CHAPTER - FIVE

ACCOUNTING STANDARDS ON VALUATION AND PRESENTATION
OF INVENTORIES IN THE CONTEXT OF THE HISTORICAL
COST SYSTEM AND THEIR JUSTIFICATION
Introduction

"No, area of accounting has produced wider differences in practice than the computation of the amount at which stocks and work in progress are stated in financial accounts."¹ This was the view given in the preamble to SSAP-9, the English standard on stocks and work in progress. The pertinent questions surrounding valuation and presentation of inventory are: Should inventory be valued at the lower of cost or net realisable value? Should the book value of inventory exceed its realisable value? Is the inclusion of exceptional amounts of wasted material, labour or other expenses as part of inventory cost acceptable? How to select the suitable cost formula? What should be the disclosure requirement of inventory accounting? Diversities exist not only on these issues but also on the way of presenting them in the books of accounts. Disclosure requirement of inventories varies from person to person. Inventory is the primary and most important resource to many business concerns. So, valuation of inventories and their presentation have a great effect on their profitability and financial position not only for current year but also they have effect on the financial statements of the subsequent years.

Due to the diversities of problems involved, it is very difficult to issue a composite set of rules and

policies which will cover all the aspects of the problem and is applicable in all cases. But such a coherent set of rules for accounting treatment of stocks and work in progress was urgently felt. As a result different standard setting bodies have come forward to include 'Inventory' as an item in their standard setting programme. The basic object of accounting standards on inventory was to narrow the areas of differences and variations in accounting practices on the item and to ensure uniform and adequate disclosure in the accounts. This chapter seeks to study how far uniformity is achieved in the accounting treatment and disclosure requirement of inventory and to what extent the objectives of the accounting standards are fulfilled.

With this end in view, this chapter discussed first the definition and composition of inventory. This is followed by an analysis of the objectives of inventory measurement. Thereafter various cost formulae used for ascertaining the cost of inventory are presented. Next to it is discussed the items to be included in cost of inventory. Subsequently ascertainment of net realisable value is considered in detail. Next is presented a comparative statement of the accounting standards on inventory issued by major standard setting bodies. How far the standards ensure uniformity in accounting practices of inventory and to what extent they are proper from the different users' point of view are discussed later. For empirical verification of the above comments, an opinion poll from selected
academicians, professionals and executives across the world was conducted and results of the same has been subsequen-
tly presented. Before conclusion, the possible areas of
further research and scope for further study are presented.

**Definition and composition of inventory**

The Dictionary definition of the term inventory is
"Raw materials and supplies, goods finished and in process
of manufacture and merchandise on hand, in transit and
owned, in storage, or consigned to others at the end of an
accounting period : (a) their aggregate value, usually at
cost or some portion of cost, (b) the process of counting,
listing, and pricing them, (c) the listing in which they
are itemized, showing description, quantities, unit prices,
extensions, and totals, (d) a physical inventory."² According
to E.S. Hendriksen. "The term inventory includes mer-
chandise destined for sale in the normal course of business
and materials and supplies to be used in the process of
production for sale. Excluded from this category are supp-
plies that will be consumed in nonproducing operations,
securities held for sale, but incidental to the operations
of the firm, and plant and equipment in use or awaiting
final disposition upon termination of use."³

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   of India Private Limited, New Delhi-110 001, 1979, P.271.
   House, 28 Jawahar Nagar, Delhi-110 007, 1984, P.298.
From the above two definitions it is clear that authorities have tried to define inventory in terms of components comprising the item. The same line of defining the inventory is also adopted by the various standard setting bodies. For example, SSAP-9; the English standard defined the term 'stocks and work in progress' in terms of its component parts, these being listed as goods purchased for resale, consumable stores, materials purchased for manufacture into products for sale, products and services in the course of completion, and finished goods.  

Although authors and standard setters defined the term inventory with reference to its component parts, opinions differ as to the constituent of inventory. Traditionally, inventories are considered to be current assets as they will be converted into cash or some other form within the production cycle of the business. Obsolete and unsaleable goods are generally excluded from the components of inventory unless it can be disposed off in available markets within the normal selling period. In the traditional accounting structure, inventory at the end of one accounting period is interrelated with the generation of income in that period. Even though inventories are residually determined, some arguments are found to determine the inventory in some other ways and the amount to be charged as expense should be ascertained residually.

Accounting standards have come forward to minimise the difference of opinion and to guide the accountants to have an unified concept about the term inventory. Time will prove, to what extent this objective of the standards is fulfilled.

Objectives of inventory measurement

In the traditional accounting structure, total cost of merchandise i.e. opening stock plus purchases is allocated between the current and future operating periods. In the current period the charged portion is considered as expense while in the future operating periods the other portion is shown as a current asset. The objective behind this allocation system can be fulfilled only through proper inventory measurement. Besides, accountants have other objectives also for the accurate measurement and proper accounting treatment of inventory. It is very difficult to formulate one method which can satisfy all these objectives. 5 Accountants want to match costs with related revenue, they like to report proper values of inventories in the balance sheet, they desire to minimise current income tax burden, they want to ascertain the effect of inventory measurement upon expected future cash flows with the ultimate objective of presenting measures with a high degree of reliability. These objectives are now briefly discussed.

i) Matching of cost with revenue

The primary and most common objective of inventory measurement is the matching of cost with related revenue for determining net profit of the business. In this matching process a certain portion of the total cost of merchandise should be allocated and charged against the reported revenue. So the relationship of inventory measurement to the process of income measurement is very important.

ii) Inventory asset account

The balance sheet will not reflect the true and fair view of the financial position of the business if inventory is not shown as an item of current asset. The objective of the measurement of inventory should be the presentation of the value of the goods to the firm. Here value to the firm is the difference between the value of the firm including inventory as compared to the value of the firm without it. Whatever the method may be, the measurement of inventory should be made in such a way that permit clear interpretation. Otherwise the amount of inventory shown in the balance sheet will not be acceptable.

iii) Minimisation of current income tax burden

Another important objective of inventory measurement is to reduce the current income tax liability to the extent possible. For the purpose accountants try to

allocate a major portion of the total cost of merchandise to the current period and charged it as expense so that taxable income is minimised. However such a process will have a carried forward effect of increasing the income of the subsequent period. In any case, in the process of inventory measurement and its allocation between current and subsequent periods, accountants always try to reduce the current income tax burden.

iv) Inventory measurement and cash flow

The value of inventory resources have two fold effect on the cash flow of the business. It will generate inflow of cash through sale and also effect the outflow required for purchasing the merchandise. The objective of inventory measurement is to present relevant information regarding the item in a way that permits investors and other users to predict the effect of inventories on the future cash flows of the business.

v) Reliability as an objective of inventory measurement

It is the objective of the accountants to ensure reliability of information they supply. This depends on the measurement procedure adopted for valuation of inventory. It is the duty of the accountants to prepare the accounts in such a way that the investors and other users can rely upon the inventory measurement system for their decision making.
From the above discussion it is clear that some of the objectives of inventory measurement are conflicting. Accountants must balance properly the various conflicting objectives and should make a choice of them.  

