# EXPOSURE DRAFT
# GUIDANCE NOTE
# ON
# COST ACCOUNTING STANDARD
# ON
# COST OF PRODUCTION FOR
# CAPTIVE CONSUMPTION (CAS-4)

*Issued by*

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## *Chapter 1* *Introduction*

The Council of the Institute of Cost and Works Accountants of India has issued the Cost Accounting Standard 4(CAS-4) for determination of cost of production for captive consumption.

This Guidance Note deals with the principles, methods and practical aspects in connection with the determination of cost of production for captive consumption. Para 1 “Introduction” of CAS 4 refers to Central Excise Act and Rules framed there under for determination of assessable value of goods used for captive consumption. CAS-4 has been issued to determine assessable value of captively consumed goods on cost construction method as a measure of simplification. Therefore, this Guidance note also refers to relevant sections of Central Excise Act,1944, Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000, other relevant rules thereto, and also case laws on the subject as well as Cost Accounting Standard-4. The Cost Accounting Standard-4 have been set in bold type. This guidance note is illustrative only and does not form part of the CAS-4.

**BACKGROUND:**

The scheme of valuation of excisable goods is contained in Sec. 3A, Sec. 4 and Sec. 4A of the Central Excise Act 1944. The goods manufactured have to be valued in a prescribed manner as per above provisions to determine the excise duty payable by the assessee. Section 3 provides that duties of excise shall be levied and collected on all excisable goods which are produced or manufactured in India at the rates set forth in Schedule to the Central Excise Tariff Act,1985. Section 4 provides the machinery to determine the value of goods subject to duty for purpose of assessment. Earlier Section 4 was replaced by new Section 4 w.e.f 1-07-2000 and concept of transaction value has been introduced under Section 4(3)(d). Section 4A provides for valuation of excisable goods with reference to retail sale price and applicable to commodities as notified by the Government from time to time and on which retail price is required to be indicated under the provision of the Standard of Weights & Measures Act 1976 and the rules made there under.

**VALUATION OF CAPTIVELY CONSUMED GOODS:**

Section 4(1) (a) of Central Excise Act,1944 deals with the Valuation of excisable goods when following requirements are satisfied:

1. Goods are sold at the time and place of removal from factory/warehouse;
2. The assessee and the buyer of the goods are not related; and

3. The price is the sole consideration of sale.

If any one of the above requirements is not satisfied, assessable value shall be determined under the Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000 notified on 30.6.2000, as provided under Section 4(1)(b) of the Act. For facility of ready reference extract of Section 4 and the Central Excise Valuation Rules,2000 are annexed as **Annexure 1 and 2.**

Each transaction is treated as a separated transaction for valuation purposes.

Rule 8 of the Central Excise Valuation Rules provides that where the excisable goods are not sold but are used for consumption by him or on his behalf in the production or manufacture of other articles, the value shall be one hundred and ten per cent of the cost of production or manufacture of such goods. (115% was substituted by 110% vide notification no. 60/2003 – CE (NT) dated 05-08-2003) In other words when goods are captively consumed, the assessable value will be 110% of cost of production. The earlier concept of deemed profit / notional profit has been done away and margin of 10% by way of profit is prescribed in the rule itself for ease of assessment of goods used for captive consumption.

As per proviso to Rule 9 and Rule 10 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000, where excisable goods are sold to the related party/ inter connected undertaking who does not sell the goods but uses or consumes such goods in the production or manufacture of articles, the value of goods shall be determined in the manner specified in rule 8 . The details of persons who shall be deemed to be related are prescribed under Section 4(3) (Refer **Annexure 1**). Under the new rules, the definition of related person has been widened.

## Chapter 2 Meaning of Captive Consumption

*"Captive Consumption"* means that the goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles in the same premises or elsewhere.

When goods manufactured are supplied to a related party who does not sell the goods but consumes the same in manufacture of another product(s), such goods are also treated to be "captively consumed" for the purpose of valuation under Excise Laws.

Excise duty is on manufacture of goods. Liability of excise duty arises as soon as goods liable to excise duty are manufactured/ produced. It is payable at the time of removal of the goods from the factory. It is collected at the time of removal for sale or clearance from the place of manufacture. Excise duty is also payable when goods are dispatched from one factory to another factory of the same manufacturer except provided otherwise.

In many cases during the manufacture, certain intermediate goods also emerge. These intermediate goods are further used in manufacture/production of other goods. The use of such intermediate product within the factory is termed as "Captive Consumption" Excise duty is payable once a new intermediate product is manufactured/produced within the factory, unless it is exempted.

Sometimes the goods are not removed from the factory but are used in the further manufacture/production of goods and in such cases also duty is payable as soon as the goods are manufactured/produced within the factory unless exempted. Goods captively consumed in the same factory of the manufacturer are exempted from duty as per Notification No. 67/95-CE dt.16.03.1995, if duty is payable on the final product.. For example, the manufacturer of Motor Vehicles also manufacture various parts of the Motor Vehicles like brakes, panels etc. These parts are also excisable goods and have separate entry in the schedule to Central Excise Tariff Act, 1985. If these parts are removed from the factory, duty is payable but if these parts are further used in the same factory of the manufacturer in the assembly / further manufacture of Motor Vehicles then the use of parts and components is called as captive consumption.

For purpose of valuation captively consumed goods under Excise Rules are categorized as

- Goods manufactured not sold but captively consumed
- Goods manufactured partly sold and partly captively consumed
- Goods manufactured sold to related party for captive consumption

# Chapter 3 Application of Cost Accounting Standards

In terms of Rule 8 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000 captively consumed goods are to be valued with reference to cost of production or manufacture of such goods. The Central Board of Excise and Customs interacted with the Institute of Cost Works Accountants of India (ICWAI) for developing methodology for determining the cost of production for captively consumed goods. Since the ICWAI was already in the process of developing various Cost Accounting Standards, it was agreed to develop a Cost Accounting Standard on Cost of Production for Captive Consumption also. CAS-4 on Cost of Production for Captive Consumption was developed by ICWAI.

The following Cost Accounting Standards developed by the Institute were jointly released by CBEC and ICWAI on 13th January 2003:

***CAS-1: Classification of Cost;***

***CAS-2: Capacity Determination;***

***CAS-3: Overheads; and***

***CAS-4: Cost of Production for Captive Consumption.***

Department of Revenue (CBEC) issued Circular No. 692/08/2003-CX dated 13th February 2003 stating that for valuing goods which are captively consumed, the general principles of costing would be adopted for applying Rule 8. The Board has interacted with the Institute of Cost & Works Accountants of India (ICWAI) for developing costing standards for costing of captively consumed goods. Paragraph 3 of the above circular has clarified:

> ***"that cost of production of captively consumed goods will henceforth be done strictly in accordance with CAS-4. Copies of CAS-4 may be obtained from the local Chapter of ICWAI. "***

The above circular is reproduced as Annexure 3.

CAS- 4 specifies the method of calculation of cost of production for captive consumption. The objective of this standard is to bring uniformity in the principles and methods used for determining the cost of production of excisable goods used for captive consumption.

CAS-4 refers to Cost Accounting Standard 1, 2 and 3 also. Therefore, CAS-4 has to be read and used in conjunction with CAS 1, CAS 2 and CAS 3.

As per CAS-1 (Classification of cost) formula for cost of production will be:
Direct Material cost + Direct Labour Cost + Direct Expenses = Prime Cost
Prime Cost + Production Overheads + Administration Overheads + R&D (Apportioned) = Cost of production

ICWAI is in the process of covering various elements of cost under Cost Accounting Standards. In addition to above CAS-1 to CAS-4, following other Cost Accounting Standards (CASs) have been notified by the ICWAI:

***CAS-5: Determination of Average (Equalized) Cost of Transportation***
***CAS-6: Material Cost***
***CAS-7: Employee Cost***
***CAS-8: Cost of Utilities***
***CAS-9: Packing Material Cost***
***CAS-10: Direct Expenses***
***CAS-11: Administrative Overheads***
***CAS-12: Repair and Maintenance Cost***
***CAS-13: Cost of Service Cost Centre***

The Companies (Cost Accounting Records) Rules 2011 notified by the Government of India, Ministry of Corporate Affairs vide Notification No. 429 dated 3rd June 2011 provides vide Rule4 (3) that Cost Accounting records are to be maintained as per Cost Accounting Standards and Generally Accepted Cost Accounting Principles issued by the ICWAI, to the extent these are found to be relevant and applicable. The variation if any is to be recorded and explained. Thus compliance with the above provision is mandatory for the companies registered under the Companies Act, 1956 wherein, the aggregate value of net worth as on the last date of the immediately preceding financial year exceeds five crore of rupees; or wherein the aggregate value of the turnover made by the company from sale or supply of all products or activities during the immediately preceding financial year exceeds twenty crore of rupees; or wherein the company's equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

# Chapter 4 Application of CAS-4

**TYPE OF ORGANIZATIONS**

**C**AS-4 is applicable from 13th February 2003 and applies to following type of organizations registered with Excise Department if goods manufactured are for captive consumption:

1. Proprietorship concern
2. Partnership Firms
3. Cooperative Societies
4. Private/Public Limited Companies.

SSI units registered with Excise Department are exempt from payment of excise duty as per registration conditions.

**TYPE OF GOODS**

Following goods are covered under CAS-4:

1. Goods manufactured not sold but captively consumed
2. Goods manufactured partly sold and partly captively consumed
3. Goods manufactured sold to related party for captive consumption

**GOODS MANUFACTURED NOT SOLD BUT CAPITVELY CONSUMED**

As per Rule 8 of the Central Excise Valuation Rules, in case of goods manufactured by the assess are used for consumption by him or on his behalf in the production or manufacture of other articles, the value shall be one hundred and ten per cent of the cost of production or manufacture of such goods. The cost of production is to be determined as per CAS-4 vide Circular dated 13th February,2003 (refer Annexure 3).

CAS-4 is also relevant in cases where a manufacturer is manufacturing a product which is otherwise exempt from duty but in process of manufacture an intermediate product mentioned in the tariff, comes into existence which is dutiable. In such cases the liability to pay duty becomes applicable. The liability of excise duty on such intermediate goods is to be discharged before it gets cleared from the factory / unit for use in the manufacture of the duty exempted final product. The value of duty in all such cases shall be on 'Cost +10%' w.e.f 5th August, 2003. However, in cases where final product is dutiable then exemption Notification No. 67/95, dt. 16.3.1995 issued under CENVAT Rules shall apply.

In a landmark judgment in case No. Appeal (civil)2947-2948 of 2001 Commissioner of Central Excise, Pune vs M/s Cadbury India Ltd.(Refer Annexure 4), Hon'ble Supreme Court of India, observed :

**"the Institute of Cost and Works Accountants of India (ICWAI) has laid down the principles of determining cost of production for captive consumption and formulated the standards for costing:CAS-4. According to CAS-4 the definition of "cost of production" is as under:**

**"4.1 Cost of Production : Cost of Production shall consist of Material consumed, Direct wages and salaries, Direct expenses, Works overheads, Quality Control cost, Research and Development cost, Packing cost, Administrative Overheads relating to production."**
**"The cost accounting principles laid down by ICWAI have been recognized by the Central Board of Excise and Customs vide Circular No.692/8/2003 CX dated 13.2.2003. The circular requires the department to determine the cost of production of captively consumed goods strictly in accordance with CAS-4. "**

**The Tribunal in the case of BMF BELTINGS LTD. vs. CCE : 2005 (184) E.L.T. 158 (Tri. Bang.) for the period 1995 to 2000 has directed the department to apply CAS-4 for the determination of the cost of production of the captively consumed goods. In ITC vs. CCE (190) ELT 119 the Tribunal held that the department has to calculate the cost of production in terms of CAS-4. Other decisions of the Tribunal, wherein it has directed that CAS-4 be applied for determination of the cost of production, are Teja Engineering v/s CCE 2006 (193) ELT 100 (Tri-Chennai), Ashima Denims v/s CCE 2005 (191) ELT 318 (Tri-Mumbai), and Arti Industries vs. CCE 2005 (186) ELT 208 (Tri-Chennai). This is therefore a consistent view taken by the Tribunal. The department has not filed any appeal in these cases and accepted the legal position. Apart from this, in the light of several decision of this Court, the Department is also bound by the said circular No.692/9/2003 CX dated 13th February,2003 issued by the CBEC."**

**CASES PENDING PRIOR TO ISSUE OF CIRCULAR NO.692/08/2003-CX DATED 13TH February,2003**

The Chief Commissioner, Chennai Zone has clarified that though CAS-4 was issued on 13.2.2003, cases pending finalization for the period earlier to this, may be considered in line with costing principles laid down in CAS-4, issued by the Institute of Cost and Works Accountants of India. Assessments finalized prior to 13th February, 2003 not to be opened. The extracts of the letter is being reproduced below:

> **Copy of letter no. IV/16/92/2003-Cx.Pol dated 05.09.2003 of this office.**
> **"Please refer to the Board's circular No. 692/8/2003-CX-I (F.No. 6/29/ 2002- CX-I) dated 13.02.2003 communicating acceptance of cost Accounting Standard-4 (CAS-4) for the purpose of valuation of the excisable goods which are captively consumed under Rule 8 of Central Excise Valuation (Determination of price of Excisable goods) Rules, 2000.**
>
> **The field formations have raised certain doubts as to whether the above said CAS-4 could be applied to all pending assessments. It is observed from the above cited circular of the Board that the principles of CAS costing are to be adopted w.e.f, 13.2.2003 and therefore the assessments pending finalization on 13.02.2003 will also be covered under CAS 4. Assessments already finalized prior to 13.02.2003 on the basis of Board's Circular 258/92/96 CX dated 30.10.96 are not required to be reopened. The field officers in this Commissionerate have been advised accordingly. Kindly confirm."**

In view of above circular and decision of the Hon'ble Supreme Court of India, Cost Accounting Standard-4 (CAS-4), is also applicable for cases of captively consumed goods pending before 13th February,2003 except where cases have been finalized prior to issue of above referred circular dated 13$^{th}$ February,2003. Some important case laws are:

In National Aluminium Co.Vs CCE 2005(184)ELT 183 (CESAT) it was held that cost of production is to be determined as per CAS-4 in respect of all cases pending on date of CBE&C circular dated 13.2.2003 even in respect of period prior to 13.2.2003.

