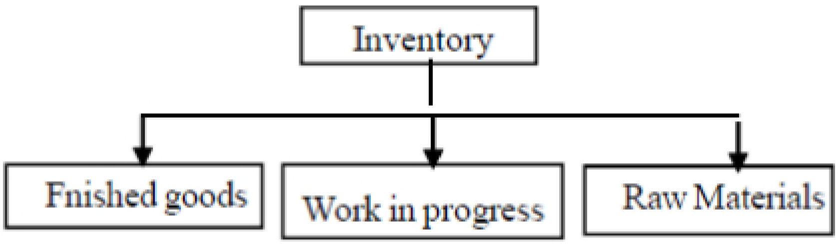
11.4 | Inventory

- **Definition for inventory**
- **Inventory cost**
- **Net Realizable Value**
- **Calculating cost of closing stock (FIFO & WAC)**
- **Value of inventory recognized as an expense**

Definition

- 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 (raw materials)



Inventory cost

- Elements of cost of inventories
    - Cost of purchase
    - Cost of conversion
    - Other costs incurred in bringing the inventory to present location and condition

Net Realizable Value

- Net realizable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated costs necessary to make the sale.

$$\text{Net realisable value} = \text{Estimated selling price} - (\text{Estimated costs of completion} + \text{Estimated costs necessary to make the sale})$$

- As per LKAS 2, inventories shall be measured at the lower of cost and net realizable value

- Methods of deciding the lower of cost or net realizable value:
    - Item by item basis
    - Group basis

Calculating cost of closing stock

- Before calculating the lower of cost or net realizable value of inventories, we should determine the purchase price or relevant product to which the remaining inventory balance represents.

- Cost formulas provide a basis in which we could decide to which purchase/product the remaining inventory is represented.

- The following cost formulas are recommended by the standard:
    - First In First Out (FIFO) method
    - Weighted Average Cost (WAC) method

First In First Out (FIFO) method

- 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.

- However, practically, it is not needed to sell the items in first out first out basis only.

Weighted Average Cost (WAC) method

- Under this method, 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.

- It is calculated as follows:

$$\text{Weighted Average Price} = \frac{\text{Value of inventory at the issuing date}}{\text{Quantity of inventory at the issuing date}}$$

Value of inventory recognized as an expense

There are two situations where inventories are recognized as an expense:

1. Cost of sales: When inventories are sold, the carrying amount of those inventions shall be recognized as an expense in the period in which the related revenue is recognized.

2. Write-downs: The amount of any write-downs of inventories to net realizable value and all losses of inventories shall be recognized as an expense in the period it occurs.