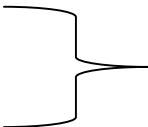


Indian Accounting Standard (Ind AS) 2 Inventories

- Indian Accounting Standard (Ind AS) 2, Inventories, prescribes the accounting treatment for inventories, such as, **determination of cost** and its **subsequent recognition as expense**, including any write-downs of inventories to net realisable value and reversal of write-downs.
- Standard applies to all inventories, except:
 - financial instruments
 - biological assets (i.e. living animals or plants) related to agricultural activity and agricultural produce at the point of harvest
- Standard does not apply to the measurement of inventories held by:
 - Producers of
 - ✓ agricultural and forest products
 - ✓ agricultural produce after harvest
 - ✓ minerals and mineral products



to the extent they are measured
at NRV

Changes in that value are recognised in profit or loss in the period of the change
 - Commodity broker – who measure their inventories at fair value less cost to sell.
Changes in value are recognized in P & L in the period of change

The exclusion is with respect to the measurement requirements of standard. However, the other requirements laid down in standard are applicable. For example, disclosure requirements of the standard are applicable to these types of inventories.

➤ **Definitions**

Inventories are assets

- a. **held for sale** in the ordinary course of business
- b. in the **process of production** for such sale; or
- c. in the **form of materials or supplies to be consumed** in the production process or in the rendering of services

Net Realisable Value (NRV) is the **estimated selling price** in the ordinary course of business **less** the **estimated costs of completion** and the **estimated costs necessary to make the sale**.

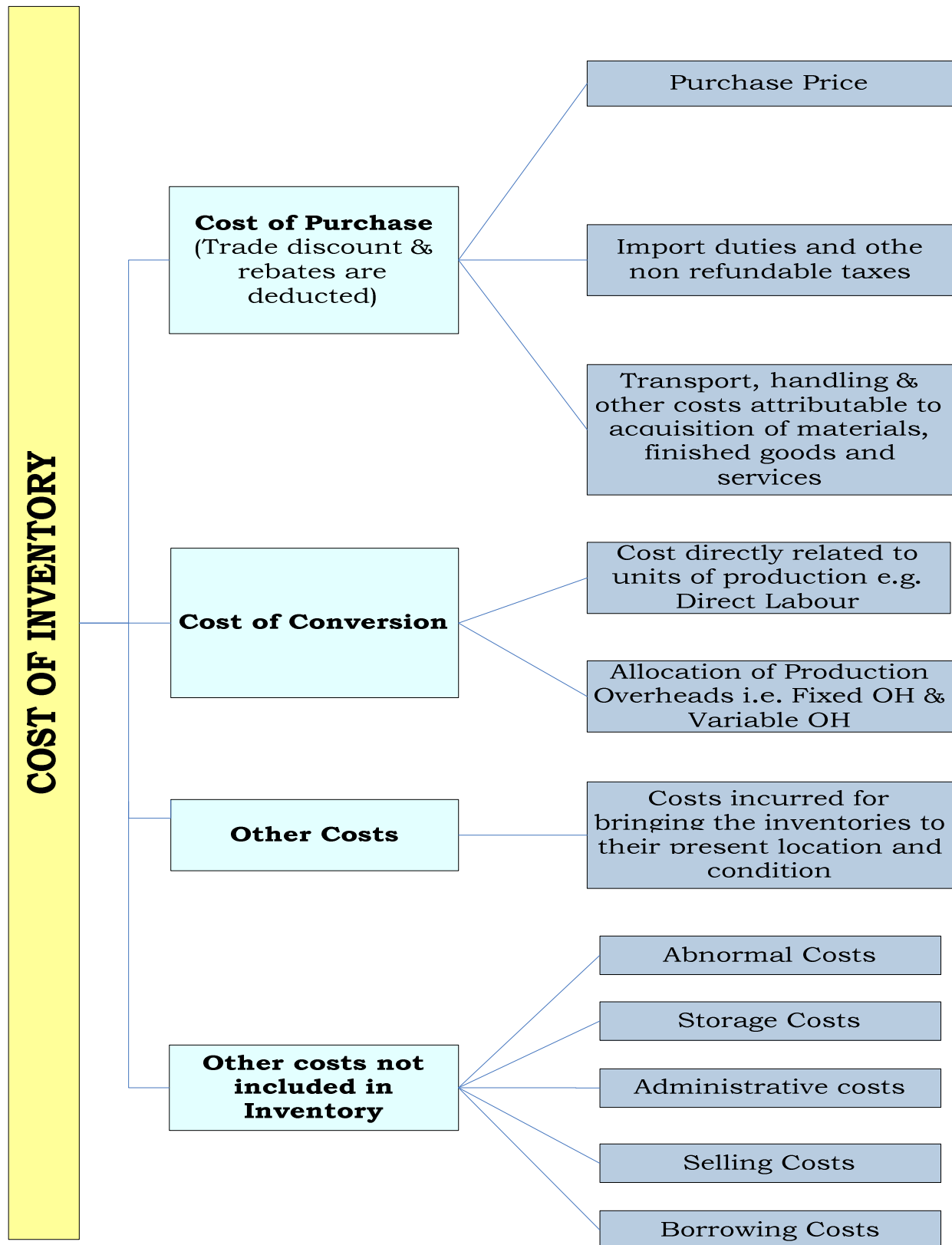
Fair Value (FV) is the **price** that would be **received to sell an asset** or **paid to transfer a liability** in an orderly transaction between market participants at the measurement date.

