



**Advisory on the Treatment of various items of Cost in light of Covid-19 pandemic & their Presentation / Disclosures in form CRA 3 of The Companies (Cost Records & Audit) Rules 2014 relating to the Accounting Period ending March 31, 2021**

The Covid-19 pandemic war against humanity began in December 2019. Since then, it has ravaged the global economy, worse than the first two world wars. It forced entire world to lockdown; brought economic activity to standstill and resulted in majority of businesses to close down. Still there is no firm solution or visible end; the only thin hope lies in mass vaccination which is underway.

In India, with the nationwide lockdown from March 25, 2020, there was major loss of production as majority of businesses were closed; and movement of goods & workers was restricted. It caused simultaneous disruptions to both supply and demand in an interconnected global economy. On the supply side, labour migrations, infections, lockdowns, business closures, and social distancing caused disruptions. On the demand side, layoffs and the loss of income (from morbidity, quarantines, and unemployment) reduced household consumption and firms' investment.

Owing to the nationwide lockdown, the Indian economy shrank 24.4% year-on-year in the first quarter of 2020, i.e. from April to June. With the phase-wise lifting of lockdowns, the contraction narrowed to 7.3% in Q2 and in the third quarter, the economy came out of contraction and recorded a growth of 0.4%. Hence technically, it exited the recession phase. This change has reflected a continued V-shaped recovery. The recently released Economic Survey has projected Indian Economy to contract 7.7% in current fiscal and growth to rebound to 11% next fiscal.

In the post Covid-19 situation, it is significant to study the role of cost accounting principles & practices while undertaking the reconstruction & restart of industries & businesses. On April 13, 2020, the Institute issued an advisory to guide the stakeholders on treatment of various elements of costs in compilation of Cost Records, Cost Statements & Annexures to Cost Audit Report for the year 2019-20. The said Advisory was applicable for the Accounting Period ended 31<sup>st</sup> March 2020.

Now the time has come to take stock of the impact in Financial Year 2020-21 and issue requisite advisory for the treatment of various elements of costs in compilation of Cost Records, Cost Statements & Annexures to Cost Audit Report for the year 2020-21. Hence this Advisory is applicable for the Accounting Period ended 31<sup>st</sup> March 2021.

Generally, the businesses have witnessed following nature of impacts:



- Change in Production, Sales, & Capacity Utilization - Majority of industries and businesses faced close down of production facilities resulting in under utilization of installed capacities. These industries/ businesses also witnessed fall in sales owing to multiple reasons. Besides lockdown, other reasons that caused loss of production capacity and sales are indicated below. Further, the loss of production, sales & capacity may be temporary for short or medium term; or it may be of permanent and non-recoverable nature seen in industries like tourism; air travel; passenger rail & road transport; recreation, culture & entertainment; hotels & restaurants, etc.
  - non-availability or cancellation of orders,
  - disruption in the inward supply chain for raw materials, process materials, chemicals, purchased utilities, consumable stores & spares & other inputs,
  - non-availability of skilled/un-skilled labour force,
  - plant & machinery waiting for normal repairs & maintenance,
  - non-availability of outsourced job-work operations or services,
  - fall in demand due to loss of jobs and fall in incomes, or change in economic and social considerations or priorities,
  - location of customers and vendors in areas, regions & countries impacted by lockdown, or
  - disruption in outward supply chain due to lack of transportation & other logistic facilities, etc.
- On the other hand, certain industrial & non-industrial establishments dealing with vital goods and essential services such as food grains, groceries, fruits & vegetable, dairy & milk products, meat & fish; pharmaceuticals & medical supplies; public utilities such as production & distribution of oil, gas & petroleum products, electricity, water & sanitation; telecommunication, internet, broadcasting & cable services; banks & insurance services; print & electronic media; coal mining; cold storage & warehousing services; private security services, etc, including their transportation, were allowed to operate. Such industries/sectors are unlikely to be impacted significantly. Rather, owing to sudden increase in demand, several units worked for extra hours and produced more than their normal capacity. In such units, the reverse impact was seen resulting in excess utilization of available capacities/ production facilities.
- Increase in manpower costs arising due to the following factors:
  - Idle labour cost incurred during lockdown and post-lockdown period,
  - Increased health & well-being cost of employees & workers,
  - Additional safety costs,
  - Additional vaccination costs for employees, workers & their families,



