VALUATION OF INVENTORY AS-2

BY
R KESAVADAS

What are covered?

- Assets held for sale in the ordinary course of business
- Assets in the process of production for such sale
- Assets in the form of materials or supplies to be consumed in the production process or in rendering services
Applicability

AS-2 should be applied to all inventories, except:
- Contract WIP (covered by AS-7)
- WIP of service providers
- Financial instruments (shares, debentures etc)
- Livestock, agricultural and forest products, mineral oils, ores and gases (to the extent measured at NRV, as per established industry practices)

Basis of Valuation

- Cost
- Lower of
- Net Realisable Value

1. costs of purchase
2. costs of conversion
3. costs for bringing inventories to present location/condition.

Estimated Selling Price
(-) Costs of completion
(-) Costs of sale
Cost of Purchase

- Purchase price including taxes & duties
- Taxes & duties recoverable from taxing authorities to be excluded
- Freight inwards included
- Exclude-trade discounts, rebates, drawbacks etc
- Cash discount being in the nature of interest not considered

Cost of conversion

- Direct Labour
- Allocation of overheads:
  - Variable: based on actual production
  - Fixed: based on normal capacity of production
  - Unallocated: treated as period expenses
  - Joint/By-Products: allocation may be done on a rational and consistent basis (e.g., sales value etc) if costs are not separately identifiable
Overheads

Usually exclude:
- Interest and borrowing costs (subject to applicability of AS-16)
- Abnormal waste-material, labour or others
- Storage costs- unless required in production process
- Administrative costs
- Selling and distribution costs

What is normal capacity?

- Average production expected over a number of periods/seasons under normal circumstances
- Loss of production from normal shutdown/maintenance to be factored
- Actual may approximate normal
Cost Formulae

- Specific identification
  - If items not interchangeable and specifically identifiable
- FIFO
- Weighted average

*Standard costs – fixed on normal capacity levels may be used. Should be reviewed and revised regularly*

Net Realisable Value

- To be assessed on each balance sheet date
- Usually written down to NRV on an item by item basis
- Sometimes-appropriate to group similar or related items
- Writing down not correct for a class as a whole (eg: all finished goods)
- Events after balance sheet date affecting balance sheet date position to be considered
- Materials held for consumption-written down only if cost of finished goods > it’s NRV.
- Replacement cost may be used as NRV
Illustration of NRV

- Traded goods – Market Price falls after purchase – new market price less cost of sales will be NRV
- Raw materials held for manufacture – NRV will be calculated with reference to sale price of finished goods and fall in price of raw materials will not by itself impact it.
- Only variable costs to be incurred for sale after the reporting date to be considered as costs of sales

Illustration of NRV

- Fixed overheads incurred for selling in a year being period costs will not be considered in NRV calculation as the same is not considered in costing
- It is not appropriate to consider write down of inventory based on classifications such as business segments
- Estimates of NRV to consider purpose for which inventory is held. If there is a fixed price contract of sale, this should be considered for determining NRV
Illustration of NRV

- In case quantities so contracted for is less than quantity of inventory, the excess quantity to be valued on general selling price based NRV
- Making a provision for contingent losses in this manner is consistent with para 5 of AS 4.
- Determining NRV of items like Loose Tools present a challenge as they are used in manufacturing but not consumed in the manufacturing process.

Disclosure

- Accounting policies adopted
- Cost formula used
- Total and class-wise amount of inventory held
Illustration of Accounting Policy for Disclosure

- Inventories are valued at lower of cost or net realisable value. Cost is determined on weighted average method. Costs includes appropriate element of overheads incurred for bringing the goods to its present condition and location.

Illustration of Classification of Inventories

- Raw Materials and components
- Packing materials
- Work in process
- Finished goods
- Stores and Spares
- Loose tools
Thank you