



IAS 2 — Inventories



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Overview

IAS 2 *Inventories* contains the requirements on how to account for most types of inventory. The standard requires inventories to be measured at the lower of cost and net realisable value (NRV) and outlines acceptable methods of determining cost, including specific identification (in some cases), first-in first-out (FIFO) and weighted average cost.

A revised version of IAS 2 was issued in December 2003 and applies to annual periods beginning on or after 1 January 2005.

History of IAS 2

Date	Development	Comments
September 1974	Exposure Draft E2 <i>Valuation and Presentation of Inventories in the Context of the Historical Cost System</i> published	
October 1975	IAS 2 <i>Valuation and Presentation of Inventories in the Context of the Historical Cost System</i> issued	
August 1991	Exposure Draft E38 <i>Inventories</i> published	
December 1993	IAS 9 (1993) <i>Inventories</i>	Operative for annual

	issued	financial statements covering periods beginning on or after 1 January 1995
18 December 2003	IAS 2 <i>Inventories</i> issued	Effective for annual periods beginning on or after 1 January 2005

Related Interpretations

- [IFRIC 20](#) *Stripping Costs in the Production Phase of a Surface Mine*
- [SIC-1](#) *Consistency - Different Cost Formulas for Inventories*. **SIC-1 was superseded by and incorporated into IAS 2 (Revised 2003).**

Summary of IAS 2

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

Inventories include assets held for sale in the ordinary course of business (finished goods), assets in the production process for sale in the ordinary course of business (work in process), and materials and supplies that are consumed in production (raw materials). [IAS 2.6]

However, IAS 2 excludes certain inventories from its scope: [IAS 2.2]

- work in process arising under construction contracts (see [IAS 11](#) *Construction Contracts*)
- financial instruments (see [IAS 39](#) *Financial Instruments: Recognition and Measurement*)
- biological assets related to agricultural activity and agricultural produce at the point of harvest (see [IAS 41](#) *Agriculture*).

Also, while the following are within the scope of the standard, IAS 2 does not apply to the measurement of inventories held by: [IAS 2.3]

- producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value (above or below cost) in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised in profit or loss in the period of the change
- commodity brokers and dealers who measure their inventories at fair value less

costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.

Fundamental principle of IAS 2

Inventories are required to be stated at the lower of cost and net realisable value (NRV). [IAS 2.9]

Measurement of inventories

Cost should include all: [IAS 2.10]

- 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

IAS 23 *Borrowing Costs* identifies some limited circumstances where borrowing costs (interest) can be included in cost of inventories that meet the definition of a qualifying asset. [IAS 2.17 and IAS 23.4]

Inventory cost should not include: [IAS 2.16 and 2.18]

- abnormal waste
- storage costs
- administrative overheads unrelated to production
- selling costs
- 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.

The standard cost and retail methods may be used for the measurement of cost, provided that the results approximate actual cost. [IAS 2.21-22]

For inventory items that are not interchangeable, specific costs are attributed to the specific individual items of inventory. [IAS 2.23]

For items that are interchangeable, IAS 2 allows the FIFO or weighted average cost formulas. [IAS 2.25] The LIFO formula, which had been allowed prior to the 2003 revision of IAS 2, is no longer allowed.

The same cost formula should be used for all inventories with similar characteristics as to their nature and use to the entity. For groups of inventories that have different characteristics, different cost formulas may be justified. [IAS 2.25]

Write-down to net realisable value

NRV is the estimated selling price in the ordinary course of business, less the estimated cost of completion and the estimated costs necessary to make the sale. [IAS 2.6] Any write-down to NRV should be recognised as an expense in the period in which the write-down occurs. Any reversal should be recognised in the income statement in the period in which the reversal occurs. [IAS 2.34]

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. [IAS 2.34]

Disclosure

Required disclosures: [IAS 2.36]

- accounting policy for inventories
- carrying amount, generally classified as merchandise, supplies, materials, work in progress, and finished goods. The classifications depend on what is appropriate for the entity
- carrying amount of any inventories carried at fair value less costs to sell
- amount of any write-down of inventories recognised as an expense in the period
- amount of any reversal of a write-down to NRV and the circumstances that led to such reversal
- carrying amount of inventories pledged as security for liabilities
- cost of inventories recognised as expense (cost of goods sold).

IAS 2 acknowledges that some enterprises classify income statement expenses by nature (materials, labour, and so on) rather than by function (cost of goods sold, selling expense, and so on). Accordingly, as an alternative to disclosing cost of goods sold expense, IAS 2 allows an entity to disclose operating costs recognised during the period by nature of the cost (raw materials and consumables, labour costs, other operating costs) and the amount of the net change in inventories for the period). [IAS 2.39] This is consistent with **IAS 1 Presentation of Financial Statements**, which allows presentation of expenses by function or nature.

27

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