- Additional staff hiring & training costs,
- Higher cost of HR management,
- Decrease in the value of perishable inventories (raw materials, work-in-progress, & finished goods) owing to prolonged storage; it also caused higher storage costs and losses. In certain cases, goods produced as per customer's design specifications [apparels, furnishings, furniture, etc.] were left with no market value. In few cases, the supplies held-up in transit or at ports got spoiled.
- Additional costs on account of the following developments -
  - Digitization of various functions or operations such as receipts & payments, publicity, marketing, purchase & sales, HR management, etc.
  - Automation or use of robots in various production operations; material handling & storage; loading & transportation, etc.
  - Additional repair & maintenance cost of plant & machinery owing to its non-operation & non-maintenance during lockdown period, also resulting in higher value of Depreciation.
  - Need for improved cyber security features fearing data thefts and cyber attacks.
- Unexpected gains or losses on account of the following factors -
  - Waiver in payment of statutory dues, taxes & duties,
  - Rise (quantum jump) in bad debts owing to business failures, held-up consignments, fall in prices, and fall in demand etc,
  - Demand for heavy price reductions by customers,
  - Increase/ decrease in prices of certain commodities such as crude oil, gas & petroleum products; minerals & metals, etc, and
  - Favourable/unfavorable exchange variations.
- Interest and Financing Charges -
  - Incurred during the lockdown period,
  - Whether to capitalize additional interest cost incurred on funds borrowed for acquisition, construction or production of a qualifying assets,
  - Treatment of additional interest cost incurred due to downgrading by rating agencies, and
  - Treatment of interest cost subsidized by the government and/or banks & financial institutions.



- Unrealised insurance claims arising in respect of damaged or unutilized materials & other inputs, supplies made but not reached the customer, etc.
- Time & cost overruns in all capital projects/capex plans -
  - Non-availability of manpower during the lockdown period
  - Delays in both indigenous and imported project supplies
  - Inability of technology partners to post their experts
  - Non-availability of expatriate experts
  - Inability of contractors to work on sites
  - Disruption in cash flows
  - Backing out by any of the financial or technical partner
- Losses, additional penalties and litigation costs due to disruption in meeting with various contractual rights & obligations

All the above mentioned situations either lead to abnormal gains or losses/costs. The Advisory issued by the Institute on April 13, 2020 guided the stakeholders on treatment of various elements of costs in compilation of Cost Statements and compilation of Cost Records & Annexures to Cost Audit Report. The said Advisory and the principles laid therein hold good for the Accounting Period ended 31<sup>st</sup> March 2021 as well with only variation that the period impacted in FY 2020-21 is much longer than that in FY 2019-20. Therefore, the same Advisory would remain applicable for the Accounting Period ended 31<sup>st</sup> March 2021. For sake of convenience of Members of the Institute and other stakeholders, the same is reproduced hereinafter:

## **Part A**

### **Treatment of Various Items of Cost in light of the COVID19 Pandemic**

#### **1.00 Abnormal Costs**

##### **1.10 Definition**

The concept of Abnormal Cost is deep rooted in the Costing Principles and also in the Cost Accounting Standards issued by the Institute. The Abnormal Cost is defined in the Cost Accounting Standards as –

*‘An unusual or atypical cost whose occurrence is usually irregular and unexpected and / or due to some abnormal situation of the production or operation’*



Thus the concept of Abnormal Cost is well defined and well established through the Cost Accounting Standards. The current situation of COVID19 Pandemic and its impact on the production and operations of the businesses is both Irregular and Unexpected and the situation is certainly Abnormal. Thus the impact of COVID19 Pandemic fits the premise of Abnormal Cost as defined in the Cost Accounting Standards. Hence the Costs pertaining to or arising out of the COVID19 Pandemic shall be treated as Abnormal Costs. However due to the supply chain disruption, if the input cost is increased, the same shall not be treated as Abnormal Cost and be accordingly included in the Cost of Production.

