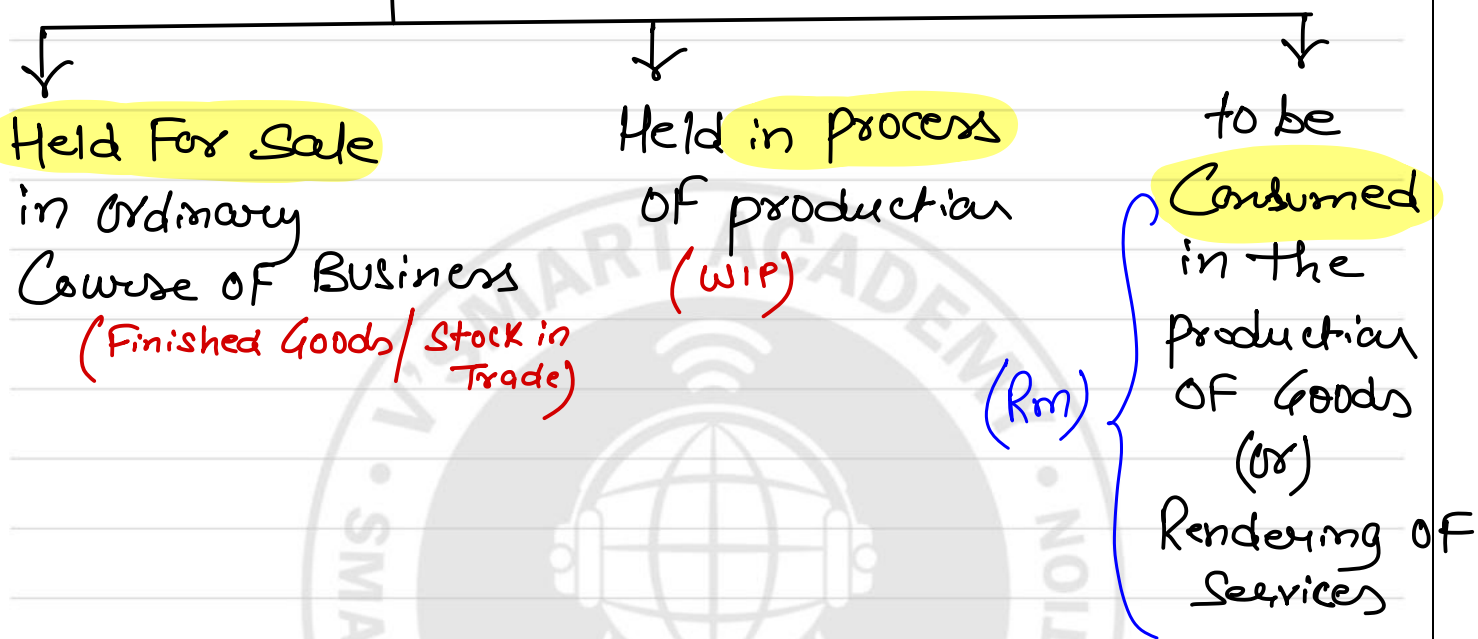


# AS 2 - Valuation OF Inventories

5-7 marks

1) Meaning of Inventory:- Inventory is an Asset  
Which is :-

Future Benefit is expected



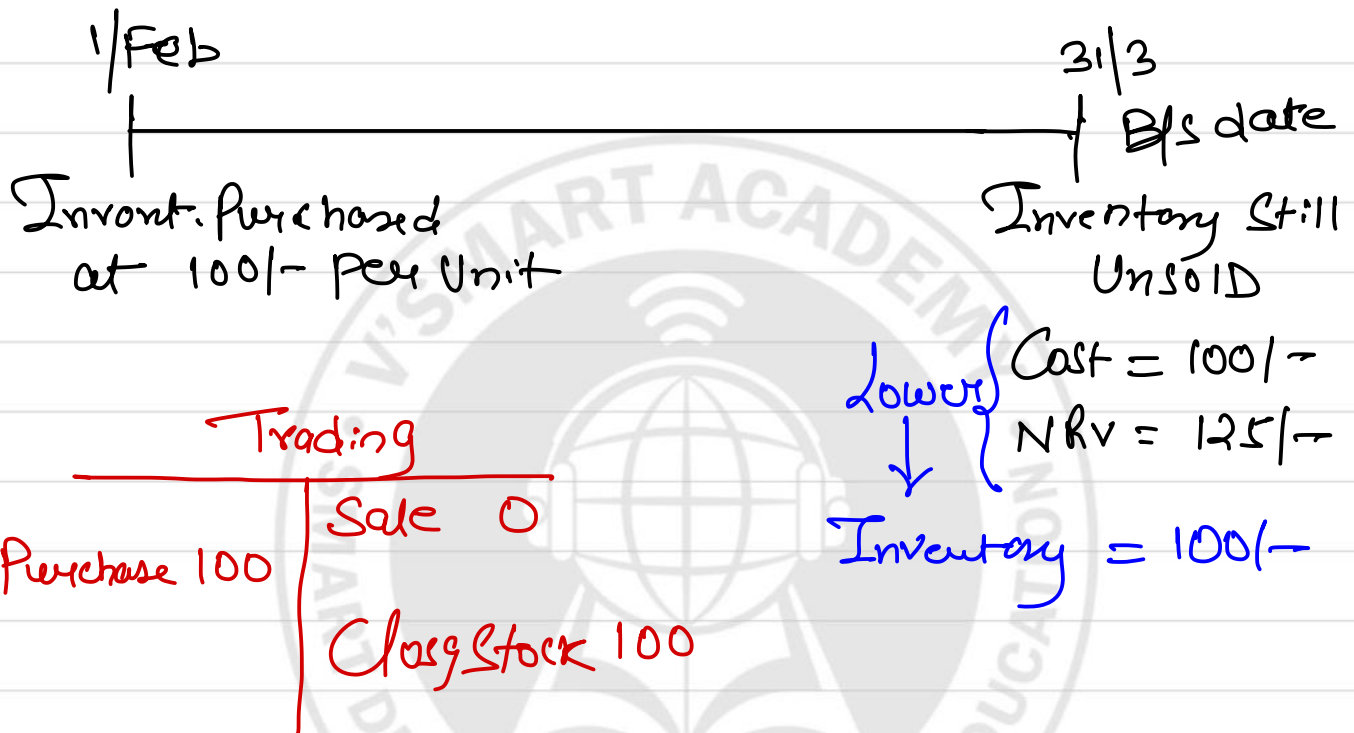
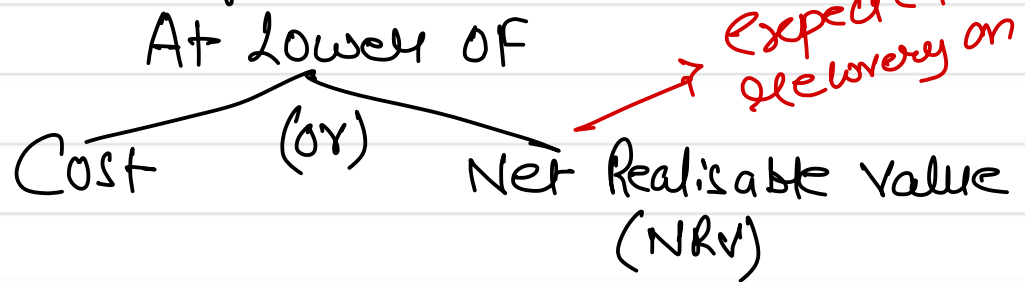
2) Non-Applicability of AS 2:- AS 2 is not applicable in following cases:-

- WIP in Construction Contracts (AS 7)
- Shares, Debentures, Bonds held as stock in Trade (Financial Instruments) (AS 13)
- Live stock used in Agricultural activities
- Incomplete Services in Service Industries such as Consultancy, Teaching etc.

1) Note:- AS 2 will be applicable in real estate industries for finished goods only, eg. Residential Unit/Commercial Unit Held For Sale.

2) Note:- Animals held for sale in ordinary business are Inventory as per AS 2 (Pet Shop)

