AS 2 - Valuation OF Inventories 5-7 marks

1) Meaning of Inventory :- Inventory is an Asset (Future Benefit is expected) Which is :-

- Held For Sale in Ordinary Course of Business (Finished Goods / Stock in Trade)
- Held in process of production (WIP)
- (Rm) to be Consumed in the production OF Goods (OR) Rendering of Services

2) Non-Applicability OF AS 2 :- AS 2 is not applicable in Following Cases :-

a) WIP in Construction Contracts (AS 7)
b) Shares, Debentures, Bonds held as stock in Trade (Financial Instruments) (AS 13)
c) Live stock Used in Agricultural activities
d) 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)

At Lower of

Cost (or) Net Realisable Value (NRV)

→ Expected recovery on sale

Lower
- Cost = 100/-
- NRV = 125/-

↓

Inventory = 100/-

Trading	
Purchase 100	Sale 0
	Closg Stock 100

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

- Purchase cost
  - Invoice value (including Taxes)
  - (-) Trade Discount / Rebate
  - (-) Refundable Taxes
  - (+) Freight / Transport Cost
  - (+) Loading Charges
  - (+) Transit Insurance
  - (+) Primary Packaging Cost
  - = PC
  - (+) Brokerage Paid to Industry Agent
  - = Total PC
- Conversion Cost
  - Labour Cost
  - Factory O/H
    - Fixed O/H → FOH Rate (X) No. of Units produced
    - Variable O/H → Rate (X) Units produced
- Other Cost → Note 1

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 O/H Rate per Unit ?

$$\text{Rate} = \frac{\text{Total Fixed O/H (₹)}}{\text{Normal Capacity (or) Actual production (No.)}}$$

(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 (MCQ)

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)

Total Cost of FG = 270/- per kg

WN

Fixed OH Rate (Per Kg) = 20,00,000 / 200000 Kg. = 10/- per kg.

Cost of 4000 kg. Inventory ⇒ 4000 × 270 = 10,80,000

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

Case A = 300/- Per kg.

Case B = 250/- 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 ⇒ 270 × 4000 kg. ⇒ 10,80,000/-	Lower is NRV, Hence Value ⇒ 250 × 4000 kg. ⇒ 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** → [Total wastage (-) Normal Loss] x Rate
- **Material Consumed** → Rm Consumed no. x Rate
- **Raw material Closing** → Rm Closing no. x Rate

* Abnormal Loss shall always be transfer to P&L a/c

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

Particulars		Amt.
1) Material Consumed (Note 5) 10200 x 10		XXX 102000
2) Direct Labour 76500	(Given in Question)	XXX 76500
3) Variable O/H	Rate x Actual production	XXX
4) Fixed O/H	Rate (Refer Note 2) x Actual production 5 x 10200	XXX 51000
5) Other Cost	(Given)	XXX
Total Cost of FG produced		229500 XXX
Cost per Unit of FG		÷ 10200 Actual production = XX per unit 22.5

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	
Estimated SP	XXX
(-) Selling exp.	XX
NRV	

NRV of WIP	
NRV of FG: Estimated SP of FG	— XXX
NRV of FG: (-) Selling Exp	— (XXX)
(-) Further Cost to Convert WIP into FG	— (XXX)
NRV	

Note:- For Calculating NRV, Consider SP after BS 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

- If FG are measured at Cost
- If FG are measured at NRV

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/-
Inventory = 43750/-

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 produced is measured at NRV and deducted from Common production Expenses.

Particulars	Amt.
Material Consumed	XXX
Direct Labour	XXX
Overheads (F & V)	XXX
Other Cost	XXX
Common production expenses	XXX
(-) NRV of By Product & Other Scraps	(XX)
Net Common Production Exp. for Joint products	XXXX
	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

Closg. Stock = 50 Units

Closing stock (FIFO) = 50 x 75/- = 3750/-

Closing stock (W.Avg) = $\frac{(500 \times 60) + (100 \times 75)}{500 + 100}$

= 62.5/- x 50 units = 3125/-

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 Rw, Labour, OH.

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

Cost = SP - Margin (i.)

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)