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LKAS 2 Inventories

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Definitions

You will learn

- How inventories are defined
- What type of inventories exist
- How inventories are measured
- Disclosure requirements

Definitions

Inventories are assets:

1. held for sale in the ordinary course of business; **[Finished goods]**
2. in the process of production for such sale **[Work in progress];** or
3. in the form of materials or supplies to be consumed in the production process or in the rendering of services **[Raw materials]**

Scope of LKAS 2

LKAS 2 does not apply to;

- Financial instruments
- Biological assets – agricultural produce at the point of harvest.

Scope of LKAS 2

Which of the following assets are inventories?

- Unharvested cotton
- Computer games
- Wholesale merchandise
- Rented buildings

Scope of LKAS 2

ABC Ltd rents new vehicles for 6 to 24 months, before selling them. Which of the following statements is correct regarding the vehicles?

a) The assets are reported during the rental period as item of PPE as the proceeds from sale comprise significant portion of the revenues from the vehicles

b) The assets have to be reported during the rental period as PPE and subsequently to be classified as inventory

c) The vehicles are recognised as inventories during the entire period as it is always foreseeable that a car will be sold.

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LKAS 2

When should an asset to be recognised?

The general criteria of the Conceptual Framework have to be applied.

- Asset definition and
- Recognition criteria [probable future economic benefits and costs can be measured reliably].

LKAS 2- Measurement

Inventories are measured at

Lower of;

Cost and NRV

LKAS 2 - cost

Inventories can arise due to

- purchases (Purchase price)
- exchanges (Carrying amount of the asset transferred or fair value of the asset received) or
- by generating them internally (Cost of conversion)

LKAS 2 – Purchase cost

A Ltd import cars. **	CU
Purchase cost	100
Transportation cost	10
Transportation insurance	2
Import VAT	5
Sales bonus	3
Discount	3

**All data relate to 1 vehicle in each case

Vehicles parked at duty free zone until they are delivered to the buyer. At this point VAT will occur. Sales bonuses are not due until sales occur. What is the purchase cost of one vehicle at the date of acquisition?

LKAS 2 – costs of conversion

Following costs per bottle are incurred to produce whisky	CU
Raw materials (Barley, yeast, water)	3
Operating supplies (electricity, oil)	1
Storage cost unit maturation	1
Storage costs for products that are ready for sale	1
Depreciation on barrels	2
Bottles and corks	1
Marketing	2

In what amount are the costs of conversion to be reported?

LKAS 2 –techniques

In general, inventories are initially measured at cost. But Standard provides an exemption to the general rule.

- Standard cost method or
- Retail method

If it closes to the cost.

Cost Formulas

- ✓ Principally inventories have to be measured specifically at their cost (i.e. individually @ their particular cost)
- ✓ An entity can diverge from **principle of specific identification of costs** if it has large numbers of items of inventories that are ordinary inter changeable
- ✓ Consistency required across each type of inventories

Net Realisable Value

A company uses crude oil as raw material to manufacture its end product. As at the end of the reporting period market price for crude oil amounts to CU 80 per barrel. The historical cost of a barrel is CU 120. The sale price for the end product continues exceeding the costs of manufacturing the product. At which price do the crude oil stocks have to be recognised?

a) Average

b) CU 120/ barrel

c) CU 80/ barrel

LKAS 2 – reversing written down

Furniture Ltd manufactures sold wood furniture	CU
In x1 cost for purchasing one unit of wood	120
In x1 market price for one unit of wood as at x1	100
In x1 the unit of wood price therefore written down to	100
As at x2 Company holds some previous years wood stock	
The market price at x2	130

At which value have the woods to be measured at year x2?

LKAS 2 – reversing written down

costs	Yes	No
Direct material costs		
Direct production costs		
Materials and production overheads		
Depreciation		
Product related administration cost		
Expenses for social facilities, to the extent there are related to production		
Expenses of employee pension schemes, to the extent they are related to production		
Selling costs		

Decide whether the costs to be included in cost of conversion?

LKAS 2 - NRV

Ref	Statements
1.	Work in progress is not written down below cost if the finished products in which it will be incorporated are expected to be sold at or above cost
2.	The value of inventory might decline as a result of partial obsolescence
3.	An increase in the estimated costs of completion never constitutes an indication of a write down

Which statements are correct?

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Disclosures

- Accounting policies adopted in measuring inventories.
- Total carrying amount, sub-divided into classifications appropriate to the entity.
- Carrying amount of inventories held at fair value less costs to sell
- Amount of inventories recognised as an expense during the period

Disclosures

- Amount of write-downs of inventories to net realisable value.
- Amount of any reversal of previous write-downs of inventories
- The circumstances or events that led to the reversal of inventories
- Carrying amount of inventories pledged as security for liabilities.

