# INVENTORIES [AS-2]

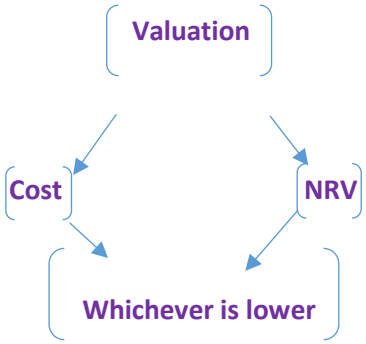
## [4-8 Marks]

### Concept 1: Meaning of Inventories


| Held for Sale | Held in process of production | Held for consumption in production |
|---|---|---|
| Finished Goods | Work –in- progress (WIP) | Raw Material & Supplies |
| (100% complete) | (0% ↑-100% ↓) | (0%) |

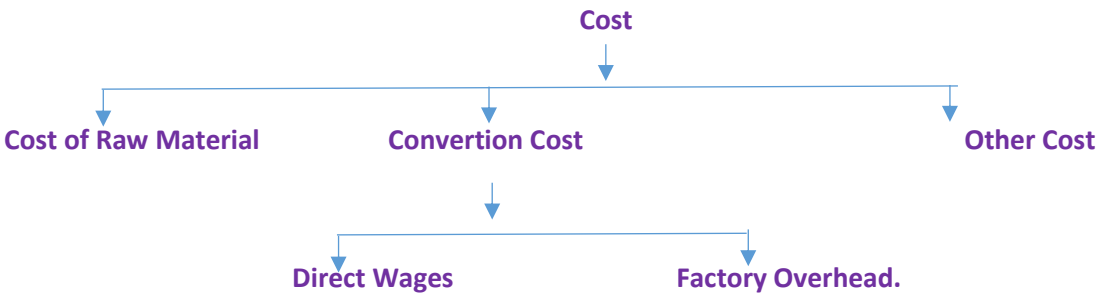
| Business Entity | |
|---|---|
| **Manufacturing Entity** | **Trading entity** |
| -Raw Materials | - Finished Goods (Trading items) |
| -WIP | |
| - Finished Goods | |

### Concept 2: Valuation Rule




- ***This is due to conservatism/prudence Concept.***

### Concept 3: Explanation of Cost of Inventory



**Point 1: Cost of Raw Material**

| | |
|---|---|
| Purchase price | XX |
| (-) Trade Discount | (XX) |
| Net Purchase price | XX |
| (+)Non- Refundable Taxes & Duties | XX |
| (+)Freight Inward/Transportation | XX |
| (+) Loading /unloading charges | XX |
| (+)Transit Insurance | XX |
| (+) All other expenses which are required For acquisition of Raw Material | XX |
| Cost of Raw Material | XX |

**Point 2: Conversion Cost**

These are the Cost incurred on Raw Material to convert it into Finished Goods.

*i) Direct Wages:* There are the wages paid to Factory workers for producing goods.

*ii) Factory Overhead:* other expenses incurred in Factory eg. Factory Rent, Factory Electricity, etc.

**Point 3: Other Cost:**

These are the cost incurred to bring the goods to its present condition and location of sale.

For eg. Cost incurred in designing for specific customer.

**Concept 4: What is excluded from the cost of inventories**

i) Abnormal Loss

ii) Storage Cost

iii)Administrative overhead

iv) Selling & Distribution overhead.