Similar view was held in Arti Industries Ltd. Vs CCE 2005(186)(CESTAT) and Nirma Ltd vs CCE2006)(200)ELT(CESTAT) and in CCE v Cadbury India Ltd., 2006(200) ELT 353 (SC).

## Chapter 5 Valuation of Goods Partly Captively Consumed And Partly Sold

Where the goods to be valued are captively consumed in one's own factory, valuation will be done on the basis of 110% of the cost of production of goods. If the goods are partially sold by the assessee and partially captively consumed, the goods sold would be assessed on the basis of transaction value under section 4 and the goods captively consumed would be valued under rule 8 i.e.110% of the cost production of goods, states the Board's circular no.643/32/2002-CE dt. 1-7-2002. The percentage mentioned can be changed by notification by the authorities.

There can be situations where an assessee may manufacture an intermediate product (which is excisable) which requires to be processed or used for further production in another unit of the same manufacturer located at a different place. In such a situation also, the principle of rule 8 is applicable. The cost of production good manufactured plus 10% thereof is to be adopted for determining the assessable value.

**APPLICABILITY OF RULE 8**

**A**pplicability of Rule 8 was examined in case of Ispat Industries Limited vs CCE(2007-207-ELT-185-TRI-LB). It was held provision of Rule 8 will apply only when the entire quantity is consumed captively. Rule 8 will not be applicable when the goods are sold and also consumed captively within the factory. In such cases Rule 4 will apply i.e. the price at which similar goods are sold. In other words, Rule 8 will apply only when the entire quantity is consumed captively and not when part quantity is sold to other buyer.

***EXAMPLE:***

KKM manufactures 100 Nos of Product Q. He clears 60 Nos. of Product Q for sale to LMN @ Rs 140/- per piece and balance 40 Nos. are issued for manufacture of another product Z which is exempt. The cost of production of Q is Rs. 100/- per piece.

KKM is required to pay duty at applicable rate on Rs 140/- per piece for the quantity sold to LMN and also excise duty for balance 40 Nos on Rs 100/- Cost of Production +10% per piece.

# Chapter 6 Valuation of Goods Sold To Related Person

**RELATED PERSON**

Rule 9 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 deals with sale to related person. Related person has been defined in Section 4(3)(b) of the Excise Act (Refer **Annexure 1**). As per above section persons shall be deemed to be "related " if:

1) they are interconnected undertakings;
2) they are relatives;
3) amongst them the buyer is a relative and a distributor of the assessee or a sub-distributor of such distributor; or
4) they are so associated that they have interest, directly or indirectly in the business of each other;

Interconnection undertaking shall have the same meaning as defined in Monopolies & Restrictive Trade Practice Act, 1969 The expression interconnected undertaking signifies corporate relationship. It covers large categories of legal entities/undertaking such as holding company, subsidiary company, a relative and a distributor of the assessee and any sub-distributor. If they were buyer, they will be held to be related to the selling assessee only if they were so associated, they have interest directly or indirectly in the business of each other.

Relatives have the same meaning as assigned to under Section 2(41) and Section 6 of the Companies Act, 1956. Details of the relative are given in Schedule 1A of Section of the Companies Act, 1956.

**VALUATION OF GOODS SOLD TO RELATED PERSON**

If a manufacturer sells goods to any of the above related person, it will be treated as goods sold to related person. Rule 9 specifies that the goods can be sold to related persons for two purposes, one for onward sale when the related person is dealer/ distributor of the assessee and secondly the related person buys goods from the assessee for consumption in the production or manufacture of articles. In case, the related person does not sell the goods but uses or consumes such goods in the production or manufacture of the articles, the value shall be determined in the manner specified in rule 8, i.e. assessable value to be 110% of cost of production.

# Chapter 7 Valuation of Goods Manufactured on Job Work Basis

**VALUATION OF CAPITAL GOODS MANUFACTURED AND CAPTIVELY CONSUMED:**

Capital goods manufactured in a factory and used within the factory of manufacturer for manufacture/production of excisable goods, are exempt from payment of excise duty as per Notification No.67/1995-CE dated 16th March,1995. This exemption is also available in case capital goods are manufactured by third party in the factory of manufacturer.

**VALUATION OF GOODS MANUFACTURED ON JOB WORK (UNDER RULE 10A)**

There could be situations where a manufacturer may clear an intermediate product which is an excisable good to a job worker who is an independent contractor for further processing and return. In such cases, if manufacturer follows the job work procedure as prescribed in the Cenvat Credit Rules, 2004 he may not be called upon to pay any duty at the time of clearing the intermediate product to the job worker provided the job worked items are returned to the factory of the manufacturer within 180 days and that the job worked item is either further used in manufacture by the manufacturer or cleared on payment of duty by the manufacturer.

By Circular No.619/10-CX(F.No.6/47/2001-CX1) dated 13.2.2002, CBEC had clarified that as per decision of Apex Court in case of Ujaggar Prints Ltd [1989 (039) ELT 0493 (SC)] and the case of Pawan Biscuits Co.Pvt Ltd [2000 (120) ELT 0024(SC)] assessable value would be job charges (including the profit of the job worker if not already included in the job charges) plus the cost of materials used in the manufacture of the item (including the cost of materials supplied free of cost to the job worker).Now, this decision is not relevant after insertion of Rule 10A.

The assessable value in such cases would not include the profit or the expenses (like advertisement and publicity, overheads etc) incurred by buyer (or the supplier of the raw materials where the deal between the two are on principal to principal basis. In other words, after introduction of Valuation rules w.e.f. 1.7.2000 , in respect of goods manufactured on job work basis, valuation will be governed by Rule 11 of the Valuation Rule 2000 read with Rule 6 (which deals with inclusion of value of material supplied free of cost by the buyer to the manufacturer and amortization of cost of tool, die, pattern, jig and fixtures, machinery, drawings etc. supplied by the buyer to the manufacturer for manufacture of parts) and read with the above decisions of the Apex Court. The above position has now been modified with insertion of Rule 10A w.e.f. 1.4.2007 in Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.

Rules 10A deals specifically with assessable value in respect of goods manufactured on job work basis. As per the above provision, the value of excisable goods manufactured on job work basis and removed from the premises of the job worker on behalf of the principal manufacturer, the excise duty is payable on the sale price of the principal manufacturer and not as per the formula of landed cost of raw materials plus job work charges. This rule also envisages removal of goods for sale as well as removal to other places from where the actual sale will take place.

**FREE SAMPLE**

CBEC vide its circular No.643/34/2000 CX dated 1.7.2002 had clarified that for excisable goods removed as free sample, provision of Rule 4 will not apply but excise duty will be paid on 110% of cost of production as per Rule 8. However on reconsideration, the CBEC has modified the above circular. As per revised circular No. 813/10/2005 CX dated 25.4.2005, value of free samples should be determined under Rule 4 of the Valuation Rules. The revised circular thus provides that valuation should be on basis of value of identical goods cleared at or around the same time. However, in case of new or improved product, price of similar goods may not be available. Therefore for such goods, valuation should be on the basis of cost of production plus 10%, under Rule 11 read with Rule 8, in the absence of any other mode available for valuation.

**GOODS REMOVED FOR TEST/TRIAL OUTSIDE THE FACTORY:**

**I**n above case Rule 4 is invoked as soon as assessee removes the manufactured goods for trial outside the factory. Since similar goods have been sold, the assessable value will be determined based on sale of such goods after making adjustment on account of difference in dates of delivery and the specification of goods. This rule will also come into play when goods are removed for exhibition.

**VALUATION OF GOODS IN CASE OF LOSS MAKING UNIT:**

It may be noted that in case of loss making unit, for valuation of product consumed in captively, is to be made under Rule 8. The Rule 9 provides that where the goods are sold to related person and related person does not sell the goods but uses or consumes the goods in production of other articles, the value shall be determined as per the provision of Rule 8. In terms of Rule 8, the assessable value shall be 110% of the cost of production.

# Chapter 8 General Guidelines

Following factors need consideration to determine the cost of production for captive consumption under Rule 8 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000:

In case where the product is covered under the Cost Accounting Records Rules issued in pursuant to Sec 209(1)(d) of the Companies Act, 1956, the system for cost calculation would be in place and the relevant information will be readily available for such calculations. If the product is not covered under above provision, maintenance of cost accounting records as per the generally accepted costing principles read with Cost Accounting Standards shall be useful for the purpose.

The principles stated in Cost Accounting Standards are applicable for all Industries and the level of its compliance determines the adequacy of the cost accounting system in the organization and accuracy of calculation of product cost.

The method of valuation of issues materials normally followed by the manufacturer shall be adopted consistently.

**PERIODICITY OF CERTIFICATES AND BASIS FOR CALCULATION OF COST OF PRODUCTION UNDER CAS-4:**

The basic purpose of CAS-4 is to calculate deemed transaction value of the goods captively consumed in the same unit or transferred to the other unit of the same manufacturer. The valuation (assessable value) is required at the time of removal of the goods.

Normally the costing will be for the future dispatches/period. It could be either for the existing product or in respect of a new product yet to be manufactured. In case of costing for the existing product, it will be worked out based on the cost for the previous quarter taking into account likely changes in cost due to various factors like input price fluctuations, changes in the taxation structures, pattern of employee cost, general inflation, projected capacity utilisation, etc.

In case of costing for a new product, it will be calculated at projected cost, projected production, projected normal capacity utilisation and other relevant factors..

The frequency of revising the certificate of cost of production will depend upon the significance in the changes in the cost due to various factors like input cost fluctuations, changes in the employee cost and other expenses. Where the prices of major materials are changing frequently and very widely, it is advisable to workout cost of production on monthly basis. In other cases cost of production may be worked out on quarterly basis.

The estimated cost of production, linked with the normal capacity only, is required to be certified, there is no need to provide revised certificate after the completion of the year particularly where such materials are used as input for manufacturing of excisable goods as it will be revenue neutral.

However, when the normal capacity utilization is not quantifiable and /or actual capacity utilization is likely to be low, as compared to previous period; It is advisable that the manufacturer shall go for Provisional Assessment under rule 7 of Central Excise Rules 2004. After the end of the year annual certification should be done based on the finalized books of account and if the cost of production is found significantly higher than the provisional costs, differential duty shall be paid by the manufacturer. It may be noted that in case of goods which are further used in production / manufacture of excisable goods, additional duty payment will remain revenue neutral.

Valuation of opening stock and closing stock of WIP and Finished goods: If the cost of product is to be worked out for a past period, valuation of opening stock and closing stock of WIP and Finished goods is to be considered. In case of a new product or for future cost, valuation of opening and closing stock of WIP and Finished goods need not be considered.

In case of multi-location units, the cost of production should be worked out separately for each unit as per CAS-4 taking into consideration the overheads of the respective units.

In case the assessee is manufacturing different sizes / varieties of goods, then cost of production for each of the variety / size should be worked out separately.

If the assessee is engaged in manufacture of goods of same variety, same type or same family of products where the manufacturing process is same, the cost of production may be worked out for the various unit of measurement viz per kg, per unit, etc. and the cost of individual product may be worked out by applying such rate per kg, per unit etc and addition /deletion of items required for a particular product. Separate cost statement is to be prepared for each size and variety of goods on the above basis

Where production process itself is prolonged, the cost of production can be worked out at the time of removal of the goods.

*Inventory Valuation:* - The valuation of inventory, which includes Raw Material, WIP and Finished Goods shall be based on as followed by the manufacturer consistently.

It is advisable for the assessee to obtain certificate from cost accountant before the removal of the goods.

Manufacturers following standard costing system should adjust the variances to the various products as per normally accepted cost accounting principles for calculation of product wise cost.

# *Chapter 9 Notes on Various Paragraphs of CAS-4*

***2. Objective***

***2.1 The purpose of this standard is to bring uniformity in the principles and methods used in determining the cost of production of excisable goods used for captive consumption.***

***2.2 The Cost Statement prepared based on standard will be used for determination of assessable value of excisable goods used for captive consumption.***

***2.3 The standard and its disclosure requirement will provide better transparency in the valuation of excisable goods used for captive consumption.***

***3. Scope***

***3.1 The standard is to be followed for determining the cost of production to arrive at an assessable value of excisable goods used for captive consumption.***

Notes: The situations in which CAS-4 can be used:

- Cost of production for captive consumption.
- Goods manufactured and transferred to project/sites for further work, e.g.. Erection, construction, etc. (Valuation for excise in case of works contracts)
- Free samples for distribution as sales promotion, if sale price is not available.
- Transfer/sale to related party/undertaking for captive consumption.
- Valuation where no specific rule is applicable.

