS 1 paragraph 6.5.19

² Adapted from CIMA Terminology

³ Adapted from CAS 1 paragraph 6.2.4 (Direct labour cost)

⁴ Adapted from CAS 1 paragraph 6.2.6

⁵ Adapted from CAS 1-6.2.3

⁶ Adapted from CAS 1 paragraph 6.5.13

⁷ Adapted from CAS 3 paragraph 4.1

**Chapter 3****Introduction****5. Principles of Measurement:****5.1 Identification of Direct Expenses shall be based on traceability in an economically feasible manner.**

Measurement of Direct Expenses depends upon identification and traceability to cost object/ product in an economically feasible manner. *The cost object 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.*⁸ It is the logical sub-unit for accumulation of cost. If an expense can be identified with a cost object / product and is sufficient material in amount, it is treated as Direct Expenses. It must also be economically feasible to associate Direct Expenses with units produced. "Economically feasible manner" means cost effectiveness for identification of direct expense and such identification should not be too expensive in relation to expected benefits.

5.2.1 Direct Expenses incurred for the use of bought out resources shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of trade discounts, rebates, taxes and duties refundable or to be credited.

Direct Expenses are incurred for the use of bought out resources.

These are:

Royalties charged on production, job charges, hire charges for use of specific equipment for a specific product, cost of special designs or drawings/ software services specifically required for a product and the like.

In such case determination of Direct Expenses incurred for a cost object will depend upon the type of Direct Expenses. For Example, royalty payment is to be determined in terms of collaboration agreement. Job /hire charges will be as per work order and invoice. It shall include duties and taxes and other expenditure (freight/transport). Direct Expenses are to be net of any discount, rebate, taxes and duties (VAT/CENVAT) refundable, if any.

If any design and drawing is imported, custom duty payable/paid, insurance and freight/ courier charges if any, will form part of the cost. Supplier will be paid full amount as per invoice. In case Excise Duty/Cess and VAT are refundable, cost of these will be net of these refunds.

⁸ Adapted from CIMA Terminology



5.2.2 Direct Expenses other than those referred to in paragraph 5.2.1 shall be determined on the basis of amount incurred in connection therewith.

Dies, tools, scaffolding, and so on are sometime produced internally. Production Cost of these items is to be determined taking into account the direct material cost, direct employee cost, Direct Expenses and production overhead. As and when a decision is taken to produce dies/tools in house, all the above expenses are recorded. Direct material cost is to be measured as per paragraph 5.1 of CAS on Material Cost (CAS-6). The receipt of material shall be valued at purchase price including duties and taxes, freight inwards and other expenditure attributable to procurement. The material cost is to be adjusted for trade discounts, rebates, taxes and duties refundable or to be credited by the taxing authorities.

Similarly benefit of import entitlement is to be credited.

Direct employee cost for internally produced dies, tools etc is to be measured as per paragraph 5.1 of CAS on Employee Cost (CAS-7). It shall take into account the gross pay including all allowances payable along with the cost to the employer of all the benefits. The share of production overhead is to be determined as per CAS-3. Expenses incurred for development and improvement of the process for existing product shall be identified as Direct Expenses.

5.2.3 Direct Expenses paid or incurred in lump-sum or which are in the nature of 'one – time' payment, shall be amortised on the basis of the estimated output or benefit to be derived from such Direct Expenses.

In case of lump sum payment or one-time payment, for which benefit is expected in future period, it shall be written off over its useful life. For example Technical know-how fee paid shall be amortized over its useful life.

5.3 If an item of Direct Expenses does not meet the test of materiality, it can be treated as part of overheads.

Whether an item of expense is to be treated as Direct expense or indirect expense, is to be determined in terms of materiality of an item. Materiality has not been defined in the standard. Materiality depends on the size and nature of item judged in particular circumstances. An item of expense is considered material if its omission could influence the economic decisions of users of the cost statement. For example Royalty is a material item of cost. It is to be indicated in the cost statement as a separate item under the Companies (Cost Audit Report) Rules, 2011 and not aggregated with production overhead even though it may not be significant in term of the total cost of the product. In another case, job charges can be identified with the cost object but not being material and significant in value, it may be treated as Production overhead.

5.4 Finance costs incurred in connection with the self generated or procured resources shall not form part of Direct Expenses.



Finance costs are interest and similar charges payable for borrowed funds. Finance costs are excluded from Direct Expenses.

5.5 Direct Expenses shall not include imputed costs. In case of goods produced for captive consumption, treatment of imputed cost shall be in accordance with Cost Accounting Standard – 4 (CAS-4).

Imputed cost does not involve at any time any outright expense or cash outlay. As such it is to be excluded from Direct Expenses. However in case of goods produced for captive consumption, imputed cost is to be considered while determining the cost of goods produced as per Cost Accounting Standard – 4 (CAS-4).

Paragraph 5.14 of CAS-4 provides that In case any input material, whether of direct or indirect nature, including packing material is supplied free of cost by the user of the captive product, the landed cost of such material shall be included in the cost of production. Landed cost of inputs received free of cost should be calculated as per the guidelines relating to material cost. Paragraph 5.15 of CAS-4 further provides that imputed cost is to be charged for Moulds, Tools, Dies & Patterns etc received free of cost. The amortization cost of such items shall be included in the cost of production. Amortisation should be done on the basis of estimated production that can be achieved during the life of the Mould, Tool, Die or Pattern.

5.6 Where Direct Expenses are accounted at standard cost, variances due to normal reasons shall be treated as part of the Direct Expenses. Variances due to abnormal reasons shall not form part of the Direct Expenses.

If standards have been fixed for any Direct Expenses, such as job charges, and the like, variance of Direct Expenses shall be analysed. Variance due to normal reason shall form part of Direct Expenses and any abnormal variance shall be excluded from Direct Expenses. The variance analysis enables management to observe the extent to which actual Direct Expenses are differing from predetermined estimates.

5.7 Any Subsidy/Grant/Incentive or any such payment received/receivable with respect to any Direct Expenses shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.

Subsidy and grant received/receivable for Direct Expenses should be deducted therefrom.

5.8 Any abnormal portion of the Direct Expenses where it is material and quantifiable shall not form part of the Direct Expenses.

Abnormal cost has been defined under paragraph 4.1 of CAS-10. The rationale of exclusion is that inclusion of such items in the cost will make the cost not comparable with a normal situation. Such an aberration is avoided to understand the cost in a better perspective for any purpose.



Illustration:

Certain Direct Expenses were incurred on design and drawing, but due to change in the specification of the product, these drawings were abandoned and were treated as abnormal cost as being material and quantifiable and will not form part of the Direct Expenses.

5.9 Penalties, damages paid to statutory authorities or other third parties shall not form part of the Direct Expenses.

Penalties/damages are levied by the statutory authorities for non-compliance with statutory requirements/delay. Penalties/Damages are an abnormal cost and do not form part of the Direct Expenses. It is charged to Profit & Loss account.

5.10 Credits/recoveries relating to the Direct Expenses, material and quantifiable, shall be deducted to arrive at the net Direct Expenses.

If any credit is available relating to Direct Expenses, it is to be deducted from the Direct Expenses for a product.

5.11 Any change in the cost accounting principles applied for the measurement of the Direct Expenses should 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 organisation.

Principles applied for determining the Direct Expenses be followed consistently. For example profit sharing bonus paid to employees was not to be treated as a part of production cost but of "Total cost of Sales" under previous Cost Audit Report Rules 1996. This principle was being followed consistently but due to change in the principle with the notification of the Companies (Cost Accounting Records) Rules, 2011 bonus is now part of the employee cost and forms part of cost production. Thus change in cost accounting principle/law for determining the cost can be made when required by any law as illustrated above or for compliance with cost accounting standards or it results in more appropriate presentation of cost statement.



Chapter 4

Introduction

6. Assignment of costs

6.1 *Direct Expenses that are directly traceable to the cost object shall be assigned to that cost object.*

Assignment of Direct Expenses involves establishing a suitable procedure to identify and record the same by cost object. Invoice/Agreement/Job on contract are the source documents indicating details of Direct Expenses. For internally produced tools, Work Order is the source for assignment of cost. These documents record the cost object / cost centre/product, and items listed are charged at their acquisition cost.



7. Presentation

7.1 Direct Expenses, if material, shall be presented as a separate cost head with suitable classification. For example

- Subcontract charges
- Royalty on production

Direct Expenses are to be reflected in the cost statement as a separate item of expense if these are material. Materiality has not been defined in the standard. What is considered material or immaterial depends upon the situation.

The following criteria can be applied for determining the materiality. No one criterion is determinative in and of itself.

- The absolute amount – the larger the amount, the more likely that it is material.
- The amount of cost of a product compared to the amount of Direct Expenses under consideration – the greater the proportion of the considered amount of Direct Expenses versus the cost of product, the more likely it is material.
- The relationship of Direct Expenses with product.
- The cumulative impact of individual immaterial items - do they offset one another or do they accumulate in one direction (increase or decrease).
- The cost of determining the Direct Expenses.

**Chapter 6****Introduction****8. Disclosures****8.1 The cost statements shall disclose the following:****8.1.1 The basis of distribution of Direct Expenses to the cost objects/ cost units.**

Disclosure is to be made relating to the basis adopted for distribution of direct cost to product/ unit in the cost statement or by way of foot note.

8.1.2 Quantity and rates of items of Direct Expenses, as applicable.

Disclosure is to be made in the cost statement both in quantity and rates of items of Direct Expenses. Certain Direct Expenses are paid in lump sum. Details where quantitative information cannot be disclosed, shall be mentioned in the cost statement.

Example:

Royalty of Rs 10.25 lakhs has been determined @ 3% of cost of Production.

8.1.3 Where Direct Expenses are accounted at standard cost, the price and usage variances

If the Direct Expenses are accounted at standard cost, the price and usage variances are to be disclosed in the cost statement.

8.1.4 Direct Expenses representing procurement of resources and expenses incurred in connection with resources generated.

