Educational Material on Indian Accounting Standard (Ind AS) 2 Inventories (Revised 2016)

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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This Educational Material has been formulated in accordance with the Ind AS notified by the Ministry of Corporate Affairs (MCA) as Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 and other amendments finalised subsequent to the notification.

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Foreword

The Institute of Chartered Accountants of India (ICAI), being the premier accounting body in the country, has always played a very influential role in taking Indian financial reporting system to newer heights and achieving international benchmarks by taking necessary initiatives from time to time. Moving forward in this direction, the ICAI has formulated IFRS-converged Indian Accounting Standards (Ind AS), which have been notified by the Ministry of Corporate Affairs (MCA) as Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015, after recommendation of the National Advisory Committee on Accounting Standards (NACAS). The MCA has also issued a Press Release on January 18, 2016, announcing the Ind AS roadmap for Scheduled Commercial Banks (excluding RRBs), Insurers/Insurance companies and Non-banking Financial Companies (NBFCs) from the financial year 2018-19.

In addition to formulation of IFRS-converged Ind AS, the ICAI through its Ind AS (IFRS) Implementation Committee is working to provide necessary support and guidance to members and other stakeholders for smooth implementation of Ind AS. In accordance with its Terms of Reference, the Ind AS (IFRS) Implementation Committee is actively engaged in formulation of Educational Materials on Ind AS to enable members and others concerned to implement Ind AS in the same spirit in which these have been formulated. Moving forward in this direction, the Ind AS (IFRS) Implementation Committee has brought out its revised Educational Material on Ind AS 2, *Inventories*.

I sincerely acknowledge the untiring efforts and support of CA. S. B. Zaware, Chairman, CA. Vijay Kumar Gupta, Vice Chairman and other members of the Committee including co-opted members and special invitees for the contribution provided in the formulation of this revised Educational Material on Ind AS 2, *Inventories*.

I am certain that this revised Educational Material will be of immense use for the members and other stakeholders in implementing the Standard.

New Delhi
February 9, 2016

CA. Manoj Fadnis
President, ICAI

Preface

The notification of IFRS-converged Indian Accounting Standards (Ind AS) and roadmap for implementation of Ind AS by MCA as Companies (Indian Accounting Standards) Rules, 2015, is significant milestone towards bringing Indian financial reporting at par with global financial reports.

The task of ensuring smooth implementation of above Ind ASs has been entrusted to Ind AS (IFRS) Implementation Committee of the ICAI. Moving forward in this direction, the Committee is working continuously to provide guidance to the members and other stakeholders in the form of Educational Materials on Ind AS containing Frequently Asked Questions. The Committee is also conducting Certification Course on IFRS, workshops, seminars, awareness programmes, webcasts etc. across the country to impart knowledge on Ind AS/IFRS.

During the Council Year 2015-16, the Committee decided to revise certain Educational Materials issued earlier since there are substantial changes in certain Ind AS notified in 2015 compared to the Ind AS notified in 2011. Working in this direction, the Committee has brought this revised Educational Material on Ind AS 2, Inventories.

Ind AS 2, Inventories, lays down the principles for recognition and measurement of inventories, recognition of inventories as expenses, write-downs of inventories to net realisable value, reversal of write-downs and other disclosure requirements. This revised Educational Material contains summary of Ind AS 2 discussing the key requirements of the Standard in brief and the Frequently Asked Questions (FAQs) covering the issues, which are expected to be encountered frequently while implementing this Standard.

I may mention that the views expressed in this publication are the views of the Ind AS (IFRS) Implementation Committee and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of examples. However, while applying Ind ASs in a practical situation, reference should be made to the text of the Standards.