***3.2 Cost of production will include various cost components. They are already defined in Cost Accounting Standard-1 (CAS-1). Thus, this standard has to be read in conjunction with CAS-1.***

## 4. Definitions

***4.1. Cost of Production: Cost of production shall consist of Material Consumed, Direct Wages and Salaries, Direct Expenses, Works Overheads, Quality Control cost, Research and Development Cost, Packing cost, Administrative Overheads relating to production.***

***To arrive at cost of production of goods dispatched for captive consumption, adjustment for Stock of work-in-Process, finished goods, recoveries for sales of scrap, wastage etc shall be made.***

Note:

This definition deals with the elements of cost of *production ,adjustment for of work-in-process, finished goods and recoveries* from sale of scrap etc to be considered while calculating the cost of production for captivity consumed goods. *Details are indicated in the illustrated cost statement .*

**4.2. Captive consumption:**

***Captive Consumption means the consumption of goods manufactured by one division or unit and consumed by another division or unit of the same organization or related undertaking for manufacturing another product(s).***

Note:

This definition specifies the scope for application of CAS-4 which has also been explained in para 3.1 above.

***4.3. Normal Capacity is the production achieved or achievable on an average over a period or season under normal circumstances taking into account the loss of capacity resulting from planned maintenance. (CAS-2)***

Note:

CAS-2 defines Practical or Achievable capacity as "the maximum productive capacity of a plant reduced by the predictable and unavoidable factors of interruption pertaining to internal causes". Thus, practical capacity is installed capacity minus the inevitable interruptions due to time lost for preventive maintenance, repairs, set ups, normal delays, weekly off days and holidays etc. Practical capacity does not consider external factors causing reduction in production e.g. lack of order.

Normal capacity for a defined period is the practical capacity minus the loss of productive capacity due to external factors. In other words Practical/Achievable capacity is after adjustment for internal causes from installed capacity and Normal Capacity is after adjustment for external causes. Method of determining the normal capacity is for absorption of fixed production overheads.

| **Illustration: 1 (Engineering industry)** | | |
|---|---|---|
| A | Installed capacity 500 Units per hour on 3 shifts basis | 365x (8-1)x3x 500= 38.33 Lakhs units per annum |
| B1<br>B2 | Practical/Achievable capacity after adjustment for internal causes:<br>No. of working days 365 days minus weekly off 52 days minus 13 holidays minus 20 days annual maintenance (Preventive maintenance on weekly off) = 280 days<br>Adjustment for Normal idle capacity for batch change over, lunch, personal needs etc = 1 hr per shift<br>Practical capacity 280 days x(8 hrs minus 1 hr) x 3 shifts x 500= | 29.40 Lakhs units per annum |
| C | Expected Capacity (adjustment for ***external factors**** such as lack of order due to prolonged recession ,etc (Based on past 3 years average (28.5 +25.5 + 26.5 lakhs units)/3 = | 26.83 lakhs units per annum |
| D | Actual utilization during the year<br>In terms of installed capacity = 28.0/38.33 x100 = 73.05% | 28.0 units per annum |
| **Illustration 2 (Process Industry- continuous operation)** | | |
| A | Installed capacity 4000 Tonnes per shift ( on 3 shifts basis) | 365x 3x 4000= 43.8Lakhs Tonnes per annum |
| B | Practical/Achievable capacity after adjustment for internal causes:<br>No. of working days 365 days minus 35 days for annual maintenance /shut down 330 working days | 330 days x 3 shifts x 4000 tonnes = 39.60 lakhs per annum |
| C | Normal Capacity (adjustment for external factors such as lack or order etc (Based on past 3 years average (38.5 +35.5 + 36.0 lakhs tonnes)/3 =36.67 Tonnes | 36.67 tonnes per annum |
| D | Actual Utilization during the year<br>In terms of installed capacity = 37.0/43.8X100 =84.47% | 37.0 tonnes per annum |

****external factors*** which are temporary in nature should not be considered for adjustment to normal capacity.

***5. Determination of cost of production for captive consumption:***

To determine the cost of production for captive consumption, calculation of different cost components and adjustments are explained below:

**Note:**

This part of the guidance notes deals with the method of calculation of cost of production for captive consumption. Each element of Cost of production is discussed in detail.

***5.1 Material Consumed***

***Material Consumed shall include materials directly identified for production of goods such as:***

***(a) indigenous materials***

***(b) imported materials***

***(c) bought out items***

***(d) self manufactured items***

***(e) process materials and other items***

***Cost of material consumed shall consist of cost of material, duties and taxes, freight inwards, insurance, and other expenditure directly attributable to procurement. Trade discount, rebates and other similar items will be deducted for determining the cost of materials. Cenvat credit, credit for countervailing customs duty, Sales Tax set off, VAT, duty draw back and other similar duties subsequently recovered/ recoverable by the enterprise shall also be deducted.***

Note:

Various types of materials used for production of goods have been indicated. Materials are also classified as direct material and indirect material. Direct materials identified for production is a part of material cost while indirect material is allocated to the cost centre or to the product. Direct material includes raw materials also. Before material enters the production process, it is called raw material.

| Illustration | |
|---|---|
| Industry | Type of Raw material required |
| Cement | Clinker, Lime stone, Gypsum |
| Caustic Soda | Salt |
| Cotton Fabrics | Cotton Yarn or cotton as the case may be |
| Sugar | Sugar cane/Beetroot |
| Detergent Powder | Linear Alkyl Benzene |
| Aluminum pipes | Aluminum Ingot |
| Steel tubes & pipes | Steel strips (HR/CR) |
| Dyes / Bulk Drugs (Active Pharmaceutical Ingredient- API) | Intermediates |
| Engineering Items | Components |

**Types of materials used:**

It will depend on the type of product and process of manufacture involved. For example for production of engineering product both indigenous and imported materials may be used besides bought out items. In fact for such product, bought out material's cost are of significant. In process industry, it may be indigenous/imported raw materials and process materials.

The cost elements to be considered for determining the cost of material consumed have been indicated above. The Central Excise Law also provide for maintenance of records for accounting transaction in regard to receipt, purchase, manufacture, storage, sales or delivery of goods, including inputs and capital goods as the case may be, besides excise records for daily production report, daily stock account , Cenvat credit account for inputs, etc. In brief there has to be effective material management system, properly documented, correctly accounted for to arrive at quantity and cost of material consumed for different types of products produced/manufactured. The consumption is also reconciled with Profit and loss account.

Para 5.1.1 of CAS 6, Cost Accounting Standard on Material Cost, notified subsequently, deals with principles of valuation of receipt of material and these are broadly the same as provided under para 5.1 of CAS-4. CAS- 6 also provides that finance costs incurred in connection with the acquisition of materials (e.g. LC charges / Bank charges on purchases, cash discount on purchases) will not form part of material cost. Normal loss or spoilage of material prior to reaching the factory will be absorbed in the cost of materials net of amounts chargeable to suppliers for recovery as scrap. Losses due to shrinkage or evaporation and gain due to elongation or absorption of moisture before the material is received will be absorbed in material cost to the extent they are normal.

**Unit Rate of Material Consumed**:

The unit rate of material consumed is determined with respect to (i) the source / type of material consumed, and (ii) the method of valuation followed for issue of goods to production. Weighted average rate for issues for a period takes into account the value of material received at different rates from different sources for an item of material consumed.

Illustrations of working out landed cost of indigenous material and imported material are given below:

**Indigenous Material:**

The Landed Cost of indigenous material shall be calculated in the following manner.

| Sl. | Particular of goods | Qty | Rate | Amount |
|---|---|---|---|---|
| 1 | ABC goods | 11700 | 11.00 | 1,28,700 |
| 2 | Basic Excise duty @ 16% | | | 20,592 |
| 3 | Cess on BED @ 2% | | | 412 |
| 4 | SHE Cess @ 1% | | | 206 |
| 5 | Total (1+2+3+4) | | | 1,49,910 |
| 6 | VAT 4% | | | 5,996 |
| 7 | Freight | | | 15,600 |
| 8 | Total (5+6+7) | | | 1,71,506 |
| 9 | Less : Cenvat (2+3+4) | | | 21,210 |
| 10 | Less : VAT (6) | | | 5,996 |
| 11 | Net Cost (8-9-10) | | | 1,44,300 |

In the above case material cost is excluding Excise Duty, Cess on BED and VAT as these are adjustable against payment of Excise duty on finished goods and VAT against sales.

**Imported Material:**

The landed cost of imported material shall be calculated in the following manner.

| Sl. | Particulars | Rate | Amount Rs. |
|---|---|---|---|
| 1 | Basic Value | | 100.00 |
| 2 | Basic Custom Duty | 5% | 5.00 |
| 3 | Sub Total ( 1 + 2) | | 105.00 |
| 4 | CVD | 8% | 8.40 |
| 5 | ED Cess on CVD | 2% | 0.17 |
| 6 | SHE Cess on CVD | 1% | 0.08 |
| 7 | Sub Total ( 3 to 6) | | 113.65 |
| 8 | Custom Edu Cess | 2% | 2.27 |
| 9 | Custom SHE Cess | 1% | 1.14 |
| 10 | SAD | 4% | 4.68 |
| 11 | Total Landed Cost | | 121.74 |
| 12 | Cenvat Available (4+5+6+10) | | 13.33 |

Details of imported material are available in Bill of Lading/Entry. Benefit for export such as DEPB, Advance Authorization, Duty Free Import Authorization-DFIA and other export benefits shall not be reduced from the raw material cost as well as from cost of production., since the cost of production is being calculated for captive consumption meant for domestic production. Similarly, in case of consumption of duty free material imported under any export benefit scheme for domestic sales, differential duty payable not using such goods for intended purpose is to be taken into account.

Para 5.1.9 of CAS- 6 ( Material cost) further provides that any subsidy/grant/incentive and any such payment received /receivable with respect to any material shall be reduced from cost of ascertainment of the cost of the cost object to which such amounts are related. If any subsidy / grant/ incentive is received that has to be adjusted from the cost of material.

Similarly any demurrage or detention charges or penalty levied by transport or other authorities shall not form part of the cost of materials.

**Bought out components:** Landed cost of indigenous / imported / bought out items shall be calculated on the above basis.

**Self manufactured components:** These will include any goods manufactured with raw material, indigenous or imported bought out material etc. by the manufacturer in the same factory for further use in manufacture of final product. For this purpose the cost of production of such self manufactured items shall be considered as material cost for the subsequent product, after considering inward freight, octroi, etc., as applicable. Intermediate products, goods transferred by another unit of the same manufacturer etc. shall be based on cost of production as per CAS-4.

**Process material, colour and chemicals, packing materials:** The cost of these shall be calculated on the same lines as above. In some cases, these items may get manufactured on job work basis from outside parties. In such cases, cost should consist of the cost of material supplied plus job work charges/processing charges paid to the job worker/processor. The incidental charges like freight, insurance, handling charges etc, if any shall also form cost of material.

In case of certain process materials like catalysts having longer process useful life, the cost of catalyst should be spread over its useful life.

**Quantity of Material consumed:**

The quantity of material consumed is to be worked out from material issue records from stores for such product. Such consumption in quantity may be derived by two methods.

***Method (i): Based on actual issues for batch, unit or job - This method is preferred as it establishes direct relationship of actual material usage for the product.***

***Method (ii): Based on any method other than actual e.g. Standard***

Under this method material is issued as Standard Bill of material. The standard cost for each direct material is defined at the beginning of the year. The variances from standard on account of price/consumption etc are adjusted to consumption at the end of the period. Some organizations follow "Back flush Costing "system for issue of material. As soon as a finished good is ready for stock, material is back flushed (issued) as per the bill of material for that product. Any variation between the actual issues (both quantity and value) and the standard as accumulated over the period is charged off to consumption at the end of the period. Abnormal consumption, if any, shall not from part of material consumption on products.

This method is to be used in case of goods, where the direct link of actual consumption for product is not available. The manufacturer using this method should certify the quantitative requirement considered for calculation of material consumption as per Bill of Material etc. It may be ensured that usage variance is within reasonable limit and it should be adjusted in calculation of cost of production.

Reconciliation of cost of material consumed - It is advisable that cost of the material consumed for working out cost of production is reconciled with financial books. For major direct materials, reconciliation is to be ensured both in quantity and value.

***5.2 Direct Wages and Salaries:***

***Direct wages and salaries shall include house rent allowance, overtime and incentive payments made to employees directly engaged in the manufacturing activities.***

Direct wages and salaries include fringe benefits such as:

(i) Contribution to provident fund and ESIS

(ii) Bonus/ ex-gratia payment to employees

(iii) Provision for retirement benefits such as gratuity and superannuation

(iv) Medical benefits

(v) Subsidised food

(vi) Leave with pay and holiday payment

(vii) Leave encashment

(viii) Other allowances such as children's education allowance, conveyance allowance which are payable to employees in the normal course of business etc.

Note:

Direct wages and salaries are termed as Employee cost. Employees cost are classified as direct employees cost and indirect employees cost. Direct employee cost is assigned to or linked with a cost centre or cost object. Indirect Employee Cost is the employee cost which cannot be assigned to a production / service cost centre/cost object, and is treated as Overhead as dealt later.

As per CAS 1 direct employee cost shall include the employee benefits like provident fund contribution, gratuity, ESI, overtime, incentives, bonus, ex-gratia, leave encashment, wages for holidays and idle time, Incentive payments, Provision for retirement benefits such as gratuity and superannuation, Subsidized food etc. If fringe benefits have not be identified with relevant cost centre, these should be allocated in the ratio of employee cost of the cost centres.

| **Illustration: Employee** | **Amount paid** | **Basis of Allocation** | **Production** | | **Service** | | **Prod OH** |
|---|---|---|---|---|---|---|---|
| | | | **A** | **B** | **Power** | **Steam** | |
| Mr John | 25000 | Direct | 25000 | | | | |
| Mr Smith | 20000 | Time (25:75) | 5000 | 15000 | | | |
| Mr KM | 20000 | Direct | | | 20000 | | |
| Mr Anup | 18000 | Direct | | | | 18000 | |
| Mr Ram | 20000 | Direct | | | | | 20000 |
| Mr Rohit | 25000 | Direct | | 25000 | | | |
| **Total** | **128000** | | **30000** | **40000** | **20000** | **18000** | **20000** |
| Fringe benefit | 25600 | | 6000 | 8000 | 4000 | 3600 | 4000 |
| Fringe benefit allocated in the ratio direct employee cost | | | | | | | |

The above table indicates employee cost has been assigned to respective Cost Centres /Service Centres. Where an employee has worked in different department/cost centres, it has been assigned on the basis of time spent.