### **1.20 Treatment**

Various Cost Accounting Standards have clearly specified the treatment of the Abnormal Cost. Treatment of Abnormal Cost specified under various Cost Accounting Standards is given below –

CAS 4 – Cost Accounting Standard on Cost of Production / Acquisition / Supply of Goods / Provision of Services:

*5.19. Any abnormal cost, where it is material and quantifiable, shall not form part of the cost of production or acquisition or supply of goods or provision of service.*

CAS 5 – Determination of Average (Equalized) Cost of Transportation:

*6.5 Abnormal and non-recurring cost shall not be a part of transportation cost.*

CAS 6 – Material Cost:

*5.2.3 Any abnormal cost shall be excluded from the material cost.*

CAS 7 – Employee Cost:

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

CAS 8 – Cost of Utilities:

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

CAS 9 – Packing Material Cost:



*5.7 Any abnormal cost where it is material and quantifiable shall be excluded from the packing material cost.*

CAS 10 – Direct Expenses:

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

CAS 11 – Administrative Overheads:

*5.6 Administrative overheads shall not include any abnormal administrative cost.*

CAS 12 – Repairs And Maintenance Cost:

*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.*

CAS 13 – Cost of Service Cost Centre:

*5.8 Any abnormal cost where it is material and quantifiable shall not form part of the cost of the service cost centre.*

CAS 14 – Pollution Control Cost:

*5.14 Any Pollution Control cost resulting from abnormal circumstances, if material and quantifiable, shall not form part of the Pollution Control cost.*

CAS 15 – Selling and Distribution Overheads:

*5.6 Any abnormal cost relating to selling and distribution activity shall be excluded from the Selling and Distribution Overheads.*

CAS 16 – Depreciation and Amortisation:

*6.3. Depreciation on an asset which if remains idle or temporarily retired from production of goods and services or remains idle shall be considered as abnormal cost for the period when the asset is not in use.*

CAS 18 – Research and Development Costs:

*5.3 Any abnormal cost where it is material and quantifiable shall not form part of the Research, and Development Cost.*

CAS 21 – Quality Control:



*5.7 Any abnormal portion of the Quality Control cost where it is material and quantifiable shall not form part of the Cost of Quality Control.*

CAS 22 – Manufacturing Cost:

*5.16 Any abnormal cost, where it is material and quantifiable, shall not form part of the manufacturing cost of excisable good.*

CAS 23 – Overburden Removal Cost:

*5.11. Any overburden removal cost resulting from some abnormal circumstances if material and quantifiable shall not form part of the overburden removal cost.*

Thus Majority of the Cost Elements and treatment of Abnormal Cost in each of these Cost Elements is already covered by the Cost Accounting Standards. In case of the missing Cost Elements, reference needs to be drawn from the Generally Accepted Cost Accounting Principles (GACAP) issued by the CASB of ICAI. GACAP

Chapter 7 Principles applicable to Elements of Cost of GACAP states:

*3. Any abnormal cost where it is material and quantifiable will not form part of the cost.*

**From the above it is clear that the Cost Accounting Standards treat the Abnormal Cost as a Non-Cost Item and thus the same should not form part of Cost while compiling Cost Statements. Thus the costs associated with COVID19 Pandemic or the costs associated with the operational period affected by the COVID19 Pandemic, which are Abnormal in nature, shall be treated as Non-Cost Item and shall be reported in the Reconciliation Statement between Costing & Financial Profit / (Loss).**

### **1.30 Abnormal Cost Due to Sudden Shutdown of Operations**

The COVID19 Pandemic and the resulting Shutdown were both un-anticipated and sudden events. Due to this situation the productions and operations had to be closed in emergency situation. This may result into losses or incurring of costs. These shall be treated as Abnormal and treated accordingly in costing. Some of the examples are listed below (the list is only illustrative)

- Loss of Raw Material, Work in Process and Finished Goods on account of Quality deterioration
- Expenses incurred during Closer Period on Plant Maintenance



- Loss of Process Material, Consumables, etc.
- Costs associated with Employees due to sudden lockdown

## 2.00 Normal Capacity & its application

### 2.10 CAS 2 – Capacity Determination defines the Normal Capacity

*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.*

Thus by the definition as given in the CAS 2, Normal Capacity is to be determined based on the Normal Circumstances. Outbreak of COVID19 is not a “Normal Circumstance”. Hence for calculation of the Normal Capacity, period lost due to COVID19 situation (including partial / full shutdown, scaling down of manpower deployment, etc.) needs to be adjusted / reduced. This will give the true representation of the Normal Capacity.