### 3) Measurement of Inventory :- (at B/s date)

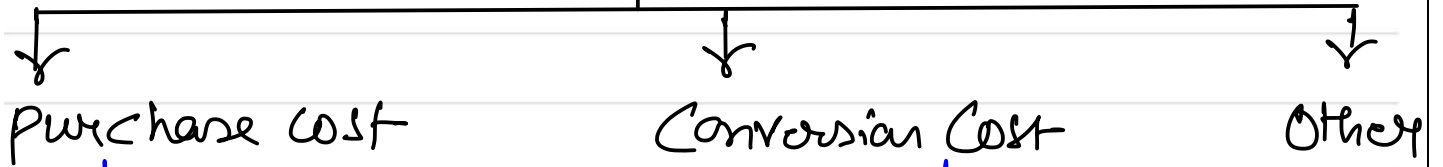


### 4) Define Cost of Inventory :-

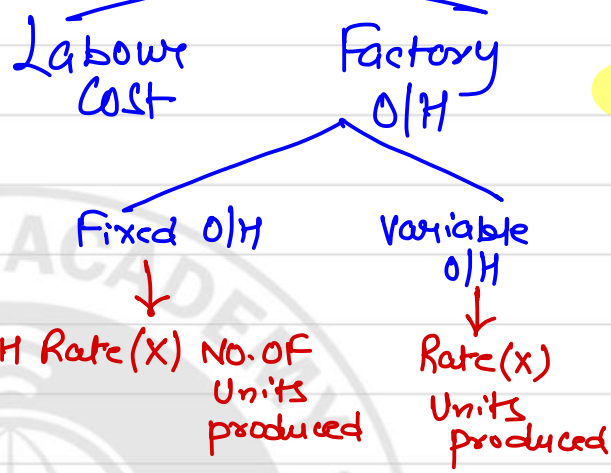
Cost of Inventory Comprise of :-

- Purchase Cost (PC)
- (+) Conversion Cost (CC)
- (+) Other Cost (OC)
- (+) Borrowing Cost (BC) (only if allowed Under AS 16)

# Cost OF Inventory



- Invoice Value (including Taxes)
- (-) Trade Discount/Rebate
  - (-) Refundable Taxes
  - (+) Freight/Transport Cost
  - (+) Loading Charges
  - (+) Transit Insurance
  - (+) Primary Packaging Cost



Note 1

## PC

- (+) Brokerage Paid to Indenting Agent
- 
- Total PC

Rent = 30 lacs. pa.  
 Machine = 5 Cr. (25 yrs)  
 Dep = 20 lacs.  
 Fixed OH = 50 lacs. p.a.  
 Target = 5 lacs. p.a. Units  
 Rate = 10/-

Note 1 Other Cost:- Any Cost which is necessary to bring the Inventory into Saleable Condition

eg:- Transport Cost from factory to warehouse  
 Transit Insurance  
 Secondary packaging.

Note 2 :- How to Calculate **Fixed OH Rate per Unit** ?

$$\text{Rate} = \frac{\text{Total Fixed OH (₹)}}{\text{Normal Capacity (or) Actual production (No.) (whichever is Higher)}}$$

\* Variable OH Rate will always be given in the Question.

Note 3 :- These **Expenses** Will Never be a part of Cost of Inventory **MCO**

a) Abnormal Loss

b) Storage Cost of FG (warehouse rent)  
(But storage cost of Rm will be a part of Cost)

c) All other Overheads (Admin/S&D/General)

d) Borrowing Cost if not allowed by AS 16

Q.AS2.SM.17:

You are required to value the inventory per kg of finished goods consisting of:

	Rs per kg.
Material cost	200
Direct labour	40
Direct variable overhead	20



Fixed production charges for the year on normal working capacity of 2 lakh kgs is Rs 20 lakhs. 4,000 kgs of finished goods are in stock at the year end.

Solution

Material Cost (Pc) = 200/-

Labour Cost (Cc) = 40/-

Variable OH (Cc) = 20/-

Fixed OH (Cc) = 10/- (WN)

$$\text{Total Cost} = \underline{270/-} \text{ per Kg OF FG}$$

$$\underline{\text{WN}} \quad \text{Fixed OH Rate (Per Kg)} = \frac{20,00,000}{200,000 \text{ Kg.}} = 10/- \text{ per Kg.}$$