The manufacturer prepares a detailed statement indicating allocation of Direct Employee Cost to different products and basis of allocation. Total Employee Cost shall be reconciled with financial accounts. VRS payment, if any, shall not form part of cost of production.

***5.3 Direct Expenses***

***Direct expenses are the expenses other than direct material cost and direct employee's costs which can be identified with the product.***

Direct Expenses Include:

(i) Cost of utilities such as fuel, power, water, steam, etc

(ii) Royalty based on production

(iii) Technical Assistance/ know –how fees

(iv) Amortized cost of moulds, patterns, patents etc

(v) Job charges

(vi) Hire charges for tools and equipment

(vii) Charges for a particular product designing etc.

Note:

Utilities include Power, water, steam, compressed air, Effluent Treatment etc. Some of the utilities are generated within the plant and others are purchased from outside source. Actual cost of utilities should be collected through utility cost centres and charged to user cost centres/departments on actual or technical estimates. In case meters have been installed, allocation of power/steam shall be as per actual reading. If any utility is supplied by a sister concern, the same shall be at landed cost. In case a utility cannot be identified with a product or service cost centre, the same may be treated as part of works overhead.

A separate cost statement for each of the utilities is to be prepared by the manufacturer. An illustration of steam and power utilities is given in the attached **Annexure 5 and 6.**

**Royalty:**

Royalty is payable either in relation to production or sales. If royalty payment is in respect of production of the goods captively consumed, then the same should be added as the cost element. If royalty is linked with sales volume or sales price, then royalty shall form part of selling overheads and therefore shall be out of the purview of cost of production. Royalty for Marketing and Distribution, if paid, will be excluded from cost of production. Sometimes, royalty payments are one time payment at the time of unit installation and are identified with the plant cost. It is capitalized and depreciated/ amortized.

**Technical Assistance/Know-how fees:**

Technical Assistance/know-how fees should be apportioned to products for which it is payable based on the payment/ provision for the relevant period as per agreement with the supplier and its impact shall be determined with reference to planned production.

**Amortized cost of moulds, dies, patterns, designs, drawings etc.:**

The cost of moulds, dies, patterns, patents etc should be apportioned to products for which such moulds, patterns, patents are used which are directly identifiable with the products, based on the useful life of the item.

Based on the representation received from foundry manufacturer, the department has clarified treatment of pattern cost vide MF (DR) Circular No. 170/4/96-CX 1(F.No.6/14/94-CX 1) dated 23.1.1996 as under:

> **"the proportionate cost of pattern has to be included in the assessable value of the castings even in cases where such patterns are being supplied by the buyers of the castings or are prepared / manufactured by the job worker at the cost of the buyer. In cases where there is a difficulty in apportioning the cost of pattern, apportionment can be made depending on the expected life and capability of the pattern and the quantity of castings that can be manufactured from it and thus working the cost to be apportioned per unit. For this purpose a certificate from a Cost Accountant may be accepted."**

**Job / Processing charges:**

Job Work Charges / Processing Charges which are directly identified or linked with the products will form part of direct expenses.

**Hire charges for tools and equipment:**

Hire charges in respect of tools and equipments which can be directly identified with a particular product will form part of direct expenses. Hire charges for tools and equipment for general use is in the nature of indirect expenses and is to be included in works overheads.

**Charges for a particular product designing etc.:**

Product design charges to the extent charged or amortized in the books of account in respect of tools and equipments which can be directly identified with a particular product will form part of direct expenses.

***5.4 Works Overheads:***

***Works overheads are the indirect costs incurred in the production process.***

Works overheads include the following expenses:

(i) Consumable stores and spares

(ii) Depreciation of plant and machinery, factory building etc.

(iii) Lease rent of production assets

| |
|---|
| (iv) Repair and maintenance of plant and machinery, factory building etc<br>(v) Indirect employees cost connected with production activities<br>(vi) Drawing and Designing department cost.<br>(vii) Insurance of plant and machinery, factory building, stock of raw material & WIP etc<br>(viii) Amortized cost of jigs, fixtures, tooling etc<br>(ix) Service department cost such as Tool Room, Engineering & Maintenance, Pollution Control etc. |

**Note:**

The word overhead is used for a type of cost that cannot be directly allocated to a cost centre or product, but can only be apportioned to cost units. Overheads comprise indirect materials, indirect employee costs and indirect expenses which are not directly identifiable or allocable to a cost object in an economically feasible manner. As per CAS-1, materials which are of small value and cannot be identified or allocated to a product/service are classified as indirect material e.g., consumables, spare parts, lubricants etc.

For the purpose of working out cost of production, classification of overheads according to function is necessary in order to ascertain the cost of each function.

The overheads are classified as:

I. Works overheads (also known as production overheads, factory overheads or manufacturing overheads)
II. Administration Overheads relating to manufacturing/ production activity
III. Administration Overheads relating to post production activity
IV. Selling overheads
V. Distribution overheads.

All the above items of overheads except (iii), (iv) and (v) will be part of cost of production. Further, it may be noted that as per the current practice, many organizations are clubbing administration expenses being incurred at Factory as a part of Production overheads. In such cases, there is no need to add any further share of administration expenses, Cost Accounting Standard 3, which deals with the methods of collection, allocation, apportionment of overheads to different cost centers and absorption thereof to products or services, should be followed to maintain uniformity in respect of classification and allocation of overheads.

A reconciliation statement showing the amount incurred under different heads of overheads and amount absorbed by different products used for captive consumption and for sale should be prepared by the assessee. The reconciliation will help in ensuring accuracy of cost statements.

**Depreciation:**

The depreciation on the fixed assets shall be as per the method of depreciation followed for the purpose of financial accounts as per rates specified under Companies Act, 1956. Depreciation on idle fixed assets shall be excluded from cost of production. Further, depreciation should not be calculated based on the replacement value or notional value on revaluation of the assets. As per CAS-4 Depreciation is part of works overhead..

Insurance premium for various assets and risk connected with production activity should be included in works overheads. However, insurance on loss of profit policy and finished goods in transit policy should not be part of works overhead. Lease rental on fixed asset shall be also considered under this head.

***5.5 Quality Control Cost:***

***The quality control cost is the expenses incurred relating to quality control activities for adhering to quality standard. These expenses shall include salaries & wages relating to employees engaged in quality control activity and other related expenses.***

**Note:**

Quality control cost shall include various costs related to Quality Control, Quality Assurance Department functions and activities such as inspection of incoming material, inspection during progressive stages of manufacture of product on completion of finished product, Testing, Analysis Charges, Fees / Charges paid to IS / QS/Quality certification expenses etc. Expenses shall be identified under major heads such as salaries and wages, ISO certification etc.

Though quality cost is a part of works overheads, CAS 4 specifies that it should be shown separately in the cost sheet. In case the cost of quality control cannot be separated from the works overheads, then it can be taken as a part of works overheads.

***5.6 Research and Development Cost:***

***The research and development cost incurred for development and improvement of the process or the existing product shall be included in the cost of production.***

**Note:**

Research and Development costs are the cost of undertaking research to improve quality of the present product or improve process of manufacture, develop a new product, market research etc.

Research and Development activities can be defined as any systematic and creative work undertaken in order to increase the stock of knowledge and use of this knowledge to devise new applications.

R & D activities include any one or more of the categories of research such as basic research, applied research and experimental research.

Basic research may be defined as any experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any particular or specific application or use in view. The R & D cost for the existing product/ process shall be included in the cost of production. In case the company has followed a policy to treat a part of the R & D cost of existing product/process as deferred cost, such share applicable for the year/period will be included in cost of production.

Research Development Cost also forms a part of Works Overheads. However, CAS 4 states that the same is to be shown separately in the cost sheet. In case the expenses related to research and development activities cannot be separated from the works overheads, same can be taken as a part of works overheads.

R & D cost incurred for developing a new product should be excluded from calculation of cost of production.

***5.7 Administrative Overheads:***

***Administrative overheads need to be analyzed in relation to production activities and other activities. Administrative overheads in relation to production activities shall be included in the cost of production. Administrative overheads in relation to activities other than manufacturing activities e.g. marketing, projects management, corporate office expenses etc. shall be excluded from the cost of production.***

Note:

Administrative Overheads for production may include share from:

- Salaries of staff for administrative and other departments relating to production such as Accounts, Purchase, HRD, Production Planning, Security etc.
- General office expenses - like rent, lighting, rates & taxes, telephone, stationery, postage etc.
- Depreciation of office building, office equipment, furniture, vehicles, etc
- Repairs & Maintenance of office building, office equipment, furniture, vehicles, etc.
- Legal expenses in relation to factory.

The role of administration is to facilitate the manufacturing, general policy making and marketing activities. The administrative overheads shall be included in the cost of production only to the extent they are attributable to the factory. Administrative overheads in relation to activities other than manufacturing activities e.g. marketing, selling, depot/branches etc. shall be excluded from the cost of production.

**Treatment of Head Office/Corporate Office Expenses:**

Expenses of Head Office are booked separately. In a multi-location multi-product company, there are common activities like purchase, inventory management, finance, personnel, R & D, Quality Assurance, security, etc. Sometimes, these are centralized at one place i.e. Head Office and booked as head office expenses along with other activities like secretarial, project, treasury, investment, trading, etc. It is necessary to properly analyze the expenses of such activities of head office and allocate these to plants/products on fair and equitable basis. For example;

(i) HRD - on the basis of manpower in different plants,

(ii) Purchase Department expenses - on the basis of purchases,

(iii) Selling expenses - on the basis of turnover basis

Interest is also allocated to different plants on the basis of funds utilized. For captively consumed goods, since interest does not form part of cost of production, the same may be excluded from Corporate Overhead.

**Freight and forwarding charges on dispatch of goods for captive consumption:**

In case goods for captive consumption are dispatched from one factory premises to another factory premises, the cost of transportation incurred by sender of the goods is to be treated as cost of transportation under Rule 5 of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, hence excluded from calculation of cost of production for CAS.

***5.8 Packing Cost:***

***If product is transferred/dispatched duly packed for captive consumption, cost of such packing shall be included.***

***Packing cost includes both cost of primary and secondary packing required for transfer/dispatch of the goods used for captive consumption.***

**Note:**

Packing cost includes both cost of primary and secondary packing required for transfer/ dispatch of the goods used for captive consumption.

**Packing Cost includes:**

I. Cost of Packing Material
II. Job charges paid for manufacture of packing material, if any.
III. Packing charges including salaries & wages of the persons involved in packing activity.
IV. Other expenses relating to packing activity.

Landed cost of the packing material should be calculated as per the guidelines given in para related to material cost. If product for captive consumption is transferred without packing (unpacked), packing cost need not be included in the cost of production. In case captive product is transferred on returnable/ durable packing container, pro-rata cost shall be estimated and charged based on the life of the container. In case packed goods are sent to job worker, the cost of packing will form part of cost of production, unless these are returned to buyer for re-use.

***5.9 Absorption of overheads:***

***Overheads shall be analyzed into variable overheads and fixed overheads.***

***Variable Overheads are the items which change with the change in volume of production, such as cost of utilities etc.***

***Fixed overheads are the items whose value do not change with the change in volume of production such as staff salaries, rent etc.***

***The variable production overheads shall be absorbed in production cost based on actual capacity utilization.***

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

**Note:**

Absorption of overheads and calculation of cost of production: Variable Overheads comprise of expenses which vary in proportion to the change in the volume of production e.g. variable portion of salaries and wages, cost of utilities, royalty, job charges, etc.

Fixed overheads comprise of expenses which do not vary with the change in volume of production such as fixed portion of salaries and wages, rent, insurance, technical assistance/know-how fees, amortized cost of moulds, patterns, patents, hire charges for tools and equipments, charges for a particular design, various items of works overheads listed in para 5.4, quality control and R & D, etc.

The principles laid down in CAS-3, which deals with the methods of collection, allocation, apportionment of overheads to different cost centers and absorption thereof to products or services on a consistent and uniform basis in the preparation of cost statements should be followed for the purpose of allocation and absorption of overheads.

The variable production overheads shall be absorbed in cost of product, based on actual capacity utilization.

When the plant is producing or utilizing capacity below normal capacity, the absorption of fixed production overheads should be done on normal capacity irrespective of actual capacity utilized.

| | |
|---|---|
| **Illustration** : Determination of Abnormal Overhead Cost due to low capacity Utilization due to strike (Product Bulk Carrier) | |
| Installed capacity | 150 Nos. Bulk Carrier |
| Normal Capacity fixed after accounting for normal unavoidable interruptions | 130 Nos. Bulk Carrier |
| Production during :<br>2005-06<br>2006-07<br>2007-08 | <br>110 Nos. Bulk Carrier<br>125 Nos. Bulk Carrier<br>53 Nos. Bulk Carrier |
| Production during 2007-08 was lower due to strike by contract labour for 5 months which resulted in loss of production. Therefore it was decided by the management to remove cost portion of fixed overheads incurred during the strike period and the same was shown as a reconciliation item (Abnormal Overhead) in the Profit Reconciliation Statement for Profit as per Cost Accounts and Profit as per financial Account. Detailed working is as under: | |
| Variable Overheads for 53 Bulk carriers<br>Variable Overhead per Bulk Carrier | Rs 5,30,000<br>Rs 10,000 |
| (A) Fixed Overheads for the year based on Normal Capacity of 130 Bulk Carriers<br>(B) Abnormal Fixed Overhead due to unutilized capacity<br>(C) Share of Fixed Overhead for Actual Production<br>(D) Fixed Overhead per Bulk Carrier | Rs 13,26,000<br><br>Rs 7,85,400<br>Rs 5,40,600<br>Rs 10,200 |
| Overheads Absorbed<br>(a) Variable Overhead<br>(b) Fixed Overhead<br>(c) Total | <br>Rs 5,30,000<br>Rs 5,40,600<br>Rs 10,70,600 |
| Fixed Overhead unabsorbed (treated as an item of reconciliation between Costing P&L A/c & Financial A/c | Rs 7,85,400 |

It is advisable that a reconciliation statement showing the amount incurred under different heads of overheads and amount absorbed by different products should be prepared for this purpose. The reconciliation will help in ensuring accuracy of cost of production in cost statements.

