Group Ind AS Accounting Manual

ABC

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# **1.3.** **Inventories**

|  |  |
| --- | --- |
| **Description:** | **Inventories** |
| **Reference:** | **Ind AS 2/ IAS 2** |
| **Purpose:** | **To ensure correct accounting treatment for inventories** |

## **1.3.1. Objective and scope:**

The objective of this accounting manual is to explain the requirements of Ind AS and highlight specific differences between Ind AS and IFRS, wherever applicable. This manual describes determination of cost of inventories and its subsequent recognition as an expense, including any write-down to net realisable value.

## **1.3.2. Definitions:**

“Inventories” are assets -

* + 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 rendering of services.

In addition to above, spare parts and servicing equipment that do not meet the definition of property, plant and equipment as per Ind AS 16 are treated as inventory.

Inventories include –

|  |
| --- |
| * goods purchased and held for resale |
| * finished goods produced |
| * work-in-progress |
| * material and supplies to be used in production |
| * assets for which risks & rewards of ownership have been transferred i.e. goods in transit, assets owned by company and held by others for processing, storage or testing |
| * Semi finished Goods |
| * Stock on Port |
| * Stock in Transit |
| * Consumable |
| * Spares |

## **1.3.3. Recognition and measurement:**

An entity should initially recognize inventory when it has **control** of the inventory, expects it to provide **future economic benefits**, and the **cost** of the inventory can be **measured reliably**. Inventories comprise assets that are:

* Held for sale in the ordinary course of business.
* In the process of production for such sale.
* In the form of materials or supplies to be consumed in the production process or in the rendering of services

Initial measurement of inventories should be at cost.

After initial recognition, inventories should be valued at lower of –

Net realizable value

Cost

or

***Net realizable value*** = Estimated selling price (-) Estimated costs of completion (-) Estimated costs necessary to make the sale

### ***Cost of inventories***

Costs of inventories include and exclude the following –

|  |  |  |
| --- | --- | --- |
| **Type of costs** | **Include** | **Exclude** |
| **Costs of purchase** | Purchase costs, non-recoverable taxes, transport charges, handling charges and other costs | Trade discounts, rebates and similar items |
| **Costs of conversion** | Direct labour costs, fixed and variable overheads (incurred in converting materials to finished goods) |  |
| **Other costs** | Costs incurred to bring inventory to its present location and condition | Abnormal wastage, selling costs, storage costs, administrative overheads that do not contribute to bring inventory to its present location and condition and demurrage charges. |
| **Fixed Overheads** | * Fixed overheads are allocated based on **normal capacity**. * **Normal capacity** = Production under normal circumstances – loss due to planned maintenance * The actual level of production may be used if it approximates normal capacity. | Unallocated overheads are recognized as  Expenses in the period in which they are  Incurred. |

* In case the production process results in more than one product being produced simultaneously (joint products) and the costs cannot be separately identifiable, the costs are allocated on some rational basis. E.g. relative sales value.
* When any by-product emerges, the same should be valued at **NRV and deducted from cost of main product**.
* Scrap is valued at **net realizable value**.

*In case of deviation in any of the above-mentioned policies, the same should be discussed with Corporate Finance Team.*

Ind AS 23, borrowing costs, identifies some circumstances where borrowing costs are included in costs of inventories. Refer Accounting Manual *“Ind AS 23: Borrowing Costs”.*

Where an entity purchases goods on deferred settlement terms, the arrangement might effectively contain a **financing element**.

The financing element (that is, the difference between the purchase price of goods under normal trade terms and the actual price paid) should be accounted for as interest expense over the period of the financing.

### ***Cost Formulae***

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

*As per the ABC Group policy, inventories are measured using the weighted average cost method.*

1. *The calculations for valuation of Finished goods and semi finished goods are done manually as mentioned below:*

|  |  |  |
| --- | --- | --- |
| ***S.no*** | ***Particulars*** | ***Basis of allocation*** |
| *1* | *Material* | *Material includes Raw Material, Packing Material, consumables and others that are directly attributable to that product.*  *Valuation of these is done on basis of BOM and Production Quantity.* |
| *2* | *Power and Fuel Cost* | *This includes cost of Electricity and Steam Cost.*  *These are allocated on basis of units consumed during the production hours based on normal capacity of production.* |
| *3* | *Labour* | *Allocated on basis of man-hours* |
| *4* | *Depreciation* | *Depreciation for the whole year is calculated for those assets that are directly attributable to that product. This is divided by Normal capacity of production to get per unit depreciation expense. The rate so calculated is multiplied by the actual production to get allocated cost of depreciation.* |

