Objective of IAS 2

The objective of IAS 2 is to prescribe the accounting treatment for inventories. It provides guidance for determining the cost of inventories and for subsequently recognising an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope

IAS 2 excludes certain inventories from its scope:

- work in process arising under construction contracts
- financial instruments
- biological assets related to agricultural activity
- producers of agricultural and forest products, agricultural produce after harvest, and
- minerals and mineral products,

Measurement of Inventories

Cost should include all:

- costs of purchase (including taxes, transport, and handling) net of trade discounts received
- costs of conversion (including fixed and variable manufacturing overheads) and
- other costs incurred in bringing the inventories to their present location and condition

Inventory cost should not include:

- abnormal waste storage costs selling costs
- administrative overheads unrelated to production
- foreign exchange differences arising directly on the recent acquisition of inventories invoiced in a foreign currency
- interest cost when inventories are purchased with deferred settlement terms.

Expense Recognition

IAS 18 *Revenue*, addresses revenue recognition for the sale of goods. When inventories are sold and revenue is recognised, the carrying amount of those inventories is recognised as an expense (often called cost-of-goods-sold). Any write-down to NRV and any inventory losses are also recognised as an expense when they occur.

Valuation

Inventories shall be measured at the *lower of*:

(a) Cost

(b) Net realisable value

the estimated selling price in the ordinary course of business less:

(a) Estimated costs of completion, and

(b) Estimated costs necessary to make the sale (e.g. marketing, selling and distribution costs).

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NRV < cost

The principal situations in which net realisable value is likely to be less than cost are where there has been:

(a) An increase in costs or a fall in selling price
(b) Physical deterioration of inventories
(c) Obsolescence of products
(d) A decision as part of a company's marketing strategy to manufacture and sell products at a loss
(e) Errors in production or purchasing.

Interchangeable items

If various batches of inventories have been purchased at different times during the year and at different prices, it may be impossible to determine precisely which items are still held at the year end and therefore what the actual purchase cost of the goods was.
In such circumstances, the following estimation methods are allowed under IAS 2:

(a) FIFO (first in, first out):
The calculation of the cost of inventories on the basis that the quantities in hand represent the latest purchases or production.
OR
(b) *Weighted average cost:*
The calculation of the cost of inventories by using a weighted average price computed by dividing the total cost of items by the total number of such items. The price is recalculated on a periodic basis or as each additional shipment is received and items taken out of inventory are removed at the prevailing weighted average cost.

The use of the LIFO (last in first out) method is *not* permitted.

An entity must use the same cost formula for all inventories having a similar nature and use to the entity

QUESTION FFQA1

A sole trader took some goods costing $800 from inventory for his own use. The normal selling price of the goods is $1,600.

Which of the following journal entries would correctly record this?

	Dr	Cr
A	Drawings account 800	
		Inventory account 800
B	Drawings account 800	
		Purchases account 800
C	Sales account 1,600	
		Drawings account 1,600

QUESTION FFQA2

A fire on 30 September destroyed some of a company's inventory and its inventory records.
The following information is available:

Inventory 1 September 318,000
Sales for September 612,000
Purchases for September 412,000
Inventory in good condition at 30 September 214,000
Standard gross profit percentage on sales is 25%

Based on this information, what is the value of the inventory lost?

A $96,000 **B** $271,000 **C** $26,400 **D** $57,000

QUESTION FFQA3

The inventory value for the financial statements of Q for the year ended 31 May 2006 was based on an inventory count on 4 June 2006, which gave a total inventory value of $836,200.
Between 31 May and 4 June 2006, the following transactions took place:

Purchases of goods 8,600
Sales of goods (profit margin 30% on sales) 14,000
Goods returned by Q to supplier 700

What adjusted figure should be included in the financial statements for inventories at 31 May 2006?

