



IAS 2 INVENTORIES

FACT SHEET

This fact sheet is based on existing requirements as at 31 December 2015 and it does not take into account recent standards and interpretations that have been issued but are not yet effective.

IMPORTANT NOTE

This fact sheet is based on the requirements of the International Financial Reporting Standards (IFRSs). In some jurisdictions, the IFRSs are adopted in their entirety; in other jurisdictions the individual IFRSs are amended. In some jurisdictions the requirements of a particular IFRS may not have been adopted. Consequently, users of the fact sheet in various jurisdictions should ascertain for themselves the relevance of the fact sheet to their particular jurisdiction. The application date included below is the effective date of the initial version of the standard unless otherwise stated.

IASB APPLICATION DATE (NON-JURISDICTION SPECIFIC)

IAS 2 was reissued in December 2003 and is applicable for annual reporting periods commencing on or after 1 January 2005.

OBJECTIVE

IAS 2 prescribes the accounting treatment for inventories.

The standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value.

IAS 2 also provides guidance on cost formulas that are used to assign costs to inventories.

SCOPE

IAS 2 applies to all inventories, except:

- a. work in progress arising under construction contracts, including directly related service contracts – refer IAS 11 *Construction Contracts*;
- b. financial instruments – refer IAS 32 *Financial Instruments: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*; and
- c. biological assets related to agricultural activities and agricultural produce at the point of harvest – refer IAS 41 *Agriculture*.

RECOGNITION AND MEASUREMENT

IAS 2 requires inventories to be measured at the lower of cost and net realisable value.

Cost of inventory

The cost of inventories is the aggregation of:

- costs of purchase (e.g. purchase price, import duties, transportation and handling costs) net of trade discounts and rebates;
- costs of conversion into finished products (e.g. labour and production overhead costs); and
- other costs incurred in bringing the inventories to their present location and condition, excluding the cost of abnormal wastage, storage, administration and selling.

The cost of inventories may be approximated using the standard cost method (cost of inventories estimated based on normal operating activity) or the retail inventory method (cost of inventories estimated based on reducing the sales value by the appropriate percentage gross margin).

The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.

The assignment of the cost of inventories to inventory items is to be done by using either the first-in first-out (FIFO) or weighted average cost formula. The FIFO formula assumes inventory items on hand at the end of the period are assigned the cost of those items most recently purchased or produced. Under the weighted average cost formula, inventory items on hand at the end of the period are assigned the weighted average of the cost of those items on hand at the beginning of the period and those produced or purchased during the period.

Net realisable value

Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items.

Estimates of net realisable value are based on the most reliable evidence at the time the estimates are made, of the amount the inventories are expected to realise. These estimates also take into consideration the purpose for which the inventory is held.

Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost.

A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed so that the new carrying amount is the lower of the cost and the revised net realisable value.

Expense recognition

Upon the sale of inventories, the carrying amount of those inventories is to be recognised as an expense in the period in which the related revenue is recognised.

The amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in which the reversal occurs.

DISCLOSURES

Refer to Appendix 1 for a checklist to assist with IAS 2 disclosure requirements.

DEFINITIONS

Inventories	Assets: <ul style="list-style-type: none">• 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 the rendering of services.
Net realisable value	The estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

RELATED INTERPRETATIONS

- IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine*

IFRIC 20 clarifies that the costs of removing mine waste materials (overburden) to gain access to mineral ore deposits during the production phase of a surface mine must be capitalised as inventories under IAS 2 Inventories if the benefits from stripping activity is realised in the form of inventory produced. On the other hand, if stripping activity provides improved access to the ore, stripping costs must be capitalised as a non-current, stripping activity asset if certain recognition criteria are met (as an addition to, or enhancement of, an existing asset).

AUSTRALIAN SPECIFIC REQUIREMENTS

The Australian equivalent standard is AASB 102 *Inventories* and is applicable for annual reporting periods commencing on or after 1 January 2005. The Australian equivalent interpretation is Interpretation 20 *Stripping Costs in the Production Phase of a Surface Mine*.