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LKAS 16

Property, Plant and Equipment

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You will learn

- How is PPE defined
- How is PPE recognised and measured
- Which are the most important notes

Recognition criteria of PPE

- It is probable that the future economic benefits associated with the item of PPE will flow to the entity and;
- the cost of the item shall be measured reliably.

Conceptual framework defines asset as;

- A resource controlled by the entity
- As a result of past events
- And from which future economic benefits are expected to flow to the entity.

LKAS 16- Scope

LKAS 2 Inventory

SLFRS 5 Non current assets held for sale

LKAS 41 Agriculture

LKAS 16 Property, plant and equipment

LKAS 40 Investment properties

LKAS 38 Intangible assets

SLFRS 6 Exploration for and evaluation of mineral resources

LFRS 16 Leases

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LKAS 16

Ref	Example – scope of LKAS 16	Yes	No
1.	Oil drilling cranes of an oil exploration and petroleum company		
2.	Fruit plantations of an agricultural operation [without its own agricultural land		
3.	Crude oil deposits		
4.	IT licenses for the consolidation system used by an entity		
5.	Land acquired for developing with the warehouse		
6.	Tools (usable once in the production process		

LKAS 16 – Initial measurement

Initial measurement

- Acquisition
- Construction
- Exchange
- Acquisition with no consideration

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LKAS 16 – Cost of acquisition

Purchase price (Cash price+ import duties and non refundable purchase taxes)

\+ Directly attributable costs (Site preparation, initial delivery cost professional fees, employment benefits etc.)

\+ Dismantling cost (recognized in accordance with LKAS 37)

\- Purchase price deductions (Trade discounts and rebates)

+Subsequent costs

LKAS 16 – Which costs to capitalize?

Ref	costs	Yes	No
1.	Cost of installing and assembling the equipment in the production hall		
2.	Cost of trade fair visits and making buying decisions		
3.	Cost of training employees to use the equipment		
4.	Import duties paid		
5.	Cost of testing		
6.	Trade discounts deducted for payment within 14 days		
7.	Initial operating losses and costs of operating under capacity before the plant is operating at its planned capacity		
8.	Costs of feasibility study		
9.	Costs for cementing the foundation		
10.	Costs of structural engineer who determined the required foundation strength		

LKAS 16 – Cost of construction

Direct material + Direct labour

+ depreciation on production related assets

+ Pro rated indirect material and labour costs

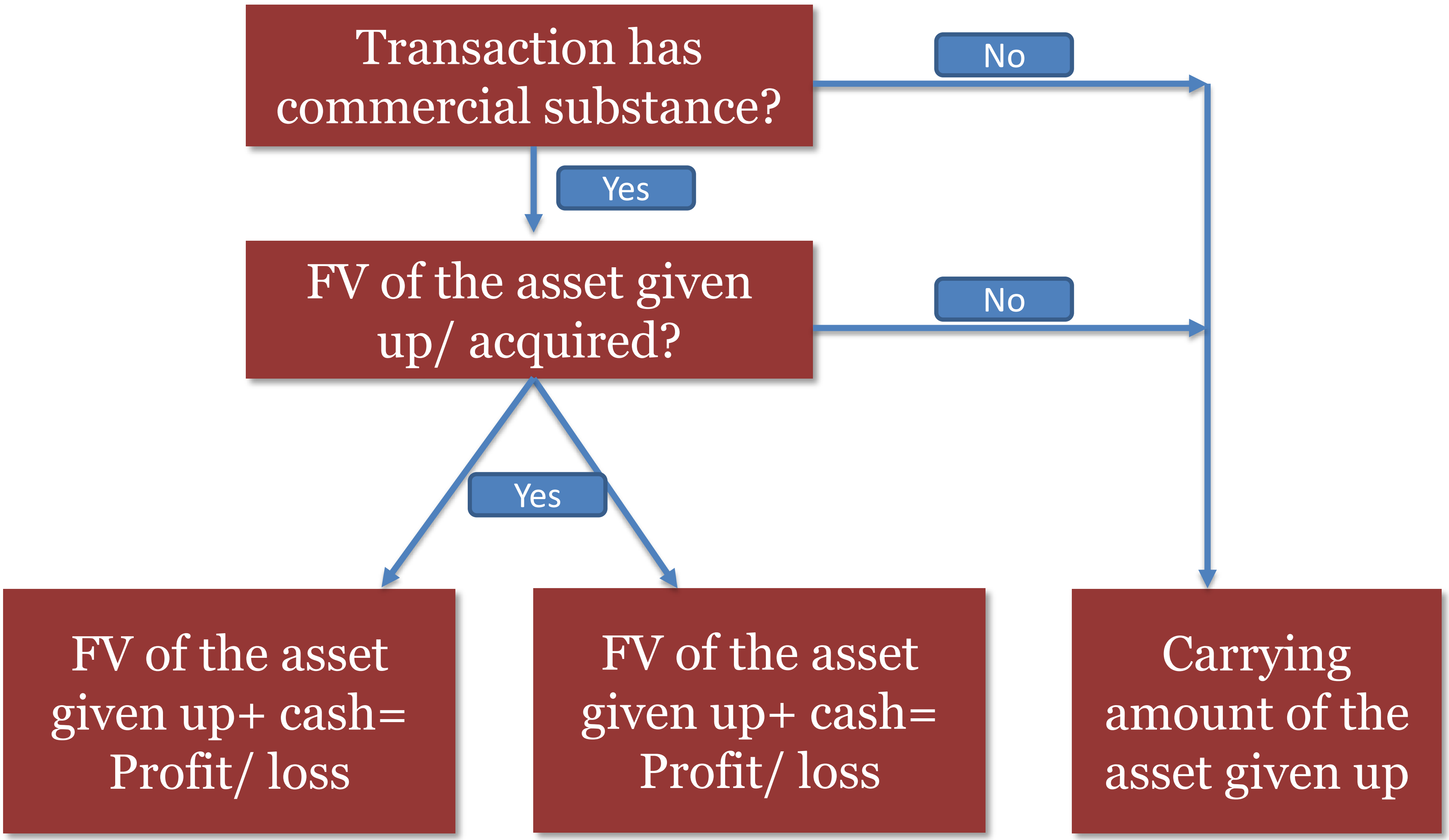
+ Production related administrative costs