Cost formulae used for ascertaining the cost of inventory

In a going concern, materials and goods are purchased several times in a year usually at varying prices. Now, which price is attributable to the merchandise allocated to current period and which price is to be applied for determining the cost of inventory at the year end is a matter of choice and judgement. Inventory is often considered to be the residue, the cost of which depends upon the cost formula used for issuing merchandise to be used for production or sale. At the end of each accounting period, it is necessary to value inventory at cost or some other valuation which will be handed over from the current period to the next period. In determining the historical cost of inventory, various cost formulae are suggested by academics and professionals. The standard setting bodies also recommended the areas where they are suitable. Some of the methods are indicated briefly as below:

i) Unit Cost Method

In this method cost of purchasing or manufacturing identifiable units of stock is taken to be the historical cost of inventory. By means of specific identification of unit cost it is possible to ensure specific matching of cost and revenue and also the matching of inventory cost with actual cost price. This method is suitable for valuable or unique items or the items which are easily identifiable. It is also recommended by some accounting standards as an acceptable method for ascertaining historical cost under certain circumstances.

ii) Average Cost Method

Under this method historical cost of inventory is determined by a single representative unit cost obtained by averaging the different rates of various lots of merchandise purchased or produced. Average rate may be calculated by simple average, weighted average or moving average method depending upon the suitability of any of them. However, the accounting standards generally recommended the weighted average formula to be more appropriate. The effect of this method on income determination and balance sheet valuation are to some extent neutral.\(^9\) Average cost formula is more suitable where there is periodic inventory system.

iii) FIFO (First in First out) Method

The first in first out rule is based primarily on the assumption that stock on hand represents the latest purchases.

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or productions and thus the oldest units are used or sold first. Here, the historical cost represents the most current price and it is almost equal to replacement cost and also a good approximation to specific identification cost. In this method balance sheet valuation expresses the most recent price but considerably old prices are charged against current revenue. So, in times of rise in price, income statement will reflect the inflated profit. However, many standard setters have recommended FIFO as an acceptable method.

iv) LIFO (Last in First out) Method

The last in first out principle is based primarily on the assumption that the stock on hand represents the latest purchases or productions and thus the current prices of merchandise are charged against current revenue ensuring a good matching of cost with revenue. In case of rise in price, profit is understated by this method. Here, the balance sheet valuation of inventory is based on old cost which is unlikely to bear a reasonable relationship to actual cost of merchandise obtained during the year. Although it is the only method acceptable for income tax purpose (vide Internal Revenue codes of 1938 and 1939)\textsuperscript{10} in USA, some standard setting bodies like ASC in UK have not recommended the formula as acceptable.

\textsuperscript{10} Ibid, P.323.
v) Base Stock Method

In this method inventory is valued by ascribing a fixed unit value to a predetermined number of units in stock and any excess over these units are valued on the basis of some other methods. Base stock method does not meet the objectives of both the matching of cost with revenue and also the balance sheet valuation of inventory. This formula is not generally accepted by the standard setters.

vi) Replacement Cost Formula

Here, historical cost of inventory is considered to be its replacement cost which means the cost at which an identical asset could be purchased or manufactured. This method is not generally recommended by the standard setting bodies.

vii) Standard Cost Method

Under this method inventory is valued on the basis of standard cost per unit of goods. The standard cost is predetermined on the basis of past experience and future estimates. Reliability of this method depends upon the accuracy of management's estimates about the future. Standard cost basically represents average cost subject to adjustment for unusual costs. Effective use of this method depends upon the frequent review of standard cost to ensure that it bears a close approximation to actual cost.
viii) Latest Purchase Price Method

In this method inventory is valued by multiplying the total number of units in hand by the rate of latest acquisition of merchandise. This valuation need not necessarily be the same as actual cost and in times of rise in price level it will create huge amount of unrealised profit. This method is not accepted by the standard setters.

ix) Adjusted Selling Price Method or Retail Inventory Method

In large retail stores or departmental retail stores dealing with large number of items, as identification of cost to individual items of stock is very difficult, it is most difficult to use the cost formulae discussed above. Accordingly, under this method the value of inventory is calculated by deducting the gross profit margin from the retail selling price of stock in hand. This method is not generally accepted. However, it is suggested only to avoid inconvenience and recommended for those cases where it gives a reasonable approximation of actual cost.

Some other methods like NIFO (Next in First out), HIFO (Highest in First out) etc. are also indicated by some authors. But these are not generally acceptable and they do not find any solid ground in the accounting practice. Thus, there in a large number of cost formulae that may be used for ascertaining the cost and value of inventory. Every method has various effects on both income measurement and
asset valuation. Also the nature of such effect differs depending on the method used. However, such differences can be minimised by raising the inventory turnover ratio. If price fluctuations are low, difference between the method will be small. "In fact, if prices are perfectly stable and all lots of merchandise are purchased at the same price, all the various cost methods will result in the same net income and asset valuation." 11

What cost should be inventoried

What items should be included in the cost of inventory is a question that still requires a definite answer. There is no straightcut line of distinction between costs that may or may not be attributed to inventories. One view is that "the costs absolutely necessary for obtaining the product and placing it into storage are reasonable to include in inventory." 12 There is a common opinion among the accountants that inward freight costs are to be included, some accountants argue that purchasing costs, material handling costs and storage costs are also properly included in cost of inventory. 13 However, costs of inefficiency, idle facility or other abnormal costs should be excluded.

In the opinion of Norman Thornton, inventory may be valued at prime cost, factory marginal cost or total factory cost. This view is clearly related to the inventory valuation of manufacturing concern. Where as prime cost valuation is considered to be a most conservative measurement, factory marginal cost valuation of inventory is supported by marginal costing technique. Marginal cost valuation is somehow relevant to the traditional accounting structure since fixed overhead costs are treated here as the expenditure for the period. But it does not take into consideration all those expenses which are incurred for bringing the inventory to its present location and condition. From this point of view total factory cost concept of inventory valuation may be considered to be less misleading.

E.S. Hendriksen opines that "cost is a measure of the value of the inputs necessary in the acquisition of material or merchandise in its present condition and location." Here, value of inputs is measured by the value of the consideration given up in acquiring the items. This broad based theoretical definition is insufficient for the accountants who try to trace out the specifically identifiable items of costs to be included or excluded in inventory valuation.


The relevant questions that require further explanation are - what costs are considered necessary? what costs can be associated with inventory and carried forward in the future period? and how to allocate the related overhead costs.

