Inventories are assets:
(a) held for sale in the ordinary course of business (finished goods);
(b) in the process of production for such sale (WIP); or
(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services (raw materials and other supplies).

NRV 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.

FV The price that would be received to sell an asset or paid to transfer a liability in orderly transaction between market participants at the measurement date.

NRV vs. FV
NRV is entity-specific value; FV is not. NRV for inventories may not equal FV-CTS.

**EXAMPLE 2A**
An entity has work in process inventory. Till now the cost of $70,000 has been spent on this inventory. The estimated cost to convert the WIP inventory into finished goods is $48,000.

The estimated selling price of inventory if sold in its present condition is $70,500 and if sold after it has been converted to finished goods is $120,000. The entity has to pay 2% commission to its distributors.

The entity does not sell the incomplete inventory.

**Required:**
Calculate NRV and explain at which amount the inventories should appear in SFP.

**EXAMPLE 2B**
You have a contract to supply 100 barrels of oil at $25 per barrel. The price is fixed for the 6 months. At the end of the 1st month the market price of oil is $30. (The fair value is $30.) You buy the 100 barrels at the market price. Selling costs are $2 per barrel.

**Required:**
What is the NRV of inventories?
# COST OF INVENTORIES: GENERAL

<table>
<thead>
<tr>
<th>Costs of Inventories</th>
<th>The costs of inventories shall comprise:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a) all costs of purchase,</td>
</tr>
<tr>
<td></td>
<td>(b) costs of conversion,</td>
</tr>
<tr>
<td></td>
<td>(c) other costs incurred in bringing</td>
</tr>
<tr>
<td></td>
<td>the inventories into their present</td>
</tr>
<tr>
<td></td>
<td>location and condition. For example,</td>
</tr>
<tr>
<td></td>
<td>it may be appropriate to include non-</td>
</tr>
<tr>
<td></td>
<td>POH or the costs of designing products</td>
</tr>
<tr>
<td></td>
<td>for specific customers in the cost of</td>
</tr>
<tr>
<td></td>
<td>inventories.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Costs of Purchase</th>
<th>Purchase price</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>XX</td>
</tr>
<tr>
<td></td>
<td>Non-refundable/import duties and taxes</td>
</tr>
<tr>
<td></td>
<td>XX</td>
</tr>
<tr>
<td></td>
<td>Transport and handling costs</td>
</tr>
<tr>
<td></td>
<td>XX</td>
</tr>
<tr>
<td></td>
<td>Other costs directly attributable to acquisition</td>
</tr>
<tr>
<td></td>
<td>XX</td>
</tr>
<tr>
<td></td>
<td>Trade discounts and rebates</td>
</tr>
<tr>
<td></td>
<td>(X)</td>
</tr>
<tr>
<td></td>
<td>XX</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Costs of Conversion</th>
<th>These include:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a) costs directly related to the units of production, such as direct labour</td>
</tr>
<tr>
<td></td>
<td>(b) a systematic allocation of fixed and variable POH that are incurred in converting materials into finished goods.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Level of Production</th>
<th>The conversion costs are included in inventory on the basis of following level of productions:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Direct labour etc → actual level of production</td>
</tr>
<tr>
<td></td>
<td>• Variable POH → actual level of production</td>
</tr>
<tr>
<td></td>
<td>• Fixed POH → normal or actual, whichever is higher</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Costs to be excluded</th>
<th>Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(a) abnormal amounts and wastages;</td>
</tr>
<tr>
<td></td>
<td>(b) storage costs, unless necessary for the production process;</td>
</tr>
<tr>
<td></td>
<td>(c) administrative overheads; and</td>
</tr>
<tr>
<td></td>
<td>(d) selling costs.</td>
</tr>
</tbody>
</table>

| Deferred Settlement Terms | amount paid – purchase price for normal credit terms = interest expense |

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**EXAMPLE 2C**

ABC Limited purchased material worth cash price of $5,000 but they had to pay $5,600 in total as they were allowed by the supplier to take two months extra credit period on ABC Limited specific request.

**Required:**

Record the journal entries.
MEASUREMENT TECHNIQUES

When to use these techniques?

Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost.

Standard Costs Method

Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilization. They are regularly reviewed and, if necessary, revised in the light of current conditions.

