Nov 2025 & Onwards

CA FINAL

FINANCIAL REPORTING

Question Bank

(Volume-1)

- Comprehensive Coverage
- All ICAI SM, RTP, MTP & PYQ's covered
- Updated & Student Friendly

CA Nitin Goel

INDEX

IND AS 2: INVENTORIES

ICAI STUDY MATERIAL

Question 1

As per Ind AS 2, inventories include 'materials and supplies awaiting use in the production process'. Examine whether the packing material and publicity material are covered by the term 'materials and supplies awaiting use in the production process'.

Solution

While the primary packing material may be included within the scope of the term 'materials and supplies awaiting use in the production process' but the secondary packing material and publicity material cannot be so included, as these are selling costs which are required to be excluded as per Ind AS 2. For this purpose, the primary packing material is one which is essential to bring an item of inventory to its saleable condition, for example, bottles, cans etc., in case of food and beverages industry. Other packing material required for transporting and forwarding the material will normally be in the nature of secondary packing material.

Question 2

ABC Ltd. buys goods from an overseas supplier. It has recently taken delivery of 1,000 units of component X. The quoted price of component X was ₹ 1,200 per unit but ABC Ltd. has negotiated a trade discount of 5% due to the size of the order.

The supplier offers an early settlement discount of 2% for payment within 30 days and ABC Ltd. intends to achieve this.

Import duties (basic custom duties) of ₹ 60 per unit must be paid before the goods are released through custom. Once the goods are released through customs, ABC Ltd. must pay a delivery cost of ₹ 5,000 to have the components taken to its warehouse.

Calculate the cost of inventory.

Solution

Particulars	₹
Purchase price (1,000 x 1,200 x 95%)	11,40,000
Import duties (1,000 x 60)	60,000
Delivery cost	5,000
Cost of inventory	**12,05,000**

Note: The intention to take settlement discount is irrelevant.

Question 3 (Normal production capacity)

A business plans for production overheads of ₹ 10,00,000 per annum. The normal level of production is 1,00,000 units per annum. Due to supply difficulties the business was only able to make 75,000 units in the current year. Other costs per unit were ₹ 126.

Calculate the per unit cost and amount of overheads to be expensed during the year.

Solution

Calculation of cost per unit:

	₹
Other costs	126
Production overhead (10,00,000/1,00,000 units)	10
Unit cost	**136**

Overhead to be expensed:

	₹
Total production overhead	10,00,000
The amount absorbed into inventory is (75,000 x 10)	(7,50,000)
The amount not absorbed into inventory	2,50,000

₹ 2,50,000 that has not been included in inventory is expensed during the year i.e. recognized in the statement of profit and loss.

Question 4 (Conversion costs)

ABC Ltd. manufactures control units for air conditioning systems. Each control unit requires the following:

1 component X at a cost of ₹ 1,205 each
1 component Y at a cost of ₹ 800 each
Sundry raw materials at a cost of ₹ 150 each

The company incurs the following monthly expenses:

Factory rent ₹ 16,500
Energy cost ₹ 7,500
Selling and administrative costs 10,000

Each unit takes two hours to assemble. Production workers are paid ₹ 300 per hour.
Production overheads are absorbed into units of production using an hourly rate. The normal level of production per month is 1,000 hours.
Calculate the cost of inventory.

Solution

The cost of a single control unit:

	₹
Materials:	
Component X	1,205
Component Y	800
Sundry raw materials	150
	2,155
Labour (2 hours x 300)	600
Production overhead [(16,500 + 7,500/1,000 hours) x 2 hours]	48
	2,803

Note: The selling and administrative costs are not part of the cost of inventory.

Question 5 (Conversion costs)

A dealer has purchased 1,000 cars costing ₹ 2,80,000 each on deferred payment basis as ₹ 25,000 per month per car to be paid in 12 equal instalments. At year end 31 March 20X1, twenty cars are in stock. Compute the cost of inventory, finance cost and cost of goods sold.

Solution

	₹
Deferred payment price (25,000 x 12)	3,00,000
Less: Cash price	2,80,000
Interest expense	**20,000**

		₹
Cost of inventory	20 cars x 2,80,000	56,00,000
Finance cost	1,000 cars x 20,000	2,00,00,000
Cost of goods sold	980 cars x 2,80,000	27,44,00,000

Question 6 (Cost of Inventory)

Venus Trading Company purchases cars from several countries and sells them to Asian countries. During the current year, this company has incurred following expenses:

1. Trade discounts on purchase
2. Handling costs relating to imports
3. Salaries of accounting department
4. Sales commission paid to sales agents
5. After sales warranty costs
6. Import duties
7. Costs of purchases (based on supplier's invoices)
8. Freight expense
9. Insurance of purchases
10. Brokerage commission paid to indenting agents

Evaluate which costs are allowed by Ind AS 2 for inclusion in the cost of inventory in the books of Venus.

Solution

Items number 1, 2, 6, 7, 8, 9, 10 are allowed by Ind AS 2 for the calculation of cost of inventories. Salaries of accounts department, sales commission, and after sale warranty costs are not considered to be the cost of inventory. Therefore, they are not allowed by Ind AS 2 for inclusion in cost of inventory and are expensed off in the profit and loss account.

Question 7

As per Ind AS 2, selling costs are excluded from the cost of inventories and are required to be recognized as an expense in the period in which these are incurred. Advise whether the distribution costs would now be included in the cost of inventories under Ind AS 2.

Solution

Selling and distribution costs are generally used as single term because both are related, as selling costs are incurred to effect the sale and the distribution costs are incurred by the seller to complete a sale transaction by making the goods available to the buyer from the point of sale to the point at which the buyer takes possession. Since these costs are not related to bringing the goods to their present location and condition, the same are not included in the cost of inventories. Accordingly, though the word 'distribution costs' is not specifically mentioned in Ind AS 2, these costs would continue to be excluded from the cost of inventories.

