



[Frequently Asked Questions]

Valuation of Inventories

Subject:	Business Economics
Course:	B.A., 1st Semester, Undergraduate
Paper No. & Title:	Paper – 103 Fundamentals of Business & Accounting
Unit No. & Title:	Unit – 3 (III) Valuation of Inventories
Lecture No. & Title:	Lecture – 3 Valuation of Inventories

Frequently Asked Questions

Q1. What is Inventory?

A1. Inventories include Raw material, Work In Progress, Finished Goods, Stock in Trade, spare parts, loose tools and consumable stores.

Q2. Which inventory is excluded from the preview of AS-2?

A2. AS-2 is not applicable to

- (i) Work-in Progress (WIP) of construction contract
- (ii) WIP arising under business of a service provider.
- (iii) Financial Instruments like shares, debentures or other securities.
- (iv) Producer's inventory (naturally available product) like livestock, agricultural / forest products, mineral oils, ores, gases etc. (These are valued at Net Realizable value).

Q3. Why is inventory recorded at cost or NRV whichever of the two is lower?

A3. In order to follow the concept of conservatism, the loss in business is recognized to the earliest time possible and the lower NRV suggests that business may suffer loss on sale of the goods. Thus, the same loss is recognized when the closing inventory is recorded in books at its Net realizable value instead of cost.

Q4. What is included in Cost of Inventory?

A4. Cost of Inventory includes Cost of purchase, Cost of conversion and other costs incurred to bring the inventory in current state.

Q5. What is the importance of valuing inventory?

A5. It is important to value inventory carefully because:

- i. Value of Inventory affects the true and fair view of financial statements.
- ii. Affects the profits of the entity (business entity)
- iii. Inventory valuation also plays an important role in cash credit or Working Capital loans
- iv. Helps in determining the investment in Working Capital.
- v. Concept of conservatism is followed, hence any losses on NRV being less than cost are recorded

Q6. State the methods of Inventory Record System.

A6. Inventory records are maintained by of Periodic record system and perpetual record system.

Q7. State the methods of valuation of closing inventory.

A7. Methods of valuation of closing inventory are LIFO, FIFO and Weighted Average.

Q8. What is FIFO method?

A8. FIFO is a method of pricing the issue or sold of materials using the purchase price of the oldest unit in the stock.

Q9. What is LIFO Method?

A9. LIFO method of pricing the issue of material using the purchase price of the latest unit of stock and the units in closing stock are valued at the oldest batch possible.

Q10. What is Weighted average cost method?

A10. Weighted Average cost method is the method of pricing the issue or sold of materials using weighted average price / cost which is calculated by considering the total quantities and total cost.