

S02.02-AS-04-I.4

I - Inventories: General principles

4. Recognition criteria

4.1. Related-IFRS Standards

Cost of inventories (IAS 2, par 10)

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

- **Costs of purchase of inventories (IAS 2, par 11)**
 - *Comprise:*
 - 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.
- **Costs of conversion of inventories (IAS 2, par 12)**
 - *(IAS 2, par 12)*
 - include costs directly related to the units of production, such as direct labour.
 - 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 labour.
 - *(IAS 2, par 13)*
 - The allocation of fixed production overheads to the costs of conversion is based on 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 recognised 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 (to avoid over-absorbing fixed costs).
 - Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.
- **Other costs (IAS 2, par 15)**
 - *(IAS 2, par 15)*

Other costs are included 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 (IAS 2, par 16)**, and recognised as expenses in the period in which they are incurred are:
 - abnormal amounts of wasted materials, labour or other production costs;
 - storage costs, unless those costs are necessary in the production process before a further production stage;
 - administrative overheads that do not contribute to bringing inventories to their present location and condition; and
 - selling costs.

4.2. Acquisition cost

4.3. Production cost: Variable production cost; Non-proportional production cost

3. Techniques for the measurement of cost

3.1. Related-IFRS Standard

(IAS 2, par 21)

Techniques for the measurement of the cost of inventories, such as the **standard cost method** (...) may be used for convenience **if the results approximate cost**. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

3.2. Allocation factors

When several intermediate or finished products are produced simultaneously by the production cycle and when it is not possible to precisely attribute production costs to each specific product, these costs are allocated on the basis of allocation factors that reflect the economic reality of the production process (sales, volumes, etc.).

Referring to **IAS 2, par 16** :

- The **allocation of indirect charges to the cost of transforming products** is based on the **normal capacity** of the production installations. The normal capacity is the average production that is expected from a certain number of years or seasons in normal circumstances (taking into account the loss of capacity generated by scheduled maintenance work).
- The indirect charges allocated to each unit produced are not increased by a decrease in production or unused production. The unallocated indirect charges are posted as an expense for the year in which they are incurred (under miscellaneous production).
- During periods of abnormally high production, the total indirect charges allocated to each unit produced are reduced so that the inventories are not valued above their cost.

These concepts are consistent with the standard cost approach.

4. Cost formulas

- **(IAS 2, par 25)**
The cost of inventories (...) shall be assigned by using the (...) 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.
- **(IAS 2, par 27)**
*(...) Under the **weighted average cost formula**, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.*