***5.10 Valuation of Stock of work-in-progress and finished goods***

***Stock of work-in-progress shall be valued at cost on the basis of stages of completion as per the cost accounting principles. Similarly, stock of finished goods shall be valued at cost. Opening and closing stock of work-in-progress shall be adjusted for***

***calculation of cost of goods produced and similarly opening and closing stock of finished goods shall be adjusted for calculation of goods dispatched.***

In case the cost of a shorter period is to be determined, where the figures of opening and closing stock are not readily available, the adjustment of figures of opening and closing stock may be ignored.

**Note:**

The valuation is required at the time of removal of the goods. Therefore, the costing will be for the future period and will be done at projected costs, projected production, projected capacity utilisation. In such cases valuation of opening stock and closing stock of WIP and Finished goods need not be considered. Sub para of Para 5.10 of the standard itself provides that for shorter period the adjustment of figures of opening and closing stock may be ignored.

However, if the cost of production is to be worked out for the past period then due consideration should be given to opening and closing stock of WIP and Finished goods.

***5.11 Treatment of Joint Products and By-Products***

***A production process may result in more than one product being produced simultaneously. In case joint products are produced, joint costs are allocated between the products on a rational and consistent basis. In case by-products are produced, the net realisable value of by-products is credited to the cost of production of the main product.***

For allocation of joint cost to joint products, the sales values of products at the split off point i.e. when the products become separately identifiable may become the basis. Some other basis may be adopted. For example, in case of petroleum products, each product is assigned certain value based on its certain properties, may be calorific value and these values become the basis of apportionment of joint cost among petroleum products.

**Note:**

The cost of production of Joint Products can be worked out at split off point as per the generally accepted cost accounting principles.

**By-products are sold:**

(1) In original form without further processing and (2) those require further processing in order to be saleable. In such case, the main product is credited with the sale realization (gross/net) as the case may be. In other words expenses incurred to bring by-product to marketable conditions shall be adjusted from the sale of by product and net realizable value of by-product shall be credited to cost of production of main product.

In case sale realization is not available, credit to main product at substitute value of by product may be given.

> ***5.12 Treatment of Scrap and Waste:***
>
> ***The production process may generate scrap or waste. Realized or realizable value of scrap or waste shall be credited to the cost of production.***
>
> In case, scrap or waste does not have ready market and it is used for reprocessing, the scrap or waste value shall be taken at a rate of input cost depending upon the stage at which such scrap or waste is recycled. The expenses incurred for making the scrap suitable for reprocessing shall be deducted from value of scrap or waste.

Illustration

| Stage | Input material cost | Processing cost | Total |
|---|---|---|---|
| | ( Rs/MT) | ( Rs/MT) | ( Rs/MT) |
| 1 | 2000 | 500 | 2500 |
| 2 | 2500 | 1000 | 3500 |
| 3 | 3500 | 1000 | 4500 |

If during the production process at stage 3, the scrap is produced and the same is recycled at stage 2 after making an expenditure of Rs 200 per MT to make it suitable for re-processing at stage 2, then scrap will be valued @ Rs ( 2500 - 200) i.e. Rs 2300. If no expenditure is involved to make scrap re-usable, the scrap value will be @ Rs 2500. The scrap value for the scrap produced during a period calculated at the rate as explained above may be deducted to find out the cost of production for the period.

**Note:**

The above illustration refers to recycled waste or inferior/ sub-standard production. Normal process loss is ignored for the sake of simplicity. If the cost calculation is done for the past period and if the actual sales realization of scrap is available, then the same shall be deducted after adjustment for opening and closing stock of scrap (to arrive at the realizable value of scrap generated) from the cost of production for the relevant period. In case the scrap is not disposed off/sold during the period and lying in the stock, the realizable value of scrap can be calculated from the quotations/market rate.

**5.13 Miscellaneous Income:**

***Miscellaneous income relating to production shall be adjusted in the calculation of cost of production, for example income from sale of empty containers used for dispatch of the captively consumed goods produced under reference.***

**Note:**

The miscellaneous income needs to be analyzed in detail for its nature (capital / revenue) and if not related to production activities, the same may be ignored. The income arising out of sale of used empty containers of the input materials shall be adjusted in the cost of production.

**5.14 Inputs received free of cost:**

***In case any input material, whether of direct or indirect nature, including packing material is supplied free of cost by the user of the captive product, the landed cost of such material shall be included in the cost of production.***

**Note:**

Landed cost of inputs received free of cost should be calculated as per the guidelines given in para related to material cost.

***5.15 Moulds, Tools, Dies & Patterns etc received free of cost:***

***The amortization cost of such items shall be included in the cost of production.***

**Note:**

Amortization should be done on the basis of estimated production that can be achieved during the life of the Mould, Tool, Die or Pattern. After the estimated life, if the moulds, dies are still in use and if the full cost has already been amortized, then amortization cost need not be considered for the purpose of cost of production. However, for this purpose, proper record needs to be maintained. The estimated life / estimated production may be certified by technical person. Where the dies, moulds etc are supplied by the customer, the necessary details may be obtained from the customer.

In case of dies, moulds etc purchased / manufactured in-house, its cost should be ascertained and above principles shall be adopted for amortization. Proportionate cost of tools, dies, moulds etc cannot be charged on the basis of depreciation because depreciation is a period cost and amortisation is linked with the utilisation of tools, dies etc.

**5.16 Interest and Financial Charges:**

***Interest and financial charges being a financial charge shall not be considered to be a part of cost of production.***

Note**:**

Interest and financial charges are finance cost, and do not form part of cost of production for captive consumption. Interest and financial charges can be on bank borrowings, amortization of discounts or premium related to borrowings, amortization of ancillary cost incurred in connection with the arrangements of borrowings, finance charges in respect of finance leases and exchange differences arising from foreign currency borrowings to the extent they are regarded as an adjustment to the interest costs.

If interest is an item shown under corporate overhead, the same shall be excluded.

Logic for excluding interest from captive consumption is that for purpose of assessable value a margin of 10% of cost of production is added to take care of return on capital employed. (Normally return on capital employed takes care of return on owners' equity and interest on borrowed fund). To make the calculation simple above approach of 110% of cost of production of captively consumed good is taken as assessable value.

**5.17 Abnormal and Non-recurring Cost**

***Abnormal and non-recurring cost arises due to unusual or unexpected occurrence of events, such as heavy break down of plants, accident, market condition restricting sales below normal level, abnormal idle capacity, abnormal process loss, abnormal scrap and wastage, payments like VRS, retrenchment compensation, lay-off wages etc. The abnormal cost shall not form the part of cost of production.***

Note:

In addition to the above events, cost of trial run for production and loss due to fire and natural calamities are treated as abnormal and non-recurring cost, and excluded from cost of production. Further, expenses which are not related to manufacturing activity and which do not form part of the cost as per the generally accepted cost accounting principles may be excluded for this purpose e.g. - donations, loss on sale of fixed assets, etc.

**6. Cost Sheet:**

The cost sheet should be prepared in the format as per Appendix-1 or as near thereto as possible. The manufacturer will be required to maintain cost records and other books of account in a manner, which would facilitate preparation and verification of the cost of production. For manufacturers covered under the ambit of Section 209(1)(d) of the Companies Act, 1956, i.e., where Cost Accounting Records are statutorily required to be maintained, the Cost Accountant certifying the cost of production for captive consumption shall verify the correctness of the cost from these records. However, for manufacturers not covered under Section 209(1)(d) of the Companies Act, 1956, it is desirable that they also maintain cost accounting records in line with the records so prescribed so as to facilitate determination and certification of cost of production.

**Note:**

Separate cost sheet shall be prepared for each type/variety/ description of product used for captive consumption. The cost sheet may be suitably modified to cover the special features, if any, of the industry.

Two illustrations of Cost Sheet are appended to this Chapter. Appendix 1 is for component costing for future projection. Adjustment for opening /closing WIP and finished goods is not applicable in this case. Appendix 2 is for past cost and adjustment for opening / closing WIP and finished goods is taken into account for determining the cost of production.

| APPENDIX 1 | | | |
|---|---|---|---|
| Name of the Manufacturer<br>**Address of the Manufacturer** | **ABC Ltd**<br>**GT Road,Ghaziabad** | | |
| **Registration No of Manufacture** | **ABB75** | | |
| **Description of product captive**<br>**Excise Tariff Heading:** | **Component**<br>**XK7** | | |
| **Statement of Cost of production of Component A manufactured of during the period of 1st April …..** | | | |
| | | **QTY** | |
| **Q1** | **Quantity Produced (Unit of Measure)** | **250** | |
| **Q2** | **Quantity Despatched (Unit of Measure)** | | |
| | **Particulars** | **Total cost (Rs)** | **Cost /unit (Rs)** |
| 1 | Material consumed | 35,000 | 140.00 |
| 2 | Direct Wages and Salaries | 9,500 | 38.00 |
| 3 | Direct Expenses | 350 | 1.40 |
| 4 | Works Overheads | 1,500 | 6.00 |
| 5 | Quality Control Cost | 750 | 3.00 |
| 6 | Research & Development Cost | 90 | 0.36 |
| 7 | Administrative Overheads (relating to production activity | 35 | 0.14 |
| 8 | Total (1 to 7) | 47,225 | 188.90 |
| 9 | Add : Opening stock of Work – in – progress | - | 0.00 |
| 10 | Less : Closing stock of work –in –progress | - | 0.00 |
| 11 | Total (8+9+10) | **47,225** | 188.90 |
| 12 | Less : Credit for Recoveries /Scrap/By-products/misc income | - | 0.00 |
| 13 | Packing cost | - | 0.00 |
| 14 | Cost of production | **47,225** | 188.90 |
| 15 | Add :Inputs received free of cost | - | 0.00 |
| 16 | Add : Amortised cost of Moulds, Tools, Dies & Patterns etc received free of cost | - | 0.00 |
| 17 | Cost of Production for goods produced for captive consumption (14+15+16) | **47,225** | 188.90 |
| 18 | Add : Opening stock of finished goods | - | 0.00 |
| 19 | Less : Closing stock of finished goods | - | 0.00 |
| 20 | Cost of production for goods dispatched (17+18-19) | **47,225** | 188.90 |

Note: Breakup of material cost is to be verified in terms of quantity and type of material used in the component. Above cost sheet is for future projections, it is to be checked that estimates are based on realistic data such as project report or any previous period data available. Other expenses related to the product are to be considered after proper scrutiny of the relevant records .

| APPENDIX -2 | | | |
|---|---|---|---|
| **Name of the manufacturer**<br>**Address of the Manufacturer** | | **XYZ**<br>**ABC Nagar Kanpur** | |
| **Description of product captively consumed**<br>**Excise Tariff Heading** | | **Processed cloth** | |
| Statement of Cost of production of xyz manufactured of during the period of 1Apt -31March 2008 | | | |
| | | **Qty** | |
| **Q1** | **Quantity Produced (Unit of Measure)** | **34000** | |
| **Q2** | **Quantity Despatched (Unit of Measure)** | **34150** | |
| | **Particulars**<br>**Cost details** | **Total cost (Rs)** | **Cost /unit (Rs)** |
| 1 | **Material consumed :**<br>**Grey cloth**<br>**Colours & Chemicals** | <br>827560<br>100182 | <br>24.34<br>2.95 |
| 2 | Direct Wages and Salaries : | 6460 | 0.19 |
| 3 | Utility :<br>Power<br>Steam Cost<br>Heat Cost | <br>27200<br>44604<br>14620 | <br>0.80<br>1.31<br>0.43 |
| 4 | Works Overheads | 60825 | 1.79 |
| | Depreciation | 19040 | 0.56 |
| 5 | Quality Control Cost | - | - |
| 6 | Research & Development Cost | - | - |
| 7 | Administrative Overheads | 5780 | 0.17 |
| 8 | Total (1 to 7) | 1106271 | 32.54 |
| 9 | Add : Opening stock of Work – in – progress | 22703 | |
| 10 | Less : Closing stock of work –in –progress | 33711 | |
| 11 | Total (8+9+10) | **1095263** | 32.07 |
| 12 | Less : Credit for Recoveries /Scrap/By-products/misc income | 37719 | 1.10 |
| 13 | Packing cost | - | - |
| 14 | Cost of production | 1057544 | 30.97 |
| 15 | Add :Inputs received free of cost | - | - |
| 16 | Add : Amortised cost of Moulds, Tools, Dies & Patterns etc received free of cost | - | - |
| 17 | Cost of Production for goods produced for captive consumption (14+15+16) | | |
| 18 | Add : Opening stock of finished goods | 6558 | 0.19 |
| 19 | Less : Closing stock of finished goods | 6176 | 0.18 |
| 20 | Cost of production for goods dispatched (17+18-19) | 1057926 | 30.98 |

**Certification:**

The responsibility of preparation of cost sheet is that of the management. After cost sheet has been authenticated by company's authorized representative, cost accountant in practice has to certify the same as per certificate appended below the cost sheet. Cost accountant shall carry out test checks with reference to books of account, cost records and other records required for the purpose. Records required under Rule 22 relating to receipt, purchases, manufacture storage, sales or delivery of goods inputs, etc may be scrutinized. He should ensure that cost data reflect true and fair view of the cost of production. Suggested list of test check to be carried out are given below.