Question 8 (PYQ Dec 2021 (5 Marks) (Similar))

In a manufacturing process of Mars Ltd, one by-product BP emerges besides two main products MP1 and MP2 apart from scrap. Details of cost of production process are here under:

Item	Unit	Amount	Output	Closing Stock 31.3.20X1
Raw material	14,500	1,50,000	MP1 - 5,000 units	250
Wages	-	90,000	MP2 - 4,000 units	100
Fixed overhead	-	65,000	BP- 2,000 units	
Variable overhead	-	50,000		

Average market price of MP1 and MP2 is ₹ 60 per unit and ₹ 50 per unit respectively, by- product is sold @ ₹ 20 per unit. There is a profit of ₹ 5,000 on sale of by-product after incurring separate processing charges of ₹ 8,000 and packing charges of ₹ 2,000, ₹ 5,000 was realised from sale of scrap.

Calculate the value of closing stock of MP1 and MP2 as on 31.3.20X1.

Solution

As per Ind AS 2 'Inventories', most by-products as well as scrap or waste materials, by their nature, are immaterial. They are often measured at net realisable value and this value is deducted from the cost of the main product.

1. Calculation of NRV of By-product BP

		₹
Selling price of by-product	2,000 units x 20 per unit	40,000
Less: Separate processing charges of by- product BP		(8,000)
Packing charges		(2,000)
Net realisable value of by-product BP		**30,000**

2. Calculation of cost of conversion for allocation between joint products MP1 and MP2

Raw material		1,50,000
Wages		90,000
Fixed overhead		65,000
Variable overhead		50,000
Less: NRV of by-product BP (See calculation 1)	30,000	
Sale value of scrap	5,000	(35,000)
Joint cost to be allocated between MP1 and MP2		**3,20,000**

3. Determination of "basis for allocation" and allocation of joint cost to MP1 and MP2

	MP 1	MP 2
Output in units (a)	5,000	4,000
Sales price per unit (b)	60	50
Sales value (a x b)	3,00,000	2,00,000
Ratio of allocation	3	2
Joint cost of3,20,000 allocated in the ratio of 3:2 (c)	1,92,000	1,28,000
Cost per unit [c/a]	38.4	32

4. Determination of value of closing stock of MP1 and MP2

Particulars	MP 1	MP 2
Closing stock in units	250 units	100 units
Cost per unit	38.4	32
Value of closing stock	**9,600**	**3,200**

Question 9 (Measurement techniques of Cost)

Mars Fashions is a new luxury retail company located in Lajpat Nagar, New Delhi. Kindly advise the accountant of the company on the necessary accounting treatment for the following items:

a. One of Company's product lines is beauty products, particularly cosmetics such as lipsticks, moisturizers and compact make-up kits. The company sells hundreds of different brands of these products. Each product is quite similar, is purchased at similar prices and has a short lifecycle before a new similar product is introduced. The point of sale and inventory system is not yet fully functioning in this department. The sales manager of the cosmetic department is unsure of the cost of each product but is confident of the selling price and has reliably informed you that the Company, on average, make a gross margin of 65% on each line.

b. Mars Fashions also sells handbags. The Company manufactures their own handbags as they wish to be assured of the quality and craftsmanship which goes into each handbag. The handbags are manufactured in India in the factory which has made handbags for the last fifty years. Normally, Mars manufactures 1,00,000 handbags a year in their handbag division which uses 15% of the space and overheads of the head office factory. The division employs ten people and is seen as being an efficient division within the overall company.

In accordance with Ind AS 2, explain how the items referred to in a) and b) should be measured.

Solution

a. The retail method can be used for measuring inventories of the beauty products. The cost of the inventory is determined by taking the selling price of the cosmetics and reducing it by the gross margin of 65% to arrive at the cost.

b. The handbags can be measured using standard cost especially if the results approximate cost. Given that the company has the information reliably on hand in relation to direct materials, direct labour, direct expenses and overheads, it would be the best method to use to arrive at the cost of inventories.

Question 10

State whether an entity can use different cost formulae for inventories held at different geographical locations having similar nature and use to it.

Solution

Paragraph 25 of Ind AS 2 prescribes that the cost of inventories, other than the items of inventories which are not ordinarily interchangeable as dealt with in paragraph 23, shall be assigned 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 similar nature and use to it. In this case, since the inventories held at different geographical location are of similar nature and use to the entity, different cost formula cannot be used for inventory valuation purposes.

Question 11

Mercury Ltd. uses a periodic inventory system. The following information relates to 20X1-20X2.

Date	Particular	Unit	Cost p.u.	Total Cost
April	Inventory	200	10	2,000
May	Purchases	50	11	550
September	Purchases	400	12	4,800
February	Purchases	350	14	4,900
	Total	**1,000**		**12,250**

Physical inventory at 31.3.20X2 400 units.

Calculate ending inventory value and cost of sales using:

a. FIFO
b. Weighted Average

Solution

FIFO: inventory 31.3.20X2	350 @14 =	4,900
	50 @ 12 =	600
		5,500
Cost of Sales	12,250-5,500 =	6,750
Weighted average: cost per item	12,250/1000 =	12.25
Weighted average inventory at 31.3.20X2	400 x 12.25 =	4,900
Cost of sales 20X1-20X2	12,250-4,900 =	7,350

Question 12 (RTP Nov 2021)

Recommend whether the following costs should be considered while determining the Net Realisable Value (NRV) of the inventories?

a. Costs of completion of work-in-progress;
b. Trade discounts expected to be allowed on sale; and
c. Cash discounts expected to be allowed for prompt payment

Solution

Ind AS 2 defines Net Realisable Value as the "estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale."

Costs of completion of work-in-progress are incurred to convert the work-in progress into finished goods. Since these costs are in the nature of completion costs, in accordance with the above definition, the same should be deducted from the estimated selling price to determine the NRV of work-in- progress.

