1. It applies to all assets except:
   (a) financial instruments
   (b) biological assets agricultural produce at the point of harvest
2. It does not apply to the measurement of inventories held by:
   (a) producers of agricultural and forest products, agricultural produce after harvest, and minerals mineral products, extent that they are measured at net realisable value
   (b) commodity broker-traders who measure their inventories at fair value less costs to sell.
3. These inventories are excluded from only the measurement requirements of this Standard.
4. Broker-traders are those who buy or sell commodities for others. When these inventories are measured at fair value less costs to sell, they are excluded from only the measurement requirements of this Standard.
5. 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.
   
   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.
6. 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. Former is an entity-specific value; latter is not. Net realisable value for inventories may not equal fair value less costs to sell.
7. Inventories shall be measured at the lower of cost and net realisable value.
8. The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.
9. The costs of purchase comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.
10. The costs of conversion include direct labour also include systematic allocation of fixed and variable production overheads. Fixed production overheads are depreciation and maintenance of factory buildings and equipment, cost of factory management and administration. Variable production overheads are indirect materials and indirect labour.
11. The allocation of fixed production is based on the normal capacity. The actual level of production may be used if it approximates normal capacity. 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.

12. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. Example, the relative sales value of each product either at the stage in the production process when the products become separately identifiable, by-products are often measured at net realisable value and this value is deducted from the cost of the main product.

Other costs

13. They are incurred in bringing the inventories to their present location and condition. Designing products for specific customers.

14. Costs excluded from the cost of inventories:
   (a) abnormal amounts materials, labour or other production costs;
   (b) storage costs
   (c) administrative overheads that
   (d) selling costs.

15. Ind AS 23, identifies limited circumstances where borrowing costs are included in cost of inventories.

16. Inventories on deferred settlement terms effectively contains a financing element, element, for is recognised as interest expense over the period of the financing.

Cost of agricultural produce harvested from biological assets

17. 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.

18. Techniques for the measurement such as the standard cost method or the retail method, may be used for convenience if the results approximate cost.

19. The retail method often used in the retail industry measuring inventories of large numbers of rapidly changing items with similar margins which it is impracticable to use other costing methods. An average percentage for each retail department is often used.

20. The cost of inventories of items that are not ordinarily interchangeable shall be assigned by using specific identification of their individual costs.

21. However, specific identification of costs is inappropriate when there are large numbers of items of inventory that are ordinarily interchangeable.

22. The cost of inventories, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. Inventories with a different nature or use, different cost formulas may be justified.

Net realisable value

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

24. Inventories are usually written down to net realisable value item by item.
25. 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. Estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period.

26. Estimates of net realisable value also take into consideration the purpose for which the inventory is held. Net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price.

27. 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. The replacement cost of the materials may be the best available measure of their net realisable value.

28. 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.

29. Disclose:
   (a) the accounting policies adopted
   (b) the total carrying amount of inventories
   (c) carrying amount of inventories carried at fair value less costs to sell;
   (d) amount of any write-down of inventories
   (e) of any reversal of any write-down
   (f) carrying amount of inventories pledged as security for liabilities.

**Questions from Study Material**

**S-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.

*(Study Material)*
**Answer:** 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.

**S-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 31-3-20X1</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.

(Study Material)

**Answer:** 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.

**S-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.

(Study Material)
**Answer:**
(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.

**S-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>Total</td>
<td></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

(Study Material)

**Answer:**
FIFO inventory 31.03.20X2
- 350 @14 = 4,900
- 50 @ 12 = 600
- Total = 5,500

Cost of Sales
- 12,250 – 5,500 = 6,750

Weighted average cost per item
- 12,250/1000 = 12.25

Weighted average inventory at 31.03.20X2
- 400 x 12.25 = 4,900

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

**S-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>Total</td>
<td>14,600</td>
<td>14,540</td>
</tr>
</tbody>
</table>
Determine the value of Inventories:

(a) On an item by item basis
(b) On a group basis

(answer)

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

S-6: 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?

(answer)

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.).

S-7: 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:

- 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 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.
**Answer:** 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.