Disclosure is to be made for Direct Expenses both for procurement of resources and resources generated internally:

Example:

Direct Expenses :

1. Special Design and Drawing procured	Rs 250,000
2. Tools & Dies produced internally:	
Material	Rs 36000
Labour	Rs 12000
Overhead	Rs 6000
Total	<u>Rs 54,000</u>



8.1.4 Direct Expenses paid/ payable to related parties⁹.

The related parties have been defined under the Companies (Accounting Standards) Rules, 2006. If Direct Expenses is paid /payable for any supply procured from or supplied to related parties, its relationship, nature of transaction viz quantity, rate, other terms/ conditions of procurement are to be disclosed. The objective of disclosure is to ascertain that the transaction is at arm's length and on purely commercial terms.

8.1.5 Direct Expenses incurred in foreign exchange.

Payment made in foreign exchange for the Direct Expenses relating to import of design/ drawing, royalty etc shall be indicated in the cost statement as a footnote.

Example: Royalty paid in foreign exchange as per Collaboration Agreement:

Royalty was paid US \$ 5600 on production during the current year (Previous year US \$ 4500).

8.1.6 Any Subsidy/Grant/Incentive and any such payment reduced from Direct Expenses.

Any subsidy/grant/incentive received relating to Direct Expenses is to be deducted from the Direct Expenses of the product and disclosure made accordingly by way of a foot note

8.1.8 Credits/recoveries relating to the Direct Expenses.

If any credit or recovery is considered while determining the Direct Expenses, the same shall be disclosed in the body of the cost statement.

8.1.9 Any abnormal portion of the Direct Expenses

Abnormal portion of Direct Expenses of a product is to be excluded from the cost of the product as the same has not contributed to the product. Disclosure is to be made by way of foot note in the cost statement.

For example : During the year there was a fire resulting in loss of special design and drawings developed for improved process valued at Rs 2.50 lakhs. The same has been excluded from the development cost.

8.1.10 Penalties and damages paid etc. excluded from the Direct Expenses.

Penalties and damages paid are not an item of cost as these are levied for non compliance with regulatory /contractual requirements. These are to be quantified and excluded from cost and disclosure made as a footnote in the cost statement.

⁹ 1 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.

Level of materiality and significance has not been stated in the standard. What is considered material or immaterial depends upon the situation. A piece of information is material, if its non disclosure could influence the decision of user.

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

Disclosure in the body of cost statement will depend on nature and materiality of Direct Expenses. If it forms material part of the Direct Expenses and can be identified with a product the same shall be disclosed in the cost statement otherwise, disclosures may be by way of foot note.

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

Cost Accounting principles, and methods applied for the measurement and assignment of Direct Expenses are to be applied consistently between one period and another uniformly applied for different Direct Expenses. If any change is made in these principles and methods which results in material impact on the cost of product, the same shall be disclosed in the cost statement or by a foot note. In case the impact of change in principles and methods of cost accounting is not ascertainable, the fact is to be disclosed by a note to the cost statements.



CAS - 11

COST ACCOUNTING STANDARD ON ADMINISTRATIVE OVERHEADS

The following is the COST ACCOUNTING STANDARD - 11 (CAS-11) issued by the Council of The Institute of Cost and Works Accountants of India on “**ADMINISTRATIVE OVERHEADS**”. 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 the principles and methods of determining the administrative overheads.
- 1.2 ***This standard deals with the principles and methods of classification, measurement and assignment of administrative overheads, for determination of the Cost of product or service, and 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 administrative overheads with reasonable accuracy.

3. Scope

This standard should be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of administrative 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.***¹
- 4.2 ***Absorption of overheads: Absorption of overheads is charging of overheads to Cost Objects by means of appropriate absorption rate.***²
Overhead Absorption Rate = Overheads of the Cost object / Quantum of base.

¹Adapted from CAS 1 Para 6.5.19

² Adapted from CAS 3 Para 4.6



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

Administrative overheads shall exclude production overheads³, marketing overheads⁴ and finance cost. Production overheads includes administration cost relating to production, factory, works or manufacturing.

4.4 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.*⁵

4.5 Finance Costs: *Costs incurred by an enterprise in connection with the borrowing of funds.* This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs⁶. The terms Finance costs and Borrowing costs are used interchangeably.

4.6 Imputed Costs: *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.*⁷

4.7 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.*⁸

4.8 Overheads: *Overheads comprise of indirect materials, indirect employee costs and indirect expenses which are not directly identifiable or allocable to a cost object.*⁹

5. Principles of Measurement

5.1 *Administrative overheads shall be the aggregate of cost of resources consumed in activities relating to general management and administration of an organisation.*

It usually represents the cost of shared services, cost of infrastructure and general management costs. Administrative overheads comprise items such as employee costs, utilities, office supplies, legal expenses and outside services. The principles of measurement of Material Cost, Employee Costs, Utilities, Repairs and Maintenance and Depreciation found in the respective standards will apply to these elements included in administrative overheads.

³ Paragraph reference 4.13 CAS -9

⁴ Paragraph reference 4.11 CAS -7

⁵ Adapted from CIMA Terminology

⁶ Adapted from CIMA Terminology

⁷ Adapted from CAS 1 Para 6.5.13

⁸ Adapted from CAS 2 Para 4.4

⁹ Adapted from CAS 3 Para 4.1



- 5.2** *In case of leased assets, if the lease is an operating lease, the entire rentals shall be included in the administrative overheads. If the lease is a financial lease, the finance cost portion shall be segregated and treated as part of finance costs.*
- 5.3** *The cost of software (developed in house, purchased, licensed or customised), including up-gradation cost shall be amortised over its estimated useful life.*
- When hardware requires up-gradation along with software up-gradation, it is recommended that compatible estimated lives be used for the two sets of cost.
- 5.4** *The cost of administrative services procured from outside shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited.*
- 5.5** *Any Subsidy/Grant/Incentive or any amount of similar nature received/receivable with respect to any Administrative overheads shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.*
- 5.6** *Administrative overheads shall not include any abnormal administrative cost.*
- Example: Expense incurred in a situation of natural calamity.
- 5.7** *Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the administrative overheads.*
- 5.8** *Credits/ recoveries relating to the administrative overheads including those rendered without any consideration, material and quantifiable, shall be deducted to arrive at the net administrative overheads.*
- 5.9** *Any change in the cost accounting principles applied for the measurement of the administrative overheads should 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 organisation.*
- 6. Assignment of Cost**
- 6.1** *While assigning administrative overheads, traceability to a cost object in an economically feasible manner shall be the guiding principle.*
- 6.2** *Assignment of administrative 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.¹⁰*

¹⁰ Adapted from of CAS 3 Para 5.1



The costs of shared services should be assigned to user activities on the basis of actual usage.

Where the resources by way of infrastructure are shared the cost should be assigned on a readiness to serve basis.

General management costs should be assigned on rational basis.

For example: Number of employees, turnover, investment size etc.

7. Presentation

7.1 *Administrative overheads shall be presented as a separate cost head in the cost statement.*

7.2 *Element wise details of the administrative overheads based on materiality shall be presented.*

8. Disclosures

8.1 *The cost statements shall disclose the following:*

- *The basis of assignment of administrative overheads to the cost objects.*
- *Any imputed cost included as a part of administrative overheads.*
- *Administrative overheads incurred in foreign exchange.*
- *Cost of administrative activities received from or supplied to related parties¹¹.*
- *Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced from administrative overheads.*
- *Credits / recoveries relating to the administrative overheads.*
- *Any abnormal portion of the administrative overheads.*
- *Penalties and damages excluded from the administrative overheads.*

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 administrative overheads during the period covered by the cost statement which has a material effect on the administrative overheads shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*

¹¹ Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement



Guidance Note on Cost Accounting Standard on Administrative Overheads (CAS-11)

The Council of the Institute of Cost Accountants of India has issued the Cost Accounting Standard - 11 (CAS-11) on Administrative Overheads which lays down a set of principles and methods of classification, measurement and assignment of Administrative Overheads for determination of the cost of product or service and the presentation and disclosure in the cost statements.

The Guidance Note deals with principles and methods as provided in the CAS-11 and practical aspects in connection with the determination of Administrative Overheads for a product or service.

In the preparation of cost statement including those requiring attestation, Administrative Overheads should be determined as per CAS-11. The Cost Accounting Standards have been set in bold italic type and reference number of the standard has been retained.

Further, The Companies (Cost Accounting Records) Rules, 2011 provide that every company, including a foreign company defined under section 591 of the Companies Act, 1956 which is engaged in production, processing, manufacturing or mining activities have to maintain cost accounting records in accordance with the Generally Accepted Cost Accounting Principles (GACAP) and Cost Accounting Standards issued by the Institute, to the extent these are found to be relevant and applicable. The above Rules further provide that these will be applicable to companies wherein:

- (a) aggregate value of net worth as on the last date of the immediately preceding financial year exceeds five crores of rupees; or
- (b) the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds twenty crores of rupees; or
- (c) the company's equity or debt securities are listed or are in the process of listing on any stock exchange whether in India or outside India.

The Companies (Cost Audit Report) Rules 2011 cast a duty on a Cost Auditor appointed under Section 233B of the Companies Act, 1956 to certify inter- alia that books and records maintained by the company are in conformity with the Cost Accounting Standards issued by the Institute to the extent these are found to be relevant and applicable.



Chapter 1

Introduction

Administrative Overheads have been defined by the CAS-11 as the cost of all activities relating to general management and administration of an entity. These costs generally represent amounts incurred at Head office / Corporate office relating to administration and policy matters of the company. Administrative Overheads are the cost of all activities relating to general management and administration of an entity. These are the total costs of formulating the policy, directing the organisation and controlling the operations of an entity.

Administrative Overheads exclude production overheads, marketing overheads and finance cost. Production overheads include administration cost relating to production, factory, works or manufacturing. Such costs are in the nature of administrative support to functions connected with the production e.g. Purchase, factory accounts, factory administration etc.

Administrative cost on the other hand represent costs incurred in connection with the management of affairs of the entity such as Policy making, Finance, Human resources and the like.

For example:

Indirect materials - printing and stationery; office supplies;

Indirect employee costs - Salaries of administrative directors, secretaries, accounts department and so on;

Indirect expenses – rent, rates and taxes, insurance, legal charges, audit fee and the like. These include the costs of the concerned departments as well as the Head Office and other administration costs as detailed below:

A. Administrative Overheads generally include the expenses of following departments:

- General Administration
- Human Resources
- Finance and Accounts
- Cost Accounts
- Internal Audit
- Secretarial
- Law and Taxation
- Information Technology
- Security

Administrative costs include all executive, organizational, and clerical costs associated with general management of an organization rather than with manufacturing, marketing, or selling. For example administrative costs include executive compensation,



Administrative Overheads

secretarial salaries, general accounting, public relations, and similar costs involved in the overall, general administration of the organization as a whole.