What costs are necessary is a matter of consideration and judgement. Concept of normality may be taken as a criteria for such judgement. Items such as idle facility expenses, excessive spoilage, double freight and rehandling costs may, in some cases be so abnormal as to require treatment as current period charges rather than as a portion of the inventory cost. 16 American Accounting Association Committee suggested that only costs reasonably traceable to the product should be included in acquisition cost. 17 Thus, what costs are necessary for production and acquisition of goods and materials should be considered in the perspective of normality and traceability.

What costs can be associated with inventory is a very important but difficult problem. It is argued that all those expenditures which are incurred in the normal course of business in bringing the product or service to its present location and condition should be associated in the inventory valuation process. These expenditures should include cost of purchase and the related cost of conversion. Here, cost of

16. AICPA Professional Standards, Para 5121.05.
purchase comprises purchase price including import duties, transport and handling costs and all other directly attributable costs, less trade discount, rebates and subsidies. Cost of conversion includes direct wages, direct expenses, production overhead and other overhead required for bringing the inventory to its present location and condition. Abnormal conversion costs including costs of exceptional spoilage, idle capacity are excluded in inventory valuation.

Allocation of overhead is another important problem of inventory valuation. There is a strong argument in favour of allocation of overhead on the basis of company's normal level of activity so that the cost of unused capacity is charged against current years revenue. Here, normal level of activity is determined by reference to such factors as: 18

i) The volume of production which the production facilities are intended by their designers and management to produce under prevailing working conditions, and ii) The budgeted and actual levels of activity for the year under review and the ensuing year.

From the above discussion it appears that identification of costs and determination of inventory value are very critical in both financial and cost accounting. After collecting all the associated costs discussed above, inventory valuation should be made with reference to the actual quantity of inventory in hand. In case of manufacturing

concern the problem becomes more serious because of the existence of various types of inventories like raw material, work-in-progress and finished goods. In valuation of WIP, degree of completion is also a matter of consideration. So, correct accounting treatment of inventory deserves serious thought of the accountants.

Ascertainment of Net Realisable Value

Net realisable value of inventory may be defined as the amount which will be realised from its sale less all further costs to completion and less all costs to be incurred in marketing, selling and distribution directly related to the items in question. In the traditional accounting structure, the concept of matching of costs with revenue is an established theory. Now, if inventory is valued at net realisable value which does not represent its cost, matching theory is violated. One way of rectifying this is to estimate additional costs of completion or sale and collection and charge it against the current year's revenue. Alternatively, all these estimated future costs and expenses can be deducted directly from the expected sale proceeds of inventory to determine the net realisable value. According to E.S. Hendriksen, net realisable value can be defined "as the current output price less the current value of all additional anticipated incremental costs and expenses (exclusive of tax effects) relating to the completion, sale and

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19. Statement of Standard Accounting Practice No.9, May 1975, UK.
delivery of the merchandise". In his opinion additional expenses of collection should also be deducted, if material.

Although the above definitions give us some idea about the process of ascertainment of net realisable value, the related questions accompanying the item are:

i) Why is the net realisable value determined?

ii) How can sale proceeds of inventory be estimated?

iii) Should inventory be valued at net realisable value irrespective of its cost price?

iv) How should inventory be written down to net realisable value?

The need for Net Realisable Value

The historical cost of inventories may not be realised if their selling prices have declined significantly, if they are damaged, if they have become wholly or partially obsolete or if all the inventories are not likely to be sold or utilised within the normal turnover period. According to doctrine of conservatism, current asset should not be carried in the financial statements in excess of amounts expected to be realised in the normal course of business. So, it is necessary to ascertain the net realisable value and if required inventories should be written down to that value.

20. E.S. Hendriksen, OP.Cit., P.303.
The situation in which net realisable value may be lower than cost are:

a) Obsolescence of stock through technical or marketing developments. Companies can forecast this factor and make necessary provision against stock.

b) Physical deterioration of stock. This factor is related with age and movement of stock. Here also the business concern can make suitable provision for stock.

c) Excessive or over priced stock holdings arising from errors in production or purchasing. Knowing this factor the management should make provision for stock and possibility of its recurrence can be avoided by taking appropriate management action.

d) A fall in the market price of stock which depends upon the overall market condition and to some extent beyond the control of management.

e) A deliberate management decision to sell goods at a loss for capturing the market. This is purely a matter of the management and is very temporary in nature.

Estimation of Sale Proceeds of Inventory

Estimation of sale proceeds is the most important and primary step in the process of ascertainment of net
realisable value. Estimated selling price should be determined on the basis of most reliable evidence available at the time the estimates are made as to what the inventories are expected to realise. Estimation must not be based on temporary fluctuation of price or cost.

Measurement of Inventory at Net Realisable Value as a Principle

According to Sprouse and Moonitz, "inventories, which are readily saleable at known prices with negligible costs of disposal, or with known or readily predictable costs of disposal, should be measured at net realisable value." They stated that this should be followed not as exception but as a rule keeping in view of the major objectives of accounting. E.S. Hendriksen supported this view and strongly criticised the rigid condition imposed by Bulletin No.43 that net realisable value can be used only when it is impossible to measure cost. In the opinion of Hendriksen, if the net realisable value can be measured objectively, it should be used regardless of whether cost can or cannot be computed.

But the main difficulty in the use of net realisable value concept is that it is very difficult to estimate the additional cost necessary to complete, sale and deliver the product. Another difficulty that arises if net realisable value is used even if it is higher than cost is that the net


22. AICPA Professional Standards, Para 5121.15.
income from the transaction is reported before all the activities of the firm relating to the sale have been accomplished. As a result, unrealised profit is taken into account and the well established doctrine of conservatism is not followed.

Comparison between Cost and Net Realisable Value

The comparison of cost and net realisable value can be made separately for each individual item, groups of similar items, an entire class of inventory, items relating to a class of business or they may be compared on an overall basis for all the inventories of the enterprise. The practice of writing down inventories based on a class of inventory, on a class of business or on an overall basis is not prudent. Because, such practice could make material distortion in the overall valuation process by offsetting losses incurred against unrealised profit. That is why most of the accounting standards on inventory accounting have recommended that inventories should be written down to net realisable value item by item or by groups of similar items.

