AS-2 Valuation of inventories

By Shravan Patel

Scope

- Determination of value at which inventories are carried until related revenues are recognized.
- Ascertainment of cost thereof &
- Circumstances in which the amount of inventory is written down below cost.

Inventories- definition

Inventories are the assets

- Held for sale in ordinary course of business.
- In the process of production of such sale or
- In the form on materials or supplies to be consumed in production process or in rendering of services
- The definition also implies that **intangible** items of inventory, such as software held for sale is also included

Not covered under as-2

- Shares, debentures and other financial instruments held as stock in trade. (AS-13)
- Livestock, agricultural and forest products, mineral oils, ores and gases etc. for valuation of which certain established practices may exist.(generally carried at NRV)
- WIP under Construction contracts or of service providers- (AS-7)
- Machinery spares that are used only in connection with an item of fixed asset- (AS-10)

Valuation of inventories

- Inventories must be values at lower of
  a) Cost and
  b) Net realizable value

Cost includes

- **Cost of purchase** net of trade discounts, rebates, duty drawback, cenvat credit availed, etc.(includes duties and taxes paid)
- **Cost of conversion**
  a. Direct labour
  b. Production overheads- variable as well as fixed
  c. Joint Costs- Allocated based on Rational & consistent Basis like sales value or when the products become separately identifiable.
- **Other costs** necessarily **incurred** to bring the inventory to its present location. (ex: design a product as per customers requirements.)

Variable OH's attribution to production

- These are indirect expenses attributable to production as would vary directly or nearly directly with the volume of production.

	Year 1	Year 2
VPOH	750,000	852,000
Actual production	250,000	300,000
Allocation per unit	3.00	2.84

Allocation of fixed production overheads

- Based on normal capacity of the production.

Actual Production < Normal Production

an element of FPOH will remain unallocated. Such unallocated portion will be charged to P/L a/c of the related period.

Actual Production> Normal Production

Allocation to each unit is revised as inventories cannot be measured above cost.

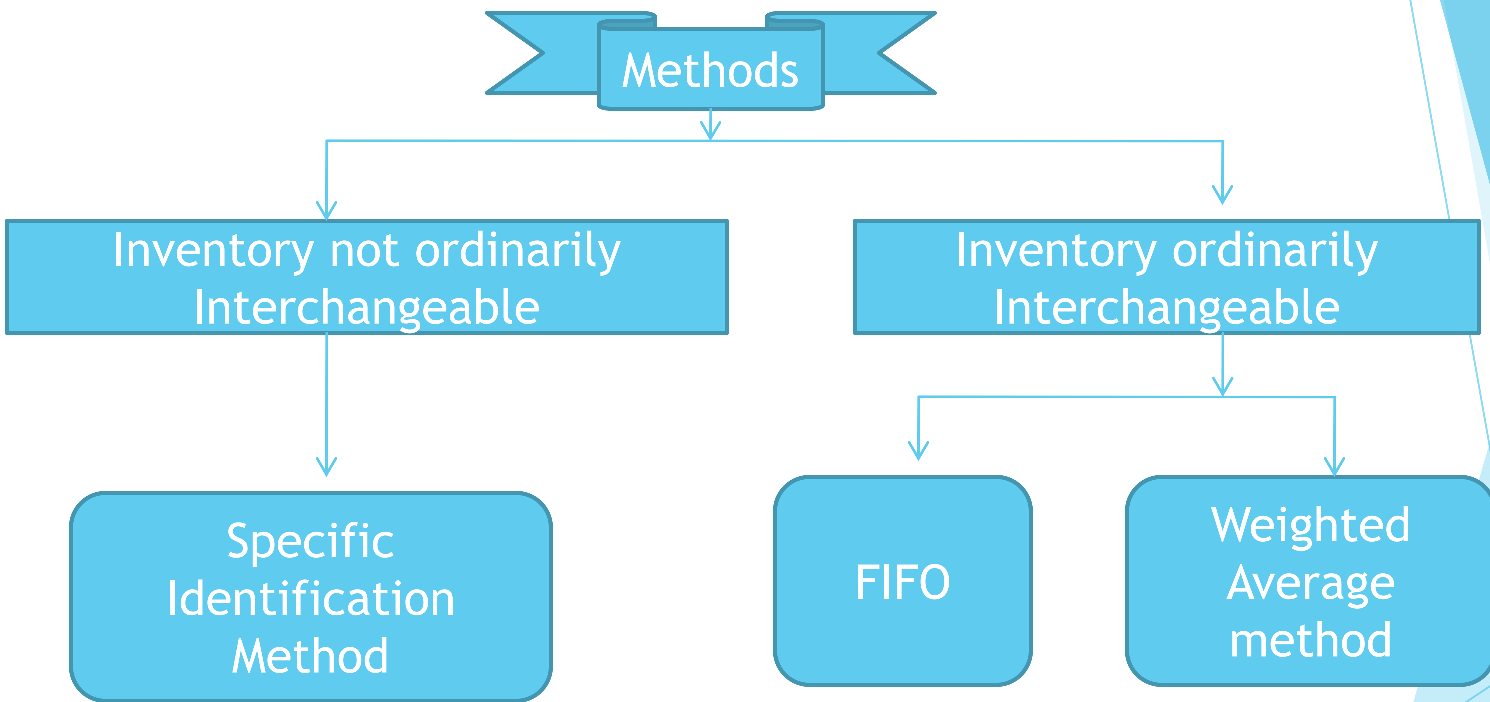
Ex: FPOH Allocation

	Year 1	Year 2
Normal Capacity	250,000	250,000
FPOH	750,000	750,000
Actual Production	242,000	300,000
Allocation per unit	3.00	2.50
Amount to be Charged as period costs	24,000	Nil

Exclusion of certain components from cost

- Abnormal wastage of Materials, Labour and Other costs
- Storage costs unless its necessary in a production process.
- Administrative Costs
- Selling & distribution Costs.

Methods of calculating cost



Methods

- **Specific Identification method:**

  Units in inventory are specifically identified and each unit cost is identified with particular invoice.

  Ex: automobiles, expensive jewelry, antique shops, etc.

- **FIFO:**

  Based on assumption that materials which are **purchased first, are issued first.**

  thus the closing inventory would thus consist of goods recently produced or purchased.

- **WAC Method:**

  WAC is calculated by dividing **TOTAL COST** of material in stock by **TOTAL QUANTITY** of material in stock.

  This method is used where, there are wide varying prices of different lots of purchases make up the stock

Net realisable value(Nrv)

Is defined as the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make sale.

Circumstances prompting valuation at NRV:

- Where cost of inventories may not be recoverable due to damage or inventory becoming wholly or partially obsolete,
- Fall in market prices,
- Estimated costs necessary to make sale have increased.

Application of rule- cost (or) NRV

- Item by Item
- Group method : Inventory relates to same product line that have similar end uses and are produces and marketed in same geographical area.

Interpretation [ICASB]

- It has clarified that machinery spares which are not specific or are generally used for various items of fixed assets should be treated as inventories as per AS-2.
- Such inventories must b charged to P/L a/c as and when consumed in ordinary course of business.

Disclosure

- Accounting policies adopted in measuring inventories, including the cost formulae used.
- Total carrying amount of inventories and its classification.
- As per AS-1 disclosures must include changes if any in the accounting policies w.r.t valuation of inventories and its effect on F.S.

Thank you

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