Other Administrative Expenses:

Printing and stationery

Travelling & Local Conveyance

Membership fee

Computer maintenance expenses for administration

Vehicle maintenance expenses and the like for administration.

A detailed list of other administrative expenses is at **Annexure 1**

B. Corporate Office Expenses:

Board of Directors:

- Directors' sitting fees, remuneration and commission;
- Directors' travelling expenses;
- Meeting and other board expenses.

Other Management Expenses:

1. Administration - Salaries and fringe benefits of general and administrative personnel. For example salaries of managers, and other employees in the administrative functions of the company. Rent, rates and taxes, travelling and other administrative expenses;
2. Cost information should be collected and analyzed systematically and consistently, whether for a routine information system, or for a specific application and / or purpose. In the preparation of cost statement and its attestation, if required, Administrative Overheads relating to a product / service should be determined with reference to CAS-11.



Chapter 2

Definitions

- 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.
- 4.2 Absorption of overheads:** Absorption of overheads is charging of overheads to Cost Objects by means of appropriate absorption rate.
- 4.3 Administrative Overheads:** Cost of all activities relating to general management and administration of an organisation.
- 4.4 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.
- 4.5 Finance Costs:** Costs incurred by an enterprise in connection with the borrowing of funds.
- 4.6 Imputed Costs:** Hypothetical or notional costs, not involving cash outlay, computed for any purpose.
- 4.7 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.
- 4.8 Overheads:** Overheads comprise of indirect materials, indirect employee costs and indirect expenses which are not directly identifiable or allocable to a cost object.



5.1 Administrative overheads shall be the aggregate of cost of resources consumed in activities relating to general management and administration of an organisation.

Administrative Overheads is the cost of all activities relating to general management and administration of an organisation. It is represented by cost of shared services, infrastructure cost and general management cost. Resources consumed are in terms of employee costs, utilities, office supplies, legal expenses and outside services. The measurement of these resources consumed is to be determined in terms of relevant cost accounting standards.

CAS-6 lays down the principles with regard to the valuation of receipts of material. Therefore receipt of indirect materials 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.

The consumption of indirect material is to be valued at issue rate adopted i.e. First in First out, Last in First out, Weighted Average. Such basis should be followed consistently.

Indirect employee cost is to be measured in terms of CAS-7 (Employee cost). Employee cost relating to administrative staff should be the gross pay and allowances payable. It should take into account the employee's salary including all allowances and other benefits, such as Employer's contribution to EPF, FPS, ESIS, Holiday Pay, Gratuity Payable, Bonus and so on. Remuneration paid to Officers, Managers and Executive Directors of an entity - engaged in administrative function should cover fixed salary, PF contribution, leave, superannuation and severance payment, other benefits, and the like. It should also include any amount paid as commission based on percentage of profit. Other benefits include free furnished accommodation, house rent allowance, leave travel concession, reimbursement of medical expenses for self and family. Personal accident insurance, fully maintained company's car with driver, gardener, watchmen and the like. These should form part of employee cost. Remuneration paid to non-executive directors should be treated as Administrative Overheads.

Utilities consumed by administrative cost centres are to be collected and measured in accordance with principles laid down by CAS-8. Repair and maintenance cost should be measured in accordance with principles laid down by CAS -12.

5.2 In case of leased assets, if the lease is an operating lease, the entire rentals shall be included in the administrative overheads. If the lease is a financial lease, the finance cost portion shall be segregated and treated as part of finance costs.

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time. Leases are of two types viz Finance lease and Operating lease. A finance lease



is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Whereas an operating lease is a lease other than a finance lease. The basic concept of lease accounting is that operating lease is merely rental, whereas financial is a disguised purchase.

Lease Rentals in respect of assets taken on 'Operating Lease' for administrative activities should be included under Administrative Overheads. Payments under an operating lease will be recognised by the lessee as an expense over the lease term. Lease rentals for assets acquired under Financial Lease should be segregated between the cost component of asset and interest component by applying an implicit rate of return. Interest component should form part of the Finance Cost and should not be included under Administrative Overheads.

5.3 The cost of software (developed in house, purchased, licensed or customised), including up-gradation cost shall be amortised over its estimated useful life.

Software may be either developed in house, purchased, licensed or customised. Where software is included in the purchase price of hardware (For example operating system software) and the cost of the software cannot be easily calculated, the software should be capitalized and amortized as part of hardware. In case of licensed software, if one-off licensing fee is paid during the period in order to use the software which has acquired service potential or future economic benefits relating to that software, such cost of license fee should be capitalized as part of the software and amortised over its useful life. In case licensing fee is not a one-off (For example a yearly licensing fee which covers maintenance and upgrades automatically provided by the vendor) service potential or future economic benefits obtained will normally expire when the next payment is due and should not be capitalized and charged during the period. In house developed software, as soon as it is put to use, should be capitalized and amortized over its useful life.

5.4 The cost of administrative services procured from outside shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited.

Various types of services related to administration may be procured from outside, such as legal consultancy, management consultancy, internal audit, and so on. In such cases determination of cost of administrative services procured from outside should be as per agreed price / invoice. It should include duties and taxes and other expenditure. These are to be net of any discount, rebate, taxes and duties refundable, if any.

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

Subsidy and grant received / receivable should be recognized on a systematic basis. These should be matched with the related cost for which these are intended to compensate over the period.



For example:

Subsidy may be receivable for any social service, such as crèche, schooling, community centre and the like. Subsidy receivable for this purpose may be reduced from the cost of such services, while ascertaining the cost of the administrative overheads.

5.6 Administrative overheads shall not include any abnormal administrative cost.

Abnormal cost has been defined under paragraph 4.1 of CAS - 11. The rationale of exclusion is that inclusion of such items in the cost will make the cost not comparable with a normal situation. Such an aberration is avoided to understand the cost in a better perspective for any purpose. For determining the abnormal cost following two conditions should be satisfied:

- a) Costs were never envisaged; and
- b) They are not likely to recur during an accounting period.

For example:

- Abnormal administrative cost resulting from natural calamity (flood, earthquake, and the like).
- Sudden breakdown/ loss due to major fire accident.

It should not form part of the administrative overheads and should be dealt with in the costing profit and loss account.

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

Fines, Penalties, damages and the like are levied by the statutory authorities for non-compliance with statutory requirements or delays. These are abnormal cost and should not form part of Administrative Overheads.

For example:

- Penalty for delay in depositing Provident Fund contribution with the Provident Fund Authorities.
- Penalties for non-payment of statutory dues / noncompliance with legal requirement for example not filing certain statutory returns in time.

5.8 Credits / recoveries relating to the administrative overheads including those rendered without any consideration, material and quantifiable, shall be deducted to arrive at the net administrative overheads.

If any administrative services are provided to other activity / unit without any consideration, the cost of the same, if material and quantifiable, should be determined and adjusted against the Administrative Overhead.

For example management consultancy services provided to other unit, the cost of the same should be adjusted against the administrative overheads



5.9 Any change in the cost accounting principles applied for the measurement of the administrative overheads should 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 organisation.

Resources consumed in the administrative overheads are indirect material, indirect employees cost, utilities and other similar items. These are represented in the form of shared services, infrastructure cost and general management cost. Principles applied for measurement of these resources are to be as per relevant cost accounting standard and are to be followed consistently. However, change in principle of measurement of Administrative Overheads should be applied 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.

For example profit sharing bonus paid to employees was not earlier treated as employee cost. But as per the CAS - 7, profit sharing bonus now forms part of employee cost. It is to be measured as per requirement of Bonus Act and CAS - 7. If there is any change in computation of bonus, its measurement has to comply with required changes.



6.1 While assigning administrative overheads, traceability to a cost object in an economically feasible manner shall be the guiding principle.

Once administrative overheads have been accumulated and measured, these are to be assigned to a cost object. Cost Object is a logical sub-unit for collection of cost. Cost Object may be classified in different ways like function-wise and nature-wise. Thus cost object may be any customer, product service, contract, project, activity or other work unit for which a separate cost measurement is desired.

For assigning the administrative overheads, traceability is a key element. Tracing administrative overheads to cost objects can occur by way of:

1. Direct tracing;
2. Driver tracing; and
3. Allocation.

Direct tracing is the process of identifying and assigning cost that is specifically or physically associated with cost object. For example, tracing cost of stationery consumed in the accounts department to a cost object i.e. accounts department. Drivers tracing may be through cost activities viz. units manufactured, hours worked, number of batches in production, number of orders processed, number of departments, and so on.

The method of direct cost tracing usually relies on the observation, counting, and/or recording of the consumption of resource units, such as staff hours or days that are spent on or assignment, or gallons of fuel consumed in a transport trip. Direct tracing also applies to specific resources that are dedicated to particular outputs.

Direct cost tracing often minimizes distortion and ensures accuracy in cost assignments. It shall be applied only to items that account for a substantial portion of the cost of an output and only when it is economically feasible. For example, it is usually unnecessary to trace the cost of office supplies (pens, papers, computer disks, etc.) to various activities or outputs.

The tracing of such costs directly usually outweighs the benefit of the increased accuracy in assigning the resources.

It is often not possible to physically observe the exact amount of resources consumed by a cost object, especially in case of administrative overhead, being an indirect cost. In case of indirect cost there is no relationship between the cost and cost object and tracing is not economically feasible.

The following steps are to be followed when tracing the administrative cost:

1. Identify the activities that cause the administrative costs,
2. Measure the cost of those activities; and
3. Assign the cost of the activities to those products and customers.



