



# Decoding of *Cost Accounting Standards*

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## Background of Cost Accounting Standards

Cost accounting standards are drafted, in order to bring uniformity and consistency in classification, measurement and assignment of cost to products and services. Cost Accounting Standards are formulated by the Cost Accounting Standard Board and issued by The Institute of Cost Accountants of India. As on today Institute has issued 24 Cost Accounting Standards.

## Whether application of Cost Accounting Standards is mandatory?

Application of Cost Accounting Standards is mandatory while preparation and certification of the General-Purpose Cost Statements. In case the cost accountant is of the opinion that aforesaid standards have not been complied with for preparation of Cost Statements, it shall be his duty to make a suitable disclosure / qualification in his audit report / certificate.

## Structure of Cost Accounting Standards

- Introduction
- Objective
- Scope
- Definitions
- Principles of Measurement
- Assignment of costs
- Presentation
- Disclosure

## Take you through (Coverage)

- Important definitions from each standard
- Calculation of respective Cost
- Key take away from the Cost Accounting standards
  - CAS-14 Pollution Control Cost
  - CAS-18 Research and Development Cost
  - CAS-20 Royalty and Technical Know-How Fee
  - CAS-21- Quality Control Cost

## Common points from CAS-14, 18, 20 & 21

- **Definitions:**

- 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) **Cost Object:** An activity, contract, cost centre, customer, process, product, project, service, or any other object for which costs are ascertained.
- 3) **Direct Employee Cost:** Employee cost, which can be attributed to a Cost Object in an economically feasible way
- 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  
Examples of Direct Expenses are royalties charged on production, 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.

## Common points from CAS-14, 18, 20 & 21

- **Definitions:**

**5) Direct Materials:** Materials, the cost of which can be attributed to a cost object in an economically feasible way

**6) Imputed Costs:** Notional cost, not involving cash outlay, computed for any purpose.

**7) Interest and Finance charges:** Interest and Financing Charges are interest and other costs incurred by an entity in connection with the financing arrangements.

**Examples are:**

1. Interest and commitment charges on bank borrowings, other short term and long term borrowings:
2. Financing Charges in respect of finance leases and other similar arrangements: and
3. Exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs.

The terms Interest and financing charges, finance costs, and borrowing costs are used interchangeably.

# Decoding of CAS

## Common points from CAS-14, 18, 20 & 21

- **Definitions:**

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

**9) Indirect Material Cost:** Material cost that cannot be directly attributed to a particular cost object.

**10) Indirect expenses:** Expenses which cannot be directly attributed to a particular cost object.

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

**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

**13) Standard Cost:** A predetermined cost of a product or service based on technical specifications and efficient operating conditions..

## Common points from CAS-14, 18, 20 & 21

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



### **Relevant provisions of The Companies (Cost Records and Audit) Rules, 2014.**

- Royalty and Technical Know-How Fee- Clause 10
- Research and Development Cost- Clause 11
- Quality Control Cost- Clause 12
- Pollution Control Cost- Clause 13



# *Cost Accounting Standard 18* **Research and Development Cost**

# • Decoding of CAS-18 •

## Key Definitions

- **Research:** Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding
- **Development cost:** Development cost is the cost for application of research finding or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems, or services before the start of commercial production or use
- **Research Cost:** Research cost is the cost of original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

## **How to arrive at Research and Development Cost?**

Research, and Development Costs shall include following elements

1. Cost of materials and services consumed in R & D
2. Cost of bought out materials and hired services
3. The salaries, wages and other related costs of personnel engaged in R & D
4. The depreciation of equipment and facilities used in R & D activity incl (tangible and intangible)
5. Overhead costs, related to Research, and Development activities.
6. Costs paid for R & D activities done by other entities and charged to the entity
7. Expenditure incurred in securing copyrights or licences
8. Expenditure incurred for developing computer software
9. Costs incurred for the design of tools, jigs, moulds and dies
10. Other costs that can be directly attributed to Research, and Development activities and can be identified with specific projects.

# • Decoding of CAS-18 •

## **Exclusions**

- 1) Abnormal Cost (which is material and quantifiable)
- 2) Fines, penalties, damages and similar levies (both statutory and other)
- 3) Imputed Cost

## **Other points to be considered while calculating R & D Cost**

Following amounts should be reduced from the R & D Cost

- Subsidy / Grant / Incentive or amount of similar nature received / receivable related R & D shall be reduced
- Credits/recoveries relating to Research, and Development cost (if material and quantifiable)

## Key takeaway

### □ Assignment of R & D Cost

Assignment of cost should be based on benefit received.