$$\text{Cost of 4000 Kg. Inventory} \Rightarrow 4000 \times 270 = 10,80,000$$

Example 1 :- Suppose in above question, NRV is :-

$$\text{Case A} = 300/- \text{ Per Kg.}$$

$$\text{Case B} = 250/- \text{ Per Kg.}$$

Calculate Value as per AS 2

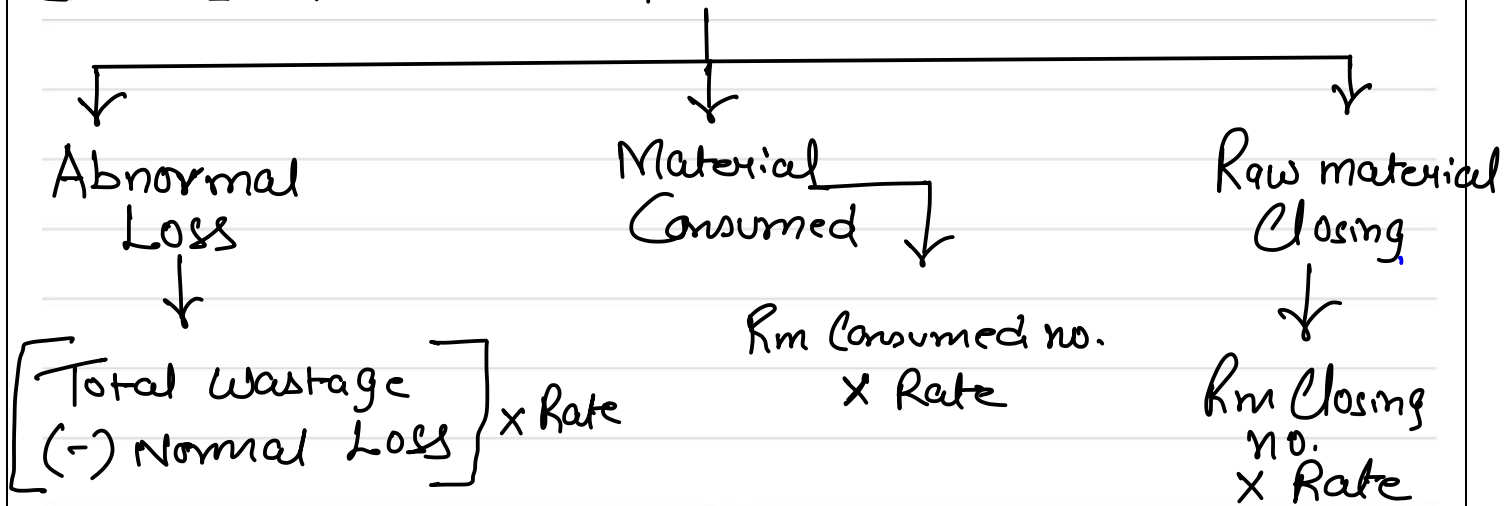
Solution As per AS 2, Inventory is measured at lower of Cost (or) NRV as under :-

Case A	Case B
Cost = 270 per Kg	Cost = 270 per Kg.
NRV = 300 per Kg.	NRV = 250 per Kg.
Lower is Cost, Hence Value $\Rightarrow 270 \times 4000 \text{ Kg.}$ $\Rightarrow 10,80,000/-$	Lower is NRV, Hence Value $\Rightarrow 250 \times 4000 \text{ Kg.}$ $\Rightarrow 10,00,000/-$

Note 4 :- How to Calculate Raw material purchase Cost per Unit/Kg ? (Refer Q2, Q3, Q15)

$$\frac{\text{Total Purchase Cost}}{\text{purchased Units} - \text{Normal Wastage}}$$

## Note 5:- Allocation of Raw Material Cost



\* Abnormal Loss shall always be transferred to P&I a/c

## Note 6:- How to Calculate the Cost of FG ?

Particulars	Amount
1) Material Consumed (Note 5) $10200 \times 10$	XXX 102000
2) Direct Labour (Given in Question) 76500	XXX 76500
3) Variable O/H $\circ$ Rate $\times$ Actual production	XXX
4) Fixed O/H $\times$ Rate $\times$ Actual production Refer Note 2 $5 \times 10200$	XXX 51000
5) Other Cost (Given)	XXX
	229500 XXX
Total Cost of FG produced	$\div 10200$ Actual production
Cost per Unit of FG	XX per unit

Note:- Always assume that 1 unit of RM Consumed will be required to produce 1 unit of FG

5) How to Calculate NRV OF FG and WIP ?

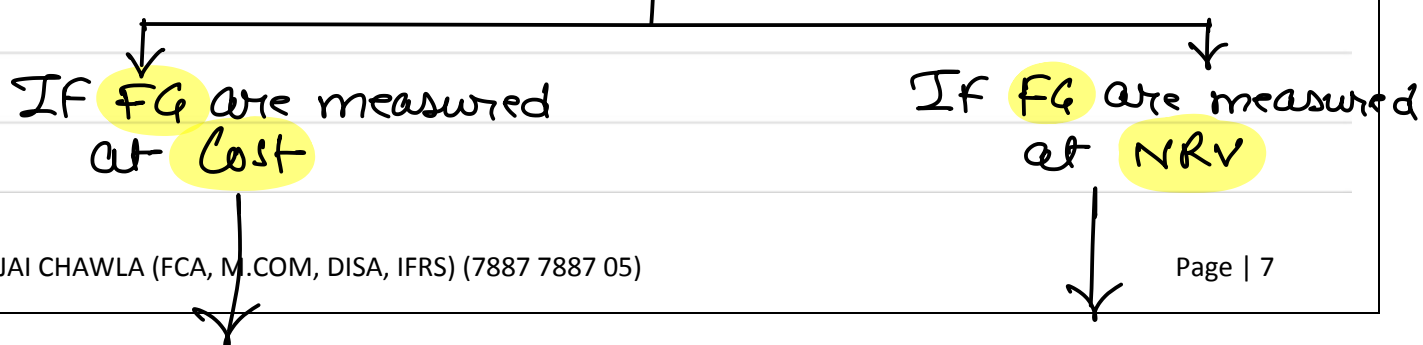
NRV OF FG		NRV OF WIP	
Estimated SP	XXX	Estimated SP of FG	— XXX
(-) Selling exp.	XX	(-) Selling Exp	— (xxx)
	<u>NRV</u>	(-) Further Cost to Convert WIP into FG	— (xxx)
			<u>NRV</u>