It is revealed from the discussions made above that there is a wide difference of opinion about various aspects of inventory accounting. Variation exists about the composition of inventory, objectives of its measurement, classification, elements of cost to be included, suitability of cost formula to be used, determination of net realisable

value and the proper accounting treatment and also the disclosure requirement of inventory. Authorities have expressed different views about the valuation and presentation of inventory. Diversities are found to take place from country to country, industry to industry, firm to firm, unit to unit of the same firm or even from person to person. These variations pose a great problem to the accountants in dealing with inventory. Considering the seriousness of the problem various standard setting authorities have issued accounting standards on inventory at national and international levels. Through these standards, recommendations are made about various aspects of valuation and presentation of inventory with some similarities and differences. A comparative study of the accounting standards on inventory issued by some major standard setting bodies is presented below.
Comparative Statement of Accounting Standards on Valuation and Presentation of Inventories issued by some major standard setting bodies

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<th>INTERNATIONAL</th>
<th>INDIA</th>
<th>UK</th>
<th>Academic Views</th>
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<td>Valuation principles</td>
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<tr>
<td>1. Inventories should be valued at lower of historical cost and net realisable value whichever is lower.</td>
<td>1. Inventories should be valued at lower of historical cost and net realisable value subject to following exceptions stated in para 29.1 to 29.4. (a) Inventory of consumable stores and maintenance supplies should ordinarily be valued at cost. In appropriate circumstances, however, this may be valued at below cost. But what should be the appropriate circumstance is not indicated.</td>
<td>1. English standard requires inventories to be valued at lower of historical cost and net realisable value. Academicians have expressed diverse views about the basis of inventory valuation. Critical analysis (as given earlier in this chapter) are made by them about the conditions under which stock and work in progress other than long term contract work in progress, should be valued at the lower of the lower of the cost and the net realisable value. This statement originally suggested that long term contract work in progress should be valued at cost plus attributable profit less foreseeable loss. Progress payments received and receivable should be shown as a deduction from this figure. However, by an amendment in 1988, long term contract WIP was recommended to be valued only at cost for balance sheet purpose. The standard setters are unanimous about the use of lower of the historical cost or net realisable value as the value of contract WIP. Standard setters and academic considerations contributed greatly in the evolution of accounting standards. However, special mention is made of the above, the possible</td>
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The process of comparison between historical cost and net realisable value of inventory as recommended in the accounting standards can be viewed as the outcome of the different academic views on the matter. Academicians have discussed all the possible ways of writing down the historical cost to net realisable value, item by item, by groups of similar items, by class of inventory, by class of business or on overall basis. But the accounting standards have made an improvement. They recommend writing down the inventory only
3. The historical cost of manufactured inventories may be arrived at on the basis of either direct costing or absorption costing. Where absorption costing has been used, the allocation of fixed costs to inventories should be based on the normal level of production.

Elements of Cost to be Included

3. The historical cost of manufactured inventories should include a systematic allocation of those production overhead costs that relate to putting the inventories in their present location and condition. Allocation of fixed production overhead to the cost of for which historical cost of inventories may not be realised at a time. According to principle of conservatism current asset should not be carried in books in excess of amounts expected to be realised. So, its value should be written down to net realisable value. This explanation is similar to International standard.

3. The statement defines cost of inventory as the expenditure incurred in the normal course of business in bringing the product or service to its present location and condition. The statement specifically lays down that this expenditure include both cost of purchase and cost of conversion. Here, cost of unrealised profits on items where item by item and where it cost is less than net realisable value.

The statement provides a list of specific causes for which net realisable value may be less than historical cost. These causes are: obsolescence, physical deterioration, over priced stock holding, fall in market price and deliberate management decision to sell goods at a loss for marketing purpose. Here also we find the similarity among the English, International and Indian standards.

3. Academicians are vertically divided over the use of marginal costing and absorption costing technique. There are large number of advocates for both the techniques of costing. There is general opinion that all those expenditures incurred in putting the inventories
conversion should be based on the capacity of the facilities. If fixed production overhead has been entirely or sub-
stantially excluded from the valuation of inventories on the ground that it does not directly relate to putting the inventories in their present location and condition, that fact should be disclosed.

Allocation of overheads other than production overhead to cost of inventory

4. Overheads other than production overhead should be included as part of inventory cost only to the extent that they clearly relate to putting the inventories in their present location and condition.

4. Overheads other than production overhead should be included as part of the inventory cost only to the extent that they clearly relate to putting the inventories in their present location and condition. This clause is

In the explanatory notes, the standard states that there is substantial support for use of these two methods but which method is more acceptable is not indicated. It is not clear whether direct costing method can be used even if fixed costs directly relate to putting the inventories to the present location and condition.

conversion comprises direct costs, production overheads or any other attributable overheads. This statement also requires that overhead should be apportioned on the basis of normal level of activity and cost of unused capacity should be written off in the year it is incurred.

4. Any other attributable overhead besides production overhead may be included in the inventory cost. It suggests that where there is a specific contract to supply goods and services the overhead relating to

in their present location and condition should be included in inventory valuation. This includes both cost of purchase and cost of conversion. Now, which costs of conversion are included depends upon the type of inventory i.e. raw materials, work in progress or finished goods. It is also generally agreed that all abnormal costs should be charged against current periods revenue. So, recommendations of the standards and academic views are not very different.

4. In the traditional accounting structure selling and distribution overheads are not included in inventory cost. Office and administration overheads are included in addition to factory overhead on the same ground as given in the standards.
5. It is generally accepted that all abnormal costs should be charged against the revenue of the current period. No portion of such cost is carried forward in the subsequent period. Accordingly, any expense arising out of abnormal loss of material, wastage of labour time or other abnormal costs should not be included in inventory cost. The academicians have expressed the same view as recommended by the accounting standards on this item.

6. Several methods of valuation for determining the cost of inventory are discussed in detail by Appendix-2 to SSAP-9. The definitions of Average cost, FIFO, LIFO, Base stock, Replacement cost, Standard cost etc. are discussed in detail by...
However, the following exceptions are also recommended:

1) The 'specific identification' method may be used for inventories of items that are not ordinarily interchangeable or for goods manufactured and segregated for specific projects should be accounted for by using specific identification of their individual costs.

2) The LIFO or base stock formula may be used provided that there is the disclosure of the difference between the amount of the inventories as shown in the balance sheet and either (a) the lower of the amount as per FIFO or weighted average cost formula and not realisable value or (b) the lower of the current cost at the balance sheet date and net realisable value. By

So, the methods used for determining the cost of inventory include FIFO, LIFO, base stock, average cost and replacement cost. The Appendix to SSAP-9 rejects LIFO, base stock and replacement cost methods. But it does not make any recommendation on which of the other methods should be applied. In UK where SSAP-9 is applicable, LIFO is a rarely used method. However, for companies with USA subsidiaries, LIFO is a commonly used method for tax reasons.

SSAP-9 refers to the method generally used by retail stores where cost of stock is obtained by deducting from the sales value, the gross profit percentage. The statement advises that it is acceptable only when it can be demonstrated that this method does give a reasonable approximation to the realisation value of the stock. The methods used are also recommended:

1) The 'specific identification' method may be used for inventories of items that are not ordinarily interchangeable or for goods manufactured and earmarked for a specific purpose.

