



✓ 1. **MEANING AND DEFINITION**

Inventories are assets :

1. Held for sale in the ordinary course of business (finished goods).
2. In the process of production of such sale (raw material and work-in-progress).
3. In the form of materials or supplies to be consumed in production process or in the rendering of services (stores, spares, raw material, consumables). Inventories do not include machinery.

**Q. 1. What is Inventory? / Write short note on Inventory.**

### 3.1.1 Cost of Purchase

Cost of purchase includes :

1. Purchase Price.
2. Duties and Taxes.
3. Freight Inward.
4. Other expenditures directly attributable to the acquisition.

**Less :**

- i) Duties and taxes recoverable by enterprise from taxing authorities.
- ii) Trade Discount.
- iii) Duty Drawback.
- iv) Other similar items.

**Q. 8. How is cost of Purchase Calculated? / Write Note on : Cost of Purchase.**

### 3.1.5 Exclusion from Cost of Inventories

The following costs should be excluded from the cost of Inventories :

1. Abnormal amounts of wasted materials, labour, other production costs.
2. Storage cost.
3. Administrative overhead.
4. Selling and distribution cost.
5. Interest and borrowing cost. However, if AS-16 allows such cost to be included, it can form part of the cost.

**Q. 13. Which costs are excluded from Inventory Valuation?**

**5. SIMPLE ILLUSTRATIONS (SHORT PROBLEMS)****Illustration : 1 (Duties and taxes not recoverable)**

Ascertain the cost of purchase of inventory by using the data given below :

i) Purchase Price	₹ 10 lakhs
ii) Duties and Taxes paid on the acquisition and are not recoverable	₹ 2 lakhs
iii) Freight Inward	₹ 1 lakhs
iv) Others paid for acquisition of inventory	₹ 1 lakhs

**Solution****Cost of Purchase**

	₹ in lakhs
Cost of Purchase	10
Duties & Taxes not recoverable	02
Freight Inward	01
Other Expenses	01
Total	<u>14</u>

**TRY YOURSELF – 1**

How do you ascertain the cost of purchase of inventory by using the following data :

i) Purchase Price	₹ 5,00,000
ii) Duties and Taxes paid on the Acquisition of Inventory and are not recoverable	₹ 2,00,000
iii) Freight Inward	₹ 1,00,000
iv) Other Expenses for Acquisition of Materials	₹ 2,00,000

[Ans. ₹ 10,00,000]

**Illustration : 2 (Duties and taxes recoverable and not recoverable given)**

Ascertain the cost of purchase of inventories by using the data given below :

i) Cost of Purchase of Inventory	₹ 20 lakhs
ii) Duties & Taxes paid and are recoverable from Tax Authorities	₹ 5 lakhs
iii) Trade Discount	₹ 2 lakhs
iv) Duties & Taxes paid and not recoverable	₹ 2 lakhs
v) Freight Inwards	₹ 1 lakhs
vi) Other Expenses directly attributable to Acquisition of Inventory	₹ 2 lakhs

**Solution****Calculation of Cost of Purchase**

	₹ in lakhs
Cost of Purchase	20
Duties & Taxes paid and not recoverable	02
Freight Inward	01
Other Expenses	02
	<u>25</u>
Less : Duties & Taxes recoverable from Tax Authorities	05
Trade Discount	02
Total	<u>07</u> <u>18</u>

**TRY YOURSELF – 2**

Ascertain the cost of purchase by using the following data :

i) Cost of Purchase of inventory	₹ 5.50 lakhs
ii) Duties & Taxes paid and recoverable from Tax Authorities	₹ 0.50 lakhs
iii) Trade Discount	₹ 0.50 lakhs
iv) Duties & Taxes paid and not recoverable	₹ 1.00 lakhs
v) Freight Inward	₹ 2.00 lakhs

[Ans. ₹ 7.5 lakhs]

**Illustration : 3 (Fixed production overheads including interest is given)**

Satyam Ltd. manufactures computers. During the year ended 31st March, 2022; the company manufactured 500 computers. The break up of cost is as under :

Raw Material	₹ 450 lakhs
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Direct Labour	₹ 300 lakhs
Variable Production Overheads	₹ 200 lakhs
Fixed Production Overheads (includes interest of ₹ 100 lakhs)	₹ 300 lakhs

Compute the cost per computer for the purpose of closing stock.