+ Borrowing costs

LKAS 16 – Which costs to capitalize?

Ref	Costs	Yes	No
1.	Personnel expenses incurred in connection with construction		
2.	Costs of the materials used in construction		
3.	Cost of site preparation		
4.	General administration costs		
5.	Directly attributable indirect materials and indirect labour		
6.	Interest on the loan taken out specifically for this investment		
7.	Costs for an unusually high level of waste in the self generation of the large glass cylinders used at the plant		

LKAS 16 – Cost of exchange

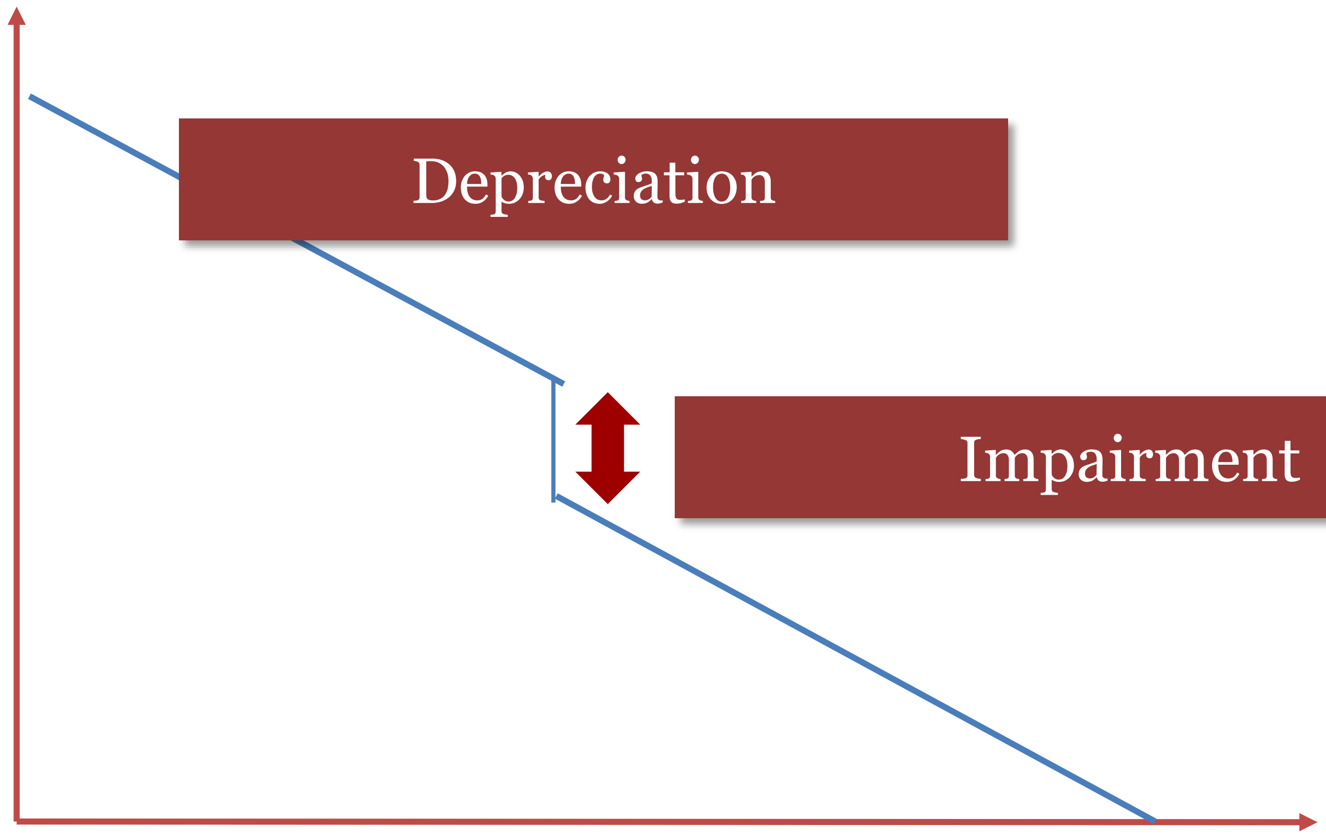


LKAS 16 – subsequent measurement

Cost model	Revaluation model
Cost less any accumulated depreciation and any accumulated impairment loss	Revaluation amount

Depreciation

Impairment losses


Depreciation
Impairment

Depreciation:

- Depreciation starts when the asset is available for use
- Depreciable amount = Cost or revaluation less significant residual value
- If the residual value equal or greater than the carrying value the depreciation charge would be zero.
- The residual value and the useful life of an asset should be reviewed at the end of each financial year.
- Depreciable amount should be allocated on a systematic basis over the useful life of the asset

Depreciation:

- Significant parts should be depreciated separately.
- Depreciation charge recognize in the P/L unless it is absorbed to an other asset.
- Depreciation ceased when asset classified as held for sale or when the asset derecognized.
- Depreciation does not cease when the asset becomes idle or retired form active use

LKAS 16 – Impairment

Various levels of testing

- Individual asset level
- CGU excluding goodwill
- CGU including goodwill

Do indications of an impairment loss exist? Review at the reporting date?

Are the assets impaired ? Carrying amount > recoverable amount

LKAS 16

On 1/1/x1 A Ltd purchases a machine for CU 1200. The useful life is 10 years. In x2 a technical innovation is introduced on the market relating to the product of the Company and at the end of x2 the company decided to discontinue production at the end of x5. The value in use of the machine at the end x2 is 300.

1. In addition to the depreciation, must an impairment be recognized in x2?

2. What is the depreciation amount in x3?

LKAS 16

1. Cost (1200) /useful life (10) = Depreciation of CU120

Carrying value at the end of x2 = 1200 – (120*2) = CU960

