

CHAPTER 7

VALUATION OF INVENTORIES (IND AS 2)

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: As per Ind AS 2, inventories include 'materials and supplies awaiting use in the production process'. Examine whether the packing material and publicity material are covered by the term 'materials and supplies awaiting use in the production process'.

Ans: While 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.

Q2: ABC Ltd. buys goods from an overseas supplier. It has recently taken delivery of 1,000 units of component X. The quoted price of component X was ₹ 1,200 per unit but ABC Ltd. has negotiated a trade discount of 5% due to the size of the order.

The supplier offers an early settlement discount of 2% for payment within 30 days and ABC Ltd. intends to achieve this.

Import duties (basic custom duties) of ₹ 60 per unit must be paid before the goods are released through custom. Once the goods are released through customs, ABC Ltd. must pay a delivery cost of ₹ 5,000 to have the components taken to its warehouse.

Calculate the cost of inventory.

[MTP SEP 2025]

Ans:

	₹
Purchase price (1,000 x 1,200 x 95%)	11,40,000
Import duties (1,000 x 60)	60,000
Delivery cost	<u>5,000</u>
Cost of inventory	<u>12,05,000</u>

Note: The intention to take settlement discount is irrelevant.

Q3 A business plans for production overheads of ₹ 10,00,000 per annum. The normal level of production is 1,00,000 units per annum.

Due to supply difficulties the business was only able to make 75,000 units in the current year. Other costs per unit were ₹ 126.

Calculate the per unit cost and amount of overhead to be expensed during the year

Ans:

Calculation of cost per unit:	₹
Other costs	126
Production overhead (10,00,000/1,00,000 units)	<u>10</u>
Unit cost	<u>136</u>

Overhead to be expensed:	₹
Total production overhead	10,00,000
The amount absorbed into inventory is (75,000 x 10)	<u>(7,50,000)</u>
The amount not absorbed into inventory	<u>2,50,000</u>

₹ 2,50,000 that has not been included in inventory is expensed during the year i.e. recognised in the statement of profit and loss.

Q4: ABC Ltd. manufactures control units for air conditioning systems.

Each control unit requires the following:

1 component X at a cost of ₹ 1,205 each 1 component Y at a cost of ₹ 800 each

Sundry raw materials at a cost of ₹ 150 each The company faces the following monthly expenses:

Factory rent ₹ 16,500 Energy cost ₹ 7,500

Selling and administrative costs ₹ 10,000

Each unit takes two hours to assemble. Production workers are paid ₹ 300 per hour.

Production overheads are absorbed into units of production using an hourly rate. The normal level of production per month is 1,000 hours.

Determine the cost of inventory.

Ans:

<i>The cost of a single control unit :</i>	₹
Materials:	
Component X	1,205
Component Y	800
Sundry raw materials	<u>150</u>
	2,155
Labour (2 hours x 300)	600

Production overhead $[(16,500 + 7,500/1,000 \text{ hours}) \times 2 \text{ hours}]$	<u>48</u>
	<u>2,803</u>

Note: The selling and administrative costs are not part of the cost of inventory.

Q5: A dealer has purchased 1,000 cars costing ₹ 2,80,000 each on deferred payment basis as ₹ 25,000 per month per car to be paid in 12 equal instalments.

At year end 31 March 20X1, twenty cars are in stock. What would be the cost of goods sold, finance cost and inventory carrying amount?

Ans:

	₹
Deferred payment price (25,000 x 12)	3,00,000
Less: Cash price	<u>2,80,000</u>
Interest expense	<u>20,000</u>

		₹
Cost of inventory	20 cars x 2,80,000	56,00,000
Finance cost	1,000 cars x 20,000	2,00,00,000
Cost of goods sold	980 cars x 2,80,000	27,44,00,000

Q6: Cost of Inventory

Venus Trading Company purchases cars from several countries and sells them to Asian countries. During the current year, this company has incurred following expenses:

1. Trade discounts on purchase
2. Handling costs relating to imports
3. Salaries of accounting department
4. Sales commission paid to sales agents
5. After sales warranty costs
6. Import duties
7. Costs of purchases (based on supplier's invoices)
8. Freight expense
9. Insurance of purchases
10. Brokerage commission paid to indenting agents

Evaluate which costs are allowed by Ind AS 2 for inclusion in the cost of inventory in the books of Venus.

Ans: Items number 1, 2, 6, 7, 8, 9, 10 are allowed by Ind AS 2 for the calculation of cost of inventories. Salaries of accounts department, sales commission, and after sale warranty costs are not considered to be the cost of inventory. Therefore, they are not allowed by Ind AS 2 for inclusion in cost of inventory and are expensed off in the profit and loss account.

Q7: As per Ind AS 2, selling costs are excluded from the cost of inventories and are required to be recognized as an expense in the period in which these are incurred. Advise whether the distribution costs would now be included in the cost of inventories under Ind AS 2.

Ans: Selling and distribution costs are generally used as single term because both are related, as selling costs are incurred to effect the sale and the distribution costs are incurred by the seller to complete a sale transaction by making the goods available to the buyer from the point of sale to the point at which the buyer takes possession. Since these costs are not related to bringing the goods to their present location and condition, the same are not included in the cost of inventories. Accordingly, though the word 'distribution costs' is not specifically mentioned in Ind AS 2, these costs would continue to be excluded from the cost of inventories.

Q8: In a manufacturing process of Vijoy Limited, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process are here under:

Item	Unit	Amount (₹)	Output (unit)	Closing stock as on 31-03-2012
Raw material	15,000	1,60,000	MP1-6,250	800
Wages	-	82,000	MP2- 5,000	200
Fixed overhead	-	58,000	BP-1,600	-
Variable overhead	-	40,000		-

Average market price of MP1 and MP2 is ₹ 80 per unit and ₹ 50 per unit respectively, by product is sold @ ₹ 25 per unit. There is a profit of ₹ 5,000 on sale of by-product after incurring separate processing charges of ₹ 4,000 and packing charges of ₹ 6,000, ₹ 6,000 was realised from sale of scrap.

Calculate the value of closing stock of MP1 and MP2 as on 31-03-2012.

[Exam Dec 21 (5 Marks); May 2025 (5 Marks)]

Ans: As per IND AS 2 'Inventories', most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realizable value and this value is deducted from the cost of the main product.

1.	Calculation of net realizable value of by-product, BP	₹
	Selling price of by-product BP (1,600 units x ₹ 25 per unit)	40,000
	Less: Separate processing charges of by- product BP	(4,000)
	Packing charges	(6,000)

	Net realizable value of by-product BP		30,000
2.	Calculation of cost of conversion for allocation between joint products MP1 and MP2		
		₹	₹
	Raw material		1,60,000
	Wages		82,000
	Fixed overhead		58,000
	Variable overhead		40,000
		3,40,000	
	Less: NRV of by-product BP (See calculation 1)	(30,000)	
	Sale value of scrap	(6,000)	(36,000)
	Joint cost to be allocated between MP1 and MP2		3,04,000
3.	Determination of “basis for allocation” and allocation of joint cost to MP1 and MP2		
		MP1	MP2
	Output in units (a)	6,250 units	5,000 units
	Sales price per unit (b)	₹ 80	₹ 50
	Sales value (a x b)	₹ 5,00,000	₹ 2,50,000
	Ratio of allocation	2	1
	Joint cost of ₹ 3,04,000 allocated in the ratio of 2:1 (c)	₹ 2,02,667	₹ 1,01,333
	Cost per unit [c/a]	₹ 32.43	₹ 20.27
4.	Determination of value of closing stock of MP1 and MP2		
		MP1	MP2
	Closing stock in units	800 units	200 units
	Cost per unit	₹ 32.43	₹ 20.27
	Value of closing stock	₹ 25,944	₹ 4,054

Q9: Mars Fashions is a new luxury retail company located in Lajpat Nagar, New Delhi. Kindly advise the accountant of the company on the necessary accounting treatment for the following items:

- (a) One of Company's product lines is beauty products, particularly cosmetics such as lipsticks, moisturizers and compact make-up kits. The company sells hundreds of different brands of these products. Each product is quite similar, is purchased at similar prices and has a short lifecycle before a new similar product is introduced. The point of sale and inventory system is not yet fully functioning in this department. The sales manager of the cosmetic department is unsure of the cost of each product but is confident of the selling price and has reliably informed you that the Company, on average, make a gross margin of 65% on each line.
- (b) Mars Fashions also sells handbags. The Company manufactures their own handbags as they wish to be assured of the quality and craftsmanship which goes into each handbag. The handbags are manufactured in India in the head office factory which has made handbags for the last fifty years. Normally, Mars manufactures 100,000 handbags a year in their handbag division which uses 15% of the space and overheads of the head office

factory. The division employs ten people and is seen as being an efficient division within the overall company.

In accordance with Ind AS 2, explain how the items referred to in a) and b) should be measured.

- Ans:** (a) The retail method can be used for measuring inventories of the beauty products. The cost of the inventory is determined by taking the selling price of the cosmetics and reducing it by the gross margin of 65% to arrive at the cost.
- (b) The handbags can be measured using standard cost especially if the results approximate cost. Given that The company has the information reliably on hand in relation to direct materials, direct labour, direct expenses and overheads, it would be the best method to use to arrive at the cost of inventories.

Q10: State whether an entity can use different cost formulae for inventories held at different geographical locations having similar nature and use to it.

- Ans:** Paragraph 25 of Ind AS 2 prescribes that the cost of inventories, other than the items of inventories which are not ordinarily interchangeable as dealt with in paragraph 23, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having similar nature and use to it. In this case, since the inventories held at different geographical location are of similar nature and use to the entity, different cost formula cannot be used for inventory valuation purposes.

Q11: Mercury Ltd. uses a periodic inventory system. The following information relates to 20X1-20X2.

Date	Particular	Unit	Cost p.u.	Total Cost
April	Inventory	200	10	2,000
May	Purchases	50	11	550
September	Purchases	400	12	4,800
February	Purchases	350	14	4,900
Total		1,000		12,250

Physical inventory at 31.03.20X2 400 units. Calculate ending inventory value and cost of sales using:

- (a) FIFO & (b) Weighted Average

Ans: **FIFO inventory 31.03.20X2**

Closing inventory at 31.03.20X2

350 @14 = 4,900

50 @ 12 = 600

5,500

Cost of sales 20X1-20X2 = 12,250-5,500 = 6,750

Weighted average cost per item

Weighted average inventory at 31.03.20X2

12,250/1000 = 12.25

Closing inventory = 400 x 12.25 = 4,900

Cost of sales 20X1-20X2 = 12,250-4,900 = 7,350

Q12: Whether the following costs should be considered while determining the Net Realisable Value (NRV) of the inventories?

- a) Costs of completion of work-in-progress;
- b) Trade discounts expected to be allowed on sale; and
- c) Cash discounts expected to be allowed for prompt payment

[RTP Nov 2021]

Ans: Ind AS 2 defines Net Realisable Value as 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.”

Costs of completion of work-in-progress are incurred to convert the work-in-progress into finished goods. Since these costs are in the nature of completion costs, in accordance with the above definition, the same should be deducted from the estimated selling price to determine the NRV of work-in-progress.

Trade Discount is “A reduction granted by a supplier from the list price of goods or services on business considerations other than for prompt payment”. Trade discount is allowed either expressly through an agreement or through prevalent commercial practices in the terms of the trade and the same is adjusted in arriving at the selling price. Accordingly, the trade discount expected to be allowed should be deducted to determine the estimated selling price.

Cash Discount is “A reduction granted by a supplier from the invoiced price in consideration of immediate payment or payment within a stipulated period.” These types of costs are incurred to recover the sale proceeds immediately or before the end of the specified period or credit period allowed to the customer. In other words, these costs are not incurred to make the sale, therefore, the same should not be considered while determining NRV.

Q13: ABC Ltd. manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of 31st March, 20X1, at a cost of ₹ 50 per pack. During the final audit, the auditors noted that the subsequent sale price for the inventory at 15th April, 20X1, was ₹ 40 per pack. Furthermore, enquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd. has spent a total of ₹ 15 per pack for repairing and reapplying glue to the envelopes.

Calculate the net realizable value and inventory write-down (loss) amount.

Ans: The net realisable value is the expected sale price ₹ 40, less cost incurred to bring the goods to its saleable condition ie ₹ 15.

Thus, NRV of envelopes pack = ₹ 40 – ₹ 15 = ₹ 25 per pack.

Q14: At the end of its financial year, Company P has 100 units of inventory on hand recorded at a carrying amount of ₹ 10 per unit. The current market price is ₹ 8 per unit at which these units can be sold. Company P has a firm sales contract with Company Q to sell 60 units at ₹ 11 per unit, which cannot be settled net. Estimated incremental selling cost is ₹ 1 per unit.

Determine Net Realisable Value (NRV) of the inventory of Company P

Ans: While performing NRV test, the NRV of 60 units that will be sold to Company Q is ₹ 10 per unit (i.e. 11-1).

NRV of the remaining 40 units is ₹ 7 per unit (i.e. 8-1).

Therefore, Company P will write down those remaining 40 units by ₹ 120 (i.e. 40 x 3). Total cost of inventory would be

Goods to be sold to Company Q	60 units x ₹ 10	₹ 600
Remaining goods	40 unit x ₹ 7	₹ 280
		₹ 880

Q15: A business has four items of inventory. A count of the inventory has established that the amounts of inventory currently held, at cost, are as follows:

	Cost	Estimated Sales price	Selling costs
Inventory item A1	8,000	7,800	500
Inventory item A2	14,000	18,000	200
Inventory item B1	16,000	17,000	200
Inventory item C1	6,000	7,500	150

Determine the value of closing inventory in the financial statements of a business.

2023]

[MTP May

Ans: The value of closing inventory in the financial statements:

Item of inventory	Cost	NRV (Estimated Sales price- Selling costs)	Measurement base (lower of cost or NRV)	Value
A1	8,000	(7,800 – 500) 7,300	NRV	7,300
A2	14,000	(18,000 – 200) 17,800	Cost	14,000
B1	16,000	(17,000 – 200) 16,800	Cost	16,000
C1	6,000	(7,500 – 150) 7,350	Cost	<u>6,000</u>
Value of Inventory				<u>43,300</u>

Q16:

Particulars		Kg.	₹
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory:	Raw Materials	900	
	Finished Goods	1200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ₹ 20 per kg and the replacement cost for the raw material was ₹ 9.50 per kg on the closing day. You are required to calculate the closing inventory as on that date. [MTP Jan 2026]

Ans: Calculation of cost for closing inventory

Particulars	₹
Cost of Purchase (10,200* x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead 75,000 x 10,200 15,000	51,000
Cost of Production	2,29,500
Cost of closing inventory per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit	₹ 20.00

* (OS Of Raw Material + Purchase of Raw Material - CS Of Raw Material) = 1,100+10,000 – 900 = 10,200

Since net realisable value is less than cost, closing inventory will be valued at ₹ 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. ₹ 9.50.

Therefore, value of closing inventory:

Finished Goods (1,200 x 20)	₹ 24,000
Raw Materials (900 x 9.50)	₹ 8,550
	₹ 32,550

Q17: Sun Pharma Limited, a renowned company in the field of pharmaceuticals has the following four items in inventory: The cost and net realisable value is given as follows:

Item	Cost	Net Realisable Value
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A	2,000	1,900
B	5,000	5,100
C	4,400	4,550
D	3,200	2,990
Total	14,600	14,540

Calculate the value of Inventories:

- On an item by item basis
- On a group basis

Ans: Inventories shall be measured at the lower of cost and net realisable value.

Item by item basis:	
A	1,900
B	5,000
C	4,400
D	<u>2,990</u>
	<u>14,290</u>
Group basis	14,540

Q18: UA Ltd. purchased raw material @ ₹ 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realizable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is ₹ 300 per kg. How will you value the inventory of raw material?

Ans: As per Ind AS 2 "Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value. Therefore, in this case, UA Ltd. will value the inventory of raw material at ₹ 30,00,000 (10,000 kg. @ ₹ 300 per kg.).

Q19: Sun Ltd. has fabricated special equipment (solar power panel) during 2014-15 as per drawing and design supplied by the customer. However, due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31-03-2016 are as follows:

Solar power panel (WIP) ₹ 85 lakhs

Solar power panel (finished products) ₹ 55 lakhs

Sundry Debtor (solar power panel) ₹ 65 lakhs

The petition for winding up against the customer has been filed during 2015-16 by Sun Ltd.

Comment with explanation on provision to be made of ₹ 205 lakh included in Sundry Debtors, Finished Goods and Work-in-progress in the financial statements of 2015-16.

Ans: From the fact given in the question it is obvious that Sun Ltd. is a manufacturer of solar power panel. As per IND AS 2 'Valuation of Inventories', 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. Therefore, solar power panel held in its stock will be considered as its inventory. Further, as per the standard, inventory at the end of the year are to be valued at lower of cost or NRV.

As the customer has postponed the delivery schedule due to liquidity crunch the entire cost incurred for solar power panel which were to be supplied has been shown in Inventory. The solar power panel are in the possession of the Company which can be sold in the market. Hence company should value such inventory as per principle laid down in IND AS 2 i.e. lower of Cost or NRV. Though, the goods were produced as per specifications of buyer the Company should determine the NRV of these goods in the market and value the goods accordingly. Change in value of such solar power panel should be provided for in the books. In the absence of the NRV of WIP and Finished product given in the question, assuming that cost is lower, the company shall value its inventory as per IND AS 2 for ₹ 140 lakhs [i.e solar power panel (WIP) ₹ 85 lakhs + solar power panel (finished products) ₹ 55 lakhs].

Note: Alternatively, if it is assumed that there is no buyer for such fabricated solar power panel, then the NRV will be Nil. In such a case, full value of finished goods and WIP will be provided for in the books.

As regards Sundry Debtors balance, since the Company has filed a petition for winding up against the customer in 2015-16, it is probable that amount is not recoverable from the party. Hence, the provision for doubtful debts for ₹ 65 lakhs shall be made in the books against the debtors amount.

Q20: On 31 March 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare parts was ₹ 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is ₹ 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock reduced to ₹ 8 million. The estimated selling expense required to make the sales would ₹ 0.5 million. Financial statements were authorised by Board of Directors on 20th April 20X1.

As at 31st March 20X2, Directors noted that such inventory is still unsold and lying in the warehouse of the company. Directors believe that inventory is in a saleable condition and active marketing would result in an immediate sale. Since the market conditions have improved,

estimated selling price of inventory is ₹ 11 million and estimated selling expenses are same ₹ 0.5 million. What will be the value inventory at the following dates:

(a) 31st March 20X1

(b) 31st March 20X2

[RTP May 2018; MTP Nov 2023]

Ans: As per Ind AS 2 'Inventories', inventory is measured at lower of 'cost' or 'net realisable value'. Further, as per Ind AS 10: 'Events after Balance Sheet Date', decline in net realisable value below cost provides additional evidence of events occurring at the balance sheet date and hence shall be considered as 'adjusting events'.

- (a) In the given case, for valuation of inventory as on 31 March 20X1, cost of inventory would be ₹10 million and net realisable value would be ₹7.5 million (i.e. Expected selling price ₹8 million- estimated selling expenses ₹ 0.5 million). Accordingly, inventory shall be measured at ₹7.5 million i.e. lower of cost and net realisable value. Therefore, inventory write down of ₹2.5 million would be recorded in income statement of that year.
- (b) As per para 33 of Ind AS 2, a new assessment is made of net realizable value in each subsequent period. It Inter alia states that if there is increase in net realizable value because of changed economic circumstances, the amount of write down is reversed so that new carrying amount is the lower of the cost and the revised net realizable value. Accordingly, as at 31 March 20X2, again inventory would be valued at cost or net realisable value whichever is lower. In the present case, cost is ₹10 million and net realisable value would be ₹10.5 million (i.e. expected selling price ₹11 million – estimated selling expense ₹0.5 million). Accordingly, inventory would be recorded at ₹ 10 million and inventory write down carried out in previous year for ₹2.5 million shall be reversed.

Q21: The following is relevant information for an entity:

- Full capacity is 10,000 labour hours in a year.
- Normal capacity is 7,500 labour hours in a year.
- Actual labour hours for current period are 6,500 hours.
- Total fixed production overhead is ₹ 1,500.
- Total variable production overhead is ₹ 2,600.
- Total opening inventory is 2,500 units.
- Total units produced in a year are 6,500 units.
- Total units sold in a year are 6,700 units.
- The cost of inventories is assigned by using FIFO cost formula. [in RTP May 2025 Q, Total closing inventory is 2,300 units is given]

How will the overhead cost be allocated to inventory at normal capacity and at less than normal production for the current year based on the above information? [RTP May 2020; May 2025]

Ans: Hours taken to produce 1 unit = 6,500 hours / 6,500 units = 1 hour per unit.

Fixed production overhead absorption rate:

= Fixed production overhead / labour hours for normal capacity

= ₹ 1,500 / 7,500 = ₹ 0.2 per hour

Management should allocate fixed overhead costs to units produced at a rate of ₹ 0.2 per hour.

Therefore, fixed production overhead allocated to 6,500 units produced during the year (one unit per hour) = 6,500 units x 1 hour x ₹ 0.2 = ₹ 1,300.

The remaining fixed overhead incurred during the year of ₹ 200 (₹ 1500 – ₹ 1300) that remains unallocated is recognised as an expense.

The amount of fixed overhead allocated to inventory is not increased as a result of low production by using normal capacity to allocate fixed overhead.

Variable production overhead absorption rate:

= Variable production overhead/actual hours for current period

= ₹ 2,600 / 6,500 hours = ₹ 0.4 per hour

Management should allocate variable overhead costs to units produced at a rate of ₹ 0.4 per hour.

The above rate results in the allocation of all variable overheads to units produced during the year.

Closing inventory = Opening inventory + Units produced during year – Units sold during year

= 2,500 + 6,500 – 6,700 = 2,300 units

As each unit has taken one hour to produce (6,500 hours / 6,500 units produced), total fixed and variable production overhead recognised as part of cost of inventory:

= Number of units of closing inventory x Number of hours to produce each unit x (Fixed production overhead absorption rate + Variable production overhead absorption rate)

= 2,300 units x 1 hour x (₹ 0.2 + ₹ 0.4) = ₹ 1,380

The remaining ₹ 2,720 [(₹ 1,500 + ₹ 2,600) – ₹ 1,380] is recognised as an expense in the income statement as follows:

	₹
Absorbed in cost of goods sold (FIFO basis) (6,500 – 2,300) = 4,200 x ₹ 0.6	2,520
Unabsorbed fixed overheads, not included in the cost of goods sold	200
Total	2,720

Q22: Sharp Trading Inc. purchases motorcycles from various countries and exports them to Europe. Sharp Trading has incurred these expenses during 20X1:

- Cost of purchases (based on vendors' invoices) 5,00,000

- Trade discounts on purchases 10,000
- Import duties 200
- Freight and insurance on purchases 250
- Other handling costs relating to imports 100
- Salaries of accounting department 15,000
- Brokerage commission payable to indenting agents for arranging imports 300
- Sales commission payable to sales agents 150
- After-sales warranty costs 600

Sharp Trading Inc. is seeking your advice as if which of the above item is to be included in the cost of inventory and wants you to calculate cost of inventory as per Ind AS 2.

Ans: Items (a), (b), (c), (d), (e), and (g) are permitted to be included in the cost of inventory since these elements contribute to cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition, as per Ind AS 2

Statement showing cost of inventory

	₹
Cost of purchases (based on vendors' invoices)	5,00,000
Trade discounts on purchases	(10,000)
Import duties	200
Freight and insurance on purchases	250
Other handling costs relating to imports	100
Brokerage commission payable to indenting agents for arranging imports	300
Cost of inventory under Ind AS 2	4,90,850

Note: Salaries of accounting department, sales commission, and after-sales warranty costs are not considered as part of cost of inventory under Ind AS 2.

Q23: On 1 January 20X1 an entity accepted an order for 7,000 custom-made corporate gifts.

On 3 January 20X1 the entity purchased raw materials to be consumed in the production process for ₹ 5,50,000, including ₹ 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of ₹ 5,55,000 (including ₹ 5,000 loan-raising fees). The loan is secured by the inventories.

During January 20X1 the entity designed the corporate gifts for the customer. Design costs included:

- cost of external designer = ₹ 7,000; and
- labour = ₹ 3,000.

During February 20X1 the entity's production team developed the manufacturing technique and made further modifications necessary to bring the inventories to the conditions specified in the agreement. The following costs were incurred in the testing phase:

- materials, net of ₹ 3,000 recovered from the sale of the scrapped output = ₹ 21,000;
- labour = ₹ 11,000; and
- depreciation of plant used to perform the modifications = ₹ 5,000.

During February 20X1 the entity incurred the following additional costs in manufacturing the customised corporate gifts:

- consumable stores = ₹ 55,000;
- labour = ₹ 65,000; and
- depreciation of plant used to manufacture the customised corporate gifts = ₹ 15,000.

The customised corporate gifts were ready for sale on 1 March 20X1. No abnormal wastage occurred in the development and manufacture of the corporate gifts.

Compute the cost of the inventory? Substantiate your answer with appropriate reasons and calculations, wherever required.

[RTP May 21; MTP Nov 22; May 2023; Exam May 2023 (5 Marks); IBS MTP May 24]

Ans: Statement showing computation of inventory cost

Particulars	Amount (₹)	Remarks
Costs of purchase	5,00,000	Purchase price of raw material [purchase price (₹ 5,50,000) less refundable purchase taxes (₹ 50,000)]
Loan-raising fee	–	Included in the measurement of the liability
Costs of purchase	55,000	Purchase price of consumable stores
Costs of conversion	65,000	Direct costs—labour
Production overheads	15,000	Fixed costs—depreciation
Production overheads	10,000	Product design costs and labour cost for specific customer
Other costs	37,000	Refer working note
Borrowing costs	–	Recognised as an expense in profit or loss
Total cost of inventories	6,82,000	

Working Note:

Costs of testing product designed for specific customer:

₹ 21,000 material (ie net of the ₹ 3,000 recovered from the sale of the scrapped output) + ₹ 11,000 labour + ₹ 5,000 depreciation.

Q24: Night Ltd. sells beer to customers; some of the customers consume the beer in the bars run by Night Limited. While leaving the bars, the consumers leave the empty bottles in the bars and the company takes possession of these empty bottles. The company has laid down a detailed internal record procedure for accounting for these empty bottles which are sold by the company by calling for tenders. Keeping this in view:

- (i) Decide whether the stock of empty bottles is an asset of the company;
- (ii) If so, whether the stock of empty bottles existing as on the date of Balance Sheet is to be considered as inventories of the company and valued as per IND AS 2 or to be treated as scrap and shown at realizable value with corresponding credit to 'Other Income'?

Ans: Tangible objects or intangible rights carrying probable future benefits, owned by an enterprise are called assets. Night Ltd. sells these empty bottles by calling tenders. It means further benefits are accrued on its sale. Therefore, empty bottles are assets for the company.

As per IND AS 2 "Valuation of Inventories", inventories are assets held for sale in the ordinary course of business. Stock of empty bottles existing on the Balance Sheet date is the inventory and Night Ltd. has detailed controlled recording and accounting procedure which duly signify its materiality. Hence stock of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with IND AS 2.

QUESTIONS FROM RTP/MTP/EXAMS

Q25: On 5th April, 20X2, fire damaged a consignment of inventory at one of the Jupiter's Ltd.'s warehouse. This inventory had been manufactured prior to 31st March 20X2 costing ₹ 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at ₹ 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of ₹ 2 lakhs on repairing and re- packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of ₹ 9 lakhs.

The accountant of Jupiter Ltd. Treats this event as an adjusting event and adjusted this event of causing the damage to the inventory in its financial statement and accordingly re-measures the inventories as follows:

	₹ lakhs
Cost	8.00
Net realisable value (9.6 -2)	7.60
Inventories (lower of cost and net realisable value)	7.60

Analyse whether the above accounting treatment made by the accountant in regard to financial year ending on 31.0.20X2 is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

[MTP May 2025]

Ans: The above treatment needs to be examined in the light of the provisions given in Ind AS 10 'Events after the Reporting Period' and Ind AS 2 'Inventories'.

Para 3 of Ind AS 10 'Events after the Reporting Period' defines "Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

- (a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
- (b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

Further, paragraph 10 of Ind AS 10 states that:

"An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period".

Further, paragraph 6 of Ind AS 2 defines:

"Net realisable value 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".

Further, paragraph 9 of Ind AS 2 states that:

"Inventories shall be measured at the lower of cost and net realisable value".

Accountant of Jupiter Ltd. has re-measured the inventories after adjusting the event in its financial statement which is not correct and nor in accordance with provision of Ind AS 2 and Ind AS 10.

Accordingly, the event causing the damage to the inventory occurred after the reporting date and as per the principles laid down under Ind AS 10 'Events After the Reporting Date' is a non-adjusting event as it does not affect conditions at the reporting date. Non-adjusting events are not recognised in the financial statements, but are disclosed where their effect is material.

Therefore, as per the provisions of Ind AS 2 and Ind AS 10, the consignment of inventories shall be recorded in the Balance Sheet at a value of ₹ 8 lakhs calculated below:

	₹ lakhs
Cost	8.00
Net realisable value	9.60
Inventories (lower of cost and net realisable value)	8.00

Q26: XYZ Limited has a plant with the normal capacity to produce 10,00,000 units of a product per annum and the expected fixed overhead is ₹ 30,00,000, Fixed overhead, therefore based on normal capacity is ₹ 3 per unit. Determine Fixed overhead as per Ind AS 2 'Inventories' if

- (i) Actual production is 7,50,000 units.

(ii) Actual production is 15,00,000 units.

[Exam May 2018 (4 Marks)]

Ans: Actual production is 7,50,000 units: Fixed overhead is not going to change with the change in output and will remain constant at ₹ 30,00,000, therefore, overheads on actual basis is ₹ 4 per unit (30,00,000 / 7,50,000).

Hence, by valuing inventory at ₹ 4 each for fixed overhead purpose, it will be overvalued and the losses of ₹ 7,50,000 will also be included in closing inventory leading to a higher gross profit than actually earned.

Therefore, it is advisable to include fixed overhead per unit on normal capacity to actual production (7,50,000 x 3) ₹ 22,50,000 and balance ₹ 7,50,000 shall be transferred to Profit & Loss Account.

Actual production is 15,00,000 units: Fixed overhead is not going to change with the change in output and will remain constant at ₹ 30,00,000, therefore, overheads on actual basis is ₹ 2 (30,00,000 / 15,00,000).

Hence by valuing inventory at ₹ 3 each for fixed overhead purpose, we will be adding the element of cost to inventory which actually has not been incurred. At ₹ 3 per unit, total fixed overhead comes to ₹ 45,00,000 whereas, actual fixed overhead expense is only ₹ 30,00,000. Therefore, it is advisable to include fixed overhead on actual basis (15,00,000 x 2) ₹ 30,00,000.

Q27: A company normally produced 1,00,000 units of a high precision equipment each year over past several years. In the current year, due to lack of demand and competition, it produced only 50,000 units. Further information is as follows:

Material = ₹ 200 per unit;

Labour = ₹ 100 per unit;

Variable manufacturing overhead = ₹ 100 per unit;

Fixed factory production overhead = ₹ 1,00,00,000;

Fixed factory selling overhead = ₹ 50,00,000;

Variable factory selling overhead = ₹ 150 per unit.

Calculate the value of inventory per unit in accordance with Ind AS 2. What will be the treatment of fixed manufacturing overhead? **[RTP Nov 2020]**

Ans: Calculation of Inventory value per unit as per Ind AS 2:

Particulars	Value per unit (₹)
Raw material	200
Labour	100
Variable manufacturing overhead	100
Fixed production overhead (1,00,00,000/1,00,000)	100
	500

Fixed overheads are absorbed based on normally capacity level, i.e.; 1,00,000 units, rather than on the basis of actual production, i.e.; 50,000 units. Therefore, fixed manufacturing overhead on 50,000 units, will be absorbed as inventory value. The remaining fixed manufacturing overhead ₹ 50,00,000 (1,00,00,000 - 50,00,000) will be charged to P&L.

Note: Selling costs are excluded from the cost of inventories and recognised as expense in the period in which they are incurred.

Q28. State the major changes in Ind AS 2 vis-a-vis AS 2 in respect of the following namely:

- i) Machinery Spares
- ii) Subsequent assessment of Net Realisable value
- iii) Cost Formulae

[MTP May 2021]

Ans: The major changes in Ind AS 2 vis-à-vis AS 2 with respect to following are as follows:

- (i) **Machinery Spares:** AS 2 explains that inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS 10, Property, Plant and Equipment. Such items are accounted for in accordance with AS 10. Ind AS 2 does not contain specific explanation in respect of such spares as this aspect is covered under Ind AS 16.
- (ii) **Subsequent Assessment of Net Realisable Value (NRV):** Ind AS 2 provides detailed guidance in case of subsequent assessment of net realisable value. It also 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. AS 2 does not deal with such reversal.
- (iii) **Cost Formulae:** AS 2 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 whereas Ind AS 2 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.

Q29: A retailer company imported goods at a cost of ₹ 1,30,000 including ₹ 20,000 non-refundable import duties and ₹ 10,000 refundable purchase taxes. The risks and rewards of ownership of the imported goods were transferred to the retailer company upon collection of the goods from the harbour warehouse. The retailer company was required to pay for the goods upon collection. The retailer company incurred ₹ 5,000 to transport the goods to its retail outlet and a further ₹ 2,000 in delivering the goods to its customer. Further selling costs of ₹ 3,000 were incurred in selling the goods.

State whether delivery charges and selling expenses will form part of the cost of inventory. If not, then why? Also calculate the cost of inventory.

[RTP Nov 2022]

Ans: Calculation of Inventory cost:

Particulars	Amount (₹)
-------------	------------

Purchase Price (1,30,000 – 20,000 – 10,000)	1,00,000
Non-refundable import duties	20,000
Transport cost	5,000
Total	1,25,000

Note: The cost of purchase excludes the refundable purchase taxes paid on acquisition of the goods as the ₹ 10,000 paid will be refunded to the retailer.

Ind AS 2 specifically exclude selling cost from forming part of cost of inventory. However, selling and distribution costs are generally used as single term because both are related, as selling costs are incurred to effect the sale and the distribution costs are incurred by the seller to complete a sale transaction by making the goods available to the buyer from the point of sale to the point at which the buyer takes possession. Since these costs are not related to bringing the goods to their present location and condition, the same are not included in the cost of inventories. Accordingly, though the word 'distribution costs' is not specifically mentioned in Ind AS 2, these costs would continue to be excluded from the cost of inventories. Therefore, it excludes the selling expenses incurred (i.e., ₹2,000 delivery costs and ₹ 3,000 other selling costs).

Q30: An entity has following details regarding cost and retail price of the goods purchased and unsold at the beginning of the year:

	Cost	Retail Price
Opening inventory	6,250	8,000
Purchases	19,500	34,000
Inventory on hand		(23,000)
Sales for the period		19,000

Applying the retail method, compute the following:

- Percentage of cost price over retail price;
- Cost of closing inventory;
- Value of cost of sales (at cost); and
- Profit earned during the year on sale of inventory

Ignore the impact of mark-ups or mark-downs on the selling price.

[RTP May

2023]

Ans: Table showing application of Retail method for calculation of the goods sold during the year and unsold inventory

S. No.	Particulars		₹
	Cost price of goods	6,250 + 19,500	25,750
	Retail price of goods	8,000 + 34,000	42,000
(a)	Cost percentage of retail price	25,750 / 42,000	61%

(b)	Closing inventory (at cost)	23,000 x 61%	14,030
(c)	Cost of sales for the period	[(6,250 + 19,500) - 14,030]	11,720
	Sales for the period		19,000
(d)	Profit earned on sale of goods during the year	19,000 - 11,720	7,280

Q31. A Ltd. began operations in the year 20X1-20X2. In 20X1-20X2, it incurred the following expenditures on purchasing the raw materials for its product:

- Purchase price of the raw materials = ₹ 30,000;
- Import duty and other non-refundable purchase taxes = ₹ 8,000;
- Refundable purchase taxes = ₹ 1,000;
- Freight costs for bringing the goods from the supplier to the factory's storeroom for raw materials = ₹ 3,000;
- Costs of unloading the materials into the storeroom for raw materials = ₹ 20; and
- Packaging = ₹ 2,000.

On 31st March, 20X2, A Ltd. received ₹ 530 volume rebate from a supplier for purchasing more than ₹ 15,000 from the supplier during the year.

A Ltd. incurred the following additional costs in the production run:

- Salary of the machine workers in the factory = ₹ 5,000;
- Salary of factory supervisor = ₹ 3,000;
- Depreciation of the factory building and equipment used for production process = ₹ 600;
- Consumables used in the production process = ₹ 200;
- Depreciation of vehicle used to transport the goods from the storeroom for raw materials to the machine floor = ₹ 400;
- Factory electricity usage = ₹ 300;
- Factory rental = ₹ 1,000; and
- Depreciation of the entity's vehicle used by the factory supervisor is ₹ 200.

During 20X1-20X2, A Ltd. incurred the following administrative expenses:

- Depreciation of the administration building = ₹ 500;
- Depreciation and maintenance of vehicles used by the administrative staff = ₹ 150; and
- Salaries of the administrative personnel = ₹ 3,050.

Of the administrative expenses, 20% is attributable to administering the factory. Remaining expenses are attributable, in equal proportion, to the sales and other non- production operations (eg financing, tax and corporate secretarial functions).

In 20X1-20X2, A Ltd. incurred the following selling expenses:

- Advertising costs = ₹ 300;
- Depreciation and maintenance of vehicles used by the sales staff = ₹ 100; and
- Salaries of the administrative personnel = ₹ 6,000.

Pass necessary journal entries to record the cost of inventory in the books of A Ltd.

[RTP Nov 2023]

Ans.

Journal Entries for the year 20X1-20X2

		₹	₹
Inventory A/c (W.N.1)	Dr.	42,490	
To Cash/Bank A/c			42,490
(To recognise the cost of raw materials purchased)			
Inventory A/c (W.N.2)	Dr.	11,240	
To Cash/Bank A/c (cost of direct labour)			5,000
To Property, plant and equipment (accumulated depreciation-factory equipment)			600
To Property, plant and equipment (accumulated depreciation-raw-materials delivery vehicle)			400
To Cash/Bank A/c (cost of electricity used)			300
To Property, plant and equipment (accumulated depreciation-factory supervisor's vehicle)			200
To Cash/Bank A/c (factory management's salaries)			3,000
To Cash/Bank A/c (factory rental)			1,000
To Cash/Bank A/c (administrative salaries attributable to the factory)			610
To Property, plant and equipment (attributable portion of accumulated depreciation- administration building)			100
To Property, plant and equipment (attributable portion of accumulated depreciation- administration vehicles)			30
(To recognise the costs of conversion)			
Inventory A/c (W.N.2)	Dr.	200	

To Inventory A/c (consumable stores) (To recognise the costs of consumable stores inventory consumed)			200
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The total cost of inventories = Costs of purchase + Costs of conversion
= ₹ 42,490 + ₹ 11,240 + ₹ 200 = ₹ 53,930

Working Notes:

1. Computation of costs of purchase

Description	₹
Purchase price	30,000
Import duty and other non-refundable purchase taxes	8,000
Freight costs for bringing the goods to the factory storeroom	3,000
Cost of unloading the raw materials into the storeroom	20
Packaging	2,000
Less: Trade discounts, rebates and subsidies	(530)
Cost of purchase	42,490

Note: Refundable taxes do not form part of the cost of inventories.

2. Computation of costs of conversion

Description	₹
Direct labour	5,000
Fixed production overheads	
Depreciation and maintenance of factory equipment	600
Depreciation of vehicle used for transporting the goods	400
Depreciation of vehicle used by factory supervisor	200
Factory electricity usage	300
Factory management	3,000
Factory rental	1,000
Other costs of administering the factory	
20% of depreciation of administration building	100
20% of depreciation of administration vehicles	30
20% of administrative staff costs	610
Variable production overheads	

Indirect material—consumables	200
Cost of conversion	11,440

Q32: B Limited has valued its Stock held for distribution as free items on claim by customers (on offers) at zero. Customers have a right to claim the free item within 14 days from date of invoice. If the time limit of 14-day exceeds, the claim is foregone by the customer.

The majority of the free items require online registration by the buyers for participation in the contest conducted by the respective brand which needs to be done by the buyers within 3 days from the date of invoice.

Out of it, a few items under this category were found damaged. The replacement cost of such items would be ₹ 2,50,000.

Determine whether the entity has to book loss of inventory or provide for replacement cost of the goods that need to be given as free items to customers as per the principles of Ind AS.

[RTP May 2024]

Ans: Ind AS 2 deals with write-off in value of inventory. The stock of free items is valued at zero by the company. The question of “Loss of Inventory ₹ 2,50,000” does not arise as the claim of free stock is subject to various conditions like claim within 14 days, online registration within 3 days, etc. which are all contingent in nature.

However, provision is to be made for goods to be distributed in case claims from customers are received since the customer can claim the free items within 14 days from the date of invoice. Hence provision of ₹ 2,50,000 is to be made for.

Q33: On March 31, 2024 it imported its first batch of 100 professional cycles from a company in France. The details of expenses incurred at the dealership in Mumbai are given below:

Sr. No.	Details	Amount (₹)
1	Cost of purchases (based on supplier's invoice)	50,00,000
2	Handling costs relating to imports	6,00,000
3	Salaries of accounting staff at the dealership	5,00,000
4	Sales commission paid to sales agents	8,00,000
5	After sales warranty costs	4,00,000
6	Import duties	2,50,000
7	Freight expenses	2,50,000
8	Insurance of purchases	1,00,000
9	Brokerage commission paid to indenting agents	1,00,000

These 100 professional cycles are held in stock as on March 31, 2024 which is the end of the financial year. The current market price for these cycles is ₹64,000 per unit. CIL also has a firm sales contract with a smaller cycle dealership for 30 cycles at ₹65,000 per unit, which cannot be settled yet. Estimated incremental selling cost is ₹2,000 per unit for all cycles.

- Evaluate which of the costs pertaining to the 100 imported cycles are allowed to be included in the cost of inventory in the books of CIL.
- Calculate the Net Realizable Value (NRV) of the inventory of CIL relating to these 100 imported cycles?
- Calculate the value of inventory of the 100 imported cycles as of March 31, 2024.

[IBS CS 21]

Ans: (i) As per Ind AS 2, the following costs pertaining to the 100 imported cycles are includable in the cost of inventory of books of CIL:

Details	Amount (₹)
Cost of purchases (based on supplier's invoice)	50,00,000
Handling costs relating to imports	6,00,000
Import duties	2,50,000
Freight expenses	2,50,000
Insurance of purchases	1,00,000
Brokerage commission paid to indenting agents	1,00,000
Total cost to be included in inventory	63,00,000

Hence, the total cost includable in the cost of inventory of the 100 imported cycles is ₹ 63,00,000. Per unit cost would therefore be ₹ 63,000 per cycle.

Salaries of accounts department, sales commission, and after sale warranty costs are not considered to be the cost of inventory. Therefore, they are not allowed by Ind AS 2 for inclusion in cost of inventory and are expensed off in the profit and loss account.

- (ii) Calculation of NRV of the inventory of CIL relating to these 100 imported cycles

While performing the NRV test, the NRV of 30 cycles to be sold to the other cycle dealership under a firm contract will be ₹ 63,000 per cycle (Selling price per cycle ₹65,000 per cycle less additional selling expenses ₹ 2,000 per cycle). The cost of inventory per cycle as calculated in (i) above is also ₹ 63,000 per cycle. Therefore, no adjustment is required for the value of the 30 cycles under firm contract.

NRV of the remaining 70 cycles is ₹ 62,000 per cycle (market price of ₹ 64,000 per cycle less additional selling expenses ₹ 2,000 per cycle).

- (iii) The cost of inventory per cycle as calculated in (i) above is ₹ 63,000 per cycle for 30 cycles. Therefore, these 70 cycles have to be valued at NRV of ₹ 62,000 per cycle which is lower than the cost of ₹ 63,000 by ₹ 1,000 per cycle. Therefore, CIL has to write down the value of inventory for these 70 cycles by ₹ 70,000 (70 cycles x write down of ₹ 1,000 per cycle).

Value of inventory of 100 cycles on March 31,2024 lower of cost or NRV

Sr No.	Details	Amount (₹)
1	Value of 30 cycles under firm contract (30 cycles x ₹63,000 per cycle)	18,90,000
2	Value of balance 70 cycles at NRV (70 cycles x ₹ 62,000 per cycle)	43,40,000
3	Total inventory value	62,30,000

The cost of the imported cycles is ₹ 63,00,000 whereas the NRV is ₹ 62,30,000. Hence, the inventory will be valued at ₹ 62,30,000.

Q34: An entity manufactures a equipment in three stages. There is a market for semi-finished product for each state, but the entity only sells the completed equipment. The following are details of the cost structure of the equipment as at the year-end:

	Conversion Cost/unit ₹	Selling price /unit ₹
Stage 1	170	130
Stage 2 – Incremental cost	35	
	205	195
Stage 3- Incremental cost	62	
	267	275

Required: Assuming that the selling cost are zero, what is the NRV of the semi- finished product in stage 1 and stage 2 at the year end? **[RTP Jan 2026]**

Ans: No impact for lower of cost and NRV provision is made at stage 1 and stage 2 because the final equipment will be sold at a profit. The profit margin on the estimated cost of completion should, therefore, be considered when calculating the net realisable value of work in progress if the entity has the ability to dispose of the finished product at a price that exceeds the production cost. The net realisable value of the semi-finished product at stage 1 is:

	₹
Selling price of completed product	275
Less: Stage 3 conversion costs	(62)

Less: Stage 2 conversion costs	(35)
Net realisable value at stage1	<u>178</u>

At stage 1, inventory will be valued at ₹170 (lower of cost i.e. ₹ 170 and NRV i.e. ₹ 178). The inventory at stage 1 will be valued at ₹170, though the selling price at stage 1 is ₹130.

NOTES

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