



CAS - 1
(REVISED 2015)
COST ACCOUNTING STANDARD ON
“CLASSIFICATION OF COST”

The following is the COST ACCOUNTING STANDARD - 1 (CAS - 1) (Revised 2015) issued by the Council of the Institute of Cost Accountants of India for determination of “**CLASSIFICATION OF 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 the principles of Classification of Cost for determining the cost of a product or service.

2. Objective

The objective of this standard is to bring uniformity and consistency in the principles of Classification of Cost for disclosure and presentation in the cost statements of a product or service.

3. Scope

This standard shall be applied to cost statements, which require classification, presentation and disclosure of 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.

4.2. Administrative Overheads: Cost of all activities relating to general management and administration of an entity.

Administrative overheads shall exclude production overheads, marketing overheads and interest and finance charges. Administrative overheads do not include administration cost relating to production, factory, works or manufacturing.



- 4.3. Classification of cost: Classification of cost is the arrangement of items of costs in logical groups having regard to their nature (subjective classification) and purpose (objective classification).**
- 4.4. Conversion cost: Conversion cost is the production cost excluding the cost of direct materials.**
- 4.5. 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. The type of cost often referred to in the costing system depends on the purpose for which cost is incurred. For example, material cost is the price of materials consumed for manufacturing a product or for rendering a service.

- 4.6. Cost Centre: Any unit of an entity selected with a view to accumulating all cost under that unit. The unit can be division, department, section, group of plant and machinery, group of employees or combination of several units.**

Cost Centre is the logical unit for accumulation 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. Cost centres may also be classified into broad types i.e. Operating Cost Centres and Support- Service Cost Centres. Operating Cost Centres are those which are in the chain of operations like machine shop, welding shop, assembly shop, operation theatre, call centre and so on. Support-service Cost centres are for rendering services to operating cost centre like power house, maintenance, stores, help desk, transport for call centre staff and so on.

- 4.7. Cost Object: An activity, contract, cost centre, customer, process, product, project, service or any other object for which costs are ascertained.**
- 4.8. Cost of Production: Cost of production of a product or a service consists of cost of materials consumed, direct employee costs, direct expenses, production overheads, quality control costs, packing costs, research and development costs and administrative overheads relating to production.**

Cost of production of a service means cost of the service rendered. To arrive at cost of production of goods, including those despatched for captive consumption, adjustment for stock of work-in-process, finished goods, recoveries for sales of scrap, wastage and the like, shall be made.



4.9. 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.

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

Examples:

- Power - MW
- Cement - MT
- Automobile - Number
- Transportation- Tonne- Kilometre

4.11. Development Cost: *Development cost is the cost for application of research findings 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.*

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

4.13. 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:

- Royalties charged on production
- Job charges
- Hire charges for use of specific equipment for a specific job
- Software services specifically required for a job

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



4.15. Distribution Overheads: *Distribution overheads, also known as distribution costs, are the costs incurred in handling a product or service from the time it is ready for despatch or delivery until it reaches the ultimate consumer including the units receiving the product or service in an inter-unit transfer. The cost of any non manufacturing operations such as packing, repacking and labelling at an intermediate storage location will be part of distribution cost.*

Examples:

- Secondary packing
- Outward transportation cost
- Warehousing cost
- Cost of delivering the products to customers
- Clearing and forwarding charges
- Cost of mending or replacing packing materials at distribution point.

4.16. Employee Cost: *Benefits paid or payable for the services rendered by employees (including temporary, part time and contract employees) of an entity.*

Explanation:

- 1 Contract employees include employees engaged by the employer on contract basis, either directly or through a contractor but does not include employees of any contractor engaged in the entity for a contractual job.
 - 2 Compensation paid to employees for the past period on account of any dispute / court orders in the current period shall form part of employee cost, but not a part of production cost.
 - 3 Short provisions of prior period employee cost in current period shall form part of the employee cost in the current period, but not a part of production cost.
- Employee cost includes payment made in cash or kind.