- Attributable to cost object- Assign to cost object
- Not Attributable – Shall be part of reconciliation statement
- Development cost results into an intangible asset (amortized as per CAS 16)
- Development cost for improvement of existing product
  - Improvement continues for more than one accounting year- accumulate such expenses and amortise over the period you receive the benefit.
  - Improvements amounts new process or new product, cost shall be assigned to new product within that year
  - Improvement in quality or minor changes would not be qualified as the R & D Cost.
- Development cost related to sales should be treated as the part of selling overhead

## Key takeaway

### □ Presentation & Disclosures (if material)

- R & D should be presented Separately as a part of Cost Statement
- Basis of accumulation & assignment
- R & D cost paid to the related party and recoveries therefrom
- R & D Cost paid in foreign exchange
- Abnormal Cost incl abandoned activities
- Subsidy/grant/recoveries excluded from the R & D Cost
- Penalties and damages paid



## *Cost Accounting Standard 21* **Quality Control Cost**



## Key Definitions

**1) Quality:** Quality is the conformance to requirements or specifications.

The quality of a product or service is fitness of that product or service for meeting its intended use as required by customer.

**2) Quality control:** A procedure or a set of procedures exclusively designed to ensure that the manufactured products or performed service adhere to a defined set of quality criterion or meets requirement of the client or the customer.

**3) Quality Control cost:** Cost of resources consumed towards quality control procedures

**4) Defectives:** Materials, products or intermediate products that do not meet quality standards. This may include reworks or rejects.

## Key Definitions

**5) Rework:** Defectives which can be brought up to the standards by putting in additional resources. (Repairs, reconditioning and refurbishing)

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

**7) Scrap:** Discarded material having no or insignificant value and which is usually either disposed off without further treatment (other than reclamation and handling) or reintroduced into the process in place of raw material.

### **8) Waste and spoilage:**

**a. Waste:** Material lost during production or storage and discarded material which may or may not have any value.

**b. Spoilage:** Production that does not meet the quality requirements or specifications and cannot be rectified economically.

## How to arrive at Quality Control Cost?

Quality Control cost incurred in-house shall be the aggregate of the cost of resources consumed and includes components such as

1. Cost of materials and services consumed in Quality Control (including tax and other exp and net of discount and taxes refunded)
2. Cost of bought out materials and hired services
3. The salaries, wages and other related costs of personnel engaged in Quality Control
4. The depreciation of equipment and facilities used in Quality Control activity incl (tangible and intangible)
5. Overhead costs related to Quality control activities.
6. Costs paid for Quality control activities done by other entities and charged to the entity
7. Other costs that can be directly attributed to quality control activities.

### **Exclusions**

- 1) Abnormal Cost (which is material and quantifiable)
- 2) Fines, penalties, damages and similar levies (both statutory and other)
- 3) Imputed Cost
- 4) Finance costs incurred in connection with the self-generated or procured resources shall not form part of Quality Control cost.

## **Other points to be considered while calculating quality Cost**

Following amounts should be reduced from the quality Cost

- Subsidy / Grant / Incentive or amount of similar nature received / receivable related Quality shall be reduced
- Credits/recoveries relating to Quality cost (if material and quantifiable)

## Key takeaway

### Assignment of Quality Control Cost

Assignment of cost should be based on benefit received.

- **Attributable to cost object-** Assign to cost object

### Presentation & Disclosures (if material)

- Quality Control Cost should be presented Separately as a part of Cost Statement
- Basis of accumulation & assignment
- Quality Control cost paid to the related party and recoveries therefrom
- Quality Control Cost paid in foreign exchange
- Abnormal Cost incl abandoned activities
- Subsidy/grant/recoveries excluded from the Quality Control Cost
- Penalties and damages paid

*Cost Accounting Standard 20*  
***Royalty and Technical Know-How Fee***

## Key Definitions

**1) Royalty: Royalty is any consideration for the use of asset (tangible and/or intangible) to the owner.** Royalty is often expressed as a percentage of the revenues obtained by use of the owners asset(tangible and/or intangible); per unit of production or sales value. It may relate to use of: Non-renewable resource (petroleum and mineral resources); Patents; Trademarks; Franchise rights; Copy rights; art-work, software and the like.