**Concept 5: Net Realisable value (NRV)**

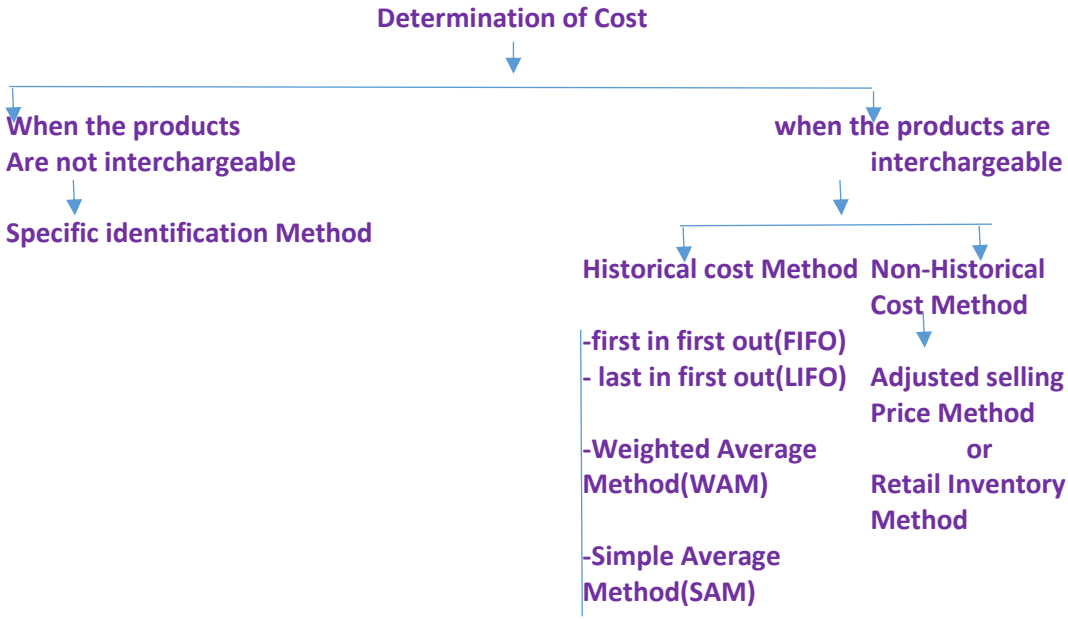
| | |
|---|---|
| Estimated Sale value | XX |
| (-) Estimated cost to sale the product | XX |
| (-) Estimated Cost of completion | XX |
| *NRV* | **XX** |

**Concept 6: Effect of under valuation /overvaluation of Stock**

| **Stock** | **Profit of current year** |
|---|---|
| Closing Stock↑ | Profit↑ |
| Closing Stock↓ | Profit↓ |
| Opening Stock↑ | Profit↓ |
| Opening Stock↓ | Profit↑ |

| Items | Profit of Current Year | Profit of Next year |
|---|---|---|
| Cl. stock↑ | ↑ | ↓ |
| Cl. Stock↓ | ↓ | ↑ |
| Op. stock ↑ | ↓ | NO EFFECT |
| Op. stock ↓ | ↑ | NO EFFECT |

## Concept 7: Methods to Determine Cost of Stock.




* According to AS-2 only FIFO & WAM is allowed.

## Concept 8: FIFO

1. It is based on the assumption that the goods which are received first are issued first. This assumption is made for the purpose of assigning costs and not for the purpose of the physical flow of goods. The physical flow of goods therefore, need not necessarily coincide with the pattern of cost flow assumption.
2. It uses the price of the first lot received for all the issues until all units from this lot have been issued after which the price of next lot received is used for pricing and so on.
3. Cost of Material issued represents the cost of earlier purchases.
4. Cost of Closing Stock represents the cost of latest purchases.

***Self-Note:-***

I. New Receipt will be placed at the Bottom in the Balance column.
II. Under FIFO method issue will be made from Top to Bottom.

## Concept 9: LIFO

1. It is based on the assumption that the goods which are received last are issued first. This assumption is made for the purpose of assigning costs and not for the purpose of the physical flow of goods. The physical flow of goods therefore, need not necessarily coincide with the pattern of cost flow assumption.
2. It uses the price of the last lot received for all the issues until all units from this lot have been issued after which the price of previous lot received is used for pricing and so on. In case a new

lot is received, new lot becomes the last lot and its price is used for pricing the issues in the manner explained above.

3. Cost of Material issued represents the cost of latest purchases.
4. Cost of Closing Stock represents the cost of earlier purchases.

**Self-Note: -**

I. New Receipt will be placed at the Bottom in the Balance column.
II. Under LIFO method issue is done from Bottom to Top.

## Concept 10: Weighted Avg method.(WAM)

1. It is based on the assumption that each issue of goods consists of a due proportion of the earlier lots.
2. I uses a weighted average price for pricing the issue of materials until a new lot is purchased when a new weighted average price will be calculated
3. Weighted Average Price is calculated as follows:

$$Weighted\ Average\ Price = \frac{Total\ Cost\ of\ Materials\ in\ Stock}{Total\ Quantity\ of\ Material\ in\ Stock}$$

4. It is useful when the quantity of material in each lot purchased is not uniform

***Self Note: -***

I. New Receipt will be placed at the Bottom in the Balance column.
II. Under WAM issue will be made at last weighted Avg. Rate.

## Concept 11: Simple Average Rate (SAM)

| | | | Units | Amt. | Rate |
|---|---|---|---|---|---|
| (eg) | 1.1.2022 | op. Balance | 100 | 5000 | 50 |
| | 2.1.2022 | Purchase | 900 | 54000 | 60 |
| | 31.1.2022 | Issue | 600 | - | |

Cl.stock as on 31.1.2022=?

| Soln | | Units |
|---|---|---|
| | op.stock | 100 |
| | (+) Purchase | 900 |
| | | 1000 |
| | (-) Issue | 600 |
| | Unsold | 400 |

Simple Avg. Rate= $\frac{50+60}{2}$

= ₹ 55

∴ value of Cl. Stock =400 x ₹ 55 = ₹ 22000.