A $838,100 **B** $853,900 **C** $818,500 **D** $834,300

QUESTION FFQA4

A company values its inventory using the first in, first out (FIFO) method. At 1 May 2005 the company had 700 engines in inventory, valued at $190 each.
During the year ended 30 April 2006 the following transactions took place:
2005
1 July Purchased 500 engines at $220 each
1 November Sold 400 engines for $160,000
2006
1 February Purchased 300 engines at $230 each
15 April Sold 250 engines for $125,000
What is the value of the company's closing inventory of engines at 30 April 2006?
A $188,500 **B** $195,500 **C** $166,000 **D** $106,000

QUESTION FFQA5
The closing inventory of Epsilon amounted to $284,000 at 30 September 2001, the balance sheet date. This total includes two inventory lines about which the inventory taker is uncertain.
1. 500 items which had cost $15 each and which were included at $7,500. These items were found to have been defective at the balance sheet date. Remedial work after the balance sheet date cost $1,800 and they were then sold for $20 each. Selling expenses were $400.
2. 100 items which had cost $10 each. After the balance sheet date they were sold for $8 each, with selling expenses of $150.
What figure should appear in Epsilon.s balance sheet for inventory?
A $283,650 B $283,800 C $292,150 D $283,950

QUESTION FFQA6
On 30 September 2001 part of the inventory of a company was completely destroyed by fire. The following information is available:
. Inventory at 1 September 2001 at cost $49,800
. Purchases for September 2001 $88,600
. Sales for September 2001 $130,000
. Inventory at 30 September 2001 . undamaged items $32,000
. Standard gross profit percentage on sales 30%
Based on this information, what is the cost of the inventory destroyed?
A $17,800 B $47,400 C $15,400 D $6,400

QUESTION FFQA7
The analysis of a company.s financial statements revealed that the number of days. sales in inventory was 80 days. The average for companies in the same industry was 35 days.
Which one of the following is LEAST likely to account for the high level of 80 days?
A The company.s trade is seasonal
B Poor inventory control
C A large purchase was made just before the balance sheet date
D **An increase in the company.s sales in the three months before the balance sheet date.**

QUESTION FFQA8

Cash received from credit customers 218,500
Cash sales receipts paid into bank 114,700
Expenses paid out of cash sales before banking 9,600
Trade receivables: 30 June 2000 41,600
30 June 2001 44,200
Refunds to customers 800
Discounts allowed 2,600
Bad debts written off 1,500
Amount due from credit customer deducted by Lamorgan in paying supplier.s account 700

Required:

Compute the sales revenue figure from this information.

QUESTION FFQA9

Payments to suppliers 114,400
Trade payables: 30 June 2000 22,900
30 June 2001 24,800
Cost of items taken from inventory by Lamorgan for personal use 400
Amount due from credit customer deducted by Lamorgan in settling supplier.s account 700

Required:

Compute the purchases figure from this information.

QUESTION FFQA10

Cost of inventory obtained from physical count on 30 June 2001 77,700
This figure does NOT include any amounts for the two items below.
(i) An inventory line which had cost $1,800 was found to be damaged. Remedial work costing $300 is needed to enable the items to be sold for $1,700. Selling expenses of $100 would also be incurred in selling these items.
(ii) Goods sent to a customer on approval in May 2001 were not included in the inventory. The sale price of the goods was $4,000 and the cost $3,000. The customer notified his acceptance of the goods in July 2001.

Required:

Compute the adjusted closing inventory figure from this information.

Sales revenue total account

	$		$
Opening receivables	41,600	Cash received from customers	218,500
Refunds to customers	800	Discounts allowed	2,600
		Bad debts written off	1,500
Sales	**225,100**	Contra purchases	700
		Closing receivables	44,200
	267,500		267,500

	$
Credit sales as above	225,100
Cash sales $114,700 + $9,600	124,300
	349,400

Purchases total account

	$		$
Payments to suppliers	114,400	Opening payables	22,900
Contra sales	700	Lamorgan – goods taken	400
Closing payables	24,800	**Purchases**	**116,600**
	139,900		139,900

Inventory

	$
Per inventory count	77,700
Damaged item: $1,700 – $300 – $100	1,300
Goods on approval	3,000
	82,000

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QUESTION FFQA11

A business has compiled the following information for the year ended 31 October 2002:

Opening inventory 386,200

Purchases 989,000

Closing inventory 422,700

The gross profit as a percentage of sales is always 40%

Based on these figures, what is the sales revenue for the year?

A $1,333,500 B $1,587,500 C $2,381,250

D The sales revenue figure cannot be calculated from this information

QUESTION FFQA12

A fire on 30 September 2002 destroyed some of a company's inventory and its inventory records.

The following information is available:

Inventory 1 September 2002 318,000

Sales for September 2002 612,000

Purchases for September 2002 412,000

Inventory in good condition at 30 September 2002 214,000

Standard gross profit percentage on sales is 25%

Based on this information, what is the value of the inventory lost?