**2) Technical service fee:** Technical service fee is any consideration payable to provider of technical or managerial services

## How to arrive at Royalty and Technical Know How Fees?

- **Lump sum Payment:** Sum total of amount paid (Amortised over the period )
- **Payment on ad valorem basis**

### Exclusions

- 1) Abnormal Cost (which is material and quantifiable)
- 2) Fines, penalties, damages and similar levies (both statutory and other)
- 3) Imputed Cost
- 4) Finance costs incurred in connection with the self-generated or procured resources shall not form part of R & T Cost.

### Other points to be considered while calculating Royalty and Technical Know How Fees

Following amounts should be reduced from the Royalty and Technical Know How Fees

- Subsidy / Grant / Incentive or amount of similar nature received / receivable related Quality shall be reduced
- Credits/recoveries relating to Quality cost (if material and quantifiable)



## Key takeaway

### Assignment of Cost

- **If traceable to a cost object- assigned to that cost object.**
- **If not traceable to a cost object- assigned on the basis of**
  - Unit Produced
  - Unit Sold
  - Sales Value
- The amount of Royalty and technical know-how fees shall be assigned on the nature/purpose of such fees e.g. Royalty paid for mining will for the part of Cost of Production. Similarly, trademark or brands shall be treated as the cost of sales.

## Key takeaway

### Presentation & Disclosures

- R & T Cost should be presented Separately as a part of Cost Statement
- Basis of accumulation & assignment
- Quantity and related rate items
- R & T cost paid to the related party and recoveries therefrom
- R & T Cost paid in foreign exchange
- Subsidy/grant/recoveries excluded from the Quality Control Cost
- Penalties and damages paid

# Decoding of CAS



## *Cost Accounting Standard 14* **Pollution Control Cost**

## Key Definitions

- 1) **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 environment
- 2) **Air Pollution:** Air pollution means the presence in the atmosphere of any air pollutant
- 3) **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.
- 4) **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
- 5) **Environment Pollution:** Environmental pollution means the presence in the environment of any environmental pollutant.

## Key Definitions

**6) 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

**7) Soil Pollutant:** Soil Pollutant is a substance which is the source of soil contamination 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.

**8) Water pollution:** Water 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

## **How to arrive at Pollution Control Cost**

Pollution Control costs shall be the aggregate of direct and indirect cost relating to Pollution Control activity. Pollution Control Cost for each activity i.e. water, air, soil pollution should be calculated separately.

### **Cost of In-house pollution control cost**

- 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.

## How to arrive at Pollution Control Cost

### Cost of pollution control carried out by the contractor within entity

- Charges payable to the contractor
- Cost of materials,
- Consumable stores,
- Spares,
- Manpower,
- Equipment usage,
- Utilities,
- other costs used in such jobs.

## How to arrive at Pollution Control Cost

### Cost of pollution control carried out by the contractor at its premises

- Invoice value payable to the contractor incl non-refundable tax & duties and net of discount
- Cost of materials,
- Consumable stores,
- Spares,
- Manpower,
- Equipment usage,
- Utilities,
- Other costs used in such jobs

### Cost of pollution control excludes

- 1) Abnormal Cost (which is material and quantifiable)
- 2) Fines, penalties, damages and similar levies (both statutory and other)
- 3) Imputed Cost
- 4) Finance costs



## Other points to be considered while calculating Pollution Control Cost

- Following amounts should be reduced from the Pollution Control Cost
  - Subsidy / Grant / Incentive or amount of similar nature received / receivable related Quality shall be reduced
  - Credits/recoveries relating to Quality cost (if material and quantifiable)
- 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.
- 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.

### **Other points to be considered while calculating Pollution Control Cost**

- 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.

## Key Takeway

### Assignment of Cost

- **If traceable to a cost object-** assigned to that cost object. (if economically feasible)  
e.g. Treatment and disposal of waste shall be assigned directly to the product
- **If not traceable to a cost object-** shall be treated as overheads and shall be apportioned over the product on the basis of
  - Cause and Effect
  - Benefits received

### Presentation

- **Pollution Control cost, if material, shall be presented in the cost statement as a separate item of cost.**
- **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.

Activity wise details of Pollution Control cost, if material, shall be presented separately.

## Key Takeaway

### Disclosures

**The cost statements shall disclose the following: (if material, significant and quantifiable)**

- 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 parties.
5. Pollution Control cost incurred in foreign exchange.
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.

## Key Takeaway

### Disclosures

- Cost incurred on pollution control relating to prior periods and taken to reconciliation directly shall be disclosed separately.
- Where estimates are made of future costs to be incurred on pollution control, the basis of estimate shall be disclosed separately.
- 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.
- Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule.



# Thank You

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