---

**Questions from Diploma IFRS**

**D-1:** An entity has the following items of inventory.

(a) Materials costing ₹12,000 bought for processing and assembly for a profitable special order. Since buying these items, the cost price has fallen to ₹10,000,

(b) Equipment constructed for a customer for an agreed price of ₹18,000. This has recently been completed at a cost of ₹16,800. It has now been discovered that, in order to meet certain regulations, conversion with an extra cost of ₹4,200 will be required. The customer has accepted partial responsibility and agreed to meet half the extra cost.

**Required:**

In accordance with IAS 2 inventories, at what amount should the above items be valued?

*(Dip. IFRS – UK)*

**Answer:**

(a) Inventory is valued at the tower of cost or net realisable value, not the lower of cost or replacement cost. Since the materials will be processed before sale there is no reason to believe that net realisable value will be below cost. Therefore the inventory should be valued at its cost of ₹12,000.

(b) The net realisable value is ₹15,900 (contract price ₹18,000 - constructor's share of modification cost ₹2,100). The net realisable value is below the cost price. Therefore the inventory should be held at ₹15,900.
Questions from Educational Material of ICAI

E-1: What is the difference between ‘Net Realisable Value’ and ‘Fair Value’? Explain with suitable example?

Answer: 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.
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.
In accordance with the above definitions, net realisable value refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business. Whereas, 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 measurement; the latter is market-based measurement. Net realisable value for inventories may not be equal to fair value less costs to sell.

Example:
An entity holds inventories of 10000 units and it could sell the same in the market @ ₹10/- each after selling expenses. The entity has an order in hand to sell the inventories @ ₹11/- In this situation, fair value is ₹10/- each, but net realisable value is ₹11/- each.

E-2: A Management consultancy company is engaged by a client to analyse its internal control systems and provide a report on the same for a fee of ₹20,00,000. As at the end of the reporting period, i.e., on 31st March, 2012, the report is not ready. The costs incurred during the financial year for the project are follows:

Direct expenses:
- Salary expenses of staff engaged on the project: ₹7,50,000
- Overheads: ₹5,00,000 (1/5 directly attributable to the project)
- General administration expenses: ₹2,00,000

Assuming that at the end of the reporting period, in accordance with Ind AS 18, revenue has not been recognised, what will be the cost of inventory with regard to this project?

Answer: Management consultancy company is a service provider and as per Ind AS 2, in case of a service provider, inventories include the costs of service, for which the entity has not yet recognised related revenue.
Since in the present case revenue has not been recognised, expenses incurred on the project will be treated as cost of inventory in accordance with paragraph 19 of Ind AS 2, which provides as follows:

“19. 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.”
In accordance with the above, cost of inventories will include:

| Description                                                                 | Amount  
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of personnel directly engaged in providing the services, i.e., salary</td>
<td>₹7,50,000</td>
</tr>
<tr>
<td>expenses of staff engaged on the project</td>
<td></td>
</tr>
<tr>
<td>Directly attributable overheads (₹5,00,000/5)</td>
<td>₹1,00,000</td>
</tr>
<tr>
<td>Cost of inventories</td>
<td>₹8,50,000</td>
</tr>
</tbody>
</table>

Expenses incurred on general overheads and any profit margin will not be included in the cost of inventories.

**E-3:** As per paragraph 8 of Ind AS 2, inventories include ‘materials and supplies awaiting use in the production process’.

**Whether packing material and publicity material are covered by the term ‘materials and supplies awaiting use in the production process’?**

**Response:** 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.

**E-4:** A management consultancy company is engaged by a client to analyse its internal control systems and provide a report on the same for a fee of ₹20,00,000. As at the end of the reporting period, i.e., on 31st March, 2012, the report is not ready. The costs incurred during the financial year for the project are as follows:

**Direct expenses:**
- Salary expenses of staff engaged on the project: ₹7,50,000
- Overheads: ₹5,00,000
  - (1/5 directly attributable to the project)
- General administration expenses: ₹2,00,000

**Assuming that at the end of the reporting period, in accordance with Ind AS 18, revenue has not been recognised, what will be the cost of inventory with regard to this project?**

**Response:** Management consultancy company is a service provider and as per Ind AS 2, in case of a service provider, inventories include the costs of service, for which the entity has not yet recognised related revenue.