## Concept 12: Adjusted Selling price method

1. According to Accounting Standard 2, 'this method may be used in retail businesses or in business where the inventory comprises items the individual costs of which are not readily ascertainable'.
2. The cost of the inventory is determined by reducing the estimated percentage of gross margin from the sales value of the inventory.
3. The calculation of the estimated gross margin of profit may be made for individual items or groups of items or by departments, as may be appropriate to the circumstances. This method is also used by some manufacturing organisations for valuing the inventory of finished products held against forward sale contract.

**Manufacturing Expenses- Direct Expenses – Trading A/c**
**Office & Administration Expenses- Indirect Expenses → PL A/c**
**Selling & Distribution Expenses- Indirect Expenses → PL A/c**
**Finance Cost → Indirect Expenses → PL A/c**

**Normal Goods:** Those Goods which follow normal GP Rule are known as normal Goods.
**Abnormal Goods:** Those Goods which do not follow Normal GP Rule are known as Abnormal Goods.

## Concept 13: Inventory System [Read theory from Book]

There are two inventory systems, viz.
1. Perpetual Inventory system
2. Periodic Inventory system.

### MEANING OF PERIODIC INVENTORY SYSTEM

Periodic Inventory System is a method of ascertaining inventory by taking an actual physical count (or measurement or weight) of all the inventory items on hand at a particular date on which information about inventory is required. The cost of goods is calculated as a residual figure (which includes lost goods also) as under:

**Cost of Goods Sold = Opening Inventory + Purchases – Closing Inventory**

### MEANING OF PERPETUAL INVENTORY SYSTEM

Perpetual Inventory System is a method of recording inventory balances after each receipt and issue in order to ensure accuracy of perpetual inventory records, physical stocks should be checked and compared with recorded balances. The discrepancies, if any, should be investigated and adjusted in the accounts properly. The closing inventory is calculated as a residual figure (which includes lost goods also) as under:

**Closing Inventory = opening Inventory + Purchases – Cost of Goods Sold**

## DISTINCTION BETWEEN PERIODIC INVENTORY SYSTEM AND PERPETUAL INVENTORY SYSTEM

Periodic Inventory System differs from Perpetual Inventory System in the following respects:

| Basis of Distinction | Periodic Inventory System | Perpetual Inventory System |
|---|---|---|
| 1. Basis of Ascertaining Inventory | Inventory is ascertained by taking an actual physical count | Inventory is ascertained on the basis of records |
| 2. Calculation of Inventory | Inventory is directly calculated by applying the method of valuation of inventories | Inventory is calculated as a residual figure as under: Closing Inventory = Opening Inventory + Purchases -Cost of Goods Sold |
| 3. Calculation of Cost of Goods Sold | Cost of Goods Sold is calculated as a residual figure as under: Cost of Goods Sold = Opening Inventory + Purchases - Closing Inventory | Cost of Goods Sold is directly calculated by applying the method of valuation of inventories. Cost of Goods Sold = Opening Inventory + Purchases – Closing Inventory |
| 4. Lost Goods (if any) | Cost of Goods Sold incudes | Inventory includes lost goods |
| 5. Closing Down of work for Stock taking | It requires closing down of work for stock taking | It does not require closing down of work for stock taking |
| 6. Continuous Stock checking | It does not facilitate the checking | It facilitates the continuous stock checking |
| 7. Simplicity and Cost | It is simple and unexpensive | It is elaborate and expensive |

## Concept 14: Stock Reconciliation

### If Stock verification is done after B/S date (say7.4)

| | |
|---|---|
| Physical Stock as on 7.4 | XX |
| (-) Goods Received between 1.4 to 7.4 | XX |
| (+) Goods Despatched between 1.4 to 7.4 | XX |
| *Physical Stock as on 31.3* | *XX* |

### If Stock verification is done before B/S date (Say 23.3)

| | |
|---|---|
| Physical Stock as on 23.3 | XX |
| (+) Goods Received between 24.3 to 31.3 | XX |
| (-) Goods Despatched between 24.3 to 31.3 | XX |
| *Physical Stock as on 31.3* | XX |

**Note:** For Finding ***Book value /Balance sheet value of Stock*** we should include Goods owned by us , but not physically with us and Exclude those stock which physically with us but not owned by us.