4.17. Fixed Costs: *Fixed costs are costs which do not vary with the change in the volume of activity. Fixed indirect costs are termed fixed overheads.*

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

4.19. Indirect Expenses: *Expenses, which cannot be directly attributed to a particular cost object.*



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

4.21. Marketing overheads: *Marketing Overheads comprise of selling overheads and distribution overheads.*

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

4.23. 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.*

The above definition is also applicable for normal capacity in relation to a service being rendered.

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

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

Packing material can be classified into primary packing material and secondary packing material. Primary packing material is essential to hold and preserve the product for its use by the customer and secondary packing material enables to store, transport, inform the customer, promote and otherwise make the product marketable.

4.26. Prime cost: *Prime cost is the aggregate of direct material cost, direct Employee cost and direct expenses.*

4.27. Production Overheads: *Indirect costs involved in the production of a product or in rendering service.*

The terms Production Overheads, Factory Overheads, Works Overheads and Manufacturing Overheads denote the same meaning. Production overheads include administration costs relating to production, factory, works or manufacturing.

4.28. 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.*

4.29. Selling Overheads: *Selling overheads are the expenses related to sale of products or services and include all indirect expenses incurred in selling the products or services.*



Selling overheads are also known as selling costs.

4.30. Semi Variable Costs: Semi Variable Costs are the costs that contain both fixed and variable elements. They partly change with the change in the level of activity.

4.31. Support-Service Cost Centre: The cost centre which primarily provides auxiliary services across the entity.

The cost centre which provides services to production, operation or other service cost centre but not directly engaged in manufacturing process or operation or in rendering a service is a support-service cost centre. A support-service cost centre renders services to other cost centre's/ other units and in some cases to outside parties.

Examples:

- Engineering
- Workshop
- Quality control
- Quality assurance
- Designing
- Laboratory
- Help desk
- Transport for call centre staff

4.32. Standard Cost: A predetermined cost of a product or service based on 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.

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

Variable indirect costs are termed as variable overheads.

5. Principles of Classification of Costs

5.1. Costs shall be classified by the process of grouping the components of cost under a common designation on the basis of similarities of nature, attributes or relations. Items grouped together under common heads shall be further classified according to their fundamental differences.



It is the process of identification of each item and the systematic placement of like items together according to their common features. The same costs may appear in several different classifications depending on the purpose of classification.

Cost is classified normally in terms of 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.

Cost may be classified with reference to the nature of expense, its traceability to a cost object (direct/ indirect), its relation to functions /activities, its behaviour (fixed, semi-variable or variable) and its relationship to production process.

5.2. *Scheme of classification shall be such that every item of cost is classified.*

6. Classification of Costs

6.1. *By Nature of expenses*

6.1.1. *Items of costs differ on the basis of their nature. Costs shall be gathered together in their natural groupings such as material, employee and expenses. The elements of cost can be classified in the following three categories :*

- i) Material***
- ii) Employee***
- iii) Expenses***

6.1.2. *Material Costs are cost of materials used for the purpose of production of a product or rendering of a service, net of trade discounts, rebates, taxes and duties refundable that can be quantified with reasonable accuracy.*

6.1.3. *Employee Costs are consideration, including benefits paid or payable to employees, permanent or temporary, for the purpose of production of a product or rendering of a service.*

It is the aggregate of all kinds of consideration paid and payable for the services rendered by employees of an entity (including temporary, part time and contract employees). Consideration include wages, salaries, and other payments, including benefits, as applicable.



6.1.4. Expenses are costs other than material cost and employee cost for the purpose of production of a product or rendering of a service.

Examples :

- Cost of utilities
- Payment for bought out services
- Job processing charges

6.2. By nature of traceability to a cost object

6.2.1. Classification shall be on the basis of method of assigning cost to a cost object. If a cost can be assigned to a cost object in an economically feasible way, it shall be termed as direct to that cost object. A cost that cannot be assigned directly shall be indirect cost.