### Solution

As per AS-2 Inventory should be valued as per absorption costing.

The cost is calculated as under :

#### Calculation of Cost of Purchase

	₹ in lakhs
Raw Material	450
Direct Labour	300
Variable Production Overheads	200
Fixed Production Overheads	300
Less Interest	<u>100</u>
	<u>1,150</u>

$$\text{Cost per Computer} = \frac{1,150}{500} = 2.3 \text{ lakhs.}$$

**Note :** Interest is excluded from cost of inventory.

### TRY YOURSELF - 3

X Ltd. produces Chemical Y. From the following data, calculate the value of Closing Stock.

Direct Materials	: ₹ 10 per unit
Direct Labour	: ₹ 4 per unit
Chargeable Expenses	: ₹ 6 per unit
Normal Capacity	: 10,000 units p.a.
Actual Production	: 8,000 units p.a.
Fixed Production Overheads	: ₹ 40,000 p.a.

The company has 4,000 units of closing stock at the end of the year.

[Ans. ₹ 96,000]

### Illustration : 4 (Fixed production overheads and normal capacity given)

From the following information, find the value of inventory per kg of finished goods :

Material Cost	₹ 150 per kg
Direct Labour Cost	₹ 50 per kg
Direct Variable Production Overheads	₹ 20 per kg

Fixed production overheads for the year on normal capacity of 1,00,000 kgs is ₹ 15 lakhs.

Finished goods on stock at the end of the year 3,000 kgs.

### Solution

As per AS-2 cost of conversion includes a systematic allocation of fixed and variable production overheads, which are incurred for converting materials into finished goods. The allocation of fixed production overheads is based on normal capacity.

#### Statement of Cost (Per Kg)

	₹
Material Cost	150
Direct Labour	50
Direct Variable Production Overheads	20
Fixed Production Overheads $\left(\frac{15,00,000}{1,00,000}\right)$	<u>15</u>
	<u>235</u>

$$\begin{aligned} \text{Value of Stock} &= 3,000 \text{ kgs @ ₹ 235} \\ &= ₹ 7,05,000 \end{aligned}$$

### TRY YOURSELF - 4

- a) Instant Ltd. incurred ₹ 40,00,000 as fixed production overheads per year. Its normal production is 2,00,000 units in a year.

In 2021–22, the production has been 80,000 units. On 31st March, 2022, the closing stock was 20,000 units. The cost details are as under :

Direct Materials	₹ 1,000 per unit
Direct Labour	₹ 500 per unit
Fixed Administration Overheads	₹ 20,00,000 p.a.

Calculate the value of Closing Stock.

[Ans. ₹ 304,00,000 per unit ₹ 1,520]

b) Indulkar Ltd. produced 1,00,000 units during the year 2021–22.

The cost per unit is as follows :

Direct Materials	₹ 100
Direct Labour	₹ 50
Direct Expenses	₹ 10
	<u>₹ 160</u>

Production overheads are ₹ 2,00,000 of which 60% is variable. The company sold 80,000 units and 20,000 units were in stock as on 31st March, 2022. Normal capacity is 50,000 units.

Calculate the value of Closing Stock.

[Ans. Variable Production Overheads	₹ 1,20,000
Fixed Production Overheads	₹ 80,000
Variable Production Overheads per unit	<u>₹ 1,20,000</u>
	₹ 1,00,000 = 1.20
Fixed Production Overheads	<u>₹ 80,000</u> = 1.60
Per unit	<u>₹ 50,000</u>
Cost per unit	₹ 162.80
Value of Stock =	20,000 × 162.80
	= ₹ 32,56,000]

### Illustration : 5 (Replacement cost given)

Raw material was purchased at ₹ 200 per kg. It is on decline. The finished goods in which raw material is incorporated are expected to be sold at below cost. 5,000 kgs of raw material is in stock at the end of the year. Replacement cost is ₹ 180 per kg.

How would you decide the value of inventory?

### Solution

In this case, it is mentioned that the price of material is declining. As a result finished goods are expected to be sold below cost. In such a case, replacement cost of material is the measure of valuation.

