



WEBINT Series on Cost Accounting Standards

Presentation on CAS 10: Direct Expenses

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Mandatory compliance with CAS

As per proviso to Section 148 (3) of the Companies Act 2013, the auditor conducting the cost audit shall comply with the **Cost Auditing Standards** issued by the Institute of Cost Accountants of India with the approval of Central Government.

*Cost Auditing Standard 103 on “Overall Objective of the Independent Cost Auditor and Conduct of an Audit in accordance with Cost Auditing Standards”, states that the **cost auditor conducting cost audit shall comply with the Cost Accounting Standards (CAS) and Generally Accepted Cost Accounting Principles (GACAP) issued by the Institute of Cost Accountants of India.***

Direct Expenses: CRA-1

Form CRA-1 annexed to the “Companies (Cost Records and Audit) Rules, 2014 specifies various items of costs which are to be included in the books of accounts. **Para 4 of Form CRA-1** of the said Rules deals with Direct Expenses. The cost accounting principles given thereunder are to be applied while maintaining cost records.

Direct v/s Indirect Expenses

Direct expenses are the expenses that a business incurs that are directly associated with any cost object including products or services. Direct expenses are directly related to the production of the product sold or service rendered.

Examples: Wages, Factory rent, raw material, Fuel, Carriage inwards etc

Indirect expenses are the expenses that a business incurs that are associated with operating the business as a whole and cannot be traced back to a specific cost object. Indirect expenses are necessary to keep the business up and running, but they can't be directly related to the cost of the products or services.

Examples: Salaries, Telephone bills, Printing & stationery, Legal & Accounting charges, Carriage outwards etc.

CAS – 10 Direct Expenses

Introduction

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.

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.

Scope

This standard should be applied to cost statements, which require classification, measurement, assignment, presentation and disclosure of Direct Expenses including those requiring attestation.

CAS – 10 Direct Expenses

Important Definitions

Cost Object: An activity, contract, cost center, customer, process, product, project, service or any other object for which costs are ascertained.

Direct Employee Cost: Employee cost, which can be directly attributed to a cost object in an economically feasible way.

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

Overheads: Overheads comprise of costs of indirect materials, indirect employees and indirect expenses.

CAS – 10 Direct Expenses

Important Definitions

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

Royalty: Royalty is to be paid to Collaborators or technology suppliers in terms of agreement entered with them 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.

CAS – 10 Direct Expenses

Important Definitions

Examples of Direct Expenses

Technical Assistance/know-how fees is 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.

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.

Hire charges in respect of tools and equipment 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 overheads.**

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 developed for a tool as per customer requirements.

CAS – 10 Direct Expenses

Principles of Measurement

- *Identification of Direct Expenses shall be based on traceability in **an economically feasible manner**.*

Cost object is the logical sub-unit for accumulation of cost. If an expense can be identified with a cost object /product and is sufficiently material in amount, **it is treated as Direct Expenses**. “Economically feasible manner” means cost effectiveness for identification of direct expense and such identification should not be too expensive in relation to expected benefits.

- *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.*

Royalty payment is to be determined in terms of collaboration agreement. Job /hire charges will be as per work order and invoice including duties and taxes and freight/transport. Direct Expenses are to be net of any discount, rebate, taxes and duties refundable, if any.

CAS – 10 Direct Expenses

Principles of Measurement

- *Direct Expenses other than those referred to in previous paragraph shall be determined **on the basis of amount incurred in connection therewith.***

Dies, tools, scaffolding, if produced internally, production Cost of these items is to be determined taking into account direct material cost, direct employee cost, Direct Expenses and production overhead.

The receipt of material shall be valued at purchase price including duties and taxes, freight inwards and other expenditure attributable to procurement.

Direct employee cost for internally produced dies, tools etc is to be measured taking into account the gross pay including all allowances payable along with the cost to the employer of all the benefits.

Expenses incurred for development and improvement of the process for existing product shall be identified as Direct Expenses.

CAS – 10 Direct Expenses

Principles of Measurement

- *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.

- *If an item of Direct Expenses does not meet **the test of materiality**, it can be treated as part of overheads.*

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 and not aggregated with production overhead even though it may not be significant in term of the total cost of the product. **Job charges** can be identified with the cost object but not being material and significant in value, it may be treated as **Production overhead**.

