

Query relating to CAS-2 from CMA Srinivasarao Gudi through email dated 22nd September, 2015

Clarification on computation of Abnormal cost due to under-utilization of capacity as per CAS – 2

“As per CAS-2, if there is an underutilization of capacity of plant, we have to compute Abnormal cost and shown under reconciliation between profit as per cost records and financial records.

Suppose Company ‘X’ has only one power plant and within the plant there are 4 sub-units which are equal capacity generation whereas utilities like water plants, coal handling and supporting services are common for all sub-units. During the year due to lack of demand from customers the 2 sub units were idle for entire year balance two units are run at normal captivity.

In this case what type of expenses is to be considered to compute the abnormal cost and we have considered the following fixed expenses as abnormal cost:

1. Depreciation of particular sub-units which are not utilized
2. Proportionate of O&M Expenses (Monthly Fixed charges paying for 4 units to Contractor irrespective of capacity utilization as per agreement)
3. Proportionate of Factory overheads

And whether we can consider the proportionate of admin overheads of Head office and Interest and Financial cost since company have only one production plant and no other business and these are the major fixed expenses incurred during the year.”

Clarification:

Abnormal Idle Capacity as defined in CAS-2 is the difference between Normal Capacity and Actual Capacity Utilization where the Actual Capacity is lower than the Normal Capacity. In this case two sub-units of the power plant are idle due to lack of demand for the entire year and two units are running at normal capacity. They are determining the abnormal idle cost considering the above mentioned items. This appears to be the correct procedure as the items mentioned are related to the cost of generation activity. It is assumed that Normal Capacity has been determined as per paragraph 4.5 of CAS-2.

The second query is relating to consideration of the Administrative Overheads of the Head Office and the Interest and Finance Cost. Administration Overheads of the Head Office [not related to production] are to be absorbed during the year of incurrence as period costs. Interest and finance expenses are not treated as item of production/ generation cost in the cost statement. Therefore those costs should be charged as period cost in the cost statements. As such the above mentioned items will not form part of the underutilization of the capacity.