- What is a difference between NRV & FV

Net Realizable Value (NRV)	Fair Value (FV)
NRV refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business.	Fair value reflects the amount for which the same inventory could be exchanged between Knowledgeable and willing buyers and sellers in the market place.
Entity-specific measurement	Market-based measurement
Example: An entity holds inventories of 20,000 units and it could sell the same in the market @ Rs.15/- each after selling expenses. The entity has an order in hand to sell the inventories @ Rs. 11/-. In this situation, fair value is Rs 15/- each, but net realizable value is Rs. 11/- each.	

- Inventories include ‘materials and supplies awaiting use in the production processes. Whether packing material and publicity material are covered by the term ‘materials and supplies awaiting use in the production process’.
- The primary packing material may be included within the scope of the term ‘materials and supplies awaiting use in the production process’ but the secondary packing material and publicity material cannot be so included, as these are selling costs which are required to be excluded as per Ind AS 2.
 - For this purpose, the primary packing material is one which is essential to bring an item of inventory to its saleable condition, for example, bottles, cans etc., in case of food and beverages industry.
 - Other packing material required for transporting and forwarding the material will normally be in the nature of secondary packing material.

➤ **Measurement of Inventories**



➤ **Allocation of Production Overheads**

- Fixed Overheads
 - If Actual Production < Normal capacity : On the basis of Normal capacity and unallocated Fixed OH are recognized as an expenses in the period in which they are incurred
 - If Actual Production > Normal capacity : On the basis of Actual production
- Variable Overheads
 - On the basis of basis of the actual use of the production facilities

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

Joint & By-Products

- Costs are not separately identifiable - Allocated on rational & consistent basis (e.g. based on sales value)
- By-Product is immaterial
 - By-Product valued at NRV
 - Main product at cost less NRV of By- product

➤ **Techniques for the measurement of cost**

- Standard Cost Method:
 - Take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation.
 - They are regularly reviewed and if necessary, revised in the light of current conditions.
- Retail Method:
 - Used in the retail industry for measuring inventories of large numbers of rapidly changing items with similar margins for which it is impracticable to use other costing methods.
 - Cost of Inventory = Sales value of the inventory (-) gross margin (%).
 - The percentage used takes into consideration inventory that has been marked down to below its original selling price.
 - An average percentage for each retail department is often used.

Example:

ABC Ltd. A dealer in garment has thousands of items in inventory. It uses retail method. Its average gross margin is 20%. The sale price per box of 10 shirts is 100

Each box will be valued at Rs. 80 (100-20%).

Each shirt at Rs.8 (80/10)

➤ **Cost Formulas**

- Cost formula is needed to determine the value of material issued and material remaining in the inventory. The selection of most appropriate cost formula depends upon the nature of items.
 1. Specific Identification Method (for the items not ordinarily interchangeable)
 - This method is applied to the items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects.
 - Specific costs are attributed to identified items of inventory
 2. First In First Out (FIFO)
 - This method assumes that the items of inventory that were purchased or produced first are sold first.
 - This means the items remaining in inventory at the end of the period are those most recently purchased or produced.
 3. Weighted Average Cost formula
 - Total cost of material (opening inventory plus subsequent purchases) is divided by the total quantity (opening inventory plus subsequent purchases).
 - The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.
- An entity shall use the same cost formula for all inventories having a similar nature and use to the entity
- For inventories with a different nature or use, different cost formulas may be justified

➤ **Net Realisable Value (NRV)**

NRV = Estimated selling price in the ordinary course of business (-) [Estimated cost of completion + Estimated cost necessary to make sales]