Since in the present case revenue has not been recognised, expenses incurred on the project will be treated as cost of inventory in accordance with paragraph 19 of Ind AS 2, which provides as follows:

“19. 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.”
In accordance with the above, cost of inventories will include:
Cost of personnel directly engaged in providing the services, i.e., salary expenses of staff engaged on the project ₹ 7,50,000
Directly attributable overheads (₹ 5,00,000/5) ₹ 1,00,000
Cost of Inventories ₹ 8,50,000
Note: Expenses incurred on general overheads and any profit margin will not be included in the cost of inventories.

E-5: 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.

Does this mean that Ind AS 2 allows free choice between FIFO and weighted average methods?
Response: Yes. Since the sentence “The formula used should reflect the fairest possible approximation to the cost incurred in bringing the items of inventory to their present location and condition.” has been omitted in Ind AS 2, any of the permitted methods, i.e., FIFO or weighted average method can be used when specific identification method is not possible.

E-6: Whether an entity can use different cost formulae for inventories held at different geographical locations having similar nature and use to it?
Response: 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.

E-7: 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
Response: 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 covert 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.

The Guidance Note on Terms Used in Financial Statements defines Trade Discount as “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.
The Guidance Note on Terms Used in Financial Statements defines Cash Discount as “A reduction granted by a supplier from the invoiced price in consideration of immediate payment or payment within a stipulated period.”

These type 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.

**AS Questions**

**A-1:** A private limited company manufacturing fancy terry towels had valued its closing inventory of inventories of finished goods at the realisable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goods had not been transferred to the foreign buyers.

Required:
Comment on the valuation of the inventories by the company.

*Answer:*
Accounting Standard 2 “Valuation of Inventories” states that inventories should be valued at lower of historical cost and net realizable value. AS 9 on “Revenue Recognition” states, “at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods invoiced are often valued at net realisable value.”

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing inventory of finished goods (Fancy terry towel) should have been valued at lower of cost and net realisable value and not at net realisable value.

Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing inventory or inventories of finished goods is not correct.

**A-2:** 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. The accountant of the company is of the view that these empty bottles are not an asset to the company and are scrap for the company.

Required:
Analyse the contention of the accountant of the company.

*Answer:*
(i) 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.
(ii) As per AS 2 “Valuation of Inventories”, inventories are assets held for sale in the ordinary course of business. Inventory 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 inventory of empty bottles cannot be considered as scrap and should be valued as inventory in accordance with AS 2.

A-3: Omega Ltd. has to pay delayed cotton clearing charges over and above the negotiated price for taking delayed delivery of cotton from the Suppliers’ godown. Up to 20X1-20X2, the company has regularly included such charges in the valuation of closing inventory. This being in the nature of interest the company has decided to exclude it from closing inventory valuation for the year 20X2-20X3. This would result into decrease in profit by ₹7.60 lakhs.

Required:
Treatment to be done in the annual accounts of a company for the year ended 31st March, 20X3 and appropriate disclosures to be made in this regards.

(Study Material)

Answer: Para 29 of AS 5 (Revised) ‘Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies” states that a change in an accounting policy should be made only if

(a) It is required by statute, or
(b) for compliance with an accounting standard, or
(c) if it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise.

Therefore, the change in the method of inventory valuation is justified in view of the fact that the change is in line with the recommendations of AS 2 (Revised) ‘Valuation of Inventories’ and would result in more appropriate preparation of the financial statements.

Disclosure:
As per AS 2, this accounting policy adopted for valuation of inventories including the cost formulae used should be disclosed in the financial statements in Notes to Accounts.

Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change is necessary as per AS 1, AS 2 and AS 5. Therefore, the under mentioned note should be given in the annual accounts.

"In compliance with the Accounting Standards, delayed cotton clearing charges which are in the nature of interest have been excluded from the valuation of closing inventory unlike preceding years. Had the company continued the accounting practice followed earlier, the value of closing inventory as well as profit before tax for the year would have been higher by ₹7.60 lakhs."
Extra Questions

EQ-1: 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’?