Various items of administration overheads are first collected according to nature of expenditure. These are arranged according to department or function. This is the method of primary distribution. The expenses which are capable of being identified with a specific department are directly assigned. The expenses which cannot be assigned directly to specific departments are assigned on suitable basis. Examples of direct identifying with department or functions are:

General Office	
Secretariat	
Finance and Accounts	
Human Resources	
Legal	
Following are the bases used for assignment of administrative expenses:	
<i>Expenses</i>	<i>Bases</i>
Office rent, rates and taxes	Floor area
Depreciation of office building	Floor area
Legal expenses	Number of cases handled / time basis for
	consultancy
Salaries and allowances	Number of employees

In brief, administrative costs shall be assigned on a reasonable and consistent basis. Directly tracing costs might be a preferred approach when economically feasible. Assigning costs on a cause-and-effect basis shall be considered for costs that cannot be directly traced to outputs. This issue therefore requires a judgment taking into account facts and circumstances of each case.

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

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

A cost is assignable or chargeable to one or more cost objects on the basis of relative benefits received or other equitable relationship. Assigning of costs shall be done on a reasonable and consistent basis. Testing reasonableness shall take into account the purpose of the cost information and the economic feasibility of collecting and assigning it. Following criterion shall be considered:

Assigning costs on a cause-and-effect basis shall be considered for costs that cannot be directly traced to outputs.



Administrative Overheads

For example: A computer technology department provides technical support to other departments of an organization. The costs of the department may be assigned to other departments on a cause-and effect basis through two steps. In the first step, the costs are assigned to the activities of the department, such as hardware installation and maintenance, software development and installation, or programming adjustments. In the second step, the costs of these activities are further assigned to other departments based on their usage of the technical services.

Assigning Cost - Benefit received:

Standard provides for assigning of Administrative Overheads to the various cost objects in proportion to the benefits received by them. Benefits received when measurable and traceable, provide guidance for assignment. The beneficiaries of the output of the cost pool shall be identified and costs allocated in proportion to the benefits received. Benefits received shall be interpreted as meaning the receiving of services or goods by the activity represented by the cost objects to which the costs are being assigned.

For example: A corporate wide advertising programme promotes the general image of corporation rather than an individual product. The costs of such programme may be allocated on the basis of division sales in the belief that divisions with higher sales levels are more likely to benefit than divisions with lower sales levels.



Chapter 5

Presentation

- 7.1 Administrative overheads shall be presented as a separate cost head in the cost statement.**
- 7.2 Element wise details of the administrative overheads based on materiality shall be presented.**

Administrative overheads are required to be presented as a separate head in the cost statement. Element wise details of administrative overheads are to be indicated in the cost statement if these are material. What is considered material or immaterial depends on the facts of each case. The materiality of a particular cost is important in classifying costs. The less significant a cost, the less likely will it need to be traced to a cost object. An example as to how administrative overheads can be reflected in a cost statement is given in **Annexure II**.

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

- **The basis of assignment of administrative overheads to the cost objects.**

Disclosure is to ensure the consistency and compliance of requirement of Cost Accounting standards. Disclosure is to be made relating to the basis of assignment of administrative overheads adopted for cost objects / units in the cost statement or by way of foot note.

- **Any imputed cost included as a part of administrative overheads.**

Imputed cost does not form part of the cost as it does not involve any cash outlay. However, if any imputed cost has been included in the administrative overheads, the same shall be disclosed.

For example: Rent of Rs. Two Lakh for owned office building may have been included in Administrative Overhead.

- **Administrative overheads incurred in foreign exchange.**
Payment made in foreign exchange for Administrative Overhead relating to import of any office equipment / consultancy / foreign travelling shall be disclosed in the cost statement.
- **Cost of administrative activities received from or supplied to related parties.**

If any administrative service has been procured from or supplied to related parties (as defined under The Companies Act, 1956), its relationship, nature of transaction viz. quantity, rate, other terms / conditions are to be disclosed. The objective of disclosure is to ascertain that the transaction is at arm's length and on purely commercial terms.

For example:

Related party → A B C Ltd

Nature of relationship → We and our subsidiaries own 51 percent of their Equity.

Nature of transactions: Hiring of office premises.

Office premises measuring 15000 sqft has been hired from ABC Ltd @ Rs 1500 per sq ft. The rate is a market prevailing rate for such premises and transaction is at arm's length. Related party disclosure is to be made.

- **Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced from administrative overheads.**

Any subsidy / grant / incentive or any amount of similar nature received or receivable relating to Administrative Overheads is to be reduced from the Administrative overheads.

For example for setting up school in township / adopting any social activity, subsidy/ grant received is to be disclosed.



- ***Credits / recoveries relating to the administrative overheads.***

If any credit or recovery is considered while determining the administrative overheads the same shall be disclosed.

For Example: certain administrative services were provided during the year to an Associate/Group entity unit, a sum of Rs 15 lakh received has been credited to the Administrative Overheads.

- ***Any abnormal portion of the administrative overheads.***

Abnormal portion of administrative overhead in the cost of cost object is to be excluded as the same has not contributed to the cost object. Disclosure is to be made.

For example: During the year there was fire resulting in loss of office equipment, furniture and fixtures of Rs. 9 lakh. The same has been excluded from the administrative overheads.

- ***Penalties and damages excluded from the administrative overheads.***

Penalties and damages paid are not an item of cost as these are levied for non compliance with regulatory / contractual requirements. These are to be excluded from cost and disclosure made.

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

Level of materiality and significance has not been stated in the standard. Materiality is to be judged in terms of quantity and nature of cost element and in particular context of its omission. A piece of information is material, if its non disclosure could influence the decision of a user.

Materiality and significance of any information will be different from situation to situation. If material, the same is to be disclosed.

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

Disclosure in the body of cost statement will depend on nature and materiality of Administrative Overheads. If it forms material part of the Administrative Overheads and can be identified with a cost object the same shall be disclosed in the cost statement otherwise, disclosures may be made either in the body of the Cost Statement or by way of foot note.

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

Cost Accounting principles, and methods applied for the measurement and assignment of Administrative Overheads are to be applied consistently between one period and another and uniformly applied for different elements of Administrative Overheads. If



Administrative Overheads

any change is made in these principles and methods which results in material effect on the cost of product, the same shall be disclosed in the cost statement. In case the impact of change in principles and methods of cost accounting is not ascertainable, the fact is to be disclosed by a note to the cost statements.

For example Head Office (General Management) expenses were being assigned to various units on the basis of turnover. During the current year the general management expenses have been assigned on a composite ratio which takes into account turnover, capital employed, gross profit, employee cost of units. Previous year's figure is not on comparable basis.



List of other administrative expenses:

- i. General Charges;
- ii. Casual labour;
- iii. Licence fees;
- iv. Insurance expenses;
- v. Training expenses;
- vi. Printing of the Annual Report;
- vii. Telephone;
- viii. Bank charges;
- ix. Printing and stationery;
- x. Vehicle maintenance expenses;
- xi. Travelling and local conveyance for staff;
- xii. Water charges;
- xiii. Electricity charges;
- xiv. Subscription and membership fee;
- xv. Books and periodicals;
- xvi. Inspection fees;
- xvii. Computer maintenance expenses;
- xviii. Gas charges;
- xix. Cleaning and plant watering;
- xx. Advertisement (related to recruitment);
- xxi. Stipend and trainee expenses;
- xxii. Gifts and presents;
- xxiii. Depreciation and repair & maintenance of administrative fixed assets (machines and furniture located in HO; and
- xxiv. Other miscellaneous expenses, such as Reception; Company party to celebrate functions.



COST STATEMENT OF PRODUCT

ELEMENTS OF ADMINISTRATIVE OVERHEADS

(as at serial no.9 of the Cost Statement)

For the period/year ending _____

S.No.	Item	Unit	Quantity	Rate	Amount	Cost per unit
1.	Material cost					
1(a)	Indigenous – I. Purchases II. Self manufactured					
1(b)	Imported					
2.	Other materials					
3.	Total Material cost					
4.	Utilities – Power Steam Water etc.					
5.	Employee cost					
6.	Direct expenses: Royalty Others (specify)					
7	Production Overhead					
8	Adjustment for opening/closing WIP					
9	Cost of Production					
10	Increase/decrease in Finished Goods					
11	Cost of production of goods sold					
12	ADMINISTRATIVE OVERHEADS Employees cost Repairs and Maintenance DepreciationOthersTotal					
13	Selling and Distribution					
14	Interest and Financing charges					
15	Cost of sales					
16	Net sales realization					
17	Margin (Profit /lo ss)					



CAS – 12

COST ACCOUNTING STANDARD ON REPAIRS AND MAINTENANCE COST

The following is the COST ACCOUNTING STANDARD – 12 (CAS - 12) issued by the Council of The Institute of Cost and Works Accountants of India on “**REPAIRS AND MAINTENANCE 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 the principles and methods of determining the repairs and maintenance cost.

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

3. Scope

This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of repairs and maintenance cost including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified.

4.1 **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.***¹

4.2 **Direct Expenses:** ***Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost.***

Examples of Direct Expenses are royalties charged on production, job charges, hire charges for use of specific equipment for a specific job, cost of special designs or drawings for a job, software services specifically required for a job, travelling Expenses for a specific job.

¹ Adapted from CIMA Terminology



- 4.3 Finance Costs:** *Costs incurred by an enterprise in connection with the borrowing of funds.* This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs². The terms Finance costs and Borrowing costs are used interchangeably.
- 4.4 Imputed Costs:** *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.*³
- 4.5 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.*⁴
- 4.6 Production overheads:** *Indirect costs involved in the production process or in rendering service*⁵.
- 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.
- 4.7 Repairs and maintenance cost:** *Cost of all activities which have the objective of maintaining or restoring an asset in or to a state in which it can perform its required function at intended capacity and efficiency.*
- Repairs and Maintenance activities for the purpose of this standard include routine or preventive maintenance, planned (predictive or corrective) maintenance and breakdown maintenance.
- The repair or overhaul of an asset which results in restoration of the asset to intended condition would also be a part of Repairs and Maintenance activity.
- Major overhaul is a periodic (generally more than one year) repair work carried out to substantially restore the asset to intended working condition.
- 4.8 Standard Cost:** *A predetermined cost of resource inputs for the cost object computed with reference to set of technical specifications and efficient operating conditions.*

² Adapted from CIMA Terminology

³ Adapted from CAS 1 Para 6.5.13

⁴ Adapted from CAS 2 paragraph 4.4

⁵ Adapted from CAS-1 Para 6.3.3 and 6.3.4



Standard costs are used as scale of reference 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. Standard costs are also used for estimation.

