Ind AS-2: Inventories

1. Introduction

- Inventory is one of the major item of any business entity. Ind AS-2 Prescribes accounting treatment for inventories. This standard deals with the determination of cost and its subsequent recogination as an expense.

Scope of Ind AS-2

- This standard is applicable to all inventories except -
  - a. Financial Instrument [e.g. Shares, Debentures, etc.]
  - b. Biological Asset [living animal or Plants] related to agricultural activity and its Produce at the Point of harvest.

- However, Ind AS-2 applies on following, except the measurement of inventories -
  - Agricultural, forest and minirrel Produces - Always at NRV.
  - Commodity broker-traders - Fair value less cost to sell.

2. Meaning of Inventory

- Inventories are assets:-
  - a. held for sale in the ordinary course of business [Finished Goods]
  - b. in the Process of Production for such sale [Work-in Progress]
  - c. in the form of material or supplies to be consumed in the Production Process or in the rendering of services. [Raw Material]

Notes:-

1. Cost of services

Ind AS-2 includes cost of service (service industry). e.g Classes Provided will be considered as stock for ALC.

- Direct Labour incurred and attributable cost of services should be considered as inventory.

2. Stores, spares and stand by Equipment

- If Stores, spares and stand by equipments qualifies the definition of Property, Plant and Equipments as per Ind AS-16, then it will be termed as PPE, otherwise included in inventories as per Ind AS-2.

- **Meaning of Stores, spares and stand by equipments**

Stores:- used in production process or while providing services. e.g., nails, glue, etc. in making furniture.

Spares:- Extra part that replaces lost or damaged part e.g. spare key, etc.

Stand by Equipments :- Not used, although assigned to job and was available for use.
e.g. Extra machine installed in back up. It ensures uninterrupted operations.

3. Valuation of Inventories

Inventories

- Finished Goods
  - Lower of
    - Cost or
    - NRV
- Work-in-Progress
  - Lower of
    - Cost or
    - NRV
  - NRV shall be calculated after deducting its expected cost on completion.
- Raw Material
  - Finished goods in which, material is to be incorporated is expected to sell at a price
    - < cost
      - valued at Replacement Price.
    - > cost
      - Valued at Cost Price.

Notes:-

i. Meaning of NRV

- Net Realisable value i.e., NRV refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business.

Calculation of NRV

	Estimated Selling Price	✓
Less:-	Expected Trade discount [not cash discount]	(✓)
:-	Expected cost of Completion	(✓)
	Estimated cost necessary to make sale [e.g. Commission on sale]	(✓)
		✓

- Estimated selling price will be entity specific value i.e., order received for any specific goods. However, in absence of any specific order or order is for less than the quantity held in inventory Current Market Price can be Considered as estimated selling Price.

- Sales after reporting date is the best estimates for measuring NRV.

- Lower of Cost or NRV Should be taken item by item basis.

ii. Meaning of Fair value

- It is the Price at which inventory can be Sold in the Principal (or most advantageous) market between market Participants at the measurement date.

5. Determination of cost of Inventories

A. Cost of Inventories Comprises of -

i. Cost of Purchases

ii. Conversion Cost [Labour + Production overhead]

iii. Other Costs

I. Cost of Purchase

· It includes –

	Purchase Price	✓
Less:-	Trade discount or Rebate	(✓)
		✓
Add:-	Non-refundable taxes [credit not available]	✓
:-	Other directly attributable cost	✓
	[e.g., freight, transport, handling cost, etc.]	
		✓

II Cost of Conversion

· It includes –

	Direct labour / wages	✓
Add:-	variable production overhead	✓
	(Actual rate x No. of units)	
:-	fixed production overhead	✓
	(fixed overhead Recovery Rate x No. of units)	
		✓

Notes:-

1. variable overhead

· It includes indirect materials or indirect labour. It should be allocated based on actual production.

II. fixed overhead

· It includes depreciation and maintenance of factory buildings, equipments, etc.

· Allocation of fixed overhead should be made based on Normal capacity of the production facility. But actual production may be high or low, in that case-

- Actual Production is low

Allocation should be made based on Normal capacity and unallocated i.e, unabsorbed overhead should be charged as expense, as we cannot measure inventory above cost.

- Actual Production is
Allocation should be made based on Actual capacity. Thus, Per unit cost will be low as we cannot add any cost in inventory which actually has not been incurred.

In nutshell, Fixed overhead Recovery Rate

$$= \frac{\text{Fixed overhead}}{\text{(Normal capacity or Actual Production)}}$$

whichever is higher

III. Other Costs

- Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present condition and location.

B. Cost does not include followings

i. Abnormal losses [written off in P/L]
[Unit of abnormal loss = Total loss - Normal loss]
ii. Storage cost unless necessary [e.g., whiskey]
iii. General and Administrative overhead
iv. Selling costs
v. Borrowing cost, unless Ind AS-23 allows.

Note:- If any goods purchased on deferred credit, then interest cost for deferred terms should not form Part of cost of inventory, it should be written off in P/L

Methods to Determine Cost

Historic

Actual Cost of each Product can be determined

Non-Historic

Actual Cost of each Product cannot be determined

Standard Cost Technique

Applied where Standard Cost System has been adopted and no significant variance between standard and actual cost exist.

Retail Price Technique

- Applied where large volume of inventories exist with similar gross margin.

[Selling Price - Margin]

Material Cost

Item not ordinarily interchangeable

[e.g., Paintings, high value equipment]

Specific Identification method

Item ordinarily interchangeable

[e.g., Stationery, grocery items, etc]

Other Methods
- FIFO
- Weighted Avg. Method.

Conversion Cost

Direct Labour

Production overhead

Fixed

Overhead Recovery Rate × No. of units

Fixed overhead: Higher of Normal OR Actual Production

Variable

Actual Rate × No. of units [Based on actual Production]

Other Cost

6. Treatment of Joint and By-Product

More than one Product is Produced in the Process

- Outcome is Joint Product [Planned outcome]
  - ↓ Cost of Conversion is separately identifiable
    - Yes ↓ Cost of each Product is based on the separate Cost incurred
    - No ↓ Cost is allocated to Production in ratio of Sales Value at split off Point.
- Outcome is By-Product [Incidental outcome]
  - ↓ Whether by-Product is Material
    - Yes ↓ It will be treated as Joint Product
    - No ↓ It will be measured at NRV and the Same will be deducted from Cost of main Product.

7. Recognition as an Expense

- Amount of inventories recognized as an expenses in the Period will be -
  a. Carrying amount of inventory sold as cost of goods sold.
  b. amount of any write-down of any inventory to NRV.
  c. As depreciation of Said PPE in which it is used and cost is Capitalised.

Note:- • NRV of any item which was write-down earlier and still held as inventory should be reviewed and NRV has increased now then the same should be accounted as Reversal of write down of inventories. Hence, inventory will be valued at lower of Cost or Revised NRV.