A $96,000 B $271,000 C $26,400 D $57,000

QUESTION FFQA13

Which of the following inventory valuation methods is likely to lead to the lowest figure for closing inventory at a time when prices are rising?

A Average cost

B First in, first out (FIFO)

C Last in, first out (LIFO)

D Replacement cost

QUESTION FFQA14

Which of the following costs may be included when arriving at the cost of finished goods inventory for inclusion in the financial statements of a manufacturing company?

(1) Carriage inwards

(2) Carriage outwards

(3) Depreciation of factory plant

(4) Finished goods storage costs

(5) Factory supervisors' wages

A (1) and (5) only

B (2), (4) and (5) only

C (1), (3) and (5) only

D (1), (2), (3) and (4) only

QUESTION FFQA15

Which of the following statements about the treatment of inventory and work in progress in financial statements are correct?

1 Inventory should be valued at the lowest of cost, net realisable value and replacement cost.

2 In valuing work in progress, materials costs, labour costs and variable and fixed production overheads must be included.

3 Inventory items can be valued using either first in, first out (FIFO) or weighted average cost.

4 A company's financial statements must disclose the accounting policies used in measuring inventories.

A All four statements are correct.

B 1, 2 and 3 only **C** 2, 3 and 4 only **D** 1 and 4 only

QUESTION FFQA16

A business received a delivery of goods on 29 June 2006, which was included in inventory at 30 June 2006. The invoice for the goods was recorded in July 2006.

What effect will this have on the business?

1 Profit for the year ended 30 June 2006 will be overstated.
2 Inventory at 30 June 2006 will be understated.
3 Profit for the year ending 30 June 2007 will be overstated.
4 Inventory at 30 June 2006 will be overstated.

A 1 and 2 **B** 2 and 3 **C 1 only** **D** 1 and 4

QUESTION FFQA17 **According to IAS 2 *Inventories*, which of the following costs should be included in valuing the inventories of a manufacturing company?**

(1) Carriage inwards
(2) Carriage outwards
(3) Depreciation of factory plant
(4) General administrative overheads

A All four items **B** 1, 2 and 4 only **C** 2 and 3 only **D** 1 and 3 only

QUESTION FFQA18 The closing inventory at cost of a company at 31 January 2003 amounted to $284,700. The following items were *included* at cost in the total:

(1) 400 coats, which had cost $80 each and normally sold for $150 each. Owing to a defect in manufacture, they were all sold after the balance sheet date at 50% of their normal price. Selling expenses amounted to 5% of the proceeds.

(2) 800 skirts, which had cost $20 each. These too were found to be defective. Remedial work in February 2003 cost $5 per skirt, and selling expenses for the batch totalled $800. They were sold for $28 each.

What should the inventory value be according to IAS 2 Inventories after considering the above items?

A $281,200 **B** $282,800 **C** $329,200 **D** None of these.

QUESTION FFQA19

According to IAS 2 Inventories, which of the following costs should be included in valuing the inventories of a manufacturing company?

(1) Carriage inwards
(2) Carriage outwards
(3) Depreciation of factory plant
(4) General administrative overheads

A All four items **B** 1, 2 and 4 only **C** 2 and 3 only **D 1 and 3 only**

QUESTION FFQA20

IAS 2 *Inventories* defines the extent to which overheads are included in the cost of inventories of finished goods.

Which of the following statements about the IAS 2 requirements in this area are correct?

1 Finished goods inventories may be valued on the basis of labour and materials cost only, without including overheads.

2 Carriage inwards, but not carriage outwards, should be included in overheads when valuing inventories of finished goods.

3 Factory management costs should be included in fixed overheads allocated to inventories of finished goods.

A All three statements are correct **B** 1 and 2 only **C** 1 and 3 only **D 2 and 3 only**

QUESTION FFQA21

Which of the following statements about inventory valuation for balance sheet purposes are correct?

1 According to IAS 2 *Inventories*, average cost and FIFO (first in and first out) are both acceptable methods of arriving at the cost of inventories.
2 Inventories of finished goods may be valued at labour and materials cost only, without including overheads.
3 Inventories should be valued at the lowest of cost, net realisable value and replacement cost.
4 It may be acceptable for inventories to be valued at selling price less estimated profit margin.

A 1 and 3 **B** 2 and 3 **C 1 and 4** **D** 2 and 4