Trade discount is a reduction granted by a supplier from the list price of goods or services on business considerations other than for prompt payment.
Trade discount is allowed either expressly through an agreement or through prevalent commercial practices in the terms of the trade and the same is adjusted in arriving at the selling price. Accordingly, the trade discount expected to be allowed should be deducted to determine the estimated selling price.

Cash discount is a reduction granted by a supplier from the invoiced price in consideration of immediate payment or payment within a stipulated period.

These types of costs are incurred to recover the sale proceeds immediately or before the end of the specified period or credit period allowed to the customer. In other words, these costs are not incurred to make the sale, therefore, the same should not be considered while determining NRV.

Question 13

ABC Ltd. manufactures and sells paper envelopes. The stock of envelopes was included in the closing inventory as of 31st March, 20X1, at a cost of ₹ 50 per pack. During the final audit, the auditors noted that the subsequent sale price for the inventory at 15th April, 20X1, was ₹ 40 per pack. Furthermore, enquiry reveals that during the physical stock take, a water leakage has created damages to the paper and the glue. Accordingly, in the following week, ABC Ltd. has spent a total of ₹ 15 per pack for repairing and reapplying glue to the envelopes.
Calculate the net realisable value and inventory write-down (loss) amount.

Solution

The net realisable value is the expected sale price ₹ 40 less cost incurred to bring the goods to its saleable condition i.e. ₹ 15.
Thus, NRV of envelopes pack = ₹ 40 – ₹ 15 = ₹ 25 per pack.
The loss (inventory write-down) per pack is the difference between cost and net realisable value = ₹ 50 – ₹ 25 = ₹ 25 per pack.

Question 14

At the end of its financial year, Company P has 100 units of inventory on hand recorded at a carrying amount of ₹ 10 per unit. The current market price is ₹ 8 per unit at which these units can be sold. Company P has a firm sales contract with Company Q to sell 60 units at ₹ 11 per unit, which cannot be settled net. Estimated incremental selling cost is ₹ 1 per unit.
Compute Net Realisable Value (NRV) of the inventory of Company P.

Solution

While performing NRV test, NRV of 60 units that will be sold to Company Q is ₹ 10 per unit (11-1)
NRV of the remaining 40 units is ₹ 7 per unit (i.e. 8-1).
Therefore, Company P will write down those remaining 40 units by ₹ 120 (i.e. 40 x 3).
Total cost of inventory would be

Goods to be sold to Company Q	60 units x ₹ 10	= ₹ 600
Remaining goods	40 units x ₹ 7	= ₹ 280
		= ₹ 880

Question 15 (MTP May 2023)

A business has four items of inventory. A count of the inventory has established that the amounts of inventory currently held, at cost, are as follows:

	Cost	Estimated Sales price	Selling costs
Inventory item A1	8,000	7,800	500
Inventory item A2	14,000	18,000	200
Inventory item B1	16,000	17,000	200
Inventory item C1	6,000	7,500	150

Calculate the value of closing inventory in the financial statements of a business.

Solution

The value of closing inventory in the financial statements:

Item of inventory	Cost	NRV (Estimated Sales price- Selling costs)	Measurement base (Lower of cost or NRV)	Value
A1	8,000	(7,800 – 500) 7,300	NRV	7,300
A2	14,000	(18,000 – 200) 17,800	Cost	14,000
B1	16,000	(17,000 – 200) 16,800	Cost	16,000
C1	6,000	(7,500 – 150) 7,350	Cost	6,000
Value of Inventory				**43,300**

Question 16

Particulars		Kg.	₹
Opening Inventory:	Finished Goods	1,000	25,000
	Raw Materials	1,100	11,000
Purchases		10,000	1,00,000
Labour			76,500
Overheads (Fixed)			75,000
Sales		10,000	2,80,000
Closing Inventory:	Raw Materials	900	
	Finished Goods	1,200	

The expected production for the year was 15,000 kg of the finished product. Due to fall in market demand the sales price for the finished goods was ₹ 20 per kg and the replacement cost for the raw material was ₹ 9.50 per kg on the closing day. Calculate the closing inventory as on that date.

Solution

Calculation of cost for closing inventory

Particulars	₹
Cost of Purchase (10,200 x 10)	1,02,000
Direct Labour	76,500
Fixed Overhead [(75,000 x 10,200) / 15,000]	51,000
Cost of Production	**2,29,500**
Cost of closing inventory per unit (2,29,500/10,200)	₹ 22.50
Net Realisable Value per unit	₹ 20.00

Since net realisable value is less than cost, closing inventory will be valued at ₹ 20.

As NRV of the finished goods is less than its cost, relevant raw materials will be valued at replacement cost i.e. ₹ 9.50.

Therefore, value of closing inventory: Finished Goods (1,200 x ₹ 20) = ₹ 24,000

Raw Materials (900 x ₹ 9.50) = ₹ 8,550

= ₹ **32,550**

Question 17

Sun Pharma Limited, a renowned company in the field of pharmaceuticals has the following four items in inventory: The cost and net realisable value is given as follows:

Item	Cost	Net Realisable Value
A	2,000	1,900
B	5,000	5,100
C	4,400	4,550
D	3,200	2,990
Total	**14,600**	**14,540**

Calculate the value of Inventories:

a. On an item-by-item basis
b. On a group basis

Solution

Inventories shall be measured at the lower of cost and net realisable value.

Item by item basis:	₹
A	1,900
B	5,000
C	4,400
D	2,990
	14,290
Group basis	**14,540**

Note: Group wise computation has been required in the question only to explain the concept.

Question 18

UA Ltd. purchased raw material @ ₹ 400 per kg. Company does not sell raw material but uses in production of finished goods. The finished goods in which raw material is used are expected to be sold at below cost. At the end of the accounting year, company is having 10,000 kg of raw material in inventory. As the company never sells the raw material, it does not know the selling price of raw material and hence cannot calculate the realisable value of the raw material for valuation of inventories at the end of the year. However, replacement cost of raw material is ₹ 300 per kg. Compute the value of inventory of raw material?