I would like to convey my sincere gratitude to our Honourable President CA. Manoj Fadnis and Vice-President CA. M. Devaraja Reddy for providing me this opportunity of bringing out implementation guidance on Ind ASs in the form of Educational Materials. I wish to place on record my sincere appreciation of CA. Vijay Kumar Gupta, Vice-Chairman, CA. Sanjeev Singhal, Principal Resource Person, CA. Pravin Tulsyan, CA. Nikhil Gupta and other members of the Study Group, for preparing the revised draft of this Educational Material. I would also like to thank all members, co-opted members, special invitees of the Ind AS (IFRS) Implementation Committee for their invaluable suggestions and contributions for finalising this publication.

I hope this Educational Material will be of immense use in understanding the provisions of Ind AS 2 and in implementation of the same.

New Delhi
February 9, 2016

CA. S. B. Zaware
Chairman
Ind AS (IFRS) Implementation Committee

Foreword to the First Edition

In view of global developments a need for a single set of high quality accounting standards had been felt. It had been realised that International Financial Reporting Standards (IFRS) are increasingly being recognised as Global Accounting Standards. Considering the substantial benefits expected by convergence with IFRS, including decreased cost of capital, greater mobility of capital, greater efficiency in the allocation of resources, improved and more comparable financial reporting, in 2007, the Institute of Chartered Accountants of India (ICAI) decided to converge with IFRS. The Ministry of Corporate Affairs, Govt. of India, has also supported the initiative of ICAI to converge with IFRS. The ICAI has formulated IFRS-converged Indian Accounting Standards corresponding to IFRS, which were in force as on 1st April, 2011. The same have been placed by the MCA on its website after the recommendation of the NACAS.

Considering these major developments in India with regard to convergence with IFRS and global developments with regard to IFRS, immense need is being felt to get the members and other stakeholders ready for proper implementation of IFRS-converged Indian Accounting Standards. For this purpose, a Committee, namely, Ind AS (IFRS) Implementation Committee, has been constituted. One of the primary objectives of the Committee is to support the members and other stakeholders in proper implementation of IFRS-converged Indian Accounting Standards (Ind ASs) by providing guidance on the same.

I congratulate the Ind AS (IFRS) Implementation Committee of ICAI, especially its Chairman, CA. Amarjit Chopra, for formulating this Educational Material on Ind AS 2, *Inventories*. Ind AS 2 prescribes the accounting treatment for inventories, such as, measurement of inventories, recognising the same as expense and disclosures in this regard. The purpose of this Educational Material is to provide guidance by way of Frequently Asked Questions (FAQs) explaining the principles enunciated in the Standard.

I am confident that this Educational Material will be extremely useful not only to the members of the profession but also to others concerned in proper understanding and implementation of the Standard.

New Delhi — CA. G. Ramaswamy
February 3, 2012 — *President*

Preface to the First Edition

Considering the global developments and expected benefits of convergence with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), which are widely recognised as global financial reporting standards, India decided to converge with IFRS. For this purpose, IFRS-converged Indian Accounting Standards corresponding to IFRS considered relevant for Indian entities as on 1^{st} April, 2011, had been formulated.

While formulating IFRS-converged Indian Accounting Standards, it was realised that in order to ensure that these Standards are implemented in the same spirit in which these had been formulated, some kind of guidance on these Standards would be required. This task of providing guidance has been entrusted to Ind AS (IFRS) Implementation Committee. Accordingly, the Committee is formulating Educational Materials on Ind ASs. Working in this direction, the Committee has brought out this Educational Material on Indian Accounting Standard (Ind AS) 2, *Inventories*.

Inventories are assets held for sale in the ordinary course of business, or assets in the process of production for sale, or materials or supplies to be consumed in the production process or rendering of services. Inventories are one of major factors of production for an entity without which it cannot run its operations. These are one of the major components of current assets of an entity and have a major impact on its profitability and financial position. Appropriate recognition and measurement of inventories is essential since its undervaluation or overvaluation will distort the financial statements for more than one accounting periods. Indian Accounting Standard (Ind AS) 2, *Inventories,* lays down the principles for recognition and measurement of inventories, recognition of inventories as expenses, write-downs of inventories to net realisable value, reversal of write-downs and other disclosure requirements.