Answer:

(i) 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.

(ii) 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.

EQ-2: The following information of Zenith Ltd. is given below:

You are required to:

(1) Calculate the value of raw materials and finished goods at cost.

(2) Calculate the value of closing stock when

(a) Net realizable value of finished goods B is ₹ 800

(b) Net realizable value of finished goods B is ₹ 600

Raw Material A

<table>
<thead>
<tr>
<th>Description</th>
<th>Quantity</th>
<th>Unit Cost (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closing Balance</td>
<td>1000 units</td>
<td>400</td>
</tr>
<tr>
<td>Cost price including excise duty</td>
<td></td>
<td>400</td>
</tr>
<tr>
<td>GST (Input credit is available)</td>
<td></td>
<td>20</td>
</tr>
<tr>
<td>Freight inward</td>
<td></td>
<td>40</td>
</tr>
<tr>
<td>Unloading charges</td>
<td></td>
<td>20</td>
</tr>
<tr>
<td>Replacement cost</td>
<td></td>
<td>300</td>
</tr>
</tbody>
</table>

Finished Goods B

<table>
<thead>
<tr>
<th>Description</th>
<th>Quantity</th>
<th>Unit Cost (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closing balance</td>
<td>2400 units</td>
<td>440</td>
</tr>
<tr>
<td>Raw materials consumed</td>
<td></td>
<td>440</td>
</tr>
<tr>
<td>Direct labour</td>
<td></td>
<td>120</td>
</tr>
<tr>
<td>Direct overhead</td>
<td></td>
<td>80</td>
</tr>
</tbody>
</table>

Raw material A is used for production of finished goods B. The total fixed overhead for the year was ₹ 4 lakhs on normal capacity of 20,000 units.

(May 2016, 5 Marks Final FR Old Course)
**Answer:**

Statement showing valuation of Raw Material and Finished Goods at cost

<table>
<thead>
<tr>
<th>Raw Material A</th>
<th>₹ per unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost price</td>
<td>400</td>
</tr>
<tr>
<td>Less: GST on which Input credit is available</td>
<td>(20)</td>
</tr>
<tr>
<td>Add: Freight inward</td>
<td>40</td>
</tr>
<tr>
<td>Unloading charges</td>
<td>20</td>
</tr>
<tr>
<td>Total cost</td>
<td>440</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Finished Goods B</th>
<th>₹ per unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw materials consumed</td>
<td>440</td>
</tr>
<tr>
<td>Direct labour</td>
<td>120</td>
</tr>
<tr>
<td>Direct overhead</td>
<td>80</td>
</tr>
<tr>
<td>Fixed overhead (₹4,00,000/20,000 units)</td>
<td>20</td>
</tr>
<tr>
<td>Total cost</td>
<td>660</td>
</tr>
</tbody>
</table>

(a) When Net Realisable Value (NRV) of the Finished Goods B is ₹800 per unit

NRV is greater than the cost of Finished Goods B i.e. ₹660 per unit Hence, Raw Material and Finished Goods will be valued at cost. Accordingly, value of closing stock will be:

<table>
<thead>
<tr>
<th>Quantity</th>
<th>Rate</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw Material A</td>
<td>1,000</td>
<td>440</td>
</tr>
<tr>
<td>Finished Goods B</td>
<td>2,400</td>
<td>660</td>
</tr>
<tr>
<td>Total cost of closing stock</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(b) When Net Realisable Value of the Finished Goods B is ₹600 per unit

NRV is less than the cost of Finished Goods B i.e. ₹660 per unit Hence, Raw Material is to be valued at replacement cost and Finished Goods are to be valued at NRV.

Accordingly, value of closing stock will be:

<table>
<thead>
<tr>
<th>Quantity</th>
<th>Rate</th>
<th>Amount (₹)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw Material A</td>
<td>1,000</td>
<td>300</td>
</tr>
<tr>
<td>Finished Goods B</td>
<td>2,400</td>
<td>600</td>
</tr>
<tr>
<td>Total cost of closing stock</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
EQ-3: The closing inventory at cost of a company amounted to `2,84,700. The following items were included at cost in the total:

(a) 400 coats, which had cost ` 80 each and normally sold for ` 150 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds.