Solution

As per Ind AS 2 "Inventories", materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value. Therefore, in this case, UA Ltd. will value the inventory of raw material at ₹ 30,00,000 (10,000 kg. @ ₹ 300 per kg.).

Question 19 (PYQ Nov 2020 (4 Marks))

Sun Ltd. has fabricated special equipment (solar power panel) during 20X1-20X2 as per drawing and design supplied by the customer. However, due to a liquidity crunch, the customer has requested the company for postponement in delivery schedule and requested the company to withhold the delivery of finished goods products and discontinue the production of balance items.

As a result of the above, the details of customer balance and the goods held by the company as work-in-progress and finished goods as on 31.3.20X3 are as follows:

Solar power panel (WIP)	₹ 85 lakhs
Solar power panel (finished products)	₹ 55 lakhs
Sundry Debtor (solar power panel)	₹ 65 lakhs

The petition for winding up against the customer has been filed during 20X2-20X3 by Sun Ltd. Advise on provision to be made of ₹ 205 lakh included in Sundry Debtors, Finished goods and work-in-progress in the financial statement of 20X2-20X3.

Solution

From the facts given in the question it is obvious that Sun Ltd. is a manufacturer of solar power panel. As per Ind AS 2 'Inventories', inventories are assets (a) held for sale in the ordinary course of business; (b) in the process of production for such sale; or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services. Therefore, solar power panel held in its stock will be considered as its inventory. Further, as per the standard, inventory at the end of the year is to be valued at lower of cost or NRV.

As the customer has postponed the delivery schedule due to liquidity crunch the entire cost incurred for solar power panel which were to be supplied has been shown in Inventory. The solar power panel are in the possession of the Company which can be sold in the market. Hence, the company should value such inventory as per principle laid down in Ind AS 2 i.e. lower of Cost or NRV. Though, the goods were produced as per specifications of buyer the Company should determine the NRV of these goods in the market and value the goods accordingly. Change in value of such solar power panel should be provided for in the books. In the absence of the NRV of WIP and Finished product given in the question, assuming that cost is lower, the company shall value its inventory as per Ind AS 2 for ₹ 140 lakhs [i.e solar power panel (WIP) ₹ 85 lakhs + solar power panel (finished products) ₹ 55 lakhs].

Alternatively, if it is assumed that there is no buyer for such fabricated solar power panel, then NRV will be Nil. In such a case, full value of finished goods & WIP will be provided for in the books.

As regards Sundry Debtors balance, since the Company has filed a petition for winding up against the customer in 20X2-20X3, it is probable that amount is not recoverable from the party. Hence, the provision for doubtful debts for ₹ 65 lakhs shall be made in the books against the debtor's amount.

Question 20 **(RTP May 2018 & MTP Nov 2023)**

On 31 March 20X1, the inventory of ABC includes spare parts which it had been supplying to a number of different customers for some years. The cost of the spare parts was ₹ 10 million and based on retail prices at 31 March 20X1, the expected selling price of the spare parts is ₹ 12 million. On 15 April 20X1, due to market fluctuations, expected selling price of the spare parts in stock is reduced to ₹ 8 million. The estimated selling expense required to make the sales would be ₹ 0.5 million. Financial statements were approved by the Board of Directors on 20th April 20X1.

As at 31st March 20X2, Directors noted that such inventory is still unsold and lying in the warehouse of the company. Directors believe that inventory is in a saleable condition and active marketing would result in an immediate sale. Since the market conditions have improved, estimated selling price of inventory is 11 million and estimated selling expenses are same ₹ 0.5 million. Determine the value inventory at the following dates:

a. 31st March 20X1
b. 31st March 20X2

Solution

As per Ind AS 2 'Inventories', inventory is measured at lower of 'cost' or 'net realisable value'. Further, as per Ind AS 10: 'Events after Balance Sheet Date', decline in net realisable value below cost provides additional evidence of events occurring at the balance sheet date and hence shall be considered as 'adjusting events'.

a. In the given case, for valuation of inventory as on 31 March 20X1, cost of inventory would be ₹ 10 million and net realisable value would be ₹ 7.5 million (i.e. Expected selling price ₹ 8 million - estimated selling expenses ₹ 0.5 million). Accordingly, inventory shall be measured at ₹ 7.5 million i.e. lower of cost and net realisable value. Therefore, inventory write down of ₹ 2.5 million would be recorded in income statement of that year.

b. As per para 33 of Ind AS 2, a new assessment is made of net realisable value in each subsequent period. It inter alia states that if there is increase in net realisable value because of changed economic circumstances, the amount of write down is reversed so that new carrying amount is the lower of the cost and the revised net realisable value. Accordingly, as at 31 March 20X2, again inventory would be valued at cost or net realisable value whichever is lower. In the present case, cost is ₹ 10 million and net realisable value would be ₹ 10.5 million (i.e. expected selling price ₹ 11 million – estimated selling expense ₹ 0.5 million). Accordingly, inventory would be recorded at ₹ 10 million and inventory write down carried out in previous year for ₹ 2.5 million shall be reversed.

Question 21 (RTP May 2020)

The following information is gathered from an entity:

a. Full capacity is 10,000 labour hours in a year.
b. Normal capacity is 7,500 labour hours in a year.
c. Actual labour hours for current period are 6,500 hours.
d. Total fixed production overhead is ₹ 1,500.
e. Total variable production overhead is ₹ 2,600.
f. Total opening inventory is 2,500 units.
g. Total units produced in a year are 6,500 units.
h. Total units sold in a year are 6,700 units.
i. The cost of inventories is assigned by using FIFO cost formula.

Determine the overhead costs to be allocated to cost of goods sold and closing inventory?

Solution

Hours taken to produce 1 unit = 6,500 hours / 6,500 units = 1 hour per unit.

