Cost Accounting Standard: 2

Capacity Determination

Why is CAS-2 Required?

CAS-2, issued by ICMAI, provides guidelines for determining capacity utilization in cost accounting.

It is required for the following reasons:

1. It helps businesses apply a uniform approach to determine capacity utilization, making cost data reliable and comparable.

2. Improves accuracy in calculating product cost by properly allocating fixed costs based on actual capacity utilization.
3. Helps in evaluating how efficiently production resources are utilized.
4. It provides decision making information into pricing, budgeting, and production planning based on capacity levels.
5. Ensures that cost statements comply with Indian cost accounting regulations, especially in industries where cost audits are mandatory.

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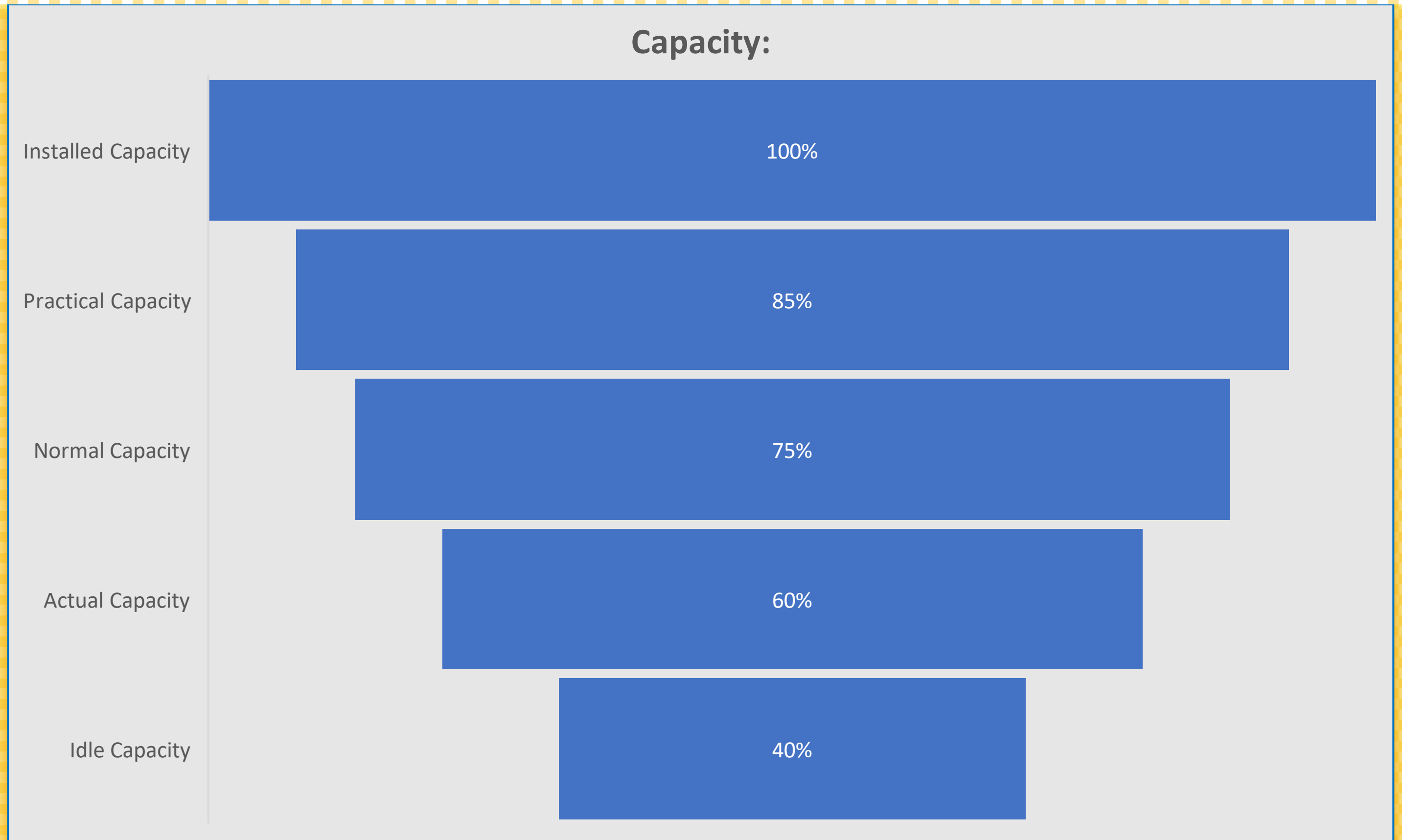
Important Terms:

- **Installed Capacity:** The maximum production a plant can achieve under ideal conditions.
- **Practical Capacity:** Capacity achievable under normal working conditions, considering maintenance and unavoidable breaks.
- **Normal Capacity:** Long-term expected production considering regular demand patterns.
- **Actual Capacity Utilization:** The actual output achieved in a given period.
- **Idle Capacity:** The difference between installed capacity and utilized capacity, due to factors like low demand or breakdowns.

For example: Starts with 100% and ends up with 60% capacity utilization.



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Capacity Determination

1. Scope of CAS-2:

- Applies to all industries where cost accounting records are maintained.
- Provides a structured method to determine installed, normal, and actual capacity.

2. Measurement of Capacity:

CAS-2 requires capacity to be measured in terms of:

- Units of Production: Used in textile mill producing 1,000 meters of cloth per day.
- Machine Hours: Used as a CNC machine running for 10 hours per shift.
- Labour Hours: Used in a factory where 500 workers work 8 hours daily.

3. Determination of Installed Capacity:

Installed capacity is determined based on Manufacturer's specifications, Industry standards, Regulatory limits.

4. Types of Capacity & Their Importance:

Capacity Type	Meaning	Why It Matters?
Installed Capacity	Maximum possible production	Basis for measuring utilization
Practical Capacity	Adjusted for routine stoppages	Realistic upper limit of efficiency
Normal Capacity	Average demand-based capacity	Used for cost allocation
Actual Capacity Utilization	Actual production achieved	Measures efficiency & wastage
Idle Capacity	Unused installed capacity	Indicates inefficiency & cost impact

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5. Cost Allocation & Treatment of Idle Capacity:

- **Idle Capacity Cost (unused fixed cost due to unutilized capacity) should be separately disclosed.**
- **Fixed costs should be apportioned based on normal capacity, not actual capacity, to avoid cost distortion.**

6. Presentation & Disclosure:

- **CAS-2 requires companies to disclose capacity details in cost statements, including installed, utilized, and idle capacity.**
- **Idle capacity costs should be separately reported for better financial clarity.**

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Conclusion:

- CAS-2 helps businesses standardize capacity measurement, improve cost accuracy, and analyze performance efficiently.
- Different capacity levels ensures better decision-making, fair pricing, and regulatory compliance in cost accounting.

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