

# Inventories

## 1.1. Measurement of inventories

**An entity shall measure inventories at the lower of cost and estimated selling price less costs to complete and sell.**

**An entity shall include in the cost of inventories all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.**

**The costs of purchase** of inventories comprise the **purchase price, import duties and other taxes** (other than those subsequently recoverable by the entity from the taxing authorities), and **transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services**. **Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.**

**An entity may purchase inventories on deferred settlement terms.** In some cases, the arrangement effectively contains an unstated financing element, for example, a difference between the purchase price for normal credit terms and the deferred settlement amount. In these cases, **the difference is recognized as interest expense over the period of the financing and is not added to the cost of the inventories.**

**The costs of conversion** of inventories **include costs directly related to the units of production, such as direct labor**. They also **include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods**. **Fixed production overheads** are those indirect costs of production that remain relatively constant regardless of the volume of production, such as **depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration**. **Variable production overheads** are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as **indirect materials and indirect labor**.

**An entity shall allocate fixed production overheads to the costs of conversion on the basis of the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance.** The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognized as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

**A production process may result in more than one product being produced simultaneously.** This is the case, for example, when joint products are produced or when there is a main product and a by-product.

**When the costs of raw materials or conversion of each product are not separately identifiable, an entity shall allocate them between the products on a rational and consistent basis.** The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, the entity shall measure them at selling price less costs to complete and sell and deduct this amount from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

An entity shall include other costs in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

Examples of **costs excluded from the cost of inventories and recognized as expenses** in the period in which they are incurred are:

- (a) abnormal amounts of wasted materials, labor or other production costs.
- (b) storage costs, unless those costs are necessary during the production process before a further production stage.
- (c) administrative overheads that do not contribute to bringing inventories to their present location and condition.
- (d) selling costs.

**To the extent that service providers have inventories, they measure them at the costs of their production.** These costs consist primarily of the **labor and other costs of personnel directly engaged in providing the service**, including supervisory personnel, and attributable overheads. **Labor and other costs relating to sales and general administrative personnel are not included but are recognized as expenses** in the period in which they are incurred. The cost of inventories of a service provider **does not include profit margins or non-attributable overheads** that are often factored into prices charged by service providers.

IFRS for SMEs require that **inventories comprising agricultural produce** that an entity has harvested from its biological assets **should be measured on initial recognition at their fair value less estimated costs to sell at the point of harvest.** This becomes the cost of the inventories at that date for application of this section.

**An entity may use techniques such as the standard cost method, the retail method or most recent purchase price for measuring the cost of inventories if the result approximates cost. Standard costs take into account normal levels of materials and supplies, labor, efficiency and capacity utilization. They are regularly reviewed and, if necessary, revised in the light of current conditions. The retail method measures cost by reducing the sales value of the inventory by the appropriate percentage gross margin.**

An entity shall measure the cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects by using specific identification of their individual costs. **An entity shall measure the cost of inventories, other than costs of purchase, 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. **The last-in, first-out method (LIFO) is not permitted by this IFRS.**

## **1.2. Impairment of inventories**

Section “Impairment of Assets” of IFRS for SMEs requires an entity **to assess at the end of each reporting period whether any inventories are impaired, i.e. the carrying amount is not fully recoverable** (e.g. because of damage, obsolescence or declining selling prices). If an item (or group of items) of **inventory is impaired**, that Section requires the entity **to measure the inventory at its selling price less costs to complete and sell, and to recognize an impairment loss**. Section also requires a reversal of a prior impairment in some circumstances.

## **1.3. Recognition as an expense**

**When inventories are sold, the entity shall recognize the carrying amount of those inventories as an expense in the period in which the related revenue is recognized.**

Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are accounted for subsequently in accordance with the section of these IFRS relevant to that type of asset.

## **1.4. Disclosures**

An entity shall disclose the following:

- (a) the accounting policies adopted in measuring inventories, including the cost formula used.
- (b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity.
- (c) the amount of inventories recognized as an expense during the period.
- (d) impairment losses recognized or reversed in profit or loss in accordance with Section “Impairment of Assets”.
- (e) the total carrying amount of inventories pledged as security for liabilities.

## Provisions and Contingencies

### 1.1. Initial recognition

An entity shall recognize a provision only when (initial recognition criteria):

- (a) the entity has an obligation at the reporting date as a result of a past event;
- (b) it is probable (i.e. more likely than not) that the entity will be required to transfer economic benefits in settlement; and
- (c) the amount of the obligation can be estimated reliably.