(b) 800 skirts, which had cost ` 20 each. These too were found to be defective. Remedial work in April cost ` 5 per skirt, and selling expenses for the batch totalled ` 800. They were sold for ` 28 each.

What should the inventory value be according to Ind AS 2 after considering the above items?

Answer:

Valuation of Closing Inventory

<table>
<thead>
<tr>
<th>Particulars</th>
<th>₹</th>
<th>₹</th>
</tr>
</thead>
<tbody>
<tr>
<td>Closing Inventory at cost</td>
<td></td>
<td>2,84,700</td>
</tr>
<tr>
<td>Less: Cost of 400 coats (400 x 80)</td>
<td>32,000</td>
<td></td>
</tr>
<tr>
<td>Less: Net Realisable Value [(400 x 75) - (5% of ` 75) x 400]</td>
<td>(28,500)</td>
<td>(3,500)</td>
</tr>
<tr>
<td>Value of Closing Inventory</td>
<td></td>
<td>2,81,200</td>
</tr>
</tbody>
</table>

Note: Since, 800 defective skirts were sold, the reduction in the price of the same had not been adjusted from the value of the closing inventory.

EQ-4: On 1.6.2015, X Ltd. Purchases raw material from one of its regular supplier at ` 60 lakhs.

As per terms of the contract, the entity would pay the amount after 2 years.

Assume Incremental borrowing rate of X Ltd. is 11%.

Find out purchase price applying Ind AS 2?

How should the difference be accounted for?

Answer: Purchase price = Present value of ` 60 lakhs discounted at the purchaser’s incremental borrowing rate.

\[
\text{Purchase Price} = \frac{\text{₹ 60 lakhs}}{(1 + 11\%)^2} = \text{₹ 48.70 lakhs}
\]

Accounting entries:

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Dr.</th>
<th>Cr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.6.2015</td>
<td>Purchase A/c</td>
<td></td>
<td>48.70</td>
</tr>
<tr>
<td></td>
<td>To Trade Payables A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31.3.2016</td>
<td>Unwinding of Discount A/c</td>
<td>4.46</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Trade Payables A/c</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31.3.2017</td>
<td>Unwinding of Discount A/c</td>
<td>5.85</td>
<td></td>
</tr>
<tr>
<td></td>
<td>To Trade Payables A/c</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
EQ-5: A dealer of sanitary fittings hold 1000 pcs of wash basins for delivering a constructor under firm contract. The contract quantity is 900 pcs @ ₹ 3,400 whereas retail price of the same is ₹ 4,200.

What should be the net realisable value of the inventories?

Answer: As per Paragraph 31, Ind AS 2, 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.

Accordingly, net realisable value of 1000 pcs of wash basin should be -

\[
\begin{align*}
900 \times 3,400 &= ₹ 30,60,000 \\
100 \times 4,200 &= ₹ 4,20,000 \\
\hline
&= ₹ 34,80,000
\end{align*}
\]

Differences IAS/IFRS & Ind AS

Other Differences Ind AS 2

1. Classification of Expenses: IAS 2 dealing with recognition of inventories as an expense based on function-wise classification, has been deleted keeping in view the fact that option provided in IAS 1 to present an analysis of expenses recognised in profit or loss using a classification based on their function within the entity has been removed and Ind AS 1 requires only nature-wise classification of expenses.

Differences AS & Ind AS

Ind AS 2 and AS 2

(i) Machinery Spares: The existing AS 2 explains that inventories do not include machinery spares which can be used only in connection with an item of fixed asset and whose use is expected to be irregular; such machinery spares are accounted for in accordance with AS 10, ‘Accounting for Fixed Assets’. Ind AS 2 does not contain specific explanation in respect of such spares as this aspect is covered under Ind AS 16.

(ii) Inventories Acquired on Deferred Settlement Terms: An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.
(iii) **Exclusion from its Scope but Guidance given:** Ind AS 2 excludes from its scope only 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. However, the existing AS 2 excludes from its scope such types of inventories.

(iv) **Cost Formulae:** The existing 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.