This Educational Material contains summary of Ind AS 2 discussing the key requirements of the Standard in brief and the Frequently Asked Questions (FAQs) covering the issues, which are expected to be encountered frequently while implementing this Standard. The text of Ind AS 2 and differences between Ind AS 2, *Inventories* and AS 2, *Valuation of Inventories* have been included to make this publication comprehensive.

I may mention that the views expressed in this publication are the views of the Ind AS (IFRS) Implementation Committee and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of examples. However, while applying Ind ASs in a practical situation, reference should be made to the text of the Standards.

I would like to thank my Council colleagues, co-opted members and special invitees on the Ind AS (IFRS) Implementation Committee for their valuable inputs. I would like to convey my sincere thanks to CA. S.C. Vasudeva for his significant inputs in formulation of Frequently Asked Questions on this Ind AS. My special thanks are due to CA. Sanjeev Kumar Singhal, CA. Jag Mohan Seth, CA. Manjula Banerji and CA. Archana Bhutani for their significant views in finalising the publication.

I would like to place on record my appreciation of the efforts put in by Dr. Avinash Chander, Technical Director, CA. Parminder Kaur, Secretary, Ind AS (IFRS) Implementation Committee and CA. Bibhuti Bhusan Nayak, Executive Officer, of the Institute of Chartered Accountants of India in finalising this publication.

I sincerely believe that this Educational Material will be of great help in understanding the provisions of Ind AS 2 and in implementation of the same.

New Delhi
February 3, 2012

CA. Amarjit Chopra
Chairman
Ind AS (IFRS) Implementation Committee

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I Ind AS 2 — Summary

Introduction

Inventories constitute a major portion of current assets of an entity. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised.

Indian Accounting Standard (Ind AS) 2, *Inventories*, prescribes the accounting treatment for inventories, such as, determination of cost and its subsequent recognition as expense, including any write-downs of inventories to net realisable value and reversal of write-downs.

Scope

Ind AS 2 applies to all inventories, except:

(a) work in progress arising under construction contracts including directly related service contracts;

(b) financial instruments; and

(c) biological assets (i.e., living animals or plants) related to agricultural activity and agricultural produce at the point of harvest.

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 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 fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.

Key Requirements of Ind AS 2

One of the key issues with regard to inventories is measurement of inventories to determine the carrying amount to be shown in the financial statements.

The Standard prescribes that the inventories shall be measured at the lower of cost and net realisable value. Cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

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.

Costs of Purchase

The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from 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.

Costs of Conversion

The costs of conversion of inventories include costs directly related to the units of production, such as direct labour. They also include 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. 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.

The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Variable production overheads are allocated to each unit of production on the basis of actual use of production facilities.

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. For example, cost of designing products for specific customers.

Cost of inventories of a service provider

Service providers shall measure their inventories 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.

Cost Formulae

An entity shall ascertain the costs of inventories by applying proper technique and cost formula.

The costs of inventories of items that are not ordinarily interchangeable and goods and services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.

The cost of inventories, other than above, 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.

Net Realisable Value

As mentioned earlier, 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. Estimation of net realisable value is an important point in valuing inventories. If the net realisable value is lower than cost then inventories are shown at net realisable value. The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.

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.

Recognition as an Expense

When inventories are sold, the carrying amount of inventories shall be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down to net realisable value and all losses of inventories shall be recognised as an expense in the period in which the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net relisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

Disclosure

The financial statements shall disclose:

(a) the accounting policies adopted in measuring inventories, including cost formula used;

(b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;

(c) the carrying amount of inventories carried at fair value less cost to sell;

(d) the amount of inventories recognised as an expense during the period;

(e) the amount of any write-down of inventories recognised as a expense;

(f) the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense;

(g) the circumstances or events that led to the reversal of a write- down of inventories; and

(h) the carrying amount of inventories pledged as security for liabilities.