Test checks will depend upon the type of organization i.e. covered under maintenance of cost accounts records as required under Section 209(1) (d) and cost audit thereof under section 233B of the Companies Act 1956. Cost accounting records and cost report may be examined. Based on such study; test checks required may be decided.

Other organizations are:

1. Not covered under statutory maintenance of cost accounting records but have goods cost accounting system and proper records are maintained. In such cases cost records should be reviewed and information shall be called for the purpose
2. Do not maintain cost records at all. Organization shall submit the relevant records and data on the basis of which cost sheet has been prepared with reference to financial and excise records relating to raw material, production etc. With computerized accounting system, organization can supply the necessary data required for the purpose.

**Details of product and its manufacturing process:**

Examine the material accounting systems from purchase to issue of material. Compare the norms of consumption of input of materials as mentioned in ER,4 5 and ER 6 for financial information. If the product is already being produced, consumption shall be compared with previous period. Test check some issue vouchers relating to raw material and process material. If breakup of material cost is not indicated in the cost statement, ask for separate details item-wise. The basis of valuation shall be as per financial accounts. If the method of valuation is changed, it should be ensured that it does not result in undervaluation of cost of material.

Compare consumption of major raw material as shown in annual accounts.
Check by product / waste is being properly accounted for and credit is given to the main raw material.

Review procedure of employee cost booking, direct expenses and other overheads relating to classification and allocation and absorption. (Breakup of Overhead into fixed and variable overhead).

Check that the expenses as exhibited in the cost sheet have been properly worked out as provided under CAS-4.

Obtain a certification from the management that cost of design, mould, pattern etc used in manufacture of the product under certification is included in the cost of certificate. Often, such activities are being taken up at a place other than the factory. In such case, chances of exclusion of such costs are high and found difficult to link on the basis of the records made available.

Authentication on cost sheet, workings and/or declaration shall, preferably, obtained from the professional accountant of the company.

***7. Disclosure:***

***(i) If there is any change in cost accounting principles and practices during the concerned period which may materially affect the cost of production in terms of comparability with previous periods, the same should be disclosed.***

***(i) If opening stock and closing stock of work -in-progress and finished goods are not readily available for certification purpose, the same should be disclosed.***

Note:
Disclosures shall be made in the body of the Cost Statement or as a foot note or as a separate schedule or below the certificate.

# Annexure I

## EXTRACT OF SECTION 4 OF CENTRAL EXCISE ACT, 1944

**4. Valuation of excisable goods for purposes of charging of duty of excise**.

1) Where under this Act, the duty of excise is chargeable on any excisable goods with reference to their value then, on each removal of the goods, such value shall -
    a. In a case where the goods are sold by the assessee, for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value;
    b. In any other case, including the case where the goods are not sold be the value determined in such manner as may be prescribed.
2) The provisions of this section shall not apply in respect of any excisable goods for which a tariff value has been fixed under sub-section (2) of section 3.
3) For the purposes of this section, -
    a) "assessee' means the person who is liable to pay the duty of excise under this Act and includes his agent:
    b) persons shall be deemed to be "related" if –
        I. they are inter-connected undertakings;
        II. they are relatives;
        III. amongst them the buyer is a relative and a distributor of the assessee, or a sub-distributor of such distributor; or
        IV. they are so associated that they have interest, directly or indirectly, in the business of each other.

    Explanation: In this clause-

    (i) "inter-connected undertakings" shall have the meaning assigned to it in clause (g) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969; and

    (ii) "relative" shall have the meaning assigned to it in clause (41) of section 2 of the Companies act, 1956;

c) "Place of removal" means-

   I. a factory or any other place or premises of production or manufacture of the excisable goods;

   II. A warehouse or any other pace or premises wherein the excisable goods have been permitted to be deposited without payment of duty; from where such goods are removed;

d) "transaction value" means the price actually paid or payable for the goods, when sold, and includes in addition to the amount charged as price, any amount that the buyer is liable to pay to, Or on behalf of, the assessee, by reason of , or in connection with the sale, whether payable at the time of the sale or at any other time, including, but not limited to, any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter; but does not include the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.

# ANNEXURE II

## CENTRAL EXCISE VALUAION (DETERMINATION OF PRICE OF EXCISABLE GOODS) RULES, 2000

Notification No. 45/2000-C.E. (N.T.) dated 30-6-2000 [Effective from 1-7-2000].

Amended by

Notification No. 11/2003-C.E. (N. T.), dated 1-3-2003

Notification No. 60/2003-C.E. (N.T.), dated 05-08-2003

Notification No. 09/2007-C.E. (N. T.), dated 1-3-2007

[Issue by the Ministry of Finance (Department of revenue) vide F. No. 354/81/2000-TRU; Published in the Gazette of India Extraordinary Part II, Section 3, sub-section (i) dated 30.6.2000]. NOTIFICATION [NO. 45/2000- Central Excise (N.T.)]

G.S.R.575 (E):- In exercise of the powers conferred by section 37 of the Central Excise Act, 1944 (1of 1944), and in supersession of the Central Excise (Valuation ) Rules, 1975 except as respect things done or omitted to be done before such supersession, the Central Government hereby makes the following rules, namely:-

1. (1) These rules may be called the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000.

   (2) They shall come into force on and from the 1st day of July, 2000.

CHAPTER I

PRELIMINARY

2. In these rules, unless the context otherwise requires:-

a) “Act” means the Central Excise Act, 1944 (1of 1944)
b) “normal transaction value” means the transaction value at which the greatest aggregate quantity of goods are sold ;
c) “value” means the value referred to in section 4 of the Act;
d) words and expressions used in these rules and not defined but defined in the Act shall have the meanings respectively assigned to them in the Act.

CHAPTER II

DETERMINATION OF VALUE

3. The value of any excisable goods shall, for the purposes of clause (b) of sub-section (1) of section 4 of the Act, be determined in accordance with these rules.

4. The value of the excisable goods shall be based on the value of such goods sold by the assessee for delivery at any other time nearest to the time of the time of the removal of goods under assessment, subject, if necessary, to such adjustment on account of the difference in the dates of delivery of such goods and of the excisable goods under assessment, as may appear reasonable.

5. Where any excisable goods are sold in the circumstances specified in clause (a) of sub-section (1) of section 4 of the Act except the circumstance in which the excisable goods are sold for delivery at a place other than the place of removal, then the value of such excisable goods shall be deemed to be the transaction value , excluding the actual cost of transportation from the place of removal upto the place of delivery of such excisable goods.

Explanation 1: "Cost of transportation includes"

I. the actual cost of transportation, and
II. In case where freight is averaged, the cost of transportation calculated in accordance with generally accepted principles of costing.

Explanation 2: For removal of doubts, it is clarified that the cost of transportation from the factory to the place of removal, where the factory is not the place of removal, shall not be excluded for the purposes of determining the value of excisable goods.

6. Where the excisable goods are sold in the circumstances specified in clause (a) of sub section (1) of section 4 of the Act except the circumstance in where the price is not the sole consideration for sale, the value of such goods shall be deemed to be the aggregate of such transaction value and the amount of money value of any additional consideration flowing directly or indirectly from the buyer to the assessee.

Explanation 1: For removal of doubts, it is hereby clarified that the value, apportioned as appropriate, of the following goods and services, whether supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale of such goods, to the extent that such value has not been included in the price actually paid or payable, shall be treated to be the amount of money value of additional consideration flowing directly or indirectly from the buyer to the assessee in relation to sale of the goods being valued and aggregated accordingly, namely:-

I. Value of materials, components, parts and similar items relatable to such goods;
II. Value of tools, dies, moulds, drawings, blue prints, technical maps and charts and similar items used in the production of such goods;
III. Value of materials consumed, including packaging materials, in the production of such goods;
IV. Value of engineering, development, art work, design work and plans and sketches undertaken elsewhere than in the factory of production and necessary for the production of such goods.

Explanation 2 – Where an assessee receives any advance payment from the buyer against delivery of any excisable goods , no notional interest on such advance shall be added to the value unless the Central Excise Officer have evidenced to the effect that the advance received has influenced the fixation of price of the goods by way of charging a lesser price from or by offering a special discount to the buyer who has made the advance deposit.

Illustration 1: X an assessee, sells his goods to Y against full advance payment at Rs 100 per piece. However, X also sells such goods to Z without any advance payment at the same price of Rs 100 per piece. No notional interest on the advance received by X is includible in the transaction value.

Illustration 2: A an assessee manufactures and supplies certain goods as per design and specification furnished by B at a price of Rs 10 lakhs. A takes 50% of the price as advance against these goods and there is no sale of such goods to any other buyer. There is no evidence available with the Central Excise Officer that the notional interest on such advance has resulted in lowering of the prices. Thus , no notional interest on the advance received shall be added to the transaction value.

7. Where the excisable goods are not sold by the assessee at the time and place of removal but are transferred to a depot, premises of a consignment agent or any other place or premises (hereinafter referred to as "such other place") from where the excisable goods are to be sold after their clearance from the place of removal and where the assessee and the buyer of the said goods are not related and the price is the sole consideration for the sale, the value shall

be the normal transaction value of such goods sold from such other place at or about the same time and, where such goods are not sold at or about the same time, at the time nearest to the time of removal of goods under assessment.

8. Where the excisable goods are not sold by the assessee but are used for consumption by him or on his behalf in the production or manufacture of other articles. The value shall be one hundred and ten per cent of the cost of production or manufacture of such goods.

9. When the assessee so arranges that the excisable goods are not sold by an assessee except to or through a person who is related in the manner specified in either of sub clauses (ii) or (iii) or (iv) of clause (b) of sub-section (3) of section 4 of the Act, the value of the goods shall be the normal transaction value at which these are sold by the related person at the time of removal, to buyer (not being related person ); or where such goods are not sold to such buyers, to buyers (being related person), who sells such goods in retail:

   Provided that in a case where the related person does not sell the goods but uses or consumes such goods in the production or manufacture of articles, the value of goods shall be determined in the manner specified in rule 8.

10. When the assessee so arranges that the excisable goods are not sold by him except to or through an inter-connected undertaking, the value of goods shall be determined in the following manner, namely:-
    a) If the undertakings are so connected that they are also related in terms of sub-clause (ii) or (iii) or (iv) of clause (b) of sub-section (3) of Section 4 of the Act or the buyer is a holding company or subsidiary company of the assessee, then the value shall be determined in the manner prescribed in rule 9.

       Explanation:- In this clause "holding company" and "subsidiary company" shall have the same meanings as in the Companies Act, 1956 (1 of 1956).

    b) In any other case, the value shall be determined as if they are not related persons for the purpose of sub-section (1) of section 4.

10A. Where the excisable goods are produced or manufactured by a job-worker, on behalf of a person (hereinafter referred to as principal manufacturer), then, -

(i) in a case where the goods are sold by the principal manufacturer for delivery at the time of removal of goods from the factory of job-worker, where the principal manufacturer and the buyer of the goods are not related and the price is the sole consideration for the sale, the value of the excisable goods shall be the transaction value of the said goods sold by the principal manufacturer;

(ii) In a case where the goods are not sold by the principal manufacturer at the time of removal of goods from the factory of job-worker, but are transferred to some other place from where the said goods are to be sold after their clearance from the factory of job-worker and where the principal manufacturer and buyer of the goods are not related and the price is the sole consideration for the sale, the value of the excisable goods shall be the normal transaction value of such goods sold from such other place at or about the same time and, where such goods are not sold at or about the same time, at the time nearest to the time of removal of said goods from the factory of job-worker;

(iii) in a case not covered under clause (i) or (ii), the provisions of foregoing rules, wherever applicable, shall mutatis mutandis apply for determination of the value of the excisable goods:

**Provided** that the cost of transportation, if any, from the premises, wherefrom the goods are sold, to the place of delivery shall not be included in the value of excisable goods.

**Explanation** – For the purposes of this rule, job-worker means a person engaged in the manufacture or production of goods on behalf of a principal manufacturer, from any inputs or goods supplied by the said principal manufacturer or by any other person authorized by him.

11. If the value of any excisable goods cannot be determined under the foregoing rules, the value shall be determined using reasonable means consistent with the principles and general provisions of these rules and sub-section (1) of section 4 of the Act.

# ANNEXURE-III

Circular No. 692/08/2003-CX 13th February, 2003 F.No.6/29/2002-CX.I

Government of India

Ministry of Finance and Company Affairs

Department of Revenue

Subject:- Valuation of goods captively consumed.

I am directed to say that on introduction of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, w.e.f. 1.7.2000, it was clarified by the Board vide Circular No.354/81/2000TRU dated 30.6.2000 (para 21) that for valuing goods which are captively consumed, the general principles of costing would be adopted for applying Rule 8. The Board has interacted with the Institute of Cost & Works Accountants of India (ICWAI) for developing costing standards for costing of captively consumed goods.

The Institute of Cost & Works Accountants of India [ICWAI] has since developed the Cost Accounting Standards, CAS 2, 3 and 4, on capacity determination, overheads & cost of production for captive consumption, respectively, which were released by the Chairman , CBEC on 23.1.2003.

