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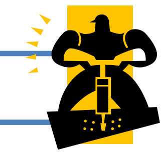
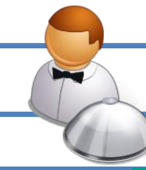
ACCOUNTING STANDARD -2 – VALUATION OF INVENTORY

Standard Exclusions

- WIP – Construction contracts



- WIP – Service Providers



- Fin. Inst. Held as Stock-in-Trade

- Producer's Inventory*

* Eg Livestock, agricultural produce, oils, ores etc. – as per industry norms

Inventory Definition

1. Held for sale → **Finished Goods**
2. In process or production for sale → **Work-in-Process**
3. Materials to be consumed in Production/ Service → **Raw Materials**

Valuation

Lower of

Valuation = (A) Cost **OR** (B) Net Realisable Value

A. Cost

1. **Cost of Purchase** – Expenses directly related to purchase
   Eg. Purchase Price + Duties + Freight + Taxes – Trade discounts – Duty Drawbacks
2. **Cost of Conversion** – Expenses directly related to
   - Conversion of inventory
   - Allocation of Fixed and variable overhead

   Eg. Direct Labour, Indirect labour, Depreciation (allocated),
3. **Other Cost** – Expenses directly related to bringing inventory to present location & condition
   Eg. Cost of Design, Factory expenses related to production etc.
4. **Cost Exclusions** – Expenses other than above
   Eg. Abnormal wastages, selling & distribution expenses, Corporate expenses such as Audit fee etc.

Cost Formula

- Interchangeable products? → No
- For Specific Projects? → No
  - Generally used method
    - FIFO Cost
    - Weighted Average
  - If results approximate actual costs
    - Standard Cost
    - Retail Method

B. Net Realisable Value

NRV = Estimated Selling Price - Estimated cost of completion - Estimated cost to make sale

Rule 1: Usually written down to NRV on Item-by-Item basis only

Exception to above rule if:
- Items relate to Same product line
- Similar end purpose
- Sold in same geographical area
- Cannot be evaluated separately

Rule 2: Estimates of NRV take into consideration the purpose

Eg: If NRV of inventory held for satisfying sales contracts – price as per contract is taken.

Rule 3: Ultimate FG Prices also considered

Materials will need to be written down if the ultimate finished goods' prices for which they will be used is less than its cost

Rule 4: Assessment to be done at each Balance sheet date

At every balance sheet date, the NRV will need to be re-evaluated.

Disclosures:

- Accounting policy for measuring inventory
- Cost Formula used
- Carrying amount of inventories
- Classification of Inventories

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