For considering the loss of production/operation days due to COVID 19 Pandemic, only loss of productive days available should alone be considered, i.e. number of days of normal shutdown due to technical reasons / maintenance or other normal circumstances should be excluded

This is specifically very important in the light of principle of absorption of Fixed & Variable Costs. The said principle is given in various Cost Accounting Standards as well as in GACAP.

CAS 3 – Production & Operation Overheads:

*6.3.1 The variable Production or Operation Overheads shall be absorbed to products or services based on actual production.*

*6.3.2 The fixed Production or Operation Overheads shall be absorbed based on the normal capacity.*

CAS 4 – Cost Accounting Standard on Cost of Production / Acquisition / Supply of Goods / Provision of Services:

*6.4. The variable production or operation overheads shall be absorbed based on actual production.*





6.5. *The fixed production or operation overheads and other similar item of fixed costs such as quality control cost, research and development costs and administrative overheads relating to manufacturing shall be absorbed in the cost of production or acquisition or supply of goods or provision of services on the basis of the normal capacity or actual capacity utilization of the plant or service centre, whichever is higher.*

CAS 22 – Manufacturing Cost:

6.3 *The variable manufacturing/production overheads shall be absorbed based on actual production.*

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

GACAP prescribes principle applicable to Elements of Cost:

*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.*

Form CRA 1 of The Companies (Cost Records & Audit) Rules, 2014 also prescribes similar treatment of Fixed & Variable Costs.

Thus determination of the Normal Capacity is critical for the absorption of the Fixed Costs. As already mentioned in point 1.00 above, the Costs Associated with COVID19 Pandemic or the costs associated with the period of operations affected due to COVID 19 Pandemic are to be treated as Abnormal Cost. Since we are eliminating the Cost from the Cost Statements it is appropriate to also eliminate the capacity portion related to COVID 19 Pandemic.

**Hence for calculation of the Normal Capacity, capacity lost due to COVID19 situation (including partial / full shutdown, scaling down of manpower deployment, etc.) needs to be adjusted / reduced.**

### **3.00 Variable Abnormal Cost**

The Concept of Variable Cost is well established and well defined through the Cost Accounting Standards & GACAP.

**CAS 1 – Classification of Costs:**

*4.33 Variable Costs: Variable costs are the cost which tends to directly vary with the volume of activity.*

**CAS 4 – Cost Accounting Standard on Cost of Production / Acquisition / Supply of Goods / Provision of Services:**

*Variable Production or Operation Overheads comprise of expenses which vary in proportion to the change of volume of production or activity or services provided.*

**CAS 22 – Manufacturing Cost:**

*Variable Manufacturing Overheads comprise of expenses which vary in proportion to the change in volume of production.*

**GACAP prescribes principle applicable to Elements of Cost:**

*Variable Costs are the cost which tends to directly vary with the volume of activity.*

Thus the Variable Costs will move in direct proportion to the volume of production / activity. However COVID19 Pandemic is an abnormal situation. There will be certain costs which by their behaviour under normal circumstances are “Variable” in nature, but under abnormal situation of COVID19 Pandemic, they are to be incurred irrespective of volume of production / activity. Such portion of the Variable Cost needs to be identified and should be treated as Abnormal Cost. Thus identification of Variable Abnormal Cost is necessary.

Some Examples of Variable Abnormal Costs are – Direct Employee Cost for the period of COVID19 Lockdown / Partial Operations, Excess Consumption of Utilities, Consumables, Stores, etc. due to Closing Down & Starting Operations due to COVID19 Lockdown, etc.

**Example :****Cost Information**

<b>Particulars</b>	<b>For the Year</b>	<b>Abnormal (COVID19)</b>	<b>To be Absorbed in Costing</b>
Variable Cost	12,00,000	1,00,000	11,00,000
Fixed Cost	18,00,000	1,50,000	16,50,000
<b>Total Cost</b>	<b>30,00,000</b>	<b>2,50,000</b>	<b>27,50,000</b>

**Capacity Information**

Normal Days of operation in the Year	352
Standard Production Per Day	100
Normal Capacity (Normal Year)	35,200
Days Lost Due to COVID19	30
Loss of Capacity (COVID19)	3,000
Normal Capacity (for COVID19 affected Year)	32,200
Actual Capacity	25,000