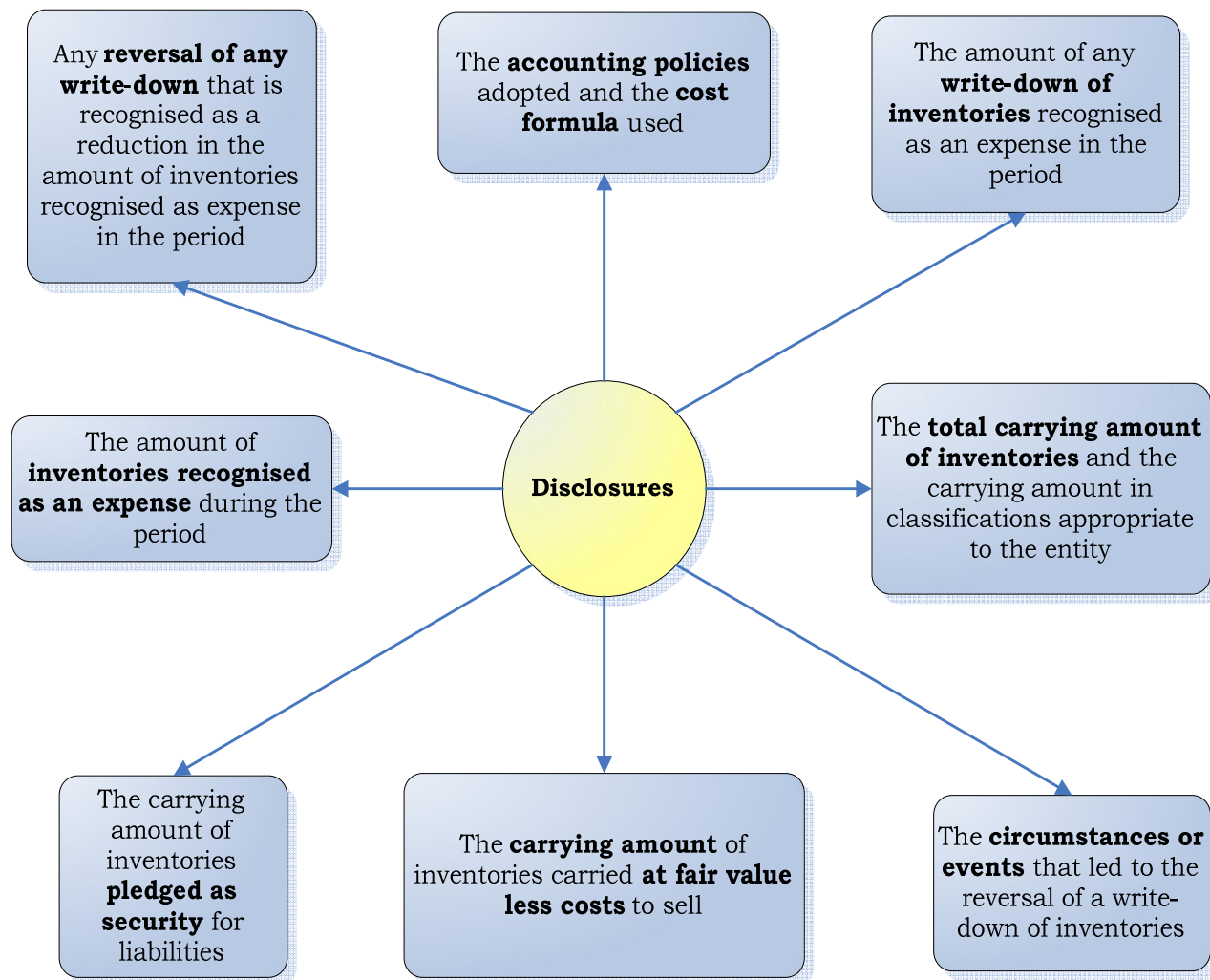
- Inventories are to be measured at cost of NRV whichever is lower. This is based on the view that assets should not be carried at a value which is excess of their realizable values.
- Comparison between the cost and NRV is to be done item by item. However, it may be appropriate to group similar or related items together. E.g. where items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line.
- NRV are determined after taking into consideration
 - The most reliable estimates available
 - Fluctuation of price or cost directly relating to events occurring after the end of the reporting period
 - Purpose for which the inventory is held
- Raw material and other supplies held for use in the production of inventories need not be written down below cost if the finished goods in which they are going to be used are likely to fetch a price higher than total cost.
- However, when a decline in the price of materials indicates that the cost of the finished goods exceeds NRV, the materials are written down to NRV.
- New assessment is made in each subsequent period. If the situation has changed, the amount of the written down may be reversed. The new carrying amount will be the lower of the cost and revised NRV.

➤ **Recognition as an expenses:**

- Inventories may be recognized as an expenses when:
 - Inventory is sold, its carrying amount is recognized as an expenses
 - Write down to NRV are needed
 - Losses of inventory e.g. loss by fire or theft.

➤ **Disclosures**

The financial statements shall disclose:



Difference between Ind AS 2 and AS 2

Ind AS 2	AS 2
Ind AS 2 requires more disclosures as compared to the existing AS 2	
Deals with the subsequent recognition of cost/carrying amount of inventories as an expense	No such provision
Does not contain specific explanation in respect of such spares	Explains that inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular; such machinery spares are accounted for in accordance with Accounting Standard (AS) 10
Does not apply to measurement of inventories held by commodity broker-traders, who measure their inventories at fair value less costs to sell.	This aspect is not covered in AS 2
Defines fair value. Provides an explanation in respect of distinction between 'net realizable value' and 'fair value'	Does not contain the definition of fair value and such explanation.
Deals with the reversal of the write-down of inventories to net realisable value to the extent of the amount of original write-down, and the recognition and disclosure thereof in the financial statements.	Does not deal with such reversal
Excludes from its scope only the measurement of inventories held by	Excludes from its scope such types of inventories.

Ind AS 2	AS 2
producers of agricultural and forest products, agricultural produce after harvest and minerals and mineral products though it provides guidance on measurement of such inventories	
Does not specifically state so and requires the use of consistent cost formulas for all inventories having a similar nature and use to the entity.	Specifically provides that the formula used in determining the cost of an item of inventory should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition