After studying this unit, you will be able to:

- Understand the objective and scope of this standard
- Define the terms inventories, net realisable value and fair value
- Determine the inventory cost
- Apply the cost formula for valuation of inventory
- Evaluate as how and when to perform write-downs to net realisable value
- Recognise the write downs as an expense
Objective
- determination of cost
- its subsequent recognition as an expense
- provides guidance on the cost formulas

Scope - Applies to all inventories except
- Ind AS 32 & 109 Financial Instruments
- Ind AS 41 Agriculture
- Ind AS 11 work-in-progress arising under construction contracts

Measurement of Inventory
- Valuation Principle
- Cost
- Cost Formulas
- Net Realisable Value

Recognition as an Expense

Disclosure
1.1 OBJECTIVE

The objective of this Standard is to prescribe the accounting treatment for inventories. This Standard provides the guidance for determining the cost of inventories and for subsequent recognition as an expense, including any write-down to net realisable value.

It provides guidance on the techniques for the measurement of cost, such as the standard cost method or retail method. It also outlines acceptable methods of determining cost, including specific identification, first-in-first-out and weighted average cost method.

1.2 SCOPE

- This Standard is applicable to all inventories, except:
  a) financial instruments (to be accounted under Ind AS 32, Financial Instruments: Presentation and Ind AS 109, Financial Instruments);
  b) biological assets (i.e. living animals or plants) related to agricultural activity and agricultural produce at the point of harvest (to be accounted under Ind AS 41, Agriculture); and
  c) work-in-progress arising under construction contracts including directly related service contracts (accounted under Ind AS 11 Construction Contracts)

- This Standard does not apply to the measurement of inventories held by:
  a) producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries.

  When such inventories are measured at net realisable value, changes in that value are recognised in profit or loss in the period of the change.

  b) commodity broker-traders who measure their inventories at fair value less costs to sell.

  When such inventories are measured at net realisable value/ fair value less costs to sell, changes in those values are to be recognised in profit or loss in the period of the change.

1.3 RELEVANT DEFINITIONS

The following are the key terms used in this standard:

1) **Inventories** are assets:
  a) held for sale in the ordinary course of business; (Finished Goods)
b) in the process of production for such sale; or (Work in progress)

c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. (Raw material)

2) Inventories encompass of:

a) goods purchased and held for resale (e.g. merchandise purchased by a retailer and held for resale, or land and other property held for resale);

b) finished goods produced, or work in progress being produced, by the entity; and includes materials and supplies awaiting use in the production process.

In the case of a service provider, inventories include the costs of the service, for which the entity has not yet recognised the related revenue (see Ind AS 18, Revenue).

3) 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.

Net realisable value refers to the net amount that an entity expects to realize from the sale of inventory in the ordinary course of business. Fair value reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date. The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

4) Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (Ind AS 113, Fair Value Measurement.)
1.4 MEASUREMENT OF INVENTORIES

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

At the lower of

- cost
- Net realisable value

1) Cost of Inventories

Cost of Inventories comprises:

a) all costs of purchase;

b) costs of conversion; and

c) other costs incurred in bringing the inventories to their present location and condition.

2) Cost of purchase

The costs of purchase of inventories include:

a) the purchase price,

b) import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities),

c) transport, handling and
d) other costs directly attributable to the acquisition of finished goods, materials and services.

Any trade discounts, rebates and other similar items are deducted in determining the costs of purchase of inventory.

3) Cost of conversion

- The costs of conversion of inventories include costs directly related to the units of production, such as:
  - a) direct material, direct labour and other direct costs; and
  - b) a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.

- Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration.
Allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity.

When production levels are abnormally low, unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost.

Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

**Example:**

Pluto Ltd. has a plant with the normal capacity to produce 5,00,000 units of a product per annum and the expected fixed overhead is ₹15,00,000. Fixed overhead on the basis of normal capacity is ₹3 per unit (15,00,000/5,00,000).

**Case 1:**

Actual production is 5,00,000 units. Fixed overhead on the basis of normal capacity and actual overhead will lead to the same figure of ₹15,00,000. Therefore, it is advisable to include this on normal capacity.

**Case 2:**

Actual production is 3,75,000 units. Fixed overhead is not going to change with the change in output and will remain constant at ₹15,00,000, therefore, overheads on actual basis is ₹4 p/u (15,00,000/3,75,000).

Hence by valuing inventory at ₹4 each for fixed overhead purpose, it will be overvalued and the losses of ₹3,75,000 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 (3,75,000 x 3) ₹11,25,000 and balance ₹3,75,000 shall be transferred to Profit & Loss Account.

**Case 3:**

Actual production is 7,50,000 units. Fixed overhead is not going to change with the change in output and will remain constant at ₹15,00,000, therefore, overheads on actual basis is ₹2 (15,00,000/7,50,000).
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 ₹ 22,50,000 whereas, actual fixed overhead expense is only ₹ 15,00,000. Therefore, it is advisable to include fixed overhead on actual basis (7,50,000 x 2) ₹ 15,00,000.

4) 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 location and condition. Cost to be excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:
  a) abnormal amounts of wasted materials, labour or other production costs;
  b) storage costs, unless those costs are necessary in the production process before a further production stage;
  c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and
  d) selling costs.

- The extent to which borrowing cost is included in the cost of inventories is determined on the basis of the requirement of Ind AS 23 Borrowing Costs.

- An entity may acquire inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase prices for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.

Illustration 1: 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.

**Solution**

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.

5) **Allocation of cost to joint products and by-products**

- A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product.

- When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production.

- Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

**Illustration 2**

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

<table>
<thead>
<tr>
<th>Item</th>
<th>Unit</th>
<th>Amount</th>
<th>Output</th>
<th>Closing Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw material</td>
<td>14,500</td>
<td>1,50,000</td>
<td>MP I-5,000 units</td>
<td>250</td>
</tr>
<tr>
<td>Wages</td>
<td>-</td>
<td>90,000</td>
<td>MP II - 4,000 units</td>
<td>100</td>
</tr>
<tr>
<td>Fixed overhead</td>
<td>-</td>
<td>65,000</td>
<td>BP- 2,000 units</td>
<td></td>
</tr>
<tr>
<td>Variable overhead</td>
<td>-</td>
<td>50,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Average market price of MP1 and MP2 is ₹ 60 per unit and ₹ 50 per unit respectively, by-product is sold @ ₹ 20 per unit. There is a profit of ₹ 5,000 on sale of by-product after incurring separate
processing charges of ₹ 8,000 and packing charges of ₹ 2,000, ₹ 5,000 was realised from sale of scrap.

Required:

Calculate the value of closing stock of MP1 and MP2 as on 31-03-20X1.

Solution

As per Ind 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 NRV of By-product BP

<table>
<thead>
<tr>
<th>Selling price of by-product</th>
<th>Less: Separate processing charges of by- product BP</th>
<th>Packing charges</th>
</tr>
</thead>
<tbody>
<tr>
<td>2,000 units x 20 per unit</td>
<td>2,000 x 20 per unit</td>
<td>40,000</td>
</tr>
<tr>
<td>40,000</td>
<td>(8,000)</td>
<td>(2,000)</td>
</tr>
</tbody>
</table>

Net realizable value of by-product BP = 30,000

2) Calculation of cost of conversion for allocation between joint products MP1 and MP2

<table>
<thead>
<tr>
<th>Raw material</th>
<th>1,50,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages</td>
<td>90,000</td>
</tr>
<tr>
<td>Fixed overhead</td>
<td>65,000</td>
</tr>
<tr>
<td>Variable overhead</td>
<td>50,000</td>
</tr>
<tr>
<td>Less: NRV of by-product BP (See calculation 1)</td>
<td>30,000</td>
</tr>
<tr>
<td>Sale value of scrap</td>
<td>5,000</td>
</tr>
<tr>
<td>(35,000)</td>
<td></td>
</tr>
</tbody>
</table>

Joint cost to be allocated between MP1 and MP2 = 3,20,000

3) Determination of “basis for allocation” and allocation of joint cost to MP1 and MP2

<table>
<thead>
<tr>
<th>MP 1</th>
<th>MP 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output in units (a)</td>
<td>5,000</td>
</tr>
<tr>
<td>Sales price per unit (b)</td>
<td>60</td>
</tr>
<tr>
<td>Sales value (a x b)</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Ratio of allocation</td>
<td>3</td>
</tr>
<tr>
<td>Joint cost of ₹ 3,20,000 allocated in the ratio of 3:2 (c)</td>
<td>1,92,000</td>
</tr>
<tr>
<td>Cost per unit [c/a]</td>
<td>38.4</td>
</tr>
</tbody>
</table>
4) Determination of value of closing stock of MP1 and MP2

<table>
<thead>
<tr>
<th>Particulars</th>
<th>MP1</th>
<th>MP2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closing stock in units</td>
<td>250 units</td>
<td>100 units</td>
</tr>
<tr>
<td>Cost per unit</td>
<td>38.4</td>
<td>32</td>
</tr>
<tr>
<td>Value of closing stock</td>
<td>9,600</td>
<td>3,200</td>
</tr>
</tbody>
</table>

5) Cost of inventories of service provider

To the extent that service providers have inventories, they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include profit margins or non-attributable overheads that are often factored into prices charged by service providers.

6) Cost of agricultural produce harvested from biological assets

In accordance with Ind AS 41, Agriculture, inventories comprising agricultural produce that an entity has harvested from its biological assets are measured on initial recognition at their fair value less costs to sell at the point of harvest. This is the cost of the inventories at that date for application of this Standard.

7) Techniques for the measurement of cost

- Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate to actual cost.

- Standard Cost Method: Cost is based on normal levels of materials and supplies, labour efficiency and capacity utilisation. They are regularly reviewed and revised where necessary.

- Retail Method: Cost is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration inventory that has been marked down to below its original selling price. This method is
often used in the retail industry for measuring inventories of rapidly changing items that have similar margins.

- The percentage used takes into consideration inventory that has been marked down to below its original selling price. An average percentage for each retail department is often used.

Illustration 3 : Measurement techniques of Cost

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.

Solution

(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.
8) Cost Formulas

9) Inventory ordinarily interchangeable

The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs. Specific identification of cost means that specific costs are attributed to identified items of inventory.

10) Inventory ordinarily interchangeable

- The costs of inventories, other than that are not ordinarily interchangeable and goods or services produced and segregated for specific projects, 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 a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.

- **FIFO formula** assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced.

- Under the **weighted average** cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.
Illustration 4
Mercury Ltd. uses a periodic inventory system. The following information relates to 20X1-20X2.

<table>
<thead>
<tr>
<th>Date</th>
<th>Particular</th>
<th>Unit</th>
<th>Cost p.u.</th>
<th>Total Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>April</td>
<td>Inventory</td>
<td>200</td>
<td>10</td>
<td>2,000</td>
</tr>
<tr>
<td>May</td>
<td>Purchases</td>
<td>50</td>
<td>11</td>
<td>550</td>
</tr>
<tr>
<td>September</td>
<td>Purchases</td>
<td>400</td>
<td>12</td>
<td>4,800</td>
</tr>
<tr>
<td>February</td>
<td>Purchases</td>
<td>350</td>
<td>14</td>
<td>4,900</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>1,000</td>
<td></td>
<td>12,250</td>
</tr>
</tbody>
</table>

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

(a) FIFO
(b) Weighted Average

Solution

**FIFO inventory 31.03.20X2**

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of Sales</td>
<td>$350 \times 14 = 4,900$</td>
<td>$4,900$</td>
</tr>
<tr>
<td></td>
<td>$50 \times 12 = 600$</td>
<td>$600$</td>
</tr>
<tr>
<td></td>
<td>$12,250 - 5,500 = 6,750$</td>
<td>$6,750$</td>
</tr>
</tbody>
</table>

**Weighted average cost per item**

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weighted average</td>
<td>$12,250 / 1000 = 12.25$</td>
<td>$12.25$</td>
</tr>
<tr>
<td></td>
<td>$400 \times 12.25 = 4,900$</td>
<td>$4,900$</td>
</tr>
<tr>
<td></td>
<td>$12,250 - 4,900 = 7,350$</td>
<td>$7,350$</td>
</tr>
</tbody>
</table>
11) Net realisable value

Measurement of net realisable value

- 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. The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined.

- Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.

- Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess is based on general selling prices.

- Inventories are usually written down to net realisable value item by item. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular operating segment.

Writing inventories down to net realisable value

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 a decline in the price of materials indicates that the cost of the finished products exceeds net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

Reversals of write-downs

- A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed (ie the reversal is limited to the amount of the original write-down) so that the new carrying amount is the lower of the cost and the revised net realisable value.

- This occurs, for example, when an item of inventory that is carried at net realisable value, because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.
Illustration 5

Sun Pharma Limited, a renowned company in the field of pharmaceuticals has the following four items in inventory: The Cost and Net realizable value is given as follows:

<table>
<thead>
<tr>
<th>Item</th>
<th>Cost</th>
<th>Net Realisable Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>2,000</td>
<td>1,900</td>
</tr>
<tr>
<td>B</td>
<td>5,000</td>
<td>5,100</td>
</tr>
<tr>
<td>C</td>
<td>4,400</td>
<td>4,550</td>
</tr>
<tr>
<td>D</td>
<td>3,200</td>
<td>2,990</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>14,600</strong></td>
<td><strong>14,540</strong></td>
</tr>
</tbody>
</table>

Determine the value of Inventories:

a. On an item by item basis
b. On a group basis

Solution

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

<table>
<thead>
<tr>
<th>Item by item basis:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>1,900</td>
</tr>
<tr>
<td>B</td>
<td>5,000</td>
</tr>
<tr>
<td>C</td>
<td>4,400</td>
</tr>
<tr>
<td>D</td>
<td>2,990</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>14,290</strong></td>
</tr>
</tbody>
</table>

Group basis: 14,540

1.5 RECOGNITION AS AN EXPENSE

1) The amount of inventories recognised as an expense in the period will generally be:

a) carrying amount of the inventories sold in the period in which related revenue is recognised; and

b) the amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs; reduced by

c) the amount of any reversal in the period of any write-down of inventories, arising from an increase in net realisable value.
2) Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset through charging of depreciation on that asset.

Example:

An item of inventory costing ₹ 20,000 as covered under Ind AS 2 is consumed in the construction of self-constructed property to be accounted as Property, plant and equipment under Ind AS 16. The cost of such property, plant and equipment other than inventories is ₹ 80,000. Such Inventory needs to be capitalized in the cost of Property, plant and equipment. The useful life of the property is 5 years. The depreciation on such property charged to profit and loss account is ₹ 20,000 per annum (i.e. 1,00,000/ 5)

1.6 DISCLOSURE

The financial statements shall disclose:

1) Accounting policies
   the accounting policies adopted in measuring inventories, including the cost formula used.

2) Analysis of carrying amount
   the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity.

   Common classifications of inventories are as follows:
   a) Merchandise;
   b) Production supplies;
   c) Materials;
   d) Work in progress; and
   e) Finished goods.

   The inventories of a service provider may be described as work in progress

3) Inventories carried at fair value less costs to sell
   the carrying amount of inventories carried at fair value less costs to sell.

4) Amounts recognised in profit or loss
   a) the amount of inventories recognised as an expense during the period;
b) the amount of any write-down of inventories recognised as an expense in the period; and

c) the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense in the period.

In addition, disclosure is required of the circumstances or events that led to the reversal of a write-down of inventories.

5) **Inventories pledged as security**

the carrying amount of inventories pledged as security for liabilities.

An entity adopts a format for profit or loss that results in amounts being disclosed other than the cost of inventories recognised as an expense during the period. Under this format, the entity presents an analysis of expenses using a classification based on the nature of expenses. In this case, the entity discloses the costs recognised as an expense for raw materials and consumables, labour costs and other costs together with the amount of the net change in inventories for the period.

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**1.7 SIGNIFICANT DIFFERENCES IN IND AS 2 VIS-À-VIS AS 2**

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Particular</th>
<th>Ind AS 2</th>
<th>AS 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Subsequent Recognition</td>
<td>Ind AS 2 deals with the subsequent recognition of cost/carrying amount of inventories as an expense</td>
<td>AS 2 does not provide the same</td>
</tr>
<tr>
<td>2.</td>
<td>Inventory of Service Provider</td>
<td>Ind AS 2 provides explanation with regard to inventories of service providers</td>
<td>AS 2 does not contain such an explanation</td>
</tr>
<tr>
<td>3.</td>
<td>Machinery Spares</td>
<td>Ind AS 2 does not contain specific explanation in respect of such spares as this aspect is covered under Ind AS 16</td>
<td>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 Accounting Standard (AS) 10, Property, Plant and Equipment.</td>
</tr>
<tr>
<td></td>
<td>Topic</td>
<td>Ind AS 2 Does Not Apply to</td>
<td>This Aspect is Not There in the AS 2</td>
</tr>
<tr>
<td>---</td>
<td>-----------------------------------------------------------------------</td>
<td>-----------------------------</td>
<td>--------------------------------------</td>
</tr>
<tr>
<td>4</td>
<td>Inventory Held by Commodity Broker-Traders</td>
<td>Ind AS 2 does not apply to measurement of inventories held by commodity broker-traders, who measure their inventories at fair value less costs to sell.</td>
<td>This aspect is not there in the AS 2</td>
</tr>
<tr>
<td>5</td>
<td>Definition of Fair Value and Distinction Between NRV and Fair Value</td>
<td>Ind AS 2 defines fair value and provides an explanation in respect of distinction between ‘net realisable value’ and ‘fair value’</td>
<td>AS 2 does not contain the definition of fair value and such explanation.</td>
</tr>
<tr>
<td>6</td>
<td>Subsequent Assessment of NRV</td>
<td>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.</td>
<td>AS 2 does not deal with such reversal.</td>
</tr>
<tr>
<td>7</td>
<td>Exclusion from its Scope but Guidance Given</td>
<td>Ind AS 2 excludes from its scope the measurement of inventories held by producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products though it provides guidance on measurement of such inventories.</td>
<td>AS 2 excludes from its scope such types of inventories.</td>
</tr>
<tr>
<td>8</td>
<td>Cost Formulae</td>
<td>Ind AS 2 requires the use of consistent cost formulas for all inventories having a similar nature and use to the entity.</td>
<td>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.</td>
</tr>
</tbody>
</table>
TEST YOUR KNOWLEDGE

Practical Questions

1. 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?

2. Sun Ltd. has fabricated special equipment (solar power panel) during 20X1-20X2 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 31-03-20X3 are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Solar power panel (WIP)</td>
<td>₹ 85 lakhs</td>
</tr>
<tr>
<td>Solar power panel (finished products)</td>
<td>₹ 55 lakhs</td>
</tr>
<tr>
<td>Sundry Debtor (solar power panel)</td>
<td>₹ 65 lakhs</td>
</tr>
</tbody>
</table>

The petition for winding up against the customer has been filed during 20X2-20X3 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 statement of 20X2-20X3.

Answers to Practical Questions

1. 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.).

2. 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 ‘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].

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 20X2-20X3, 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 debtor’s amount.