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LKAS 02 - Inventories

AAT Level II

AFC – Advanced Financial Accounting & Costing

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LKAS 2 Inventories

AAT 2 – Advanced Financial Accounting and Costing

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What are Inventories?

Inventories are assets

held for sale in the ordinary course of business

(Finished Goods)

in the process of production for such sale

(Work in Progress)

in the form of materials or supplies to be consumed in the production process or in the rendering of services

(RM and Other Supplies)

Measurement of Inventories

Inventories should be measured at:

Cost

Net Realizable Value (NRV)

Lower

Activity 01

Amilas' business sells three products X, Y and Z. The following information was available at the year end:

	X	Y	Z
Cost	7	10	19
Net Realizable Value	10	8	15
Units	100	200	300

What is the value of the closing inventory?

Cost of Inventories

Cost of Inventory

- Purchase Cost
- Conversion Cost
- Other Costs

Cost of Inventories

Costs of purchase	Costs of conversion	Other costs
• **Purchase price** PLUS • **Import duties** and other taxes PLUS • Transport, handling and any other cost **directly attributable** to the acquisition of finished goods, services and materials LESS • **Trade discounts**, rebates and other similar amounts	• Costs **directly related** to the units of production, eg, direct labour • **Fixed production overheads -** , eg the cost of factory management and administration • **Variable production** overheads - eg indirect materials and labour	• Any other costs should only be recognized if they are incurred in bringing the inventories to their **present location and condition**.

Cost which **would not be** included in cost of inventories

- **Abnormal amounts** of wasted materials, labour or other production costs
- **Storage costs** (except costs which are necessary in the production process before a further production stage)
- **Administrative overheads** not incurred to bring inventories to their present location and conditions
- **Selling costs**

Recognize them as Expenses in the period they incur.

Activity 02

IAS 2 Inventories defines the items that may be included in computing the value of an inventory of finished goods manufactured by a business.

Which one of the following lists consists only of items which may be included in the statement of financial position value of such inventories according to IAS 2?

a) Foreman's wages, carriage inwards, carriage outwards, raw materials
b) Raw materials, carriage inwards, costs of storage of finished goods, plant depreciation
c) Plant depreciation, carriage inwards, raw materials, foreman's wages
d) Carriage outwards, raw materials, foreman's wages, plant depreciation

Activity 03

Below details are relating to Y (good) of Susantha PLC.

- Purchased 1000 units of Y at Rs.100/- Per unit
- Trade discount received is 2% of the purchase price
- Loading and unloading charges Rs.10,000
- Vessel Fee and insurance Rs. 28,000
- Unclaimable taxes Rs. 5,000
- Claimable (Recoverable) taxes Rs. 2,000
- Carriage inwards Rs.15,000

Calculate the cost of purchased inventories.

Activity 03 - Answer

Activity 04

Below details are relating to X (good) of Sasanga PLC.

- Purchase price Rs.20,000 (500 units)
- Carriage inwards Rs.10,000
- Direct Labour Cost Rs.10 (Per unit)
- Direct Other Costs Rs.2 (Per unit)
- Non-production overhead costs Rs.15,000
- Production overhead costs Rs.5,000
- Abnormal loss on materials Rs.2.000
- Designing Fee for the designer Rs.8,000

Calculate the cost of inventories.

Activity 04 - Answer

Assigning the cost

Specific identification

For;

a) Items that are **not ordinarily interchangeable**

b) Goods or services produced and segregated for **specific projects**

Cost Formulas

A. FIFO – First In First Out method

B. WAC – Weighted Average Cost Method

LIFO –is not permitted

Activity 05

Below details are relating to “Chem” raw material.

01.01.2023	Opening Balance of 6000 units – Rs.30,000
05.01.2023	Purchased 12,000 units at Rs.6.50 per unit
12.01.2023	Issued 8,000 units
20.01.2023	Purchased 10,000 units at Rs.6.80 per unit
22.01.2023	Purchased 2,000 units at Rs.7 per unit
25.01.2023	Issued 15,000 units
28.01.2023	Purchased 5,000 units at Rs.7.25 per unit
29.01.2023	Issued 6,000 units

1. **Calculate the cost of the closing inventory as at 31.01.2023 using both FIFO and WAC methods.**
2. **Further calculate the gross profit under each methos if each unit is sold at Rs.15.**

Activity 05 – Answer - FIFO

Date	Goods Receipts			Goods Issues			Balance	
	Qty	Unit Price (RS.)	Amount (RS.)	Qty	Unit Price (RS.)	Amount (RS.)	Qty	Amount (RS.)

Activity 05 – Answer - WAC

Date	Goods Receipts			Goods Issues			Balance	
	Qty	Unit Price (RS.)	Amount (RS.)	Qty	Unit Price (RS.)	Amount (RS.)	Qty	Amount (RS.)

Activity 05 – Answer – Gross Profit

Net Realizable Value (NRV)

Net realizable 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 Realizable Value = Expected Selling Price − Estimated Costs of Completion − Estimated Costs of Selling

Situations in which NRV is likely to be less than cost

a) An **increase in costs** or a **fall in selling price**
b) A **physical deterioration** in the condition of inventory
c) **Obsolescence** of products
d) A decision as part of the company's marketing strategy to manufacture and sell products at a **loss** (e) **Errors in production or purchasing**

Methods of writing down inventories to NRV

Item by Item Basis

Normal/Usual Method

Batch Basis

This grouping together is **acceptable** for, say, **items in the same product** line. But it is not acceptable to write down inventories based on a whole classification (eg finished goods) or a whole business

Activity 06

A company has inventory on hand at the end of the reporting period as follows.

	Units	Raw material Cost	Attributable production overheads	Attributable selling costs	Expected selling price
		Rs.	Rs.	Rs.	Rs.
Item A	300	160	15	12	185
Item B	250	50	10	10	75

1. At what amount will inventories be stated in the statement of financial position in accordance with IAS 2?
2. At what amount will inventories be stated in the statement of financial position in accordance with IAS 2 if both items are in one batch?

Activity 06 – Answer – Part 1

Activity 06 – Answer – Part 2

Recognition as an expense

The following treatment is required when inventories are sold.

a) The carrying amount is recognized as an expense in the period in which the related revenue is recognized.
b) The amount of any write-down of inventories to NRV and all losses of inventories are recognized as an expense in the period the write-down or loss occurs.
c) The amount of any reversal of any write-down of inventories, arising from an increase in NRV, is recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs

Disclosures

- The **accounting policies** adopted in measuring inventories, including the cost formula used
- The total **carrying amount** of inventories and the carrying amount in **classifications appropriate** to the entity
- The amount of inventories recognized as an **expense** during the period
- The amount of any **write-down of inventories** recognized as an expense in the period
- The carrying amount of **inventories pledged** as security for liabilities