IAS 2
Inventories

1. Objective

The objective of this Standard is to prescribe the accounting treatment for inventories. In particular, it provides guidance on the determination of costs to be included within inventories, pending recognition of the subsequent revenues.

2. Scope

IAS 2 applies to all inventories held for sale in the course of a company's business, except for:

- Financial instruments (IAS 32 and IFRS 9);
- Biological assets (living animals or plants) related to agricultural activity and agricultural produce at the point of harvest (IAS 41);
- 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 realizable value;

The following must also be considered to be inventory:

- **Assets in the process of production for sale;**
- **Materials** or supplies to be consumed in the production process or in the process of rendering services.

Net realizable value is defined by this Standard as the estimated selling price in the ordinary course of business, less the estimated costs for the completion of goods and services and the estimated selling costs.

3. Accounting impact

3.1 Measurement of inventories

The cost price of inventories of goods and merchandise includes:

- **Purchase costs**, namely purchase price, including import duties and non-recoverable taxes, transport and handling costs, after deducting trade rebates, discounts and other similar items;

- **Conversion costs**, namely costs directly related to the production of inventories, such as direct labour and production overheads (variable and fixed), incurred to convert raw materials into finished products;
- **Other costs** incurred in bringing the inventories to their present location and in marketable condition.

Inventories must be measured at the lower of cost and net realizable value.

Example 1: Company X received an invoice from its supplier Y including the following information:

Total of the goods excl. VAT	20,000
3% discount	– 600
Transport costs	2,500
20% VAT on 21,900	4,380
Total invoice incl. VAT	26,280

Invoice due within 30 days after deducting a 2% early payment discount or net 60 days.

The company also paid import duties in the total amount of 400.
Since this merchandise is still in inventory at the end of the period, it will be measured as follows:

Purchase price of the goods	20,000
Discount	– 600
Transport costs	2,500
Import duties	400
Total cost	22,300

The recoverable VAT may not be included in determining the cost.

3.2 Costs excluded from the measurement of inventories

The following costs are excluded when measuring inventories and must be **recognized as expense** for the year during which they are incurred:

- abnormal amounts of wasted materials, labour or other production costs (in particular increased costs when working under capacity);
- storage costs, unless these costs are necessary for the production process before a further production stage;
- administrative overheads that do not specifically contribute to bringing inventories to their present location and in marketable condition;
- selling costs.

Example 2: An entity has a standard production capacity of 1,000 units per year. Production overheads amount to 100,000. This means that the share of annual overheads attributable to each unit amounts to 100 (100,000 / 1,000).

In year N+1 due to an international economic crisis, production overheads remained the same at 100,000, but effective production of units amounted to only 500. In this case, when measuring the units, it would not be possible to attribute to their value the share of the under capacity related to the economic crisis. Thus, annual overheads attributable would be limited to 100
(re-evaluation at 200 (100,000 / 500) per unit would not be permitted).

In year N+2 following restructuring of the industrial plant (investment) and an upswing in consumption, effective production was increased to a level of 2,000 units. Overheads remained identical at 100,000. Thus, the annual overheads attributable per unit would be 50 (100,000 / 2,000).

➢ *Applying this method results in excluding the cost of working under capacity from the measurement of inventories and work in progress.*

3.3 The case of inventories of interchangeable items

The Standard generally authorizes the use of only:

- the **FIFO method** (“first in – first out”);
- or the **weighted average unit cost (WAUC) method.**

However, in certain cases, the following techniques may be used instead to measure the costs of inventories:

- the standard cost method (normal level of production, reviewed at least once per year);

or

- the retail price method (used for retail businesses, it enables the measurement of inventories of large numbers of items with fast turnover). The measurement of cost can thus be determined by subtracting the gross margin from the sales price.

The cost of inventories **of items that ordinarily are not interchangeable**, as well as **goods or services allocated to specific projects**, will be calculated by specifically identifying their individual costs.

Example 3: A company compares the value of its inventory using the WAUC Method and FIFO. This would be computed as follows.

Weighted Average Unit Cost (WAUC)					
Date	Description	Quantity	CUR/qnt	Total cost	Weighted Average Cost per unit
01.01	Balance	10	10.000	100.00	10.000
31.03	Purchases	5	12.000	60.00	
	Balance	15		160.00	10.667
15.05	Sales	8	10.667	85.33	
	Balance	7		74.67	10.667
02.06	Purchases	7	15.000	105.00	
	Balance	14		179.67	12.833
25.06	Sales	6	12.833	77.00	
	Balance	8		102.67	12.833

FIFO (PEPS)					
Date	Description	Quantity	CUR/qnt	Total cost	Weighted Average Cost per unit
01.01	Balance	10	10.000	100.00	10.000
31.03	Purchases	5	12.000	60.00	
	Balance	15		160.00	10.667
15.05	Sales	8	10.000	80.00	
	Balance	7		80.00	11.428
02.06	Purchases	7	15.000	105.00	
	Balance	14		185.00	13.214
25.06	Sales	2	10.000	20.00	
25.06	Sales	4	12.000	48.00	
	Balance	8		117.00	14.625

The valuation as of 25 June would be 102.66 (i.e., 12.833 per unit) using the Weighted Average Cost method and 117.00 (i.e., 14.625 per unit) with the FIFO method, resulting in a gap of 14.34 between the two methods authorized to measure inventories.

➢ *If the inventories have been damaged, or if they have become wholly or partially obsolete, or if the estimated cost of completion exceeds the net realizable value, the cost of the inventories must be written down.*

3.4 At the end of the reporting period

At the end of the reporting period, the following items must be recognized as an expense, or reduction in expense, in the income statement:

- Costs of inventories sold;
- Write-downs of inventories to bring down to their net realizable value;
- Reversals of the write-downs of inventories.

4. Disclosure

The financial statements must disclose in particular:

- The accounting policies adopted in measuring inventories, including the cost formula used;
- The total carrying value of inventories and the carrying amount in classifications appropriate to the company's business activity;
- The carrying value of inventories recognized at net realizable value;
- 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 amount of any reversal of any write down of inventories recognized as income during the period;
- 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.