Additional scope exemption – In respect of not-for-profit entities, AASB 102 does not apply to work in progress of services to be provided for no or nominal consideration directly in return from the recipients.

ADDITIONAL DEFINITIONS

Not-for-profit entity	Entity whose principle objective is not the generation of profit. A not-for-profit entity can be a single entity or a group of entities comprising the parent entity and each of the entities that it controls.
Current replacement cost	In respect of not-for-profit entities, the cost the entity would incur to acquire the asset at the end of the reporting period.
Inventories held for distribution	In respect of not-for-profit entities, assets: <ul style="list-style-type: none"> a. held for distribution at no or nominal consideration in the ordinary course of operations; b. in the process of production for distribution at no or nominal consideration in the ordinary course of operations; or c. in the form of materials or supplies to be consumed in the production process or in the rendering of services at no or nominal consideration.

Measurement of inventory held for distribution

Not-for-profit entities shall measure inventories held for distribution at cost, adjusted when applicable for any loss of service potential.

Costs of Inventories

With respect to not-for-profit entities, where the inventories are acquired at no cost or nominal consideration, the cost shall be the current replacement cost as at the date of acquisition.

Recognition as an expense

When inventories held for distribution by a not-for-profit entity are distributed, the carrying amount of those inventories shall be recognised as an expense. The amount of any write-down of inventories for loss of service potential and all losses of inventories shall be recognised as an expense in the period in which the write-down or loss occurs. The amount of any reversal of any write-down of inventories arising from a reversal of the circumstances that gave rise to the loss of service potential shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

REDUCED DISCLOSURE REQUIREMENTS (RDR)

On 30 June 2010, the Australian Accounting Standards Board published AASB 1053 *Application of Tiers of Australian Accounting Standards (and AASB 2010-2 Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements)* which established a differential reporting framework, consisting of two Tiers of reporting requirements for preparing general purpose financial statements:

- a. Tier 1: Australian Accounting Standards; and
- b. Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

A Tier 2 entity is a 'reporting entity' as defined in SAC 1 *Definition of the Reporting Entity* that does not have 'public accountability' as defined in AASB 1053 and is not otherwise deemed to be a Tier 1 entity by AASB 1053.

RDR is applicable to annual periods beginning on or after 1 July 2013.

When developing AASB 1053, the AASB concluded that the Australian Government and state, territory and local governments should be subject to Tier 1 requirements. The AASB also decided that General Government Sectors of the Australian Government and state and territory governments should continue to apply AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, without the reduction in disclosures provided by Tier 2. Other public sector entities are able to apply Tier 2 reporting requirements.

The requirements that do not apply to RDR entities are identified in Appendix 1 by shading of the relevant text.

APPENDIX 1 – DISCLOSURE CHECKLIST

This checklist can be used to review your financial statements. You should complete the “Yes / No / N/A” column about whether the requirement is included. To ensure the completeness of disclosures, provide an explanation for “No” answers.

CODE		YES / NO / N/A	EXPLANATION (If required)
IAS 2.36	<p>Has the entity disclosed the following transactions if they occurred during the period:</p> <ul style="list-style-type: none"> a. the accounting policies adopted in measuring inventories, including the cost formula used; b. the total carrying amount of inventories and in classifications appropriate to the entity; c. the carrying amount of inventories carried at fair value less costs to sell; d. the amount of inventory recognised as expense during the period; e. the amount of any write-down of inventories recognised as an expense in the period; f. 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; g. the circumstances or events that led to the reversal of a write-down of inventories; and h. the carrying amount of inventories pledged as security for liabilities? 		