Retail Method

It is often used in the retail industry having of large numbers of rapidly changing items with similar margins for which it is impracticable to use other methods. The cost is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration inventory marked down to below its original selling price. An average percentage for each department is often used.

COST FORMULAS

Consistency

An entity shall use the same cost formula for all inventories having a similar nature and use to the entity.

Different formulas

For inventories with a different nature or use, different cost formulas may be justified.

FIFO

The FIFO formula assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced.

Weighted Average

Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.
NRV

<table>
<thead>
<tr>
<th>Rationale</th>
<th>The practice of writing inventories down below cost to NRV is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item by Item</td>
<td>Inventories are usually written down to NRV item by item. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular operating segment.</td>
</tr>
<tr>
<td>Estimate</td>
<td>Estimates of NRV are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise.</td>
</tr>
<tr>
<td>NRV of Raw Material</td>
<td>Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost.</td>
</tr>
<tr>
<td>Reversal of write down</td>
<td>A new assessment is made of NRV in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in NRV because of changed economic circumstances, the amount of the write-down is reversed (i.e. the reversal is limited to the amount of the original write-down) so that the new carrying amount is the lower of the cost and the revised NRV. This occurs, for example, when an item of inventory that is carried at NRV, because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.</td>
</tr>
</tbody>
</table>

**EXAMPLE 2D**

The following data relates to inventory of King Limited:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Cost</th>
<th>NRV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Material A</td>
<td>87,000</td>
<td>98,000</td>
</tr>
<tr>
<td>Material B</td>
<td>94,000</td>
<td>82,000</td>
</tr>
<tr>
<td>Total Raw Material Inventory</td>
<td>181,000</td>
<td>180,000</td>
</tr>
<tr>
<td>WIP AX</td>
<td>105,000</td>
<td>116,000</td>
</tr>
<tr>
<td>WIP BY</td>
<td>97,000</td>
<td>87,000</td>
</tr>
<tr>
<td>Total WIP Inventory</td>
<td>202,000</td>
<td>203,000</td>
</tr>
<tr>
<td>Product X</td>
<td>120,000</td>
<td>135,000</td>
</tr>
<tr>
<td>Product Y</td>
<td>105,000</td>
<td>102,000</td>
</tr>
<tr>
<td>Total Finished goods Inventory</td>
<td>235,000</td>
<td>237,000</td>
</tr>
<tr>
<td>Total Inventory</td>
<td>618,000</td>
<td>620,000</td>
</tr>
</tbody>
</table>

**Required:**

Calculate the amount of write down to NRV, if required.
## RECOGNITION AS AN EXPENSE

<table>
<thead>
<tr>
<th>When Inventories are sold</th>
<th>The carrying amount of those inventories shall be recognized as an expense in the period in which the related revenue is recognized.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Write down and losses</td>
<td>Recognised as an expense in the period the write-down or loss occurs.</td>
</tr>
<tr>
<td>Reversal of write down</td>
<td>Recognised as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs.</td>
</tr>
<tr>
<td>Allocation to other assets</td>
<td>Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment.</td>
</tr>
</tbody>
</table>
ANSWER 2A

Estimated selling price in ordinary course of business $120,000
Less: Estimated cost of completion (48,000)
Less: Estimated cost necessary to make the sale $120,000 x 2% (2,400)
NRV 69,600

Cost 70,000

The amount at which inventories should appear in SFP (lower) 69,600

ANSWER 2B

The NRV of inventories is $23 per unit (i.e. $25 - $2). The total NRV is $23 x 100 units = $2,300

ANSWER 2C

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<tr>
<th>Inventories (purchases)</th>
<th>Dr.</th>
<th>Cr.</th>
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<tbody>
<tr>
<td>Supplier</td>
<td>SFP</td>
<td>5,000</td>
</tr>
<tr>
<td>Purchase of Inventories</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supplier</td>
<td>SFP</td>
<td>5,000</td>
</tr>
<tr>
<td>Interest exp</td>
<td>PL</td>
<td>600</td>
</tr>
<tr>
<td>Bank</td>
<td>SFP</td>
<td>5,600</td>
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<tr>
<td>Payment for Inventories</td>
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<td></td>
</tr>
<tr>
<td>Particulars</td>
<td>Cost</td>
<td>NRV</td>
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Dated: 12 August 2016