**For Cost Records Compilation**

<b>Particulars</b>	<b>Cost information</b>
Variable Cost is to be absorbed on Actual Production	11,00,000
Fixed Cost to be absorbed on Standard Production	12,81,056
Un-absorbed Fixed Cost	3,68,944

**Presentation in Reconciliation Statement**

<b>Particulars</b>	<b>Amount</b>
<b>Expenses Not Considered in Cost Accounts</b>	
Un-absorbed Cost (Capacity Under Utilization)	3,68,944
COVID 19 – Unabsorbed Abnormal Cost	2,50,000

**4.00 Interest Cost**

The Interest Cost needs a special mention as many of the financial institutions have announced relief measures for the businesses due to the situation of COVID19. One of major reliefs is the Moratorium in the payment of instalments for a period of 3 months. Thus there is a relief as to Cash Flow for the businesses. But in accounting treatment, the interest will accrue in the books of accounts and will appear as the Interest & Finance Cost. **The amount of Interest / Finance Charge pertaining to the period of COVID19 operational stoppage needs to be ascertained and shall be treated as Abnormal Cost.**



**Additionally, it is likely that the businesses will have to incur additional interest cost for the moratorium availed. This excess Interest/Finance Cost whenever incurred shall be treated as Abnormal Cost resulting out of the COVID19 Pandemic.**

**5.00 Capital Costs incurred post Covid-19 or on on-going Projects:**

Any costs of capital nature incurred in the existing operational facilities or those relating to the on-going capital projects shall be kept out of the purview of Cost Statements. Such costs shall be capitalized following the applicable Accounting Standards.

**Part B**

**Presentation / Disclosure of the various items of Quantity Information & Costs in Form CRA 3 – Cost Auditors Report & Annexure to Cost Audit Report**

**1.00 CRA 3 – Part B – 1. Quantity Information (For Manufacturing Sector)**

**CRA 3 – Part C – 1. Quantity Information (For Service Sector)**

Quantity of Production / Capacity Lost due to COVID19 Pandemic shall be given as part of Notes under this para.

**2.00 CRA 3 – Part D – 2. Profit Reconciliation (for the company as a whole)**

**2.10 CSR Costs**

The Government of India vide Circular No. 05/01/2019-CSR Dated 23.03.2020 has clarified that spending of CSR Funds for COVID19 is eligible CSR Activity.

The cost incurred on CSR Activity is treated as Non-Cost Item in the Cost Records and is reported under this para. It is advised that the CSR Cost should be classified into CSR for COVID19 & other CSR Activities. The same shall be disclosed as separate line items in the Profit Reconciliation Statement.

**2.20 Other Abnormal Costs due to COVID 19**

As mentioned in part A of this Advisory, costs pertaining to the COVID19 Pandemic are to be treated as Abnormal Costs. Thus they will form part of the Profit Reconciliation Statement. It is advised that the Un-absorbed Abnormal Cost due to the COVID19 Pandemic shall be reported as a separate line item giving description



as “COVID 19 – Unabsorbed Costs”. Using this common description by all can facilitate the authorities to consolidate the information if required.

**3.00 CRA 3 – Cost Audit Report – 2. Observations and suggestions, if any, of the Cost Auditor, relevant to the cost audit.**

The Cost Auditors during the process of Cost Audit will be assessing and auditing the impact of COVID19 Pandemic on the operations of the company. This will also include impact in terms of capacity as well as costs. It is suggested that the Auditors may include as part of observations & suggestions a separate Cost Statement giving detailed, cost element wise breakup of the “COVID 19 – Unabsorbed Costs”. This will be very helpful to the Management of the Company as well as all the stakeholders of the Cost Audit Report. It is further suggested that this Cost Statement may also contain quantity information pertaining to the COVID19 Pandemic impact (like capacity utilization, idle capacity due to COVID19, impact on Production, etc). It is suggested that such note may also briefly explain the assumptions / working used by the company to identify the costs associated with COVID19 Pandemic and comment upon its appropriateness.

In case of any doubts or the need to seek further advice on any matters connected with the preparation & certification of Cost Statements as per CRA-3 of the Companies (Cost Records and Audit) Rules 2014, the Members and other Stakeholders are advised to refer the matter to the Technical Cell of the Institute (email: [technicalcell@icmai.in](mailto:technicalcell@icmai.in)) by following the prescribed procedure.

**CMA Biswarup Basu**

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Date: 2<sup>nd</sup> April 2021