2) The 'adjusted selling price' may be used in retail business or in businesses where the inventory comprises items the individual costs of which are not readily ascertainable.

3) The 'standard cost' method of valuing inventories may be used if the results approximate consistently the results that would be obtained in accordance with FIFO, average cost or LIFO method.

4) The 'base stock' method may be used in exceptional circumstances only.

As various authors. They have suggested all the possible methods and evaluated each of them with reference to its suitability, objective, effect on income measurement, reliability of balance sheet valuation and the conditions under which it is applicable etc. They stated that every method stands by its usefulness depending upon the circumstances. Academicians have no general agreement that any particular method is more suitable in normal cases. Here, it can be observed that standards have made a step forward by recommending one or two methods to be used in general cases as for example FIFO & weighted average formula in IAS-2 and FIFO, LIFO & average formula in AS-2. Various academic views are consolidated in the standards and some progress is made in evolving a unified cost formula to be used in general cases.
7. Determination of net realisable value and its use in the process of inventory valuation is a matter of debate among the academicians and professionals. Different authors have expressed their diversified views about the use of net realisable value.

English standard defines net realisable value of stock as the amount which will be realised from the disposal of stock less all costs to complete the product and costs of marketing, selling and distribution. The statement indicates the situations that would be obtained in accordance with the methods recommended to be used in general cases i.e. FIFO and weighted average cost method.

Ascertainment of Net Realisable Value

7. International standard suggests the following procedures to be adopted for ascertaining Net Realisable Value:

1) Estimates of net realisable value should be based not on temporary means of subsequent proposed amendment, base stock method is eliminated but LIFO is allowed to continue. International standard suggests that standard cost method of valuing products or the retail method of valuing merchandise may be used for convenience if they approximate consistently the results that would be obtained in accordance with the methods recommended to be used in general cases i.e. FIFO and weighted average cost method.

7. The main part of the Accounting standard-2 does not contain any provision regarding ascertainment of net realisable value with the only exception that net realisable value is recommended to be actual cost. Indian standard recommended LIFO as a general method in a variation with International & English standard. While International standard does not accept LIFO as a general method, English standard has specifically rejected it. However, by a recent amendment LIFO is allowed as an alternative method by IAS-2.

7. English standard defines net realisable value of stock as the amount which will be realised from the disposal of stock less all costs to complete the product and costs of marketing, selling and distribution. The statement indicates the situations that would be obtained in accordance with the methods recommended to be used in general cases i.e. FIFO and weighted average cost method.

7. Determination of net realisable value and its use in the process of inventory valuation is a matter of debate among the academicians and professionals. Different authors have expressed their diversified views about the use of net realisable value.
Academic Views and its merits and demerits in the valuation of inventory.

Whether net realisable value should be considered in comparison with cost or independent of cost is a matter of serious concern among the academicians. Academics, professionals and even the accounting standards - all have expressed almost the same view about the way of ascertaining net realisable value. The opinion in common is that the net realisable value can be obtained by deducting the estimated further costs and expenses relating to completion, sale, delivery etc. from the expected sale proceeds - all estimated.

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<th>UK</th>
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The net realisable value of the quantity of inventory held to satisfy firm sales contracts should be based on the contract price. If the sales contracts are far less than the inventory quantities held, net realisable value for the excess should be based on general market price. In a note to the standard it is made clear that the firm sales contracts beyond inventory quantities and firm purchase contracts are outside the scope of this statement.

The net realisable value can be obtained by deducting from the expected sale proceeds - all estimated further costs and expenses relating to completion, sale, delivery etc.

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<tr>
<th>Fluctuation of price or cost but on the most reliable evidence available at the time the estimates are made as to what the inventories are expected to realise.</th>
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<td>iii) The net realisable value of the quantity of inventory held to satisfy firm sales contracts should be based on the contract price.</td>
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<td>If the sales contracts are far less than the inventory quantities held, net realisable value for the excess should be based on general market price. In a note to the standard it is made clear that the firm sales contracts beyond inventory quantities and firm purchase contracts are outside the scope of this statement.</td>
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<td>Compared with historical cost item by item and not on an overall basis. But in the context to the standard it is stated that the historical cost of inventories may at times not be realised e.g., if their selling prices have significantly declined or if they become wholly or partially obsolete or if the quantity of inventories is so large that it is unlikely to be sold or utilised within the normal turnover period and there exists a genuine risk of physical deterioration, obsolescence or loss on disposal. In such circumstances, it is suggested to write down the inventory to net realisable value in accordance with the principle of conservatism in which net realisable value may be lower than cost as follows:</td>
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<td>a) Obsolescence of stock through technical or marketing developments.</td>
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<td>b) Physical deterioration of stock.</td>
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<td>c) Excessive or overpriced stock holdings arising from errors in production or purchasing.</td>
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<td>d) A fall in the market price of stock.</td>
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<td>e) A deliberate management decision to sell goods at a loss for marketing purpose.</td>
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<td>While the first three items are linked with factors like age, movement in the past and forecast movement, the last two items depend upon market conditions. It is also suggested that in forecasting net realisable value, events occurring between the balance sheet date and the time of writing the estimates as to what the inventories are expected to realise,</td>
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iii) It is recommended that normal quantities of materials and other supplies held for incorporation in the production of goods should not be written down below historical cost if the finished products in which they will be incorporated are expected to be realised at or above historical cost. It is also stated that a decline in the price of materials may indicate that the historical cost of finished products to be produced will exceed net realisable value in which event a write down of the material inventories should be made. In this event, replacement cost may be the best available measure of the net realisable value of those materials.

The procedure for ascertaining net realisable value is not so specifically stated here as that stated in the International standard.

Although the statement acknowledges that in some cases replacement cost will constitute the best guide to realisable value, it specifically rejects reduction to estimated replacement cost when this is lower than cost and net realisable value on the ground that the object of provision against cost is to achieve a breakeven position and not to create profit for the future. This statement also does not provide all the guidances for ascertaining net realisable value as given in the International standard.

It is recommended that sheet date and completion of the accounts need be considered. Although the statement acknowledges that some replacement assets should not be carried in the financial statement in excess of amounts expected to be realised in the ordinary course of business, the possibility of its use independent of whether it is more or less than cost. However, recommendation of accounting standards got strong support of the principle of conservatism.
Besides, inventories are suggested to be written down item by item and not on overall basis.

**Sold inventory as a charge against revenue**

8. The profit and loss account of the period should be charged with the amount of inventories sold or used (unless allocated to other accounts) and with the amount of any write down in the period to net realisable value.

9. SSAP-9 requires disclosure in the financial statement of a summary in the notes to the accounts showing the amounts of stock held in each of the main categories, classified in a manner appropriate to the business.

**Classification of inventories**

8. Here also no specific recommendation is given regarding the cost of inventory sold or used, including the amount of write down if any to be charged to profit & loss account. However, it can be assumed that this amount being an item of expense should be charged against revenue.