It is, therefore, clarified that cost of production of captively consumed goods will henceforth be done strictly in accordance with CAS-4. Copies of CAS-4 may be obtained from the local Chapter of ICWAI.

Board's Circular No.258/92/96-CX dated 30.10.96, may be deemed to be modified accordingly so far as it relates to determination of cost of production for captively consumed goods.

This Circular may be brought to the notice of the field formations.

Suitable Trade Notices may be issued for the benefit of the Trade.

Hindi version will follow.

Receipt of these instructions may be acknowledged

# ANNEXURE-IV

CASE NO.: Appeal (civil) 2947-2948 of 2001

PETITIONER: Commissioner of Central Excise, Pune

RESPONDENT: M/s. Cadbury India Ltd.

DATE OF JUDGEMENT: 01/08/2006

BENCH: Ashok Bhan & Markandey Katju

JUDGEMENT : (with Civil Appeal Nos.1856-1857/2002, 5232-5233/2003,1425/2005 and 2878-2879/2005) MARKANDEY KATJU, J. Civil Appeals Nos. 2947-2948/2001 have been filed against the impugned final order dated 28.9.2000 passed by the Customs Excise and Gold (Control) Appellate Tribunal, West Regional Bench at Mumbai in Appeal No.E/1021, 1022/2000-MUN.

Heard learned counsel for the parties.

The question involved in these appeals is about the valuation of milk crumbs, refined milk chocolate and four other products manufactured by the respondent - M/s. Cadbury India Limited, in its factory at Induri, Pune and captively consumed in that factory and other factories of the respondent in the manufacture of chocolate. No part of these products are sold by the respondent.

The respondent had sought valuation of these goods under Rule 6(b)(ii) of the Central Excise (Valuation) Rules, which provides for basing the valuation on such goods on the "cost of production on manufacture including profits, if any, the assessee would have earned in the sale of such goods."

The assessee had showed the price of these goods supported by a statement verified by a chartered accountant. The statement indicated the cost of edible and packing material used in the manufacture including its overheads. A separate statement in support of the profit added was formulated and these assessments were provisionally approved.

At the time of the finalization of the assessment, the department took the view that the value of the goods should include the labour cost, direct expenses, total factory expense, administration expenses, travelling expense, insurance premium, advertising expense and interest. The Assistant Commissioner added these elements to the declared value. He added the total expenses of the company as shown in the balance sheet and deducted the cost material. A percentage of this cost of the remaining figure was treated as the factor by which the assessable value should be increased.

In appeal the Commissioner (Appeals) upheld the order of the Assistant Commissioner. He held that since Rule 6(b)(ii) itself specified including the profit on the goods captively consumed hence this indicated the intention in the rule that the valuation should be brought to the level of the sale value of the goods and hence this includes all expenses referred to above. The Commissioner (Appeals) also relied on the circular dated 30.10.1996 issued by the Board relating to captively consumed goods. He has also relied upon paragraph 49 of the Supreme Court's judgment in Union of India vs. Bombay Tyres International AIR 1984 SC 420. In further appeal the Tribunal set aside the orders of the Commissioner and the

Assistant Commissioner. The Tribunal held that sub-rule (ii) of Rule 6(b) can be invoked only in a situation where the goods are not sold and there are no comparable goods. The Tribunal held that the expenses other than the cost of manufacture, cost of raw materials and the profit would not be includible in the assessable value.

The issue in the present case is about the value of the goods captively consumed by the respondent. The assessee has contended that there is no dispute that these intermediate goods are not marketable and are not bought and sold in the market. Hence the valuation of these intermediate goods has to be done according to Rule 6(b)(ii) of the Central Excise (Valuation) Rules, 1975.

Rule 6(b)(ii) reads as follows : "Rule 6 If the value of the excisable goods under assessment cannot be determined under Rule 4 or Rule 5, and a) (b) (i) (ii) if the value cannot be determined under sub-clause (i), on the cost of production or manufacture including profits, if any, which the assessee would have normally earned on the sale of such goods; "

According to settled principles of accountancy only the elements that have actually gone into the manufacture/production of these intermediates i.e. sum total of the direct labor cost, direct material cost, direct cost of manufacture and the factory overheads of the factory producing such intermediate products are included in the cost of production. The Appellant produced alongwith the reply to the Show Cause Notice the following authoritative texts: Wheldon's Cost Accounting and Costing Methods, Cost Accounting methods by B K Bhar, Principles of Cost Accounting by N.K. Prasad, Glossary of Management Accounting Terms by ICWAI.

In CCE v. Dai Ichi Karkaria Ltd., (1999) 7 SCC 448, at page 459 it has been held that the normal principles of accountancy shall be applied to determine the cost. In this decision this Court observed:

"Learned Counsel for the respondents drew our attention to the judgment of this Court in Challapalli Sugar Ltd. v. CIT. The Court was concerned with "written-down value". The "written-down value" had to be taken into consideration while considering the question of deduction on account of depreciation and development rebate under the Income Tax Act.

"Written-down value" depended upon the "actual cost" of the assets to the assessee.

The expression "actual cost" had not been defined in the Income Tax Act, 1922 and the question was whether the interest paid before the commencement of production on the amount borrowed for the acquisition and installation of the plant and machinery could be considered to be a part of the "actual cost" of the assets to the assessee. As the expression "actual cost" had not been defined, this Court was of the view that it should be construed "in the sense which no commercial man would misunderstand. For this purpose, it could be necessary to ascertain the connotation of the above expression in accordance with the normal rules of accountancy prevailing in commerce and industry". Having considered authoritative books in this regard, this Court said that the accepted accountancy rule for determining the cost of fixed assets was to include all expenditure necessary to bring such assets into existence and to put them in a working condition. That rule of accountancy had to be adopted for determining the "actual cost" of the assets in the absence of any statutory definition or other indication to the contrary."

Subsequent to the filing of these appeals, the Institute of Cost and Works Accountants of India (ICWAI) has laid down the principles of determining cost of production for captive consumption and formulated the standards for costing : CAS-4. According to CAS-4 the definition of "cost of production" is as under :

"4.1. Cost of Production: Cost of Production shall consist of Material consumed, Direct wages and salaries, Direct expenses, Works overheads, Quality Control cost, Research and Development cost, Packing cost, Administrative Overheads relating to production." The cost accounting principles laid down by ICWAI have been recognized by the Central Board of Excise and Customs vide Circular No.692/8/2003 CX dated 13.2.2003. The circular requires the department to determine the cost of production of captively consumed goods strictly in accordance with CAS-4.

The Tribunal in the case of BMF BELTINGS LTD. vs. CCE : 2005 (184) E.L.T. 158 (Tri. Bang.) for the period 1995 to 2000 has directed the department to apply CAS-4 for the determination of the cost of production of the captively consumed goods. In ITC vs. CCE (190) ELT 119 the Tribunal held that the department has to calculate the cost of production in terms of CAS-4. Other decisions of the Tribunal, wherein it has directed that CAS-4 be applied for determination of the cost of production, are Teja Engineering v/s CCE 2006 (193) ELT 100 (Tri-Chennai), Ashima Denims v/s CCE 2005 (191) ELT 318 (Tri-Mumbai), and Arti Industries vs. CCE 2005 (186) ELT 208 (Tri-Chennai). This is therefore a consistent view taken by the Tribunal.

The department has not filed any appeal in these cases and accepted the legal position. Apart from this, in the light of several decisions of this Court, the Department is also bound by the said circular No.692/8/2003 CX dated 13.2.2003 issued by the CBEC. As such it cannot now take a contrary stand. It may be noted that in the present case the intermediate products (milk crumbs, refined milk chocolate and four other intermediate products) are captively consumed in the Respondent's own factory. These Intermediate products are not sold nor are marketable.

Hence there can be no question of including the expenses of the factory which produces the final product namely the chocolate e.g. advertising, insurance and another expenses in their valuation as was sought to be added by the Commissioner (Appeals) and the Assistant Commissioner. For the reasons given above, we find no merit in these appeals and they are dismissed. No costs. Civil Appeal Nos. 1856-1957/2002, 5232-5233/2003, 1425/2005 & 2878-2879/2005) In view of the decision in Civil Appeal Nos. 2947-2948/2001, these appeals are accordingly dismissed. No costs.

# Annexure V

Cost Sheet of Power

| | | |
|---|---|---|
| Name of the unit | | XYZ |
| Name and address of the factory | | ABC, New Delhi |
| | | |
| STATEMENT SHOWING THE COST OF Power produced and Consumed during the year …. | | |
| **S.No** | **PARTICULARS** | **QTY (Kwh)** |
| 1 | Installed Capacity | 215136000 |
| 2 | Quantity Produced | 136073501 |
| 3 | Capacity Utilisation | 63 |
| 4 | Quantiy Re-circulated | |
| 5 | Quantity purchased, if any | |
| 6 | Internal consumption in power plant | 12146703 |
| 7 | Net unit available | 123926798 |

| SR. | PARTICULARS | UNIT | QUANTITY | RATE | AMOUNT | RATE/KwH |
|---|---|---|---|---|---|---|
| **A.** | | | | **RS/UNIT** | **RS** | **2008-09** |
| 1 | Material cost | | | | | |
| | a. Furnace Oil | MT | 66064 | 4878.03 | 32,22,62,370 | 2.60 |
| | b. High Speed Diesel | KL | 76 | 37,393 | 28,41,893 | 0.02 |
| | c. Natural Gas | SCM | 7,26,460 | 12 | 87,95,457 | 0.07 |
| | d. Coal | MT | 66,064 | 3,596.58 | 23,76,04,281 | 1.92 |
| | e. Lube Oil | | | | 39,94,651 | 0.03 |
| 2 | Process Material / Chemicals | | | | - | - |
| 3 | Direct Wages & Salaries | | | | 1,55,56,852 | 0.13 |
| 4 | Utilities | | | | - | - |
| 5 | Other direct expenses | | | | - | - |
| 6 | Consumable Stores & Spares | | | | 38,41,898 | 0.03 |
| 7 | Repairs and Maintenance | | | | 82,74,080 | 0.07 |
| 8 | Depreciation | | | | 4,27,45,759 | 0.34 |
| 9 | Insurance | | | | 61,99,660 | 0.05 |
| 10 | Fly Ash Disposal Cost | | | | 11,28,241 | 0.01 |
| 11 | Other Works Overhead | | | | 28,75,377 | 0.02 |
| 12 | Sub-total ( 1 to 10) | | | | 65,61,20,519 | 5.29 |
| 13 | Less : Credit , if any | | | | - | - |
| 14 | Total Cost | | | | 65,61,20,519 | 5.29 |
| **B.** | **Apportioned to product** | | **Units** | | **Amount** | |
| | Product A | | 12,15,22,526 | | 64,33,01,484 | |
| | Product B | | 4,35,029 | | 23,02,905 | |
| | Product c | | 19,34,644 | | 1,02,41,388 | |
| | Product D | | 34,600 | | 1,83,161 | |
| | Service Dept | | 17,300 | | 91,581 | |
| | Total | | 12,39,44,099 | | 65,61,20,519 | |

# Annexure VI

| | | | | | | |
|---|---|---|---|---|---|---|
| | | | | | | |
| Name of the unit | ABC | | | | | |
| Address | P Road, | | | | | |
| **Steam Cost Sheet for the year ending 31.3.2008** | | | | | | |
| **Quantitative Information** | | | | | | |
| Steam Generated | 135000 | | | | | |
| **Cost** | | | | | | |
| **Particulars** | | **Unit** | **Quantity** | **Rate** | **Amount** | **Rs/M.T.** |
| **A.** | **Variable Expenses** | | | | | |
| 1 | Furnance oil | KL | 4500 | 22500 | 101250000 | 750.00 |
| 2 | Power | KWH | 1636500 | 5.2 | 8509800 | 63.04 |
| 3 | Treated Water | KL | 4350 | 36 | 156600 | 1.16 |
| 4 | Other fuel | Ncum | 16552500 | 7.4 | 122488500 | 907.32 |
| | Total -A | | | | 232404900 | 1721.52 |
| **B.** | **Fixed Cost** | | | | | |
| 1 | Personnel | Rs | | | 1202500 | 8.91 |
| 2 | Stores | Rs | | | 2564500 | 19.00 |
| 3 | Repairs & Maintenance | Rs | | | 454650 | 3.37 |
| 4 | Others | Rs | | | 39000 | 0.29 |
| 5 | Depreciation | Rs | | | 226050 | 1.67 |
| | Total - B | | | | 4486700 | 33.23 |
| | Total cost (A+B) | | | | 236891600 | 1754.75 |
| | | | | | | |
| | **Steam utilized** | | **QTY MT** | | **Amount Rs** | |
| | Department a | | 35000 | | 61416341 | |
| | Department B | | 87000 | | 152663476 | |
| | Department C | | 13000 | | 22811784 | |
| | **Total** | | **135000** | | **236891600** | |

# ANNEXURE VII

**COST ACCOUNTING STANDARD**
**ON**
**COST OF PRODUCTION FOR CAPTIVE CONSUMPTION (CAS-4)**

The following is the text of the COST ACCOUNTING STANDARD 4 (CAS-4) issued by the Council of the Institute of Cost and Works Accountants of India on "Cost of Production for Captive Consumption". The standard deals with determination of cost of production for captive consumption. In this Standard, the standard portions have been set in bold italic type. These should be read in the context of the background material which has been set in normal type.