5. Principles of Measurement:

5.1 *Repairs and maintenance cost shall be the aggregate of direct and indirect cost relating to repairs and maintenance activity.*

Direct cost includes the cost of materials, consumable stores, spares, manpower, equipment usage, utilities and other identifiable resources consumed in such activity. Indirect cost includes the cost of resources common to various repairs and maintenance activities such as manpower, equipment usage and other costs allocable to such activities.

5.2 *Cost of in-house repairs and maintenance activity shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such activity.*

5.3 *Cost of repairs and maintenance activity carried out by outside contractors inside the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other costs incurred by the entity for such jobs.*

5.4 *Cost of repairs and maintenance jobs carried out by contractor at its premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of other resources provided to the contractors.*

5.5 *Cost of repairs and maintenance jobs carried out by outside contractors shall include charges made by the contractor and cost of own materials, consumable stores, spares, manpower, equipment usage, utilities and other costs used in such jobs.*

5.6.1 *Each type of repairs and maintenance shall be treated as a distinct activity, if material and identifiable.*

For example, routine or preventive maintenance, planned (predictive or corrective) maintenance and breakdown maintenance should be identified separately.

5.6.2 *Cost of repairs and maintenance activity shall be measured for each major asset category separately.*

5.7 *Cost of spares replaced which do not enhance the future economic benefits from the existing asset beyond its previously assessed standard of performance shall be included under repairs and maintenance cost.*



- 5.8** *High value spare, when replaced by a new spare and is reconditioned, which is expected to result in future economic benefits, the same shall be taken into stock. Such a spare shall be valued at an amount that measures its service potential in relation to a new spare which amount shall not exceed the cost of reconditioning the spare. The difference between the total of the cost of the new spare and the reconditioning cost and the value of the reconditioned spare should be treated as repairs and maintenance cost.*

Example: The cost of new spare is Rs. 1 crore and the value of the existing spare after reconditioning is estimated at Rs. 20 lacs, the difference of Rs. 80 lacs should be treated as repairs and maintenance cost.

- 5.9** *The cost of major overhaul shall be amortized on a rational basis.*
- 5.10** *Finance costs incurred in connection with the repairs and maintenance activities shall not form part of Repairs and maintenance costs.*
- 5.11** *Repairs and maintenance costs shall not include imputed costs.*
- 5.12** *Price variances related to repairs and maintenance, where standard costs are in use, shall be treated as part of repairs and maintenance cost. The portion of usage variances attributable to normal reasons shall be treated as part of repairs and maintenance cost. Usage variances attributable to abnormal reasons shall be excluded from repairs and maintenance cost.*
- 5.13** *Subsidy / Grant / Incentive or amount of similar nature received / receivable with respect to repairs and maintenance activity, if any, shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.*
- 5.14** *Any repairs and maintenance cost resulting from some abnormal circumstances, if material and quantifiable, shall not form part of the repairs and maintenance cost.*

Example: Major fire, explosions, flood and similar events are abnormal circumstances referred above.

- 5.15** *Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the repairs and maintenance cost.*

Example: A penalty imposed by a regulatory authority for wrongful construction or damages paid to third party for the loss caused due to improper working of property, plant & equipment, should not be included in repairs and maintenance cost.

- 5.16** *Credits/ recoveries relating to the repairs and maintenance activity, material and quantifiable, shall be deducted to arrive at the net repairs and maintenance cost.*



- 5.17** *Any change in the cost accounting principles applied for the measurement of the repairs and maintenance cost should 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 organisation.*
- 6.** **Assignment of costs**
- 6.1** *Repairs and maintenance costs shall be traced to a cost object to the extent economically feasible.*
- 6.2** *Where the repairs and maintenance cost is not directly traceable to cost object, it shall be assigned 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.*
- 6.3** *If the repairs and maintenance cost (including the share of the cost of reciprocal exchange of services) is shared by several cost objects, the related cost shall be measured as an aggregate and distributed among the cost objects as per principles laid down in Cost Accounting Standard – 3.*
- 7.** **Presentation**
- 7.1** *Repairs and maintenance cost, if material, shall be presented in the cost statement as a separate item of cost.*
- 7.2** *Asset category wise details of repairs and maintenance cost, if material, shall be presented separately.*
- 7.3** *Activity wise details of repairs and maintenance cost, if material, shall be presented separately.*
- 8.** **Disclosures**
- 8.1** *The cost statements shall disclose the following:*
- 1. The basis of distribution of repairs and maintenance cost to the cost objects/ cost units.*
 - 2. Where standard cost is applied in repairs and maintenance cost, the price and usage variances.*
 - 3. Repairs and maintenance cost of Jobs done in-house and outsourced separately.*
 - 4. Cost of major overhauls, asset category wise and the basis of amortisation.*
 - 5. Repairs and maintenance cost paid/ payable to related parties⁶.*

⁶ Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement



6. *Repairs and maintenance cost incurred in foreign exchange.*
 7. *Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced from repairs and maintenance cost.*
 8. *Any credits / recoveries relating to the repairs and maintenance cost.*
 9. *Any abnormal portion of the repairs and maintenance cost.*
 10. *Penalties and damages excluded from the repairs and maintenance cost.*
- 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 repairs and maintenance cost during the period covered by the cost statement which has a material effect on the repairs and maintenance cost shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.*



CAS – 13

COST ACCOUNTING STANDARD ON COST OF SERVICE COST CENTRE

The following is the COST ACCOUNTING STANDARD – 13 (CAS - 13) issued by the Council of The Institute of Cost and Works Accountants of India on “**Cost of Service Cost Centre**”. In this Standard, the standard portions have been set in ***bold italic*** type. These are to 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 cost of Service Cost Centre.
- 1.2 This standard covers the Service Cost Centre as defined in paragraph 4.11 of this standard. It excludes Utilities and Repairs & Maintenance Services dealt with in CAS-8 and CAS-12 respectively.
- 1.3 ***This standard deals with the principles and methods of classification, measurement and assignment of Cost of Service Cost Centre, for determination of the Cost of product or service, and 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 Cost of Service Cost Centre with reasonable accuracy.

3. Scope

This standard should be applied to the preparation and presentation of cost statements, which require classification, measurement and assignment of Cost of Service Cost Centre, 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.¹***
- 4.2 ***Administrative Overheads: Cost of all activities relating to general management and administration of an organisation.***

Administrative overheads shall exclude production overheads², marketing overheads³ and finance cost. Production overheads includes administration cost relating to production, factory, works or manufacturing.

¹ Adapted from CAS 1 paragraph 6.5.19

² Paragraph reference 4.13 CAS -9

³ Paragraph reference 4.11 CAS -7



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 finally ascertained.*⁴

4.4 Distribution Overheads: *Distribution Overheads, also known as Distribution Cost, are the costs incurred in handling a product / service from the time it is ready for despatch until it reaches the ultimate consumer including the units receiving the product / service in an inter-unit transfer.*⁵

The cost of any non manufacturing operations such as packing, repacking, labelling, etc. at an intermediate storage location will be part of distribution cost.

4.5 Finance Costs: *Costs incurred by an enterprise in connection with the borrowing of funds.* This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs⁶. The terms Finance costs and Borrowing costs are used interchangeably.

4.6 Imputed Costs: *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.*⁷

4.7 Marketing overheads: *Marketing Overheads are also known as Selling and Distribution Overheads.*

4.8 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.*⁸

4.9 Production Overheads: *Indirect costs involved in the production process or in rendering service.*⁹

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

⁴ Adapted from CIMA Terminology

⁵ Adapted from CAS 1 Paragraph 6.3.9

⁶ Adapted from CIMA Terminology

⁷ Adapted from CAS 1 paragraph 6.5.13

⁸ Adapted from CAS 2 paragraph 4.4

⁹ Adapted from CAS 1 paragraph 6.3.3



4.10 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.¹⁰*

4.11 Service Cost Centre: *The cost centre which primarily provides auxiliary services across the enterprise.*

The cost centre which provides services to Production, Operation or other Service Cost Centre but not directly engaged in manufacturing process or operation is a service cost centre. A service cost centre renders services to other cost centres / other units and in some cases to outside parties.

Examples of service cost centres are engineering, workshop, research & development, quality control, quality assurance, designing, laboratory, welfare services, safety, transport, Component, Tool stores, Pollution Control, Computer Cell, dispensary, school, crèche, township, Security etc.

Administrative Overheads include cost of administrative Service Cost Centre.

4.12 Standard Cost: *A predetermined cost of resource inputs for the cost object computed with reference to set of technical specifications and efficient operating conditions.¹¹*

Standard costs are used as scale of reference 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. Standard costs are also used for estimation.

4.13 Stand-by service: *Any facility created to safeguard against the failure of the main source of service.*

5. Principles of Measurement

5.1 *Each identifiable service cost centre shall be treated as a distinct cost object for measurement of the cost of services subject to the principle of materiality.*

5.2.1 *Cost of service cost centre shall be the aggregate of direct and indirect cost attributable to services being rendered by such cost centre.*

5.2.2 *Cost of in-house services shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such service.*

Cost of other resources includes related overheads.

¹⁰ Adapted from CAS 1 paragraph 6.3.7

¹¹ Adapted from CAS 6 Paragraph 4.15



- 5.2.3** Cost of services rendered by contractors within the facilities of the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources provided to the contractors for such services.
- 5.2.4** Cost of services rendered by contractors at their premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of resources provided to the contractors.
- 5.2.5** Cost of services for the purpose of inter unit transfers shall also include distribution costs incurred for such transfers.
- 5.2.6** Cost of services for the purpose of inter-company transfers shall also include distribution cost incurred for such transfers and administrative overheads.
- 5.2.7** Cost of services rendered to outside parties shall also include distribution cost incurred for such transfers, administrative overheads and marketing overheads.
- 5.3** Finance costs incurred in connection with the Service Cost Centre shall not form part of the cost of Service Cost Centre.
- 5.4** The cost of service cost centre shall not include imputed costs.
- 5.5** Where the cost of service cost centre is accounted at standard cost, the price and usage variances related to the services cost Centre shall be treated as part of cost of services. Usage variances due to abnormal reasons shall be treated as part of abnormal cost.
- 5.6** Any Subsidy / Grant / Incentive or any such payment received / receivable with respect to any service cost centre shall be reduced for ascertainment of the cost to which such amounts are related.
- 5.7** The cost of production and distribution of the service shall be determined based on the normal capacity or actual capacity utilization whichever is higher and unabsorbed cost, if any, shall be treated as abnormal cost¹². Cost of a Stand-by service shall include the committed costs of maintaining such a facility for the service.
- 5.8** Any abnormal cost where it is material and quantifiable shall not form part of the cost of the service cost centre.
- 5.9** Penalties, damages paid to statutory authorities or other third parties shall not form part of the cost of the service cost centre.