9. The main part of the standard does not provide any clause regarding classification of inventories in different categories. But in the context to the standard it is stated that inventories

8. The profit and loss account of the period should be charged with the amount of inventories sold or used (unless allocated to other accounts) and with the amount of any write down in the period to net realisable value.

9. Classification of inventories and their disclosure in the financial statement is widely discussed in the academic circles. While it is accepted that classification should be made in a manner...
Disclosure of accounting policies on inventory accounting

10. The accounting policies adopted for the purpose of valuation of inventories including the cost formula used should be disclosed. A change in an accounting policy related to inventories that has a material effect

10. The accounting policies adopted for valuation of inventories including the cost formula used should be disclosed. According to the doctrine of consistency any change in an accounting policy relating to inventories (including the basis of valuation) should be disclosed. Here the disclosure requirement of attributable profit or foreseeable loss is related to inventories.

10. It is required that the accounting policies used to arrive at cost, net realisable value, attributable profit and foreseeable loss should be disclosed. Here the disclosure requirement of attributable profit or foreseeable loss is related to inventories.

10. Academicians have conducted a wide discussion with its continuity about the disclosure requirement in the financial statement and have expressed diversified views. What to disclose and how much to disclose is a matter of controversy. How to ensure
Adequate, full and fair disclosure is being analysed by the academicians for a long period of time. The generally expressed view is that all the significant accounting policies used should be disclosed. According to this view, accounting policies adopted for the purpose of valuation of inventories including the cost determination method followed should be disclosed. Recommendation of the standards to disclose any change in accounting policy related to inventories together with its effect on current or subsequent periods accounting statement is also in compliance with academic views.

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<td>of comparison of historical cost with net realisable value and the cost formula used</td>
<td>to long term contract work in progress which is not considered in IAS-2 and AS-2.</td>
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<td>have a material effect in</td>
<td>which has a material effect in the current period or which is reasonably expected to have a material effect in later periods should be disclosed</td>
<td>English standard also requires the disclosure of the value placed on long term contract work in progress and the amount deducted therefrom in respect of progress payments. This requirement is not included in IAS-2 and AS-2 because long term contract work-in-progress are not dealt with in these standards. Regarding the other requirements English standard is similar to IAS-2 and AS-2.</td>
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<td>in the International standard which is a clear variation with AS-2.</td>
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How far is the uniformity ensured?

The primary object with which accounting standards on inventory are set is to remove or at least to reduce the variations in accounting treatment of inventory. Diverse views are expressed by the authors and professionals on the accounting for inventory. There are a large number of methods of inventory valuation for finding out the elements of historical cost to be included. Wide variations are also found regarding the process of comparison between historical cost and net realisable value. Moreover, principles on the disclosure requirement of inventory also are not uniform. Due to these diversities and complex nature of the problem, a composite set of rules for accounting treatment of inventory was urgently felt. Accounting standards, hence, emerge out of these necessities.

Although it is very difficult to formulate and issue a composite set of rules and policies covering all aspects of inventory, accounting standards have undoubtedly made a significant progress in this respect. A number of wide-ranging recommendations are given in the standards which cover various aspects of valuation and presentation of inventory and the disclosure requirement. Success of the standards depends upon how far the uniformity in the accounting treatment of inventory is ensured and to what extent they help the accountants in solving this complex accounting problem.
Specific recommendation is given in the standards to value inventory at cost or net realisable value whichever is lower. The situations under which deviation from this rule is permitted are also contained in them. It is suggested that reduction of cost to net realisable value should be made item by item or by groups of similar items to avoid the possibility of writing off loss against unrealised profit. Detail guidance is provided about the ascertainment of historical cost and net realisable value. Items of cost to be included in cost of inventory are also indicated. Although some differences exist among the standards themselves regarding the cost formula to be used, FIFO, LIFO and Average Cost formula are mainly recommended to be followed in general cases. The standards on inventory accounting have concentrated on the point of disclosure requirement. The standards recommended specifically about the information regarding the inventory to be disclosed in the financial statement.

From the above discussion we see that the accounting standards on inventory have covered all the aspects of its valuation, presentation and disclosure. On most of the points, specific suggestions and guidances are provided to the accountants. It is fact that the possibility of diversity still persist but some sorts of uniformity in the accounting treatment of inventory can definitely be achieved if the recommendations of the standards are complied
with in their spirits and contents. Although complete uniformity is still far from sight, standards have achieved a big breakthrough in that direction. Whereas the use of standards ensures some sorts of uniformity in the valuation and presentation of inventory and the disclosure in this respect, uniform compliance with the standards is still a great problem. No formal authority is established to ensure the use of standards. However, attempts are being made to enforce compliance with the standards. But it should be noted that whatever may be done to enforce the standards legally, long term and uniform compliance with the standards depends upon their worth and the expert opinions. Anyway, diversitives are minimised and uniformity, at least to some extent, is ensured by the accounting standards on valuation and presentation of inventory. This view is gathered from the fact that in the pre-standard period no specific guidance regarding the valuation and presentation of inventory was available to the accountants. Selection of cost formula was also arbitrary and disclosure requirement of inventory accounting was not clear and specific. But in the post-standard period accountants are provided with handy rules for valuation and presentation of inventory. Cost formula to be followed in general and special circumstances are given and disclosure requirements are also prescribed in detail. Specific recommendations are given regarding various other aspects of the inventory accounting as
indicated earlier in this chapter. So, compliance with the standard will ensure improvement and uniformity in the accounting practice for inventory in the post standard period as compared with pre-standard period.

**Propriety of the standards**

Propriety of the accounting standards may be considered with reference to their ability to serve the diversified needs of various users of accounting statement more adequately. By reducing the areas of differences in the accounting treatment of inventory, the standards have achieved an overall improvement in inventory accounting. Now, let us study how far the individual needs of the related parties are meet by the accounting standards.

Academicians have always showed their keen interest in finding out the proper accounting treatment of inventory. For this, they have conducted a long debate on it and the process of evolution of a scientific method of inventory valuation and presentation is still continuing. The accounting standards give the diversified academic views a concrete shape and hence the purpose of the academicians are satisfied at least partially by the emergence of the standards. So, from the academicians viewpoint accounting standards on inventory are found to be proper. This view is supported by the academicians themselves as evident from the replies from them obtained by conducting opinion
poll at national and international levels. From the point of view of professionals and accountants, the propriety of the standards lies in their possible aid in the preparation of accounting statement. The accountants are provided with handy rules to be followed in the valuation and presentation of inventory. The accounting standards on inventory have provided a number of important recommendations which will undoubtedly guide the accountants in deciding the proper accounting treatment of inventory and help the professionals to examine the true and fair view of inventory accounting. A very few replies are available from the professionals in this respect. However, they opined in favour of the view that standards are helpful to them.