Fixed production overhead absorption rate:

= Fixed production overhead / labour hours for normal capacity
= ₹ 1,500 / 7,500
= ₹ 0.2 per hour

Management should allocate fixed overhead costs to units produced at a rate of ₹ 0.2 per hour.
Therefore, fixed production overhead allocated to 6,500 units produced during the year (one unit per hour) = 6,500 units x 1 hour x ₹ 0.2 = ₹ 1,300.
The remaining fixed overhead incurred during the year of ₹ 200 (₹ 1,500 – ₹ 1,300) that remains unallocated is recognized as an expense.
The amount of fixed overhead allocated to inventory is not increased as a result of low production by using normal capacity to allocate fixed overhead.
Variable production overhead absorption rate:

= Variable production overhead/actual hours for current period
= ₹ 2,600 / 6,500 hours
= ₹ 0.4 per hour

Management should allocate variable overhead costs to units produced at a rate of ₹ 0.4 per hour.
The above rate results in the allocation of all variable overheads to units produced during the year.

Closing inventory = Opening inventory + Units produced during year – Units sold during year
= 2,500 + 6,500 – 6,700 = 2,300 units

As each unit has taken one hour to produce (6,500 hours / 6,500 units produced), total fixed and variable production overhead recognized as part of cost of inventory:

= Number of units of closing inventory x Number of hours to produce each unit x (Fixed production overhead absorption rate + Variable production overhead absorption rate)

= 2,300 units x 1 hour x (₹ 0.2 + ₹ 0.4)

= ₹ 1,380

The remaining ₹ 2,720 [(₹ 1,500 + ₹ 2,600) – ₹ 1,380] is recognized as an expense in the income statement as follows:

Absorbed in cost of goods sold (FIFO basis) (₹ 6,500 – ₹ 2,300) = 4,200 x ₹ 0.6	= ₹ 2,520
Unabsorbed fixed overheads, not included in the cost of goods sold	= ₹ 200
Total	**= ₹ 2,720**

Question 22

Sharp Trading Inc. purchases motorcycles from various countries and exports them to Europe. Sharp Trading has incurred these expenses during 20X1:

a. Cost of purchases (based on vendors' invoices) ₹ 5,00,000
b. Trade discounts on purchases ₹ 10,000
c. Import duties ₹ 200
d. Freight and insurance on purchases ₹ 250
e. Other handling costs relating to imports ₹ 100
f. Salaries of accounting department ₹ 15,000
g. Brokerage commission payable to indenting agents for arranging imports ₹ 300
h. Sales commission payable to sales agents ₹ 150
i. After-sales warranty costs ₹ 600

Advise as if which of the above item is to be included in the cost of inventory and wants you to calculate cost of inventory as per Ind AS 2.

Solution

Items (a), (b), (c), (d), (e), and (g) are permitted to be included in the cost of inventory since these elements contribute to cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present location and condition, as per Ind AS 2

Statement showing cost of inventory

Particular	₹
Cost of purchases (based on vendors' invoices)	5,00,000
Trade discounts on purchases	(10,000)
Import duties	200
Freight and insurance on purchases	250
Other handling costs relating to imports	100
Brokerage commission payable to indenting agents for arranging imports	300
Cost of inventory under Ind AS 2	**4,90,850**

Note: Salaries of accounting department, sales commission, and after-sales warranty costs are not considered as part of cost of inventory under Ind AS 2.

Question 23 (RTP May 2021 & MTP Nov 2022)

On 1 January 20X1 an entity accepted an order for 7,000 custom-made corporate gifts.

On 3 January 20X1 the entity purchased raw materials to be consumed in the production process for ₹ 5,50,000, including ₹ 50,000 refundable purchase taxes. The purchase price was funded by raising a loan of ₹ 5,55,000 (including ₹ 5,000 loan-raising fees). The loan is secured by the inventories.

During January 20X1 the entity designed the corporate gifts for the customer.
Design costs included:

- cost of external designer = ₹ 7,000; and
- labour = ₹ 3,000.

During February 20X1 the entity's production team developed the manufacturing technique and made further modifications necessary to bring the inventories to the conditions specified in the agreement. The following costs were incurred in the testing phase:

- materials, net of ₹ 3,000 recovered from the sale of the scrapped output = ₹ 21,000
- labour = ₹ 11,000
- depreciation of plant used to perform the modifications = ₹ 5,000

During February 20X1 the entity incurred the following additional costs in manufacturing the customised corporate gifts:

- consumable stores = ₹ 55,000
- labour = ₹ 65,000
- depreciation of plant used to manufacture the customised corporate gifts = ₹ 15,000

The customised corporate gifts were ready for sale on 1st March 20X1. No abnormal wastage occurred in the development and manufacture of the corporate gifts.
Compute the cost of the inventory? Substantiate your answer with appropriate reasons and calculations, wherever required.

Solution

Statement showing computation of inventory cost

Particulars	Amount (₹)	Remarks
Costs of purchase	5,00,000	Purchase price of raw material [purchase price (₹ 5,50,000) less refundable purchase taxes (₹ 50,000)]
Loan-raising fee	-	Included in the measurement of the liability
Costs of purchase	55,000	Purchase price of consumable stores
Costs of conversion	65,000	Direct costs—labour
Production overheads	15,000	Fixed costs—depreciation
Production overheads	10,000	Product design costs and labour cost for specific customer
Other costs	37,000	Refer working note
Borrowing costs	-	Recognized as an expense in profit or loss
Total cost of inventories	**6,82,000**	

Working Note:

Costs of testing product designed for specific customer:

₹ 21,000 material (ie net of the ₹ 3,000 recovered from the sale of the scrapped output) + ₹ 11,000 labour + ₹ 5,000 depreciation.

Question 24 (RTP Nov 2022)

A retailer company imported goods at a cost of ₹ 1,30,000 including ₹ 20,000 non-refundable import duties and ₹ 10,000 refundable purchase taxes. The risks and rewards of ownership of the imported goods were transferred to the retailer company upon collection of the goods from the harbour warehouse. The retailer company was required to pay for the goods upon collection. The retailer company incurred ₹ 5,000 to transport the goods to its retail outlet and a further ₹ 2,000 in delivering the goods to its customer. Further selling costs of ₹ 3,000 were incurred in selling the goods.
State whether delivery charges and selling expenses will form part of the cost of inventory. If not, then why? Also calculate the cost of inventory.