6.2.2. Direct Material Costs are the cost of materials which can be assigned to a cost object in an economically feasible way.

Raw materials consumed for production of a product or rendering of a service which are identifiable to the product or service form the direct material cost. Direct material cost includes cost of procurement, freight inward, taxes & duties and insurance directly attributable to the acquisition of the material. Trade discounts, rebates, duty drawbacks, refunds of duties/taxes and other similar items are deducted in determining the costs of direct material.

6.2.3. Direct Employee Cost are employee costs, which can be assigned to a cost object in an economically feasible way.

Example :

The cost of wages of those workers who are readily identified or linked with a cost centre or cost object, including the fringe benefits like provident fund contribution, gratuity, ESI, overtime, incentives, bonus, ex-gratia, leave encashment and wages for holidays and idle time.

6.2.4. Direct Expenses are expenses, which can be assigned to a cost object.

Examples:

- 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

6.2.5. Indirect Material Costs are cost of materials, which cannot be directly assigned to a particular cost object in an economically feasible way.

Examples:

- Consumable spares and parts
- Lubricants
- Cost of computer stationary for administrative function

6.2.6. Indirect Employee costs are employee costs, which cannot be directly assigned to a particular cost object in an economically feasible way.

Examples:

- Salaries of security staff
- Operating manager's salary

6.2.7. Indirect Expenses are expenses, which cannot be directly assigned to a particular cost object in an economically feasible way.

Examples:

- Insurance
- Rates and Taxes

6.3. By function

6.3.1. Costs shall be classified according to major functions viz:

- Production/ Project;
- Administration;
- Selling;
- Distribution;
- Research;
- Development;

6.4. By nature of behaviour

6.4.1 Costs shall be classified based on behaviour in response to the changes in the activity levels such as, fixed cost, variable cost and semi-variable cost.

6.5. By nature of production or operation process



- 6.5.1. Costs shall also be classified on the basis of nature of production or operation process.**
- 6.5.2. Batch Cost shall be the aggregate cost related to a cost unit which consist of a group of similar articles or services which maintain its identity throughout one or more stages of production or operation.**
- 6.5.3. Process cost shall be the cost of production or operation process where goods are produced or services rendered from a sequence of continuous or repetitive operations or processes during a period.**
- 6.5.4. Operation Cost shall be the cost a specific operation involved in production of goods or rendering of services.**
- 6.5.5. Contract cost shall be the cost of a contract agreed upon between the contractee and the contractor.**
- 6.5.6. Joint costs are the costs of common resources used for producing two or more products or rendering two or more services simultaneously.**

7. Presentation

- 7.1. The cost items in the cost statement shall be presented on 'basis of relevant classification'.**
- 7.2. The classification of cost items shall be followed consistently from period to period.**

8. Disclosure

- 8.1 Any change in classification of cost shall be made only if it is required by law or for compliance with a Cost Accounting Standard or such change would result in a more appropriate preparation or presentation of cost statements of an entity.**
- 8.2 Any change in classification of cost which has a material effect on the cost of the product shall be disclosed in the cost statements. Where the effect of such change is not ascertainable wholly or partly, the fact shall be indicated in the cost statement.**

8.3 If an entity changes the presentation or classification of items of cost or cost heads in its cost statements, it shall reclassify comparative amounts unless reclassification is impracticable. When an entity reclassifies comparative amounts, it shall disclose (including as at the beginning of the preceding period):

(a) the nature of the reclassification;



- (b) the amount of each item of cost or cost heads that is reclassified; and**
- (c) the reason for the reclassification.**

8.4 When it is impracticable to reclassify comparative amounts, an entity shall disclose:

- (a) the reason for not reclassifying the amounts, and**
- (b) the nature of the adjustments that would have been made if the amounts had been reclassified.**