**The entity shall recognize the provision as a liability in the statement of financial position and shall recognize the amount of the provision as an expense,** unless another section of these IFRS requires the cost to be recognized as part of the cost of an asset such as inventories or property, plant and equipment.

**The condition of obligation at the reporting date as a result of a past event means that the entity has no realistic alternative to settling the obligation.** This can happen when the entity has a legal obligation that can be enforced by law or when the entity has a constructive obligation because the past event (which may be an action of the entity) has created valid expectations in other parties that the entity will discharge the obligation. **Obligations that will arise from the entity's future actions** (i.e. the future conduct of its business) **do not satisfy such condition**, no matter how likely they are to occur and even if they are contractual. To illustrate, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a particular type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation or selling the factory, it has no present obligation for that future expenditure and no provision is recognized.

### 1.2. Initial measurement and subsequent measurement

**An entity shall measure a provision at the best estimate of the amount required to settle the obligation at the reporting date. The best estimate is the amount an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time.**

**When the provision involves a large population of items, the estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities.** The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60 per cent or 90 per cent. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

**When the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation.** However, even in such a case, the entity

considers other possible outcomes. When other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.

**When the effect of the time value of money is material, the amount of a provision shall be the present value of the amount expected to be required to settle the obligation.** The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money. The risks specific to the liability should be reflected either in the discount rate or in the estimation of the amounts required to settle the obligation, but not both.

**An entity shall exclude gains from the expected disposal of assets from the measurement of a provision.**

**When some or all of the amount required to settle a provision may be reimbursed by another party (e.g. through an insurance claim), the entity shall recognize the reimbursement as a separate asset only when it is virtually certain that the entity will receive the reimbursement on settlement of the obligation.** The amount recognized for the reimbursement shall not exceed the amount of the provision. The reimbursement receivable shall be presented in the statement of financial position as an asset and shall not be offset against the provision. In the statement of comprehensive income, the entity may offset any reimbursement from another party against the expense relating to the provision.

**At subsequent measurement an entity shall charge against a provision only those expenditures for which the provision was originally recognized. An entity shall review provisions at each reporting date and adjust them to reflect the current best estimate of the amount that would be required to settle the obligation at that reporting date.** Any adjustments to the amounts previously recognized shall be recognized in profit or loss unless the provision was originally recognized as part of the cost of an asset. When a provision is measured at the present value of the amount expected to be required to settle the obligation, the unwinding of the discount shall be recognized as a finance cost in profit or loss in the period it arises.

#### **1.4. Contingent assets and liabilities**

**An entity shall not recognize a contingent asset as an asset. Disclosure of a contingent asset is required when an inflow of economic benefits is probable.** However, **when the flow of future economic benefits to the entity is virtually certain, then the related asset is not a contingent asset, and its recognition is appropriate.**

**A contingent liability is either a possible but uncertain obligation or a present obligation that is not recognized because it fails to meet one or both initial recognition criteria (b) and (c) stated earlier. An entity shall not recognize a contingent liability as a liability, except for provisions for contingent liabilities of an acquire in a business combination. Disclosure of a contingent liability is required** unless the possibility of an outflow of resources is remote. When an entity is jointly and severally liable for an obligation, the part of the obligation that is expected to be met by other parties is treated as a contingent liability.

## 1.5. Disclosures

For each class of provision, an entity shall disclose all of the following:

- (a) a reconciliation showing
  - (i) the carrying amount at the beginning and end of the period;
  - (ii) additions during the period, including adjustments that result from changes in measuring the discounted amount;
  - (iii) amounts charged against the provision during the period; and
  - (iv) unused amounts reversed during the period.
- (b) a brief description of the nature of the obligation and the expected amount and timing of any resulting payments.
- (c) an indication of the uncertainties about the amount or timing of those outflows.
- (d) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

**Comparative information for prior periods is not required.**

Unless the possibility of any outflow of resources in settlement is remote, an entity shall disclose, **for each class of contingent liability** at the reporting date, a brief description of the nature of the contingent liability and, when practicable:

- (a) an estimate of its financial effect, measured in accordance with requirements for initial and subsequent measurement of provisions and contingencies;
- (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
- (c) the possibility of any reimbursement.

If an inflow of economic benefits is probable (more likely than not) but not virtually certain, **an entity shall disclose a description of the nature of the contingent assets** at the end of the reporting period, and, when practicable without undue cost or effort, an estimate of their financial effect. If it is impracticable to make this disclosure, that fact shall be stated.

**In extremely rare cases, disclosure of some or all of the earlier stated information can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.**