Solution

Calculation of Inventory cost:

Particulars	Amount (₹)
Purchase Price (1,30,000 – 20,000 – 10,000)	1,00,000
Non-refundable import duties	20,000
Transport cost	5,000
Total	**1,25,000**

Note: The cost of purchase excludes the refundable purchase taxes paid on acquisition of the goods as the ₹ 10,000 paid will be refunded to the retailer.

Ind AS 2 specifically exclude selling cost from forming part of cost of inventory. However, selling and distribution costs are generally used as single term because both are related, as selling costs are incurred to effect the sale and the distribution costs are incurred by the seller to complete a sale transaction by making the goods available to the buyer from the point of sale to the point at which the buyer takes possession. Since these costs are not related to bringing the goods to their present location and condition, the same are not included in the cost of inventories. Accordingly, though the word 'distribution costs' is not specifically mentioned in Ind AS 2, these costs would continue to be excluded from the cost of inventories. Therefore, it excludes the selling expenses incurred (i.e., ₹ 2,000 delivery costs and ₹ 3,000 other selling costs).

Question 25 (RTP May 2023)

An entity has following details regarding cost and retail price of the goods purchased and unsold at the beginning of the year:

	Cost	Retail Price
Opening inventory	6,250	8,000
Purchases	19,500	34,000
Inventory on hand		(23,000)
Sales for the period		19,000

Applying the retail method, compute the following:

a.) Percentage of cost price over retail price;
b.) Cost of closing inventory;
c.) Value of cost of sales (at cost); and
d.) Profit earned during the year on sale of inventory

Ignore the impact of mark-ups or mark-downs on the selling price.

Solution

Table showing application of Retail method for calculation of the goods sold during the year and unsold inventory

S. No.	Particulars		₹
	Cost price of goods	6,250 + 19,500	25,750
	Retail price of goods	8,000 + 34,000	42,000
(a)	Cost percentage of retail price	25,750 / 42,000	61%
(b)	Closing inventory (at cost)	23,000 x 61%	14,030
(c)	Cost of sales for the period	[(6,250 + 19,500) - 14,030]	11,720
	Sales for the period		**19,000**
(d)	Profit earned on sale of goods during the year	19,000 – 11,720	**7,280**

Question 26 (RTP Nov 2023)

A Ltd. began operations in the year 20X1-20X2. In 20X1-20X2, it incurred the following expenditures on purchasing the raw materials for its product:

a Purchase price of the raw materials = ₹ 30,000;
b Import duty and other non-refundable purchase taxes = ₹ 8,000;
c Refundable purchase taxes = ₹ 1,000;

d Freight costs for bringing the goods from the supplier to the factory's storeroom for raw materials = ₹ 3,000;
e Costs of unloading the materials into the storeroom for raw materials = ₹ 20; and
f Packaging = ₹ 2,000.

On 31st March, 20X2, A Ltd. received ₹ 530 volume rebate from a supplier for purchasing more than ₹ 15,000 from the supplier during the year.

A Ltd. incurred the following additional costs in the production run:

i) Salary of the machine workers in the factory = ₹ 5,000;
ii) Salary of factory supervisor = ₹ 3,000;
iii) Depreciation of the factory building and equipment used for production process = ₹ 600;
iv) Consumables used in the production process = ₹ 200;
v) Depreciation of vehicle used to transport the goods from the storeroom for raw materials to the machine floor = ₹ 400;
vi) Factory electricity usage = ₹ 300;
vii) Factory rental = ₹ 1,000; and
viii) Depreciation of the entity's vehicle used by the factory supervisor is ₹ 200.

During 20X1-20X2, A Ltd. incurred the following administrative expenses:

1. Depreciation of the administration building = ₹ 500;
2. Depreciation and maintenance of vehicles used by the administrative staff = ₹ 150; and
3. Salaries of the administrative personnel = ₹ 3,050.

Of the administrative expenses, 20% is attributable to administering the factory. Remaining expenses are attributable, in equal proportion, to the sales and other non- production operations (eg financing, tax and corporate secretarial functions).

In 20X1-20X2, A Ltd. incurred the following selling expenses:

a) Advertising costs = ₹ 300;
b) Depreciation and maintenance of vehicles used by the sales staff = ₹ 100; and
c) Salaries of the administrative personnel = ₹ 6,000.

Pass necessary journal entries to record the cost of inventory in the books of A Ltd.

Solution

Journal Entries for the year 20X1-20X2

			₹	₹
1.	Inventory A/c (W.N.1)	Dr.	42,490	
	To Cash/Bank A/c			42,490
	(To recognise the cost of raw materials purchased)			
2.	Inventory A/c (W.N.2)	Dr.	11,240	
	To Cash/Bank A/c (cost of direct labour)			5,000
	To Property, plant and equipment (accumulated depreciation-factory equipment)			600
	To Property, plant and equipment (accumulated depreciation-raw-materials delivery vehicle)			400
	To Cash/Bank A/c (cost of electricity used)			300
	To Property, plant and equipment (accumulated depreciation-factory supervisor's vehicle)			200
	To Cash/Bank A/c (factory management's salaries)			3,000
	To Cash/Bank A/c (factory rental)			1,000
	To Cash/Bank A/c (administrative salaries attributable to the factory)			610
	To Property, plant and equipment (attributable portion of accumulated depreciation- administration building)			100

	To Property, plant and equipment (attributable portion of accumulated depreciation- administration vehicles)			30
	(To recognise the costs of conversion)			
3.	Inventory A/c (W.N.2)	Dr.	200	
	To Inventory A/c (consumable stores)			200
	(To recognise the costs of consumable stores inventory consumed)			

The total cost of inventories = Costs of purchase + Costs of conversion
= ₹ 42,490 + ₹ 11,240 + ₹ 200
= ₹ 53,930

Working Notes:

1. **Computation of costs of purchase**

Description	₹
Purchase price	30,000
Import duty and other non-refundable purchase taxes	8,000
Freight costs for bringing the goods to the factory storeroom	3,000
Cost of unloading the raw materials into the storeroom	20
Packaging	2,000
Less: Trade discounts, rebates and subsidies	(530)
Cost of purchase	**42,490**

Note: Refundable taxes do not form part of the cost of inventories.