Carrying value Vs VIU @ x2 = 960 Vs 300 = Impairment loss of CU660

2. New depreciation from x3 = CU300/ 3 years = CU 100

Principal : Requirement to recognize a reversal of an impairment loss

1. Cost model – the increase carrying amount of an asset attributable to a reversal shall not exceed the carrying amount that would have been determined (net of depreciation) had not impairment loss been recognized previously for the asset.

2. Revaluation model: reversal are treated as a revaluation increase in accordance with LKAS 16.

- In x1 - Land purchased @ CU 100
- In x4 impairment loss was recognized reducing the carrying amount to CU 60
- In x6 the value of the land increased to CU 120

Moreover, there is a firm offer for land for CU 110 at this time

Under cost model what is the value of the land as at x6?

- CU 120
- CU 100
- CU 110

Following are considered as **changes in estimates.**

- Residual values
- Estimated cost of dismantling removing and resorting PPE
- Useful lives
- Depreciation methods

De-recognition:

- On disposal [sale or entering into a finance lease or donating at the date when the control transfers.]
- Or when there is no future economic benefits are expected from its use or disposal

Gains or losses = net disposal proceeds less carrying amount.

Gain or loss on de-recognition shall be included in **P/L**. Gains shall **not be classified as revenue.**

Disclosures required for each class of PPE

- Measurement bases
- Depreciation method
- Useful life
- Gross carrying amount and accumulated depreciation and impairment at the beginning and end of the period
- Reconciliation of carrying amount at the beginning and end.

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Further disclosures required;

- Any restrictions on the title
- Assets pledged as securities for liabilities
- The amount of expenditure in the carrying amount of PPE in the course of its construction [CWIP]
- The amount of contractual commitments
- Compensation from third parties for PPE
- Whether deprecation charged to P/L or capitalized as part of other asset.
- Disclosure as per LKAS 36 on impaired PPE

Disclosures in relation to **revaluation**

- Disclosures on fair value as per SLFRS 13
- Effective date of the revaluation
- Whether independent valuer was involved
- Carrying value of the each class of PPE according to the cost method
- Changes in the revaluation reserve
- Restriction on distribution of R/R to share holders

Thank you.