

IAS 2 Inventories

Overview

IAS 2 sets out the accounting treatment for inventories, including the determination of cost, the subsequent recognition of an expense and any write-downs to net realisable value.

Scope

- Applies to all inventories except:
 - work in progress on construction and service contracts (IAS 11);
 - financial instruments (IAS 32 and IFRS 9); and
 - biological assets arising from agricultural activity (IAS 41).
- Does not apply to the measurement of inventories held by:
 - producers of agricultural and forest products, and minerals and mineral products, that are measured at net realisable value in accordance with well-established practices in those industries; and
 - commodity broker-traders who measure their inventories at fair value less costs to sell.Changes in the above inventory values are recognised in profit or loss in the period of the change.

Definitions

- *Inventories* – assets that are:
 - held for sale in the ordinary course of business;
 - in the process of production for such sale; or
 - in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- *Net realisable value (NRV)* - the estimated selling price less the estimated costs of completion and the estimated costs necessary to make the sale.
- *Cost of inventories* – all costs incurred in bringing the inventories to their present location and condition, including the costs of purchase and conversion.
 - Costs of purchase of inventories comprise the purchase price (less trade discounts, rebates and similar items), irrecoverable taxes, and transport, handling and other costs directly attributable to their acquisition.
 - Costs of conversion include costs directly related to the units of production, such as direct labour and systematically allocated fixed and variable production overheads incurred in producing finished goods.

- *Fair value* – 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.

Measurement

- Inventories shall be stated at the lower of cost and net realisable value.
- To the extent that service providers have inventories, they measure them at the costs of their production. These costs are primarily the costs of labour directly engaged in providing the service, including supervisory personnel, and attributable overheads.
- The cost of inventories of items that are ordinarily interchangeable and have not been produced and segregated for specific projects is determined by using the first-in, first-out (FIFO) or weighted average cost formula. The same cost formula shall be adopted for all inventories having a similar nature and use to the entity.
- Inventories are usually written down to NRV on an item by item basis, unless it is more appropriate to group similar or related items.

Recognition as an expense

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

Disclosure

- The following shall be disclosed in the financial statements
 - the accounting policies for inventories
 - the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity
 - the carrying amount of inventories carried at fair value less costs to sell
 - the amount of inventories recognised as an expense during the period

Examples of costs excluded from the cost of inventories and recognized as an expense when they are incurred:

- Abnormal amounts of wasted materials, labour or other production costs;
- Storage costs, unless those costs are necessary in the production process before a further production stage;
- Administrative overheads that do not contribute to bringing inventories to their present location and condition; and
- Selling costs.

- the amount of any write-down of inventories recognised as an expense
- the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as an expense
- the circumstances or events that led to the reversal of a write-down of inventories
- the carrying amount of inventories pledged as security for liabilities.