CAS – 10 Direct Expenses

Principles of Measurement

- *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.

- *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).*
- *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 analyzed. Variance due to normal reason shall form part of Direct Expenses and any abnormal variance shall be excluded from Direct Expenses.

CAS – 10 Direct Expenses

Principles of Measurement

- *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.*
- *Any abnormal portion of the Direct Expenses where it is material and quantifiable **shall not form part** of the Direct Expenses.*

The rationale of exclusion of abnormal cost 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.

Example: Certain Direct Expenses incurred on design and drawing, but due to change in the specification, drawings were abandoned and treated as abnormal cost for being material and quantifiable and did not form part of the Direct Expenses.

CAS – 10 Direct Expenses

Principles of Measurement

- *Penalties, damages paid to statutory authorities or other third parties **shall not form part** of the Direct Expenses.*
- *Credits/ recoveries relating to the Direct Expenses, material and quantifiable, **shall be deducted** to arrive at the net Direct Expenses.*
- *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.*

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 earlier Cost Rules. But due to change in the principle with the notification of the revised Cost Rules. bonus becomes part of the employee cost and forms part of cost production. Such a change in principle / law for determining the cost was required by law.

CAS – 10 Direct Expenses

Assignment of Costs

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 some of 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 center/product, and items listed are charged at their acquisition cost.

CAS – 10 Direct Expenses

Presentation

*Direct Expenses, if material, shall be presented **as a separate cost head** with suitable classification.*

Example: Subcontract charges or Royalty on production

Direct Expenses are to be reflected in the cost statement as a separate item of expense if material. Following can be methods applied for determining the materiality.

- **The absolute amount** –larger the amount, the more likely that it is material.
- **Cost of a product compared to 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.
- **Cumulative impact of individual immaterial items** - do they offset one another or do they accumulate in one direction (increase or decrease).

CAS – 10 Direct Expenses

Disclosures

- *The basis of distribution of Direct Expenses to the cost objects/ cost units.*
- *Quantity and rates of items of Direct Expenses, as applicable.*
- *Where Direct Expenses are accounted at standard cost, the price and usage variances*
- *Direct Expenses representing procurement of resources and expenses incurred in connection with resources generated.*
- *Direct Expenses paid/ payable to related parties.*

Objective of this disclosure is to ascertain that the transaction is at arm's length and on purely commercial terms.

- *Direct Expenses incurred in foreign exchange.*
- *Any Subsidy/Grant/Incentive and any such payment reduced from Direct Expenses.*

CAS – 10 Direct Expenses

Disclosures

- *Credits/recoveries relating to the Direct Expenses.*
- *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.

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.*

- *Penalties and damages paid etc. excluded from the Direct Expenses.*
- *Disclosures shall be made only where material, significant and quantifiable*
- *Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.*

CAS – 10 Direct Expenses

Disclosures

- *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 way of 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.

Queries: previous CAS sessions

CAS-6 Material Cost

- *How to calculate material cost for job and process industry?*
- *How the inventory valuation of By-products should be done?*
- *In edible oil industry how sale of de-oiled cake is treated?*

CAS-7 Employees Cost

- *One time compensation paid to employee under separation to reduce manpower count is part of employee cost or not?*

CAS-8 Utilities

- *In fertilizers industry final product was Urea but intermediate product is ammonia how costing can be done for utilities?*
- *Is proportionate fixed cost of Standby utilities to be treated as non cost item and taken to reconciliation?*

Queries: previous CAS sessions

CAS-8 Utilities

- *Do companies use any software tool to capture utilities details, if so which tools are those?*
- *Captive Power Generation units are not subject to Cost Audit but other products of the same company are subject to cost audit. In such a case, does the company require to prepare the Cost records for captive power generation and submit to cost auditor for considering the consumption thereof in auditable products?*

CAS-9 Packing Material Cost

- *Is Procurement OH is part of Factory OH?*
- *How to account for the cylinder charges incurred for making primary laminates?*
- *Why is not there a practice to keep average exchange fluctuation as a part of standard cost of packing where packing material is procured from approved foreign vendor?*

Thank You !!