¹² Adapted from Paragraph 5.7 of CAS 3



- 5.10** *Credits/recoveries relating to the service cost centre including charges for services rendered to outside parties, material and quantifiable, shall be reduced from the total cost of that service cost centre.*
- 5.11** *Any change in the cost accounting principles applied for the measurement of the cost of Service Cost Centre 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 enterprise.*
- 6. Assignment of Cost**
- 6.1** *While assigning cost of services, traceability to a cost object in an economically feasible manner shall be the guiding principle.*
- 6.2** *Where the cost of services rendered by a service cost centre is not directly traceable to a cost object, it shall be assigned on the most appropriate basis.*
- 6.3** *The most appropriate basis of distribution of cost of a service cost centre to the cost centres consuming services is to be derived from logical parameters which could be related to the usage of the service rendered. The parameter shall be equitable, reasonable and consistent.*
- 7. Presentation**
- 7.1** *Cost of service cost centre shall be presented as a separate cost head for each type of service in the cost statement, if material.*
- 8. Disclosures**
- 8.1** *The cost statements shall disclose the following:*
- 1.** *The basis of distribution of cost of each service cost centre to the consuming centres.*
 - 2.** *The cost of purchase, production, distribution, marketing and price of services with reference to sales to outside parties*
 - 3.** *Where the cost of service cost centre is disclosed at standard cost, the price and usage variances*
 - 4.** *The cost of services received from / rendered to related parties¹³.*
 - 5.** *Cost of service cost centre incurred in foreign exchange.*
 - 6.** *Any Subsidy/Grant/Incentive and any such payment reduced from cost of Service Cost Centre.*

¹³ Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement



- 7. Credits/ recoveries relating to the cost of Service Cost Centre**
- 8. Any abnormal cost excluded from cost of Service Cost Centre**
- 9. Penalties and damages paid excluded from cost of Service Cost Centre.**
- 8.2 Any change in the cost accounting principles and methods applied for the measurement and assignment of the cost of service cost centre during the period covered by the cost statement which has a material effect on the cost of service cost centre shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be disclosed.**
- 8.3 Disclosures shall be made only where material and significant.**
- 8.4 Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule prominently.**



CAS - 14

COST ACCOUNTING STANDARD ON POLLUTION CONTROL COST

The following is the Cost Accounting Standard - 14 (CAS - 14) issued by the Council of The Institute of Cost Accountants of India on “**POLLUTION CONTROL 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

This standard deals with principles and methods of determining the Pollution control costs.

This standard deals with the principles and methods of classification, measurement and assignment of pollution control costs, for determination of Cost of product or service, and 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 Pollution Control Costs with reasonable accuracy.

3 Scope

This standard should to be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Pollution Control Costs including those requiring attestation.

4 Definitions

The following terms are being used in this standard with the meaning specified.

4.1 Air pollutant: ***Air Pollutant means any solid, liquid or gaseous substance (including noise) present in the atmosphere in such concentration as may be or tend to be injurious to human beings or other living creatures or plants or property or environment¹.***

4.2 Air Pollution: ***Air pollution means the presence in the atmosphere of any air pollutant.²***

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.³***

4.4 Direct Expenses: ***Expenses relating to manufacture of a product or rendering a service, which can be identified or linked with the cost object other than direct material cost and direct employee cost.⁴***

¹ Section 2 (a) of The Air (Prevention and Control of Pollution) Act, 1981

² Section 2 (b) of The Air (Prevention and Control of Pollution) Act, 1981

³ Adapted from CIMA Terminology

⁴ Adapted from Paragraph 4.4 of CAS - 10



- 4.5 Environment:** *Environment includes water, air and land and the inter-relationship which exists among and between water, air and land, and human beings, other living creatures, plants, micro-organism and property.*⁵
- 4.6 Environmental Pollutant:** *Environmental Pollutant means any solid, liquid or gaseous substance present in such concentration as may be, or tend to be, injurious to environment.*⁶
- 4.7 Environment Pollution:** *Environmental pollution means the presence in the environment of any environmental pollutant.*⁷
- 4.8 Finance Costs:** *Costs incurred by an enterprise in connection with the borrowing of funds.* This will include interest and commitment charges on bank borrowings, other short term and long term borrowings, amortisation of discounts or premium related to borrowings, amortisation of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases, other similar arrangements and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs.⁸ The terms Finance costs and Borrowing costs are used interchangeably.
- 4.9 Imputed Costs:** *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.*⁹
- 4.10 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*¹⁰.
- 4.11 Pollution Control:** *Pollution Control means the control of emissions and effluents into environment. It constitutes the use of materials, processes, or practices to reduce, minimize, or eliminate the creation of pollutants or wastes. It includes practices that reduce the use of toxic or hazardous materials, energy, water, and / or other resources.*

⁵ Section 2 (a) of The Environment (Protection) Act, 1986

⁶ Section 2 (b) of The Environment (Protection) Act, 1986

⁷ Section 2 (c) of The Environment (Protection) Act, 1986

⁸ Adapted from CIMA Terminology

⁹ Adapted from CAS 1 paragraph 6.5.13

¹⁰ Adapted from CAS 2 paragraph 4.4



4.12 Production overheads: *Indirect costs involved in the production process or in rendering service.*¹¹

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.

4.13 Soil Pollutant: *Soil Pollutant is a substance such as cadmium, copper, arsenic, mercury, oil and organic solvent, which is the source of soil contamination.*

4.14 Soil Pollution: *Soil pollution means the presence of any soil pollutant(s) in the soil which is harmful to the living beings when it crosses its threshold concentration level.*

4.15 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 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. Standard costs are also used for estimation.

4.16 Water pollution: *Pollution means such contamination of water or such alteration of the physical, chemical or biological properties of water or such discharge of any sewage or trade effluent or of any other liquid, gaseous or solid substance into water (whether directly or indirectly) as may, or is likely to, create a nuisance or render such water harmful or injurious to public health or safety, or to domestic, commercial, industrial, agricultural or other legitimate uses, or to the life and health of animals or plants or of aquatic organisms.*¹²

5 Principles of Measurement:

5.1 *Pollution Control costs shall be the aggregate of direct and indirect cost relating to Pollution Control activity.*

Direct cost includes the cost of materials, consumable stores, spares, manpower, equipment usage, utilities, resources for testing & certification and other identifiable resources consumed in activities such as waste processing, disposal, remediation and others.

Indirect cost includes the cost of resources common to various Pollution Control activities such as Pollution Control Registration and such like expenses.

¹¹ Adapted from CAS-1 Para 6.3.3 and 6.3.4

¹² Section 2 (e) of The Water (Prevention and Control of Pollution) Act, 1974



5.2 *Costs of Pollution Control which are internal to the entity should be accounted for when incurred. They should be measured at the historical cost of resources consumed.*

5.3 *Future remediation or disposal costs which are expected to be incurred with reasonable certainty as part of Onerous Contract or Constructive Obligation, legally enforceable shall be estimated and accounted based on the quantum of pollution generated in each period and the associated cost of remediation or disposal in future.*

For example future disposal costs of solid waste generated during the current period should be estimated on, say, a per tonne basis.

5.4 *Contingent future remediation or disposal costs e.g. those likely to arise on account of future legislative changes on pollution control shall not be treated as cost until the incidence of such costs become reasonably certain and can be measured.*

External costs of pollution which are generally the costs imposed on external parties including social costs are difficult to estimate with reasonable accuracy and are excluded from general purpose cost statements.

Social costs of pollution are measured by economic models of cost measurement. The cost by way of compensation by the polluting entity either under future legislation or under social pressure cannot be quantified by traditional models of cost measurement. They are best kept out of general purpose cost statements.

5.5 *Cost of in-house Pollution Control activity shall include cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other resources used in such activity.*

5.6 *Cost of Pollution Control activity carried out by outside contractors inside the entity shall include charges payable to the contractor and cost of materials, consumable stores, spares, manpower, equipment usage, utilities, and other costs incurred by the entity for such jobs.*

5.7 *Cost of Pollution Control jobs carried out by contractor at its premises shall be determined at invoice or agreed price including duties and taxes, and other expenditure directly attributable thereto net of discounts (other than cash discount), taxes and duties refundable or to be credited. This cost shall also include the cost of other resources provided to the contractors.*

5.8 *Cost of Pollution Control jobs carried out by outside contractors shall include charges made by the contractor and cost of own materials, consumable stores, spares, manpower, equipment usage, utilities and other costs used in such jobs.*



- 5.9** *Each type of Pollution Control e.g. water, air, soil pollution shall be treated as a distinct activity, if material and identifiable.*
- 5.10** *Finance costs incurred in connection with the Pollution Control activities shall not form part of Pollution Control costs.*
- 5.11** *Pollution Control costs shall not include imputed costs.*
- 5.12** *Price variances related to Pollution Control, where standard costs are in use, shall be treated as part of Pollution Control cost. The portion of usage variances attributable to normal reasons shall be treated as part of Pollution Control cost. Usage variances attributable to abnormal reasons shall be excluded from Pollution Control cost.*
- 5.13** *Subsidy / Grant / Incentive or amount of similar nature received / receivable with respect to Pollution Control activity, if any, shall be reduced for ascertainment of the cost of the cost object to which such amounts are related.*
- 5.14** *Any Pollution Control cost resulting from abnormal circumstances, if material and quantifiable, shall not form part of the Pollution Control cost.*
- 5.15** *Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the Pollution Control cost.*
- 5.16** *Credits / recoveries relating to the Pollution Control activity, material and quantifiable, shall be deducted to arrive at the net Pollution Control cost.*
- 5.17** *Research and development cost to develop new process, new products or use of new materials to avoid or mitigate pollution shall be treated as research and development costs and not included under pollution control costs. Development costs incurred for commercial development of such product, process or material shall be included in pollution control costs.*
- 5.18** *Any change in the cost accounting principles applied for the measurement of the Pollution Control cost should 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 organisation.*
- 6** **Assignment of costs**
- 6.1** *Pollution Control costs shall be traced to a cost object to the extent economically feasible.*

Direct costs of pollution control such as treatment and disposal of waste shall be assigned directly to the product, where traceable economically.