Note:- For Calculating NRV, Consider SP after B/s date.

6) How to Measure Raw Material at year end ?

Rule of Cost (or) NRV whichever is lower will not be applicable to Raw material.

Measurement of Raw material depends on Finished Goods measurement



Raw material will be measured at Cost

Raw material will be measured at Replacement Cost

(Refer Q4)

Note:- If some portion of FG is defective then NRV of such defective goods will be less than Normal NRV. (Refer Q11)

Ex:- Total FG = 300 units with Cost = 150/- per unit

50 units are defective whose SP is 125/-  
Normal selling price is 250/-

Normal FG	⇒	250 units (X) 150	=	37500/-
defective FG	⇒	50 units (X) 125	=	6250/-
				<u>Inventory = 43750/-</u>

## 7) Joint Product & By product

We have to allocate Common production Expenses (Material, Labour, O/H) to each Joint product.

Joint product is treated as Inventory but By product is not treated as Inventory. By product is measured at NRV and deducted from Common production expenses.

Particulars	Amount.
Material Consumed	XXX
Direct Labour	XXX
Overheads (F & V)	XXX
Other Cost	XXX
	<hr/>
Common production expenses	XXX
(-) NRV of By Product & Other Scrap	(XX)
	<hr/>
Net Common Production Exp. for Joint products	XXXX
	<hr/>
	320000

Allocate above "Net Common production Exp" in the ratio of Total Sales Value (Market Value) of Joint products.

(Refer Q7)

## 8) Techniques of Measurement of Cost

a) FIFO :- Cost is identified from recent purchase transactions.

b) Weighted Avg :- Cost is calculated on weighted Avg. basis.

Purchased 500 units @ 60/- in April

Sold 200 units @ 110/- in June

Purchased 100 units @ 75/- in August

Sold 350 units @ 98/- in September

Closing Stock = 50 units

$$\text{Closing stock (FIFO)} = 50 \times 75/- = 3750/-$$

$$\begin{aligned}\text{Closing stock (W.Avg)} &= \frac{(500 \times 60) + (100 \times 75)}{500 + 100} \\ &= 62.5/- \times 50 \text{ units} = 3125/-\end{aligned}$$

c) Specific Identification method :- This method shall be used in such industries which produces **Customised goods**.

Hence, Cost for each Job shall be maintained & identified separately.

d) Standard Cost method :- Generally used by Manufacturing Companies.

Here, Standard Cost = Estimated Cost

Hence, Cost of Inventory is equal to Estimated Cost of RM, Labour, OH.

e) Retail price method (Adjusted SP method) :-

$$\text{Cost} = \text{SP} - \text{Margin} (10\%)$$

Generally used in Retail industries with large variety of goods but similar margin.

## 9) Other Important Points

MCQ

(i) Inventory of Agricultural Crops (or) Minerals can be measured directly at NRV if their sales is guaranteed/Assured. (Refer Q8)

(No need to Do lower of Cost or NRV)

(ii) AS 2 is not applicable to Agricultural products for Companies in Agricultural Activities.

(For wholeseller/Traders of Agricultural Goods AS 2 will be applicable) Refer Q18(b)

(iii) GST, if included in purchase cost, always assume that ITC will be available if nothing is specified in question.

(iv) Trade Discount = deduct from Purchase Cost  
Cash Discount = No need to deduct but transfer to P&L.

(v) LIFO method is not allowed.

(vi) If a Cold Drink manufacturing Company regularly sales Empty Bottles through Tenders (Advt) & Keeping proper records.

Then Sale of "Empty Bottles" is treated as Revenue from operation.

Hence, Such "Empty Bottles" shall be treated as Inventory & not Scrap. (Refer Q 1)



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