**1. Introduction**

The Cost Accounting principle for determination of cost of production is well established. Similarly, rules for levy of excise duty on goods used for captive consumption are also well defined. Captive Consumption means the consumption of goods manufactured by one division and consumed by another division(s) of the same organization or related undertaking for manufacturing another product(s). Liability of excise duty arises as soon as the goods covered under excise duty are manufactured but excise duty is collected at the time of removal or clearance from the place of manufacture even if such removal does not amount to sale. Assessable value of goods used for captive consumption is based on cost of production. According to the Central Excise Valuation (Determination of Price of Excisable Goods) Rules 2000, the assessable value of goods used for captive consumption is 115% of cost of production of such goods, and as may be prescribed by the Government from time to time.

**2. Objective**

2.1 The purpose of this standard is to bring uniformity in the principles and methods used for determining the cost of production of excisable goods used for captive consumption.

2.2 The cost statement prepared based on standard will be used for determination of assessable value of excisable goods used for captive consumption.

2.3 The standard and its disclosure requirement will provide better transparency in the valuation of excisable goods used for captive consumption.

**3. Scope**

3.1 The standard is to be followed for determining the cost of production to arrive at an assessable value of excisable goods used for captive consumption.

3.2 Cost of production will include various cost components. They are already defined in Cost Accounting Standard-1 (Classification of Cost – CAS-1). Thus, this standard has to be read in conjunction with CAS-1.

**4. Definitions**

**4.1 Cost of Production:** ***Cost of production shall consist of Material Consumed, Direct Wages and Salaries, Direct Expenses, Works Overheads, Quality Control cost, Research and Development Cost, Packing cost, Administrative Overheads relating to production. To arrive at cost of production of goods dispatched for captive consumption, adjustment for Stock of work-in-Process, finished goods, recoveries for sales of scrap, wastage etc shall be made.***

***4.2 Captive Consumption: Captive Consumption means the consumption of goods manufactured by one division or unit and consumed by another division or unit of the same organization or related undertaking for manufacturing another product(s).***

***4.3 Normal Capacity is the production achieved or achievable on an average over a period or season under normal circumstances taking into account the loss of capacity resulting from planned maintenance. (CAS-2)***

**5. Determination of Cost of Production for Captive Consumption**

To determine the cost of production for captive consumption, calculations of different cost components and adjustments are explained below:

**5.1 Material Consumed**

***Material Consumed shall include materials directly identified for production of goods such as:***

***(a) indigenous materials***
***(b) imported materials***
***(c) bought out items***
***(d) self manufactured items***
***(e) process materials and other items***

***Cost of material consumed shall consist of cost of material, duties and taxes, freight inwards, insurance and other expenditure directly attributable to procurement. Trade discount, rebates and other similar items will be deducted for determining the cost of materials. Cenvat credit, credit for countervailing customs duty, Sales Tax set off, VAT, duty draw back and other similar duties subsequently recovered/ recoverable by the enterprise shall also be deducted.***

**5.2 Direct wages and salaries**

***Direct wages and salaries shall include house rent allowance, overtime and incentive payments made to employees directly engaged in the manufacturing activities.***

Direct wages and salaries include fringe benefits such as:

(i) Contribution to provident fund and ESIS
(ii) Bonus/ ex-gratia payment to employees
(iii) Provision for retirement benefits such as gratuity and superannuation
(iv) Medical benefits
(v) Subsidised food

(vi) Leave with pay and holiday payment

(vii) Leave encashment

(viii) Other allowances such as children's education allowance, conveyance allowance which are payable to employees in the normal course of business etc.

**5.3 Direct Expenses**

***Direct expenses are the expenses other than direct material cost and direct employees costs which can be identified with the product.***

Direct expenses include:

(i) Cost of utilities such as fuel, power, water, steam etc

(i) Royalty based on production

(ii) Technical Assistance / know –how fees

(iii) Amortized cost of moulds, patterns, patents etc

(iv) Job charges

(v) Hire charges for tools and equipment

(vi) Charges for a particular product designing etc

**5.4 Works Overheads**

***Works overheads are the indirect costs incurred in the production process.***

Works overheads include the following expenses:

(i) Consumable stores and spares

(ii) Depreciation of plant and machinery, factory building etc

(iii) Lease rent of production assets

(iv) Repair and maintenance of plant and machinery, factory building etc

(v) Indirect employees cost connected with production activities

(vi) Drawing and Designing department cost.

(vii) Insurance of plant and machinery, factory building, stock of raw material & WIP etc

(viii) Amortized cost of jigs, fixtures, tooling etc

(ix) Service department cost such as Tool Room, Engineering & Maintenance, Pollution Control etc

**5.5 Quality Control Cost**

***The quality control cost is the expenses incurred relating to quality control activities for adhering to quality standard. These expenses shall include salaries & wages relating to employees engaged in quality control activity and other related expenses.***

**5.6 Research and Development Cost**

***The research and development cost incurred for development and improvement of the process or the existing product shall be included in the cost of production.***

***5.7*** **Administrative Overheads**

Administrative overheads need to be analysed in relation to production activities and other activities. Administrative overheads in relation to production activities shall be included in the cost of production. Administrative overheads in relation to activities other than manufacturing activities e.g. marketing, projects management, corporate office expenses etc. shall be excluded from the cost of production.

**5.8 Packing Cost**

***If product is transferred/dispatched duly packed for captive consumption, cost of such packing shall be included.***

Packing cost includes both cost of primary and secondary packing required for transfer/ dispatch of the goods used for captive consumption.

**5.9 Absorption of overheads**

*Overheads shall be analysed into variable overheads and fixed overheads.*

**Variable Overheads are the items which change with the change in volume of production, such as cost of utilities etc.**

**Fixed overheads are the items whose value does not change with the change in volume of production such as salaries, rent etc.**

***The variable production overheads shall be absorbed in production cost based on actual capacity utilisation.***

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

5.10 ***Valuation of Stock of work-in-progress and finished goods***

***Stock of work-in-progress shall be valued at cost on the basis of stages of completion as per the cost accounting principles. Similarly, stock of finished goods shall be valued at cost. Opening and closing stock of work-in-progress shall be adjusted for calculation of cost of goods produced and similarly opening and closing stock of finished goods shall be adjusted for calculation of goods despatched.***

In case the cost of a shorter period is to be determined, where the figures of opening and closing stock are not readily available, the adjustment of figures of opening and closing stock may be ignored.

**5.11 Treatment of Joint Products and By-Products**

***A production process may result in more than one product being produced simultaneously. In case joint products are produced, joint costs are allocated between the products on a rational and consistent basis. In case by-products are produced, the net realisable value of by-products is credited to the cost of production of the main product.***

For allocation of joint cost to joint products, the sales values of products at the split off point i.e. when the products become separately identifiable may become the basis. Some other basis may be adopted. For example, in case of petroleum products, each product is assigned certain value based on its certain properties, may be calorific value and these values become the basis of apportionment of joint cost among petroleum products.

**5.12 Treatment of Scrap and Waste**

***The production process may generate scrap or waste. Realized or realizable value of scrap or waste shall be credited to the cost of production.***

In case, scrap or waste does not have ready market and it is used for reprocessing, the scrap or waste value is taken at a rate of input cost depending upon the stage at which such scrap or waste is recycled. The expenses incurred for making the scrap suitable for reprocessing shall be deducted from value of scrap or waste.

**Illustration**

A production process has three stages.

| Stage | Input material cost ( Rs/ MT) | Processing cost ( Rs/MT) | Total ( Rs/MT) |
|---|---|---|---|
| 1 | 2000 | 500 | 2500 |
| 2 | 2500 | 1000 | 3500 |
| 3 | 3500 | 1000 | 4500 |

If during the production process at stage3, the scrap is produced and the same is recycled at stage2 after making an expenditure of Rs 200 per MT to make it suitable for re-processing at stage2, then scrap will be valued @ Rs ( 2500 – 200 ) i.e Rs 2300. If no expenditure is involved to make scrap re-usable, the scrap value will be @ Rs 2500. The scrap value for the scrap produced during a period calculated at the rate as explained above may be deducted to find out the cost of production for the period.

**5.13 Miscellaneous Income**

**Miscellaneous income relating to production shall be adjusted in the calculation of cost of production, for example, income from sale of empty containers used for despatch of the captively consumed goods produced under reference.**

**5.14 Inputs received free of cost**

***In case any input material, whether of direct or indirect nature, including packing material is supplied free of cost by the user of the captive product, the landed cost of such material shall be included in the cost of production.***

**5.15 Moulds, Tools, Dies & Patterns etc received free of cost**

***The amortization cost of such items shall be included in the cost of production.***

**5.16 Interest and financial charges**

***Interest and financial charges being a financial charge shall not be considered to be a part of cost of production.***

**5.17 Abnormal and non-recurring cost**

***Abnormal and non-recurring cost arising due to unusual or unexpected occurrence of events, such as heavy break down of plants, accident, market condition restricting sales below normal level, abnormal idle capacity, abnormal process loss, abnormal scrap and wastage, payments like VRS, retrenchment compensation, lay-off wages etc. The abnormal cost shall not form the part of cost of production.***

**6. Cost Sheet**

The cost sheet should be prepared in the format as par Appendix – 1 or as near thereto as possible. The manufacturer will be required to maintain cost records and other books of account in a manner, which would facilitate preparation and verification of the cost of production. For manufacturers covered under the ambit of Section 209(1)(d) of the Companies Act, 1956, i.e., where Cost Accounting Records are statutorily required to be maintained, the Cost Accountant certifying the cost of production for captive consumption shall verify the correctness of the cost from these records. However, for manufacturers not covered under Section 209(1)(d) of the Companies Act, 1956, it is desirable that they also maintain cost accounting records in line with the records so prescribed as to facilitate determination and certification of cost of production.

**7. Disclosure**

***(i)*** ***If there is any change in cost accounting principles and practices during the concerned period which may materially affect the cost of production in terms of comparability with previous periods, the same should be disclosed.***

***(ii)*** ***If opening stock and closing stock of work -in-progress and finished goods are not readily available for certification purpose, the same should be disclosed.***

Appendix – 1

Name of the Manufacturer :
Address of the Manufacturer :
Registration No of Manufacturer :
Description of product captively consumed:
Excise Tariff Heading :

Statement of Cost of Production of _____________ manufactured / to be manufactured during the period _____________

| | | Qty | |
|---|---|---|---|
| Q1 | Quantity Produced (Unit of Measure) | | |
| Q2 | Quantity Despatched (Unit of Measure) | | |
| | Particulars | Total Cost (Rs) | Cost/unit ( Rs) |
| 1. | Material Consumed | | |
| 2. | Direct Wages and Salaries | | |
| 3. | Direct Expenses | | |
| 4. | Works Overheads | | |
| 5. | Quality Control Cost | | |
| 6. | Research & Development Cost | | |
| 7. | Administrative Overheads (relating to production activity) | | |
| 8. | Total (1 to 7) | | |
| 9. | Add : Opening stock of Work - in –Progress | | |
| 10. | Less : Closing stock of Work -in- Progress | | |
| 11. | Total (8+9-10) | | |
| 12. | Less : Credit for Recoveries/Scrap/By-Products / misc income | | |
| 13. | Packing cost | | |
| 14. | Cost of production ( 11 - 12 + 13) | | |
| 15. | Add: Inputs received free of cost | | |
| 16. | Add: Amortised cost of Moulds, Tools, Dies & Patterns etc received free of cost | | |
| 17. | Cost of Production for goods produced for captive consumption ( 14 + 15 + 16) | | |
| 18. | Add : Opening stock of finished goods | | |
| 19. | Less : Closing stock of finished goods | | |
| 20. | Cost of production for goods despatched ( 17 + 18 - 19) | | |

Seal & Signature of Company's Authorised Representative

*I/We, have verified above data on test check basis with reference to the books of account, cost accounting records and other records. Based on the information and explanations given to me/us, and on the basis of generally accepted cost accounting principles and practices followed by the industry, I /We certify that the above cost data reflect true and fair view of the cost of production.*

Date : Seal & Signature of Cost Accountant
Place : Membership No.

# ANNEXURE VIII

**Circular dated 23-Jan-1996 on Foundry Industries**

**Circular: 170/4/96-CX dated 23-Jan-1996**

**Valuation of castings — Patterns supplied by the buyers required to be included**

**Circular No. 170/4/96-CX, dated 23-1-1996**

**[From F.No. 6/14/94-CX.1]**

**Government of India**

**Ministry of Finance (Department of Revenue)**

**New Delhi**

**Subject: Foundry Industries - Calculation of assessable value of castings - Addition of value of patterns supplied by the buyers in the assessable value.**

It has been brought to the notice of the Board by Maharashtra Chambers of Commerce & Industry that there is difficulty in determination of value of patterns used in foundry industry to be added in the cost of castings for arriving at the assessable value of the castings as the quantity of casting to be made out of a pattern cannot be anticipated and sometimes some modifications or repairs are also made in the pattern after some period of use.

2. A survey was floated to ascertain the actual position in the field formations. From the reports received, it is observed that generally Commissioners are of the view that cost of the pattern should be added in the assessable value of the castings. However, in some Commissionerates, the proportionate value of the pattern is not being added in the assessable value of the casting if such patterns are supplied by the buyers of the castings. Generally Commissionerates find that there is no difficulty in apportioning the cost of pattern in the assessable value of the casting. However, a few Commissioners have expressed difficulty in apportionment of the cost in cases where old patterns are supplied by the buyers of the castings to the job worker and when patterns are returned back to the buyers.

3. The matters has been examined and it is hereby clarified that the proportionate cost of pattern has to be included in the assessable value of the casting even in cases, where such patterns are being supplied by the buyers of the casting or are got prepared / manufactured by the job worker at the cost of the buyer. In cases where there is difficulty in apportioning the cost of pattern, apportionment can be made depending on the expected life and capability of the pattern and the quantity of castings that can be manufactured from it and thus working the cost to be apportioned per unit. For this purpose, a certificate from a Cost Accountant may be accepted.