Where these costs are not directly traceable to the product but are traceable to a process which causes pollution, the costs shall be assigned to the products passing through the process based on the quantity of the pollutant generated by the product.



6.2 *Where the Pollution Control cost is not directly traceable to cost object, it shall be treated as overhead and assigned 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.*

Typical of such costs are costs such as administration costs relating to pollution control activities, costs of certification such as ISO 14000 and registration fees payable to pollution control authorities

6.3 *If the Pollution Control cost (including the share of the cost of reciprocal exchange of services) is shared by several cost objects, the related cost shall be measured as an aggregate and distributed among the cost objects as per principles laid down in Cost Accounting Standard – 3.*

7 *Presentation*

7.1 *Pollution Control cost, if material, shall be presented in the cost statement as a separate item of cost.*

7.2 *Pollution control costs shall be presented duly classified as follows:*

- a) *Direct and Indirect cost*
- b) *Internal and External costs*
- c) *Current and future costs*
- d) *Domain area e.g. water, air and soil.*

7.3 *Activity wise details of Pollution Control cost, if material, shall be presented separately.*

8 *Disclosures*

8.1 *The cost statements shall disclose the following:*

1. *The basis of distribution of Pollution Control cost to the cost objects/ cost units.*
2. *Where standard cost is applied in Pollution Control cost, the price and usage variances.*
3. *Pollution Control cost of Jobs done in-house and outsourced separately.*
4. *Pollution Control cost paid/ payable to related parties¹³.*
5. *Pollution Control cost incurred in foreign exchange.*

¹³ Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement



6. ***Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced from Pollution Control cost.***
7. ***Any credits / recoveries relating to the Pollution Control cost.***
8. ***Any abnormal portion of the Pollution Control cost.***
9. ***Penalties and damages excluded from the Pollution Control cost.***
- 8.2 ***Disclosures shall be made only where material, significant and quantifiable.***
- 8.3 ***Cost incurred on pollution control relating to prior periods and taken to reconciliation directly shall be disclosed separately.***
- 8.4 ***Where estimates are made of future costs to be incurred on pollution control, the basis of estimate shall be disclosed separately.***
- 8.5 ***If a descriptive note dealing with the social cost of pollution caused by the entity and the control of such pollution is contained in the same document as the cost statement, the cost Statement shall carry a reference to such descriptive note.***
- 8.6 ***Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.***
- 8.7 ***Any change in the cost accounting principles and methods applied for the measurement and assignment of the Pollution Control cost during the period covered by the cost statement which has a material effect on the Pollution Control cost shall be disclosed. Where the effect of such change is not ascertainable wholly or partly the fact shall be indicated.***



CAS - 15

COST ACCOUNTING STANDARD ON SELLING AND DISTRIBUTION OVERHEADS

The following is the COST ACCOUNTING STANDARD -15 (CAS-15) issued by the Council of The Institute of Cost Accountants of India on “**SELLING AND DISTRIBUTION OVERHEADS**”. In this standard, the standard portions have been set in ***bold italic*** type. These are to be read in the context of the background material which has been set in normal type.

1. Introduction

This standard deals with the principles and methods of determining the Selling and Distribution Overheads.

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

3. Scope

This standard should be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of Selling and Distribution 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.***¹

4.2 Absorption of overheads: ***Absorption of overheads is charging of overheads to Cost Objects by means of appropriate absorption rate.***²

Overhead Absorption Rate = Overheads of the Cost object / Quantum of base.

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 cost are ascertained.***³

¹ CAS 3 (Revised 2011) Para 4.1

² CAS 3 (Revised 2011) Para 4.2

³ CAS 3 (Revised 2011) Para 4.5



- 4.4 Imputed Costs:** *Hypothetical or notional costs, not involving cash outlay, computed for any purpose.*⁴
- 4.5 Indirect expenses:** *Expenses which cannot be directly attributed to a particular cost object.*
- 4.6 Overheads:** *Overheads comprise costs of indirect materials, indirect employees and indirect expenses which are not directly identifiable or allocable to a cost object in an economically feasible manner.*⁵
- 4.7 Distribution costs or Distribution overheads:** *Distribution Overheads are the costs incurred in handling a product or service from the time it is ready for delivery until it reaches the ultimate consumer.*

The cost of packing, repacking, labelling, etc. at an intermediate storage location will be part of distribution cost.

For Example:

1. Packing, repacking / labelling at an intermediate storage location
2. Transportation cost
3. Cost of warehousing (cover depots, godowns, storage yards, stock yards etc.,)

Note:

In case of machinery involving technical help in installation, such expenses for installation are part of cost of production and not considered as cost of Selling and Distribution Overheads.

- 4.8 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.*⁶

For Example:

1. Salaries of sales personnel
2. Travelling expenses of sales personnel
3. Commission to sales agents
4. Sales and brand promotion expenses including advertisement, publicity, sponsorships, endorsements and similar other expenses.
5. Receivable Collection costs
6. After sales service costs
7. Warranty costs

⁴ CAS 3 (Revised 2011) Para 4.7

⁵ CAS 3 (Revised 2011) Para 4.13

⁶ CAS 3 (Revised 2011) Para 4.15



- 4.9 Marketing Overheads: *Marketing Overheads comprises Selling Overheads and Distribution Overheads.*⁷**
- 5. Principles of Measurement**
- 5.1 *Selling and Distribution Overheads shall be the aggregate of the cost of resources consumed in the selling and distribution activities of the entity. The cost of resources procured from outside 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 by the Tax Authorities.***
- Post sales costs such as warranty cost, product liability cost, after sales service shall be estimated on a reasonable basis.
- 5.2 *Selling and Distribution Overheads, the benefits of which are expected to be derived over a long period, shall be amortised on a rational basis.***
- 5.3 *Selling and distribution overheads shall not include imputed cost.***
- 5.4 *Cost of after Sales Service provided in terms of sale agreement for a class of transactions, shall be determined on rational and scientific basis, net of any recovery on the service.***
- 5.5 *Any Subsidy / Grant / Incentive or any such payment received / receivable with respect to any Selling and Distribution Overheads shall be reduced from the cost of the sales of the cost object.***
- 5.6 *Any abnormal cost relating to selling and distribution activity shall be excluded from the Selling and Distribution Overheads.***
- 5.7 *Any demurrage or detention charges, or penalty levied by transportation or other authorities in respect of distribution activity shall not form part of the Selling and Distribution Overhead.***
- 5.8 *Penalties and damages paid to statutory authorities or other third parties shall not form part of the Selling and Distribution Overheads.***
- 5.9 *Credits/recoveries relating to the Selling and Distribution Overheads including those rendered without any consideration, material and quantifiable, shall be deducted to arrive at the net Selling and Distribution Overheads.***
- 5.10 *Any change in the cost accounting principles applied for the measurement of the Selling and Distribution 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 of Cost**
- 6.1 *Selling and Distribution Overheads directly traceable shall be assigned to the relevant product sold or services rendered.***

⁷ CAS 3 (Revised 2011) Para 4.11



- 6.2** *Transportation cost relating to distribution shall be assigned as per CAS – 5, where relevant and applicable.*
- 6.3** *Assignment of Selling and Distribution 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.*
- 7. Presentation**
- 7.1** *Selling and Distribution overheads shall be presented as a separate cost head in the cost statement.*
- A reporting entity may use the term marketing Overheads in place of Selling and Distribution overheads.
- 7.2** *Element wise details of the Selling and Distribution overheads shall be presented, if material.*
- 8. Disclosures**
- 8.1** *The cost statements shall disclose the following:*
- 1.** *The basis of distribution of Selling and Distribution Overheads to the cost objects.*
 - 2.** *Selling and Distribution Overheads incurred in foreign exchange.*
 - 3.** *Cost of Selling and Distribution services rendered to related parties⁸.*
 - 4.** *Any Subsidy / Grant / Incentive and any such payment reduced from Selling and Distribution Overheads.*
 - 5.** *Credits / recoveries relating to the Selling and Distribution Overheads.*
 - 6.** *Penalties and damages excluded from the Selling and Distribution Overheads.*
- 8.2** *Disclosures shall be made only where material and significant.*
- 8.3** *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*

⁸ Related party as per the applicable legal requirements relating to the cost statement as on the date of the statement



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

9. Effective date:

This Cost Accounting Standard shall be effective from the period commencing on or after 1st April 2013 for being applied for the preparation and certification of General Purpose Cost Accounting Statements.



CAS -16

COST ACCOUNTING STANDARD ON DEPRECIATION AND AMORTISATION

The following is the COST ACCOUNTING STANDARD – 16 (CAS – 16) issued by the Council of The Institute of Cost Accountants of India on “**DEPRECIATION AND AMORTISATION**”. 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

This standard deals with the principles and methods of measurement and assignment of Depreciation and Amortisation for determination of the cost of product or service, and 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 Depreciation and Amortisation with reasonable accuracy.

3. Scope

This standard shall be applied to cost statements which require measurement, assignment, presentation and disclosure of Depreciation and Amortisation, including those requiring attestation.

4. Definitions

The following terms are being used in this standard with the meaning specified:-

4.1 **Amortisation: Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.**

It refers to expensing the acquisition cost minus the residual value of intangible assets such as Franchise, Patents and Trademarks or Copyrights in a systematic manner over their estimated useful economic life so as to reflect their consumption in the production of goods and services.

4.2 **Asset: The terms Asset, Fixed Asset and Intangible Asset will have the same meaning as in the Accounting Standards notified by the Central Government under the Companies (Accounting Standards) Rules, 2006.**

An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise. In case of some assets which are acquired for safety or environmental reasons, the acquisition of such assets may not provide future economic benefits directly but may be necessary for an entity to obtain the future economic benefits from other assets. Such items also qualify for recognition as assets.