1. *For valuation of* ***stock on port****, consignee wise details with respect to the quantity and the product against which stock is lying on port on the reporting date is taken from Export department. This includes stock that is sold on CIF and FOB incoterms basis and not the stock which is sold on ex-factory incoterm basis. On receiving the details, following entries are passed against all those consignees.*

|  |  |  |
| --- | --- | --- |
| *i* | *Sales A/c* | *Dr* |
|  | *Customer A/c* | *Cr* |
|  |  |  |
| *ii* | *Inventory A/c* | *Dr* |
|  | *Cost of Sales A/c* | *Cr* |

1. *For valuation of* ***stock in transit****, consignee wise details with respect to the quantity and the product against which stock is in transit on the reporting date is taken from SCM department. This includes tock that is sold on CIF incoterms basis and not the stock which is sold on ex-factory incoterm basis. On receiving the details, the same set of journal entries as mentioned above are passed against all those consignees.*
2. ***Calculation of Stock Reserve***

*Details are called on from various subsidiaries with respect to the stock lying with them sold by the parent company to them as on the date of valuation. The subsidiaries consider the stock for the purpose of stock reserve on FIFO basis.*

*Once details are received, calculation is done manually considering the cost of goods sold and then the following entry is passed*

|  |  |
| --- | --- |
| *Cost of Sales A/c* | *Dr* |
| *Inventory A/c* | *Cr* |

*In case of deviation in any of the above-mentioned policy, the same should be discussed with Corporate Finance Team*

### ***Net realizable value***

Net realizable value refers to the net amount that is expected to be realized from the sale of inventory in the ordinary course of business.

Inventories are usually written down to net realizable value *item by item.*

Materials and other supplies used in production are not written down to NRV if -

The finished good in which it is incorporated is to be sold at or above cost.

However, when cost of FG > NRV, then material is to be valued at NRV (generally, at replacement cost which pertains to cost of replacing the material).

The assessment for NRV is to be made for each period and if there is an indication of increase in NRV, then write down is to be reversed.

Any write down to NRV shall be recognized as an expense in the period in which it occurs.

At every reporting period end, obsolete, non-moving and slow-moving inventory shall be assessed for any provision.

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N

N

N

Y

Y

Y

### ***Recognition as an expense***

### **Journal Entries:-**

|  |  |
| --- | --- |
| **Particulars** | **Journal Entries** |
| Raw Materials | |  |  | | --- | --- | | Raw Materials | (Dr) | | Bank/ Vendor | (Cr) | | *(Consideration paid for purchase)* | | |
| Work in Progress | |  |  | | --- | --- | | Conversion costs | (Dr) | | Bank/Vendor | (Cr) | | *(Consideration paid for* conversion costs*)* | |  |  |  | | --- | --- | | Work in progress | (Dr) | | Raw materials | (Cr) | | Conversion costs | (Cr) | |
| Finished Goods | |  |  | | --- | --- | | Conversion costs | (Dr) | | Bank/Vendor | (Cr) | | *(Consideration paid for* conversion costs*)* | |  |  |  | | --- | --- | | Finished Goods | (Dr) | | Work in progress | (Cr) | | Conversion costs | (Cr) | |
| At the time of sale | |  |  | | --- | --- | | Cost of goods sold | (Dr) | | Finished goods | (Cr) | |

## **1.3.4. Disclosure:**

The financial statements shall disclose:

* + the accounting policies adopted in measuring inventories, including the cost formula used;
  + the total carrying amount of inventories and the carrying amount in classifications;
  + the carrying amount of inventories carried at fair value less costs to sell;
  + the amount of inventories recognised as an expense during the period;
  + the amount of any write-down of inventories recognised as an expense in the period;
  + 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;
  + 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.

## **1.3.5. GAAP differences between Ind AS and IFRS:**

There are no GAAP difference in inventories.

|  |  |
| --- | --- |
| **Approval authority** |  |
| **Version Date** |  |
| **Revision due on** |  |