II Frequently Asked Questions

The principles laid down in Accounting Standard (AS) 2, *Valuation of Inventories*, are well established and the principles laid down in Ind AS 2, *Inventories,* are almost similar to the principles laid down in AS 2. Therefore, the issues to be addressed in Frequently Asked Questions on Ind AS 2 are not many. However, differences between Ind AS 2, *Inventories,* and AS 2, *Valuation of Inventories*, have been included as Appendix I to this publication.

Question 1

What is the difference between 'Net Realisable Value' and 'Fair Value'? Explain with suitable example?

Response

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 @ Rs.10/- each after selling expenses. The entity has an order in hand to sell the inventories @ Rs. 11/- In this situation, fair value is Rs 10/- each, but net realisable value is Rs. 11/- each.

Question 2

As per Paragraphs 3(a) and 3(b), Ind AS 2 does not apply to the measurement of inventories held by certain categories of persons. In this case, whether the other requirements of this Standard are applicable for these type of inventories.

Response

Measurement criteria is not applicable to the inventories held by 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 and inventories held by the commodity broker-traders who measure their inventories at fair value less cost to sell. Paragraphs 4 and 5 of Ind AS 2 clearly state that these types of inventories are excluded from only the measurement requirements of this Standard. In other words, the other requirements laid down in the Standard are applicable. For example, disclosure requirements of this Standard are applicable to these types of inventories, say, disclosure of accounting policies adopted in measuring inventories.

Question 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.

Question 4

As per Ind AS 2, selling costs are excluded from the cost of inventories and are required to be recognised as an expense in the period in which these are incurred, whereas, AS 2 excludes both selling and distribution costs. Whether the distribution costs would now be included in the cost of inventories under Ind AS 2.

Response

Selling and distribution costs are generally used as single term because both are related, as selling costs are incurred to effect the sale and the distribution costs are incurred by the seller to complete a sale transaction by making the goods available to the buyer from the point of sale to the point at which the buyer takes possession. Since these costs are not related to bringing the goods to their present location and condition, the same are not included in the cost of inventories. Accordingly, though the word 'distribution costs' is not specifically mentioned in Ind AS 2, these costs would continue to be excluded from the cost of inventories, as being done as per AS 2.

Question 5

How the recognition and disclosure of amount of reversal of any write-down of inventories as a reduction in the amount of inventories is to be made?

Response

Paragraph 34 of Ind AS 2 'inter alia' provides, 'the amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs'.

Paragraph 36(f) requires the disclosure of '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 accordance with paragraph 34'.

In accordance with the above, the reversal of any write-down needs to be recognised in the statement of profit and loss by way of reduction in the amount of inventories recognised as an expense. The specimen disclosure in the financial statements in this regard is given below:

"Note: Inventories

	2017 (Rs. in thousands)	2016 (Rs. in thousands)
Raw Material	4,500	4,000
Product in progress	400	300
Finished products	14,000	13,000
Total	18,900	17,300

Cost of Inventories recognised as expense

	2016-2017 (Rs. in thousands)	2015-2016 (Rs. in thousands)
Cost of Inventories recognised as expenses including	50,000	45,000
— Write-down of inventories	500	400
—Reversal of earlier write-down	(100)	–

Question 6

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.

Question 7

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.

Question 8

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 convert 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.

Question 9

Paragraph 36(h) of Ind AS 2 requires the disclosure of the carrying amount of inventories pledged as security for liabilities. Whether the term pledge covers other kinds of charges/encumbrances?

Response

The term 'pledge' has not been defined in the Standard. Generally, 'pledge' is understood as bailment of personal property as a security for some debt or engagement, redeemable on certain terms, and with an implied power of sale on default.

The purpose of use of term 'pledge' for the purpose of disclosure of carrying amount of pledged inventory under this Ind AS seems to be broad, i.e., to provide the information to the user about restrictions on an entity's inventory whether physically in the possession of the entity or not. Accordingly, for the purpose of disclosures required under Ind AS 2, pledge would include all charges/encumbrances where restriction has been put by the charge holder on the use of that asset.

