

# Accounting For Inventories

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# Objectives

- **At the end of the presentation, participants should be able to:**
  - Understand what constitute Inventories; and
  - Recognize, measure and disclose Inventories in the books of account.

# Introduction

- Inventories Are Assets:
  - Held in the form of materials or supplies to be consumed in the productive process;
  - Held in the form of materials or supplies to be consumed or distributed in the rendering of services;
  - Held for sale or distribution in the ordinary course of operation; and
  - Held in the process of production for sale or distribution.

# Examples of Inventories

- Examples of Inventories Include the following:
  - Ammunition;
  - Consumable stores;
  - Machine materials/components;
  - Spare parts for plant and equipment;
  - Strategic stock piles( for example, energy reserves);
  - Stock of unissued currency;
  - Postal services supplies held for sale(for example stamps);
  - Stock of unissued PPE;

## Examples of Inventories (Cont'd)

- **Work-in-progress including:**
  - ✓ Educational/Training course