- 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.*
- 4.4** *Depreciation: Depreciation is a measure of the wearing out, consumption or other loss of value of a depreciable asset arising from use, efflux of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the estimated useful life of the asset.*
- 4.5** *Depreciable amount of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements, less the estimated residual value.*
- 4.6** *Depreciable fixed and Intangible assets are assets which:*
- (i) are expected to be used during more than one accounting period;*
 - (ii) have a limited useful life; and*
 - (iii) are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.*
- Land is not a depreciable asset as it does not have a defined useful life.
- 4.7** *Residual (salvage) value: Residual value is the amount which an enterprise expects to obtain for an asset at the end of its useful life after deducting the expected costs of disposal.*
- 4.8** *Useful life of asset is either*
- (i) the period over which a depreciable asset is expected to be used by the enterprise; or*
 - (ii) the number of production or similar units expected to be obtained from the use of the asset by the entity*
- 5. Principles of Measurement**
- 5.1** *Depreciation and Amortisation shall be measured based on the depreciable amount and the useful life.*
- The residual value of an intangible asset shall be assumed to be zero unless:
- (a)** there is a commitment by a third party to purchase the asset at the end of its useful life; or
 - (b)** there is an active market for the asset and:
 - I.** residual value can be determined by reference to that market; and
 - II.** it is probable that such a market will exist at the end of the asset's useful life.



- III. The residual value of a fixed asset shall be considered as zero if the entity is unable to estimate the same with reasonable accuracy.

The minimum amount of depreciation to be provided shall not be less than the amount calculated as per principles and methods as prescribed by any law or regulations applicable to the entity and followed by it.

5.2 *In case of regulated industry the amount of depreciation shall be the same as prescribed by the concerned regulator.*

5.3 *While estimating the useful life of a depreciable asset, consideration shall be given to the following factors:*

- (a) *Expected physical wear and tear;***
- (b) *Obsolescence; and***
- (c) *Legal or other limits on the use of the asset.***

5.4 *The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset.*

If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost. The useful life of a re-acquired right recognised as an intangible asset in a business combination is the remaining contractual period of the contract in which the right was granted and shall not include renewal periods.

The useful life of an intangible asset, in any situation, shall not exceed 10 years from the date it is available for use.

5.5 *Depreciation shall be considered from the time when a depreciable asset is first put into use.*

An asset which is used only when the need arises but is always held ready for use. Example: fire extinguisher, stand by generator, safety equipment shall be considered to be an asset in use. Depreciable assets will be considered to be put into use when commercial production of goods and services commences.

Depreciation on an asset which is temporarily retired from production of goods and services shall be considered as abnormal cost for the period when the asset is not in use.

5.6 *Depreciation of any addition or extension to an existing depreciable asset which becomes an integral part of that asset shall be based on the remaining useful life of that asset.*

5.7 *Depreciation of any addition or extension to an existing depreciable asset which retains a separate identity and is capable of being used after the expiry of the useful life of that asset shall be based on the estimated useful life of that addition or extension.*



- 5.8** *The impact of higher depreciation due to revaluation of assets shall not be assigned to cost object.*
- 5.9** *Impairment loss on assets shall be excluded from cost of production.*
- 5.10** *The method of depreciation used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.*
- 5.11** *An entity can use any of the methods of depreciation to assign depreciable amount of an asset on a systematic basis over its useful life.*
- For example:
- a) Straight-line method;
 - b) Diminishing balance method; and
 - c) Units of production method.
- 5.12** *The method of amortisation of intangible asset shall reflect the pattern in which the economic benefits accrue to entity.*
- 5.13** *The methods and rates of depreciation applied shall be reviewed at least annually and, if there has been a change in the expected pattern of consumption or loss of future economic benefits, the method applied shall be changed to reflect the changed pattern.*
- 5.14** *Spares purchased specifically for a particular asset, or class of assets, and which would become redundant if that asset or class of asset was retired or use of that asset was discontinued, shall form part of that asset. The depreciable amount of such spares shall be allocated over the useful life of the asset.*
- 5.15** *Cost of small assets shall be written off in the period in which they were purchased as per the accounting policy of the entity.*
- 5.16** *Depreciation of an asset shall not be considered in case cumulative depreciation exceeds the original cost of the asset, net of residual value.*
- 5.17** *Where depreciation for an addition of an asset is measured on the basis of the number of days for which the asset was used for the preparation and presentation of financial statements, depreciation of the asset for assigning to cost of object shall be measured in relation to the period, the asset actually utilized.*
- 6. Assignment of Costs**
- 6.1** *Depreciation shall be traced to the cost object to the extent economically feasible.*
- 6.2** *Where the depreciation is not directly traceable to cost object, it shall be assigned based on either of the following two principles:*
- i. *Cause and effect - cause is a process or operation or activity and effect is the incurrence of cost.*



- ii. Benefits received– depreciation is to be apportioned to the various cost objects in proportion to the benefits received by them.*
- 7. Presentation**
Depreciation and Amortisation, if material, shall be presented in the cost statement as a separate item of cost.
- 8. Disclosures**
 - 8.1 The cost statement shall disclose the following:-**
 - 1. The basis of distribution of Depreciation and Amortisation to the cost objects.*
 - 2. Any credits / recoveries relating to Depreciation and Amortisation.*
 - 3. Additional Depreciation on account of revaluation of asset, which is not included in cost.*
 - 4. Amount of depreciation that is not included in cost because of temporary retirement of assets from production of goods and services.*
 - 8.2 Disclosure 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 in a separate schedule.**
 - 8.4 Any change in the cost accounting principles and methods applied for the measurement and assignment of Depreciation and Amortisation during the period covered by the cost statement which has a material effect on Depreciation and Amortisation shall be disclosed. Where the effect of such change is not ascertainable wholly or partly, the fact shall be indicated.**
- 9. Effective date:**
This Cost Accounting Standard shall be effective from the period commencing on or after 1st April 2014 for being applied for the preparation and certification of General Purpose Cost Accounting Statements



CAS-17

COST ACCOUNTING STANDARD ON INTEREST AND FINANCING CHARGES

The following is the Cost Accounting Standard (CAS 17) on “**INTEREST AND FINANCING CHARGES**”. In this Standard, the standard portions have been set in ***bold italic*** type. These are to be read in the context of the background material which has been set in normal type.

1 Introduction

This standard deals with the principles and methods of classification, measurement and assignment of Interest and Financing Charges.

2 Objective

The objective of this standard is to bring uniformity and consistency in the principles ,methods of determining and assigning the Interest and Financing Charges with reasonable accuracy.

3 Scope

This standard should be applied to cost statements which require classification, measurement, assignment, presentation and disclosure of Interest and Financing Charges including those requiring attestation.

This standard does not deal with costs relating to risk management through derivatives.

4 Definitions

The following terms are being used in this standard with the meaning specified.

4.1 Asset: ***The terms Asset, Fixed Asset, Tangible Fixed Asset, Intangible Fixed Asset, Qualifying asset, current asset will have the same meaning as in the Accounting Standards notified by the Central Government under the Companies (Accounting Standards) Rules,2006.***

4.2 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.***

4.3 Imputed Costs: ***Hypothetical or notional costs, not involving cash outlay, computed for any purpose.***

4.4 Interest and Financing charges: ***Costs incurred by an enterprise in connection with the borrowing of fund or other costs which in effect represent payment for the use of non- equity fund.***

Examples are:

1. interest and commitment charges on bank borrowings, other short term and long term borrowings:
2. amortisation of discounts or premium related to borrowings:



3. amortisation of ancillary cost incurred in connection with the arrangements of borrowings:
4. Financing Charges in respect of finance leases and other similar arrangements:
and
5. exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs.¹
6. Cash discount allowed to customers.

The terms Interest and financing charges, finance costs, and borrowing costs are used interchangeably.

4.5 *Net current asset: Net current asset is the excess of current assets over current liabilities*

Current Liabilities shall include *short term borrowings and that part of long term borrowings which are classified as current liabilities*

Short term borrowing is the borrowing which is repayable within one year from the date of disbursal as per Loan Agreement.

Long term borrowing is the borrowing which is repayable after one year from the date of disbursal as per Loan Agreement.

5 Principles of Measurement:

5.1 *Interest and Financing Charges incurred shall be identified for :*

- (a) *acquisition / construction/ production of qualifying assets including fixed assets; and*
- (b) *Other finance costs for production of goods/ operations or services rendered which cannot be classified as qualifying assets.*

5.2 *Interest and Financing Charges directly attributable to the acquisition / construction/ production of a qualifying asset shall be included in the cost of the asset.*

5.3 *Interest and Financing Charges shall not include imputed costs.*

5.4 *Subsidy / Grant / Incentive or amount of similar nature received / receivable with respect to Interest and Financing Charges if any, shall be reduced to ascertain the net interest and financing charges.*

5.5 *Penal Interest for delayed payment, Fines, penalties, damages and similar levies paid to statutory authorities or other third parties shall not form part of the Interest and Financing Charges.*

In case the company delays the payment of Statutory dues beyond the stipulated date, interest paid for delayed payment shall not be treated as penal interest.

5.6 *Interest paid for or received on investment shall not form part of the other*

¹ Adapted from CIMA Terminology



financing charges for production of goods / operations or services rendered;

6. Assignment of costs

6.1 Assignment of Interest and Financing Charges to the cost objects shall be based on either of the following principles;

- I. Cause and effect- cause is the process or operation or activity and effect is the incurrence of cost.**
- II. Benefits received- Interest and Financing Charges are to be apportioned to the various cost objects in proportion to the benefits received by them.**

7. Presentation

Interest and Financing Charges shall be presented in the cost statement as a separate item of cost of sales.

8. Disclosures

8.1 The cost statements shall disclose the following:

- 1. The basis of distribution of Interest and Financing Charges to the cost objects/ cost units.**
- 2. Where predetermined cost is applied in Interest and Financing Charges, the rate and usage variances.**
- 3. Interest and Financing Charges paid/ payable to related parties.**
- 4. Interest and Financing Charges incurred in foreign exchange.**
- 5. Any Subsidy / Grant / Incentive or any amount of similar nature received / receivable reduced Interest and Financing Charges.**

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

8.3 Interest and Financing Charges incurred relating to prior periods and taken to reconciliation directly shall be disclosed separately.

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

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

9. Effective date:

This Cost Accounting Standard shall be effective from the period commencing on or after 1st April 2014 for being applied for the preparation and certification of General Purpose Cost Accounting Statements

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