2. **Computation of costs of conversion**

Description	₹
Direct labour	5,000
Fixed production overheads	
Depreciation and maintenance of factory equipment	600
Depreciation of vehicle used for transporting the goods	400
Depreciation of vehicle used by factory supervisor	200
Factory electricity usage	300
Factory management	3,000
Factory rental	1,000
Other costs of administering the factory	
20% of depreciation of administration building	100
20% of depreciation of administration vehicles	30
20% of administrative staff costs	610
Variable production overheads	
Indirect material—consumables	200
Cost of conversion	**11,440**

Question 27 (RTP May 2024)

B Limited has valued its Stock held for distribution as free items on claim by customers (on offers) at zero. The customers have a right to claim the free item within 14 days from date of invoice. If the time limit of 14-day exceeds, the claim is foregone by the customer.

The majority of the free items require online registration by the buyers for participation in the contest conducted by the respective brand which needs to be done by the buyers within 3 days from the date of invoice.

Out of it, a few items under this category were found damaged. The replacement cost of such items would be ₹ 2,50,000.

Determine whether the entity has to book loss of inventory or provide for replacement cost of the goods that need to be given as free items to customers as per the principles of Ind AS.

Solution

Ind AS 2 deals with write-off in value of inventory. The stock of free items is valued at zero by the company. The question of "Loss of Inventory ₹ 2,50,000" does not arise as the claim of free stock is subject to various conditions like claim within 14 days, online registration within 3 days, etc. which are all contingent in nature.

A provision shall be recognised when:

a) an entity has a present obligation (legal or constructive) as a result of a past event;
b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
c) a reliable estimate can be made of the amount of the obligation.

If these conditions are met, provision shall be recognised.

Here, provision is to be made for goods to be distributed because sale took place in the reporting year and assuming that the registration for the contest are received whereby there is a high probability that the customer can claim the free items within 14 days from the date of invoice. Further, a reliable estimate of the claim of ₹ 2,50,000 can be made. Hence provision of ₹ 2,50,000 is to be made for in the reporting year's financial statements.

Further, on expiry of the time period, where claim had not been made by the customers, reversal of provision will be done in the next financial year.

Question 28 (RTP Nov 2022)

Company A incurred ₹ 20,000 as cost for restoring the site on which the item of PPE was located. This item was used for manufacturing goods and the requirement for restoring will arise due to manufacturing of goods.

What will the treatment of this ₹ 20,000 in the books of Company A? Analyse on the basis of the provisions of relevant Ind AS.

Solution

Paragraph 16 of Ind AS 16, Property, Plant and Equipment, inter alia states that the cost of an item of property, plant and equipment comprises the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Further, paragraph 18 of Ind AS 16 states that an entity applies Ind AS 2 to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with Ind AS 2 or Ind AS 16 are recognised and measured in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets.

Paragraph 16 of Ind AS 16 clarifies that decommissioning costs that meet the recognition criteria under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, for a provision are added to the cost of an item of property, plant and equipment if such costs are not incurred through the asset's use to produce inventories. Paragraph 18 fills the gap by clarifying where such costs are incurred through the asset's use to produce inventories, they are added to the cost of inventories.

Where the obligation to restore the asset arises due to the use of the asset to produce inventories but not due to the asset's installation, construction or acquisition, the costs are added to the costs of inventories.

Based on the above provisions and discussion, cost of restoring the site ₹ 20,000 incurred during the period of production as a consequence of having used the item to produce inventories during that period should be added to cost of inventories. However, later the inventories are measured at the lower of cost and net realisable value in accordance with paragraph 9 of Ind AS 2.

ADDITIONAL QUESTIONS

Question 29 (RTP Nov 2020)

A company normally produced 1,00,000 units of a high precision equipment each year over past several years. In the current year, due to lack of demand and competition, it produced only 50,000 units. Further information is as follows:
Material = ₹ 200 per unit;
Labour = ₹ 100 per unit;
Variable manufacturing overhead = ₹ 100 per unit;
Fixed factory production overhead =₹ 1,00,00,000;
Fixed factory selling overhead = ₹ 50,00,000;
Variable factory selling overhead = ₹ 150 per unit.
Calculate the value of inventory per unit in accordance with Ind AS 2. What will be the treatment of fixed manufacturing overhead?

Solution

Calculation of Inventory value per unit as per Ind AS 2:

Particulars	Value per unit (₹)
Raw material	200
Labour	100
Variable manufacturing overhead	100
Fixed production overhead (1,00,00,000/1,00,000)	100
	500

Fixed overheads are absorbed based on normally capacity level, i.e.; 1,00,000 units, rather than on the basis of actual production, i.e.; 50,000 units. Therefore, fixed manufacturing overhead on 50,000 units, will be absorbed as inventory value. The remaining fixed manufacturing overhead ₹ 50,00,000 (1,00,00,000 - 50,00,000) will be charged to P&L.
Note: Selling costs are excluded from the cost of inventories and recognised as expense in the period in which they are incurred.

Question 30 (PYQ May 2018 (4 Marks))

XYZ Limited has a plant with the normal capacity to produce 10,00,000 units of a product per annum and the expected fixed overhead is ₹ 30,00,000, Fixed overhead, therefore based on normal capacity is ₹ 3 per unit.
Determine Fixed overhead as per Ind AS 2 'Inventories' if

a. Actual production is 7,50,000 units.
b. Actual production is 15,00,000 units.