Question 10

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 Accounting Standard (AS) 10, Accounting for Fixed Assets. Ind AS 2 does not contain specific explanation in respect of such spares. In the absence of specific clarification, would there be any change in the accounting treatment of machinery spares?

Response

Ind AS 2 does not specifically deal with accounting of machinery spares/ spare parts as this aspect has been dealt with under Ind AS 16, which provides as follows:

"Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Ind AS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory."

Ind AS 16 has defined *property, plant and equipment* as those tangible items that: (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) are expected to be used during more than one period.

In view of the above, critical spares which were earlier treated as inventory because conditions laid down in AS 2 for capitalising the same, *viz.*, can be used only in connection with an item of fixed asset and use was expected to be irregular were not fulfilled, may now qualify as property, plant and equipment if these meet the definition of property, plant and equipment.

For example, rotables are used in helicopters, these can be used in any helicopter of the same type. As per paragraph 8.2 of AS 10, spare parts are capitalised if such spares can be used only in connection with an item of fixed asset and their use is expected to be irregular. It implies that machinery spares which are not specific to a particular item of fixed asset but can be used generally for various items of fixed assets should be treated as inventories. Since the nature of rotables is such that it can be used in any helicopter of the same type of helicopters and not only in relation to a specific item of fixed asset (viz. helicopters), the same may be treated as inventory under existing Accounting Standards. However, in accordance with the principles of Ind AS 16, *Property, Plant and Equipment* (PPE), for an item to qualify as PPE the definition of PPE must be met otherwise such an item is classified as inventory. Since, rotables form an integral part of helicopters that are held for use in supply of services by the aviation industry and their life span is expected to be more than one period, the same may now qualify as an item of PPE under Ind AS.

Question 11

Since Ind AS 2 does not specifically deal with the accounting treatment of excise duty for the purpose of valuation of inventories and, whether there is any difference in current accounting and requirements of Ind AS 2 in this regard?

Response

The principles laid down in Ind AS 2 are the same as those laid down in AS 2 with regard to measurement of inventories insofar as the treatment of excise duty is concerned and, therefore, there is no difference in current accounting requirements and requirements under Ind AS 2 in this regard. Accordingly, excise duty will continue to be treated as an element of cost for valuation of inventory as it arises as a consequence of manufacture of excisable goods irrespective of the manner of use/disposal of goods thereafter. Tax payable by a manufacturer is a cost of manufacture like any other cost incurred by it. It is cost that must be incurred if the goods are to be put in the location and condition in which they can be sold or used further in the manufacturing process. Accordingly, excise duty should continue to be considered as an element of cost for inventory valuation like other manufacturing costs.

Appendix I

Differences between Ind AS 2, *Inventories*, and AS 2, *Valuation of Inventories*

1 Ind AS 2 deals with the subsequent recognition of cost/carrying amount of inventories as an expense, whereas the AS 2 does not provide the same (refer paragraphs 1 and 34 of Ind AS 2).

2 Ind AS 2 provides explanation with regard to inventories of service providers whereas the AS 2 does not contain such an explanation (refer paragraphs 8, 19 and 29 of Ind AS 2).

3 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 Accounting Standard (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.

4 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. However, this aspect is not there in the existing AS 2. Accordingly, Ind AS 2 defines fair value and provides an explanation in respect of distinction between 'net realisable value' and 'fair value'. The AS 2 does not contain the definition of fair value and such explanation.

5 Ind AS 2 provides detailed guidance in case of subsequent assessment of net realisable value (refer paragraph 33 of Ind AS 2). 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. AS 2 does not deal with such reversal.

6 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 (refer paragraphs 4 and 20 of Ind AS 2). However, AS 2 excludes from its scope such types of inventories.

7 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 formulae for all inventories having a similar nature and use to the entity. Ind AS 2 also explains this aspect (refer paragraphs 25 and 26).

8 Ind AS 2 requires more disclosures as compared to the AS 2 (refer paragraph 36 of the Ind AS 2).