Hence, the stock will be valued at = 5000 kgs @ ₹ 180  
= ₹ 9,00,000

### TRY YOURSELF – 5

Cost of Production of Product × 100 is given below :

Direct Material per unit	₹ 150
Direct Wages per unit	₹ 100
Overheads per unit	₹ 50
	<u>₹ 300</u>

As on the balance sheet date replacement cost of material is ₹ 120 per unit. There were 2,000 units of material on 31st March, 2022.

Calculate the value of stock of material under the following conditions :

- If finished product is sold at ₹ 320 per unit, what will be the value of stock of material.
- If finished product is sold at the rate of ₹ 280 per unit, what will be the value of closing stock of materials.

[Ans. (i) ₹ 3,00,000. (ii) ₹ 2,40,000]

**Illustration : 6 (Historical cost and replacement value given)**

The company deals in three products A, B and C, which are neither similar nor interchangeable. At the time of closing of its accounts for the year 2021-22; the historical cost and net realisable values of the items of closing stock are given below :

Items	Historical Cost (₹ in lakhs)	Net Realisable Value (₹ in lakhs)
A	25	20
B	20	20
C	10	15
	<u>55</u>	<u>55</u>

What will be the value of stock?

**Solution**

Historical Cost or Net Realisable Value whichever is less is the value of stock. This should be done item by item as given below :

	₹ in lakhs
A. Net Realisable Value	20
B. Historical Cost	20
C. Historical Cost	10
Value of Closing Stock	<u>50</u>

**TRY YOURSELF - 6**

Historical Cost and Net Realisable Value of five inventory items are given below :

Items	Historical Cost ₹	Net Realisable Value ₹
A	20,000	30,000
B	12,000	10,000
C	12,000	18,000
D	32,000	26,000
E	28,000	26,000
	<u>1,04,000</u>	<u>1,10,000</u>

Determine the value of inventory.

[Ans. ₹ 94,000]

**Illustration : 7**

Bujrang Trading purchases cars from different countries and exports them to U.S.A. It has incurred the following expenses during 2021.

- Purchase price
- Trade discount on purchases
- Import duty
- Freight
- Insurance
- Handling charges relating to imports
- Staff salaries
- Commission to agents for imports
- Sales commission
- After sales services cost

Which costs are to be considered as per AS-2 in determination of cost of inventory?

**Solution**

Item a, b, c, d, e, f, h are considered in determination of cost of inventory.

**Specimen Policies****Illustration : 8****Corporate Inventory Accounting Policies****Asian Paints (India) Ltd. 2002–03****5. Inventory**

- a) Inventories are valued at the lower of cost and net realisable value. Damaged, unserviceable and inert stocks are suitably depreciated.
- b) In case of raw materials, packing materials, stores, spares, consumables and dealer tinting systems, the cost includes duties and taxes (net of CENVAT wherever applicable) and is arrived at on weighted average cost basis.
- c) Finished goods cost includes the cost of raw materials, packing materials, an appropriate share of fixed and variable production overheads on the basis of standard cost method and excise duty as applicable on the finished goods. Finished goods, which are bought and sold, are valued at cost.
- d) Work-in-process is valued on the same basis as finished goods except that the conversion cost for paint processing and resin processing is absorbed at 50% of the expenses incurred in the respective processes.

**Illustration : 9****Bharat Aluminium Co. Ltd. 2002–03****f) Inventories**

Inventories are valued at lower of cost or net realisable value except for scrap and by-products, which are valued at net realisable value. Cost is determined on weighted average and comprises of expenditure incurred in the normal course of business in bringing such inventories to its location, excluding CENVAT Credit and includes, where applicable, appropriate overheads based on normal level of activity. Obsolete, slow moving and defective inventories are identified at the time of physical verification & where necessary provision is made for such inventories.

**Illustration : 10****Bharat Brakes & Valves Ltd. 2002–03****6. Inventory**

- i) Raw materials, Stores and Spares and Loose Tools are valued at weighted average cost.
- ii) Finished Goods are valued at actual raw materials cost plus estimated cost of labour and overhead or selling price whichever is less. Sales-in-transit are valued at selling price.
- iii) Work-in-Progress including Finished Components are valued at actual material cost plus estimated cost of labour and works overhead.  
Materials issued to sub-contractors for further processing are shown as "Material lying with sub-contractor".
- iv) Free supply items, received from the customers are not considered in Financial Accounts.
- v) Liability for excise duty on finished goods manufactured by the company is provided as and when the goods are cleared.