ADDITIONAL AUSTRALIAN DISCLOSURE REQUIREMENTS APPLICABLE TO NOT-FOR-PROFIT ENTITIES ONLY

CODE		YES / NO / N/A	EXPLANATION (If required)
AASB 2.Aus36.1	<p>Have the financial statements disclosed:</p> <ul style="list-style-type: none"> a. the accounting policies adopted in measuring inventories held for distribution, including the cost formula used; b. the total carrying amount of inventories held for distribution and the carrying amount in classification appropriate to the entity; c. the amount of inventories held for distribution recognised as an expense during the period; d. the amount of any write-down of inventories held for distribution recognised as an expense in the period; e. the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories held for distribution recognised as an expense in the period; f. the circumstances or events that led to the reversal of a write-down of inventories held for distribution; g. the carrying amount of inventories held for distribution pledged as security for liabilities; and h. the basis on which any loss of service potential of inventories held for distribution is assessed, or the bases when more than one basis is used? 		

OTHER MATTERS

LEGAL NOTICE

© CPA Australia Ltd (ABN 64 008 392 452), 2011. All rights reserved. Save and except for direct quotes from the Australian Accounting Standards Board (AASB) and accompanying documents issued by the Australian Accounting Standards Board (AASB) ("AASB Copyright"), all content in these materials is owned by or licensed to CPA Australia. The use of AASB Copyright in these materials is in accordance with the AASB's Terms and Conditions. All trademarks and trade names are proprietary to CPA Australia and must not be downloaded, reproduced or otherwise used without the express consent of CPA Australia. You may access and display these pages on your computer, monitor or other video display device and make one printed copy of any whole page or pages for personal and professional non-commercial purposes only. You must not: (i) reproduce the whole or part of these materials to provide to anyone else; or (ii) use these materials to create a commercial product or to distribute them for commercial gain.

AASB Standards may contain IFRS Foundation copyright material ("IFRS Copyright"). Enquiries concerning reproduction of IFRS Copyright material within Australia should be addressed to The Director of Finance and Administration, AASB, PO Box 204, Collins Street West, Victoria 8007. All existing rights in this material are reserved outside Australia. Requests to reproduce IFRS Copyright outside Australia should be addressed to the IFRS Foundation at www.ifrs.org.

© CPA Australia Ltd (ABN 64 008 392 452), 2010. All rights reserved. Save and except for direct quotes from the International Financial Reporting Standards (IFRS) and accompanying documents issued by the International Accounting Standards Board (IASB) ("IFRS Copyright"), all content in these materials is owned by or licensed to CPA Australia. The use of IFRS Copyright in these materials is in accordance with the IASB's Terms and Conditions. All trademarks and trade names are proprietary to CPA Australia and must not be downloaded, reproduced or otherwise used without the express consent of CPA Australia. You may access and display these pages on your computer, monitor or other video display device and make one printed copy of any whole page or pages for personal and professional non-commercial purposes only. You must not: (i) reproduce the whole or part of these materials to provide to anyone else; or (ii) use these materials to create a commercial product or to distribute them for commercial gain. Requests to reproduce IFRS Copyright should be addressed to the IFRS Foundation at www.ifrs.org.

DISCLAIMER

CPA Australia Ltd has used reasonable care and skill in compiling the content of these materials. However, CPA Australia Ltd makes no warranty that the materials are complete, accurate and up to date. These materials do not constitute the provision of professional advice whether legal or otherwise. Users should seek their own independent advice prior to relying on or entering into any commitment based on the materials. The materials are purely published for reference purposes alone and individuals should read the latest and complete standards.

LIMITATION OF LIABILITY

CPA Australia, its employees, agents and consultants exclude completely all liability to any person for loss or damage of any kind including but not limited to legal costs, indirect, special or consequential loss or damage (however caused, including by negligence) arising from or relating in any way to the materials and/or any use of the materials. Where any law prohibits the exclusion of such liability, then to the maximum extent permitted by law, CPA Australia's liability for breach of the warranty will, at CPA Australia's option, be limited to the supply of the materials again, or the payment of the cost of having them supplied again.