From the investors and creditors point of view it is expected that the accounting standards on inventory will be helpful in their respective decision making process. Investors will be in a position to evaluate and judge the liquidity and financial position of the business in a more objective way and take the investment decision more wisely. They can study, how far their investment will be safe and to what extent it will be profitable. Similarly, the suppliers can examine the credit standing of the buyer more accurately. They can decide about how much credit facility can be extended for what period of time more objectively. So, the utility of the accounting standards on inventory to the investors and suppliers is not insignificant and herein lies the propriety of the standards.
The propriety of the accounting standards to the needs of owners, government, researchers and the other users of accounting statements can be explained in the same way. The standards help the owner to study the accuracy of the financial statement and the amount of profit determined by the accountant. The government can investigate whether the reported taxable profit is genuine and tax is paid regularly. Researchers find the standards more helpful in conducting their research activities for further improvement in the accounting practice for inventory.

Although complete elimination of diversities in the accounting treatment of inventory is yet to be achieved, the accounting standards have reduced the differences to a great extent. By making specific recommendations about valuation and presentation of inventory and the disclosure requirements, the standards have achieved the uniformity in accounting practice for inventory at least to some extent. While the scope for further improvement in the proper accounting treatment of inventory is agreeable, the propriety of the accounting standards on inventory should not be lost sight off. However, the propriety of accounting standards on inventory must be supported by empirical study. Findings of the empirical study in the context of inventory accounting are presented below.

**Empirical findings**

The observations made in this chapter about the various aspects of accounting standards on inventory require
empirical evidence. For the purpose, an empirical study was conducted covering selected eminent academicians, reputed professionals and renowned business executives. The main object of this study was to see how far the views expressed by this cross section of people are in similarity with the recommendations of the standards and to what extent the issues raised in this context are settled and also to identify the debatable areas. The results of the study can also be taken as indications to the propriety of the standards from different users' point of view.

Findings of the empirical study are given below which should be considered in the context of the empirical findings on accounting standards on disclosure discussed in Chapter-3 (vide page no.64).

1. In response to the question on the issue of valuation of inventory, 98% of the respondents recommended it to be valued at 'cost or net realisable value whichever is lower' while only 2% did not consider the issue. Thus, all are in favour of the view expressed in the accounting standards that inventory should be valued at the lower of the historical cost or net realisable value (vide page no.154, point-I).

2. Relating to the question dealing with the issue of valuation of consumable stores and maintenance, 71% opinions are found to be in favour of valuing always at cost price as recommended in Indian accounting standard (vide
However, 27% did not favour the idea. Most of the people not favouring the idea are academicians who presumably thought that in some special cases these may be valued at below cost. It is also indicated in the Indian standard.

3. In reply to the question whether or not historical cost of every item be written down separately, 46% of the respondents agreed that historical cost of every item of inventory be separately written down to its net realisable value while 39% disagreed with the concept and 15% remained undecided. Majority of the 39% who disagreed with the view are found to be executives who presumably are working in the concerns where diversity of the components of inventory is so high that it may be impractical to compare cost and net realisable value of inventory for each individual item separately. Although the accounting standards recommended the writing down of inventory to net realisable value item by item, it is also suggested that similar items may be dealt with as a group (vide page no.155, point-2). Thus, recommendations of the standards are truly reflected in the opinion poll.

4. a) On the issue, whether or not book value of current assets should exceed their realisable value, 80% of the respondents accepted the view expressed in the standards that current assets should not be carried in the books in excess of the amounts expected to be realised (vide page no.155, point-2). 17% of the respondents opined against the
view. Most of them are executives who presumably may think that current assets are converted in form within a very short period and during that short period ascertainment of their realisable value may not be worthwhile. 3% of the respondents have not considered the issue.

4. b) On the issue of valuation of stock of forestry, contract and wine industry, 44% of the respondents favoured the valuation principle stated in question no.4(a) while 36% opined against it and 20% have not considered the point. The accounting standards stated that special consideration will apply in case of valuation of long term contract work-in-progress (vide page no.154, point-1). Indian standard did not recommend the principle laid down above for forestry also. Thus, difference of opinion persist among the academicians, professionals and executives. Even the standards, on the issue of valuing stock of forestry, contract etc. above their realisable value, differ.

5. On the issue of allocation of fixed production overhead to cost of inventory, 59% of the respondents suggested the allocation, 27% are against it and 14% recommended it to be decided by the authority. Accounting standards directed the allocation if it is directly related to putting the inventories in their present location and condition (vide page no.156, point-3). Thus, opinions vary on the issue. However, most of the people and the standards
agreed on the point that in normal cases fixed production overhead should be allocated and be included in the cost of inventory.

6. On the issue that allocation of fixed production overhead should be made on the basis of normal production capacity, 71% of the respondents supported the view (vide page no.156, point-3), 18% of the respondents did not agree with the view and 11% are still undecided. Most of the 18% respondents not supporting the directive of the standards in this respect are found to be academicians. They may presumably think that deviation from actual production figure for the purpose may not show the true cost of production of the related period. But, if this interpretation is accepted and the principle is adopted there will be great fluctuation in the reported profit figures and cost of production of successive years. Hence, the generally accepted view that fixed production overhead should be allocated to cost of inventory on the basis of normal production capacity is justified.

7. This question deals with, whether or not administration, selling and distribution overhead be allocated to cost of inventory, 55% of the respondents did not favour its allocation at all, 37% recommended it only in some cases while only 8% suggested the allocation in all cases. The standards allow such inclusion only to the extent that
they are directly related to putting the inventories in their present location and condition (vide page no.157, point-4). But, this is possible for administration overhead only. In case of selling and distribution overhead that is not possible. Thus, although differences of opinion exist, recommendations of the standards are found to be in line with most of the opinions gathered.

8. This question deals with the justification of the inclusion of abnormal losses and expenses in the cost of inventory. 83% of the respondents accepted the view stated in the standards that these should not be included (vide page no.158, point-5). Only 17% opinions differed with the standards, most of whom are found to be academicians and professionals. They may consider that inclusion of such abnormal expenses may help recover the total cost. But that is not justified. Hence, it can be viewed that under normal circumstances exceptional amounts of wasted material, labour and other abnormal expenses should not be included in cost of inventory.

9. In replies to the question dealing with the possibility of using a single cost formula in all cases for pricing the issues of materials to production, 33% of the respondents considered it possible, 52% found it impossible while 8% did not consider the issue. Accounting standards also did not find it possible to use a single formula in all cases (vide page no.158, point-6). Most of those supporting
the use of a single cost formula are academicians. It may be due to the fact that they are in favour of a strict adherence to uniformity in stock valuation. Although uniformity is preferred by all, possibility of using a single cost formula in all cases is most debatable.