Solution

a. **Actual production is 7,50,000 units:** Fixed overhead is not going to change with the change in output and will remain constant at ₹ 30,00,000, therefore, overheads on actual basis is ₹ 4 per unit (30,00,000 / 7,50,000).
Hence, by valuing inventory at ₹ 4 each for fixed overhead purpose, it will be overvalued and the losses of ₹ 7,50,000 will also be included in closing inventory leading to a higher gross profit then actually earned.
Therefore, it is advisable to include fixed overhead per unit on normal capacity to actual production (7,50,000 x 3) ₹ 22,50,000 and balance ₹ 7,50,000 shall be transferred to Profit & Loss Account.

b. **Actual production is 15,00,000 units:** Fixed overhead is not going to change with the change in output and will remain constant at ₹ 30,00,000, therefore, overheads on actual basis is ₹ 2 (30,00,000 / 15,00,000).

Hence by valuing inventory at ₹ 3 each for fixed overhead purpose, we will be adding the element of cost to inventory which actually has not been incurred. At ₹ 3 per unit, total fixed overhead comes to ₹ 45,00,000 whereas, actual fixed overhead expense is only ₹ 30,00,000. Therefore, it is advisable to include fixed overhead on actual basis (15,00,000 x 2) ₹ 30,00,000.

Question 31 (PYQ May 2023 (5 Marks))

Summer Solutions Limited is engaged in the manufacturing of customized gifts for its corporate customers. On 1st December, 2022, the company received an order from Rain Limited for the supply of 15,000 customized corporate gifts. On 4th December, 2022, to meet the order, Summer Solutions Limited purchased 20,000 kg of certain material at ₹ 110 per kg. The purchase price includes GST of ₹ 10 per kg in respect of which full GST credit is admissible. Freight incurred amounted to ₹ 1,00,000.

During January, 2023, the company incurred the following expenses to design the corporate gift for Rain Limited:

- Fee to external designer ₹ 20,000
- Labour ₹ 8,000

After checking the sample of gift, the management of Rain Limited did not approve the design of gift and suggested some modifications. Consequently, the production team of Summer Solutions Limited made modifications to bring the inventories as per the conditions specified in the order.

Following costs were incurred during testing phase:

- Materials ₹ 45,000
- Labour ₹ 20,000
- Depreciation of plant used during testing phase ₹ 7,000

Some of the materials used during testing phase was scrapped and sold for ₹ 5,000.

During February, 2023, Summer Solutions Limited incurred the following additional costs in the manufacturing of customized corporate gifts:

- Consumable stores ₹ 1,25,000
- Labour ₹ 1,42,000
- Depreciation of plant used in manufacturing of customized corporate gifts: ₹ 38,000

On 15th March, 2023, the customized gifts were ready for delivery. There was no abnormal loss during the manufacturing process.

You are required to compute the cost of customized gifts. Your answer should be supported by appropriate reasons and calculations wherever necessary.

Solution

Statement showing computation of inventory cost

Particulars	₹	Reasons
Costs of purchase of raw material	21,00,000	Purchase price of raw material net of GST plus freight [{20,000 x (110-10)} + 1,00,000]
Costs of purchase of consumable stores	1,25,000	Purchase price of consumable stores
Costs of conversion	1,42,000	Direct costs — labour
Production overheads	38,000	Fixed costs — depreciation
Production overheads	28,000	Product design costs and labour cost for specific customer
Other costs	67,000	Refer working note
Total cost of inventories	**25,00,000**	

Working Note:

Costs of testing product designed for specific customer:

₹ 40,000 material (net of ₹ 5,000 recovered from the sale of scrapped output) + ₹ 20,000 labour + ₹ 7,000 depreciation = ₹ 67,000

About The Author

CA Nitin Goel is an All India Rank holder at all CA levels (AIR 9 in CPT, AIR 7 in Intermediate, AIR 9 in Final) and a Gold Medalist in B.Com. With 10+ years of teaching experience, he is a renowned Accounts, Advanced Accounts, and Financial Reporting faculty at PW. A former ITC professional, he blends industry insights with teaching. His students consistently score 90+ marks and have secured All India Ranks, including AIR 1, making him a trusted name in CA education.

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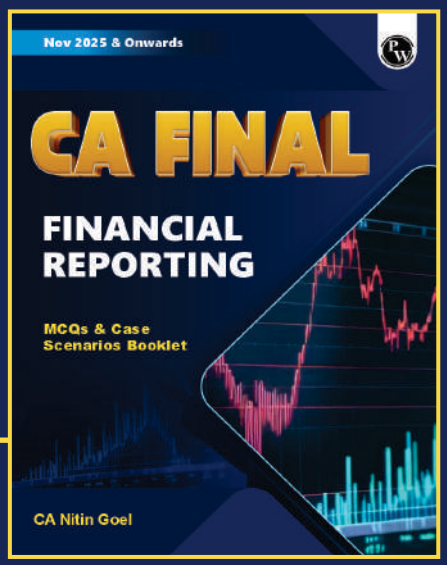

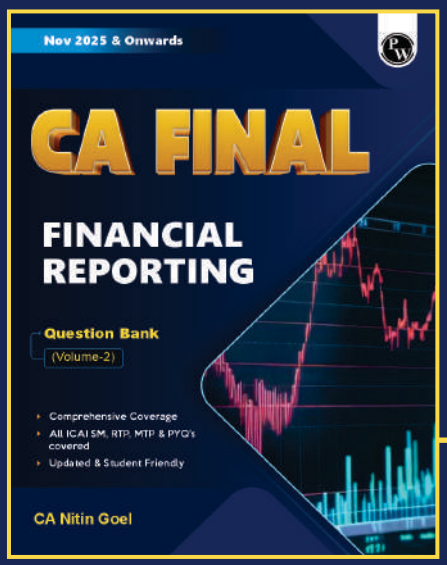

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