10. On the question of selecting one of the three suggested cost formula (FIFO, LIFO and Weighted Average) for the purpose of using it under general circumstances, 39% of the respondents selected FIFO, 10% opted for LIFO and 51% suggested Weighted Average cost method. While LIFO is specifically rejected by English standard, FIFO and Average Cost methods are equally found suitable by the standards (vide page no.158, point-6). Thus, findings of the opinion poll reflect the recommendation of the accounting standards. However, variation still exist.

11. On the issue of reduction of inventory value to replacement cost when it is less than the lower of the historical cost and net realisable value, opinions differ widely. 37% of the respondents recommended the reduction, 48% did not recommend it and 15% have not yet decided. English standard has specifically rejected the reduction (vide page no.160, point-7), while no such definite recommendation is found in International and Indian standards. Thus, the issue of reducing the inventory value to replacement cost is still unsettled.

12. In response to the question on the issue of disclosing inventories in maximum detail categories, 45% of
the respondents answered in affirmative and only 2% disagreed with it while 53% thought that it is dependent on the nature of inventory. Accounting standards recommended that inventories should be disclosed in a manner so as to indicate the amounts held in each of the main categories depending upon the nature of the business (vide page no.163, point-9). Thus, all are in agreement with the view that disclosure of inventories should be made according to some classification.

13. This question deals with the issue of disclosure of cost formula used and the accounting policy adopted for inventory valuation. 90% of the respondents favoured such disclosure while only 10% are against it. Thus, most of the respondents uphold the recommendation of the standards in this respect (vide page no.164, point-10).

14. In replies to the question of disclosing, without fail, the effect, in quantified form of shift in accounting policy adopted for inventory valuation, 93% of the respondents answered in affirmative and only 2% in negative while 5% did not consider the issue. Thus, the respondents are in complete agreement with the view expressed in the standards that effect of change in accounting policy in respect of inventory valuation be quantified and disclosed (vide page no.164, point-10).
Areas of further investigation

Findings of the empirical study discussed above reveal that while some of the issues raised in the standards are settled, debate is still continuing on some other issues. Some relevant aspects of inventory accounting are not covered by the standards. The issues on which respondents are not in agreement with the standards and those not covered by the standards require further investigation. What should be the standard accounting practices requiring on some critical issues are not yet settled. A few of them are cited below.

i) Valuation and presentation of inventory in the context of rise in price level.

ii) Identification of the elements of cost to be included in cost of inventory.

iii) Suitability of various cost formulae used in inventory valuation.

iv) Method of determining the net realisable value of inventory.

v) FIFO versus LIFO in the inflationary situation.

vi) Impact of Inventory valuation on income measurement and tax assessment.

vii) Issues on shifting from reporting the net realisable value instead of historical cost of inventory.

viii) Exploring the possibility of recommending single cost formula for inventory valuation in all spheres.
ix) Inventory valuation and its effect on stock and security pricing.

Conclusion

There is a generally accepted view that no area of accounting has produced wider differences than the valuation put on the inventory in the balance sheet and its consequent effect on the income statement.

Answers to the pertinent questions as stated in the introduction to this chapter (vide page no. 132) are obtained from the empirical study conducted for this purpose. Empirical findings show that all the academicians, professionals and business executives contacted so far are in complete agreement with the view expressed in the standards that inventory should be valued at 'the historical cost or net realisable value whichever is lower.' Majority of them strongly supported the idea that book value of current asset including inventory should not exceed its realisable value. The common opinion expressed by this cross section of respondents is that the exceptional amounts of wasted material, labour or other abnormal expenses should not be included in cost of inventory. As regards the selection and application of the suitable cost formula, neither there is any specific recommendation in the standards nor any consensus among the academicians, professionals and executives. Thus, it is still a debatable issue. Regarding the disclosure requirement of inventory accounting, expert opinions
of the cross section of persons interviewed so far are found to be in complete agreement with the recommendations of the standards.

The preambles to accounting standards on inventory have stated their basic objectives as follows:

i) To ensure uniformity in the valuation and presentation of inventory and (ii) To ensure adequate disclosure in the accounting for inventory. Study results reveal that the standards are definitely the steps forward towards achieving these objectives.

In order to fulfil these objectives, the formulation of a comprehensive set of rules and policies covering the various aspects of inventory was urgently felt. Accounting system operates in the environment which varies from time to time and place to place. Also the accounting environment is subject to change with a change in the economic and financial conditions. In this circumstances it is at best a difficult problem to issue a set of accounting rules and policies to be followed uniformly and continuously in all kinds of inventory, all types of business activity and all kinds of accounting system. Success of the standards or their failure should be considered only with reference to this complex nature of the problems involved in the valuation and presentation of inventory.

A number of accounting standards on inventory are already issued by various standard setting bodies. But,
complete uniformity in the accounting practices on inventory is still away from our reach. Truly speaking, use of same method and principle for valuation and presentation of inventory in all cases is neither feasible nor desirable. Analysis of the standards shows that they recommended different methods for varying situations. Differences exist even among the standards themselves. The practical problems of complying with various recommendations of the standards are considerable and the question of ensuring the uniform application of the standards is also a matter of inconvenience to standard setters.

However, the accounting standards contain a number of specific recommendations covering the various aspects of accounting for inventory and provide extensive guidance through the explanatory notes and appendices regarding the meaning of different terms, method of valuation and disclosure requirement. Most of these recommendations are empirically verified to be valid. These are upheld by a cross section of expert opinions. However, disagreement also persists on some issues on which debate is still continuing.

The standards provided definitions of the terms Inventory, Historical cost, Cost of purchase, Cost of conversion, Direct costing, Absorption costing, Variable cost, Fixed cost, Net realisable value etc. These definitions undoubtedly provided more specific and unified meaning and concept of the terms to the accountants, professionnals and other related parties. Detail but unique discussion is made in the standards relating to the process of ascertainment of historical cost and net realisable value. Specific situations are identified for use of any
particular cost formula to determine the cost price of inventory. Informations regarding inventory to be disclosed in the accounting statement are specifically stated in the standards. If these recommendations are followed carefully, areas of differences and variations in the valuation and presentation of inventory will definitely comedown. So, outcome of the accounting standards on inventory is a mixed one. They have made a step forward by providing a more specific way of accounting for inventory. While the standards are expected to reduce the areas of differences, a lot of things and improvements are yet to be done to ensure complete uniformity in the accounting practices on inventory.

Inventories relate to the goods in which the enterprises deal. Accounts across the world are concerned with their valuation and measurement. But another crucial issue relates to the expenses which are not directly related to current production. But they are unavoidable for survival and future growth of an enterprise. They relate to the Research and Development Costs. The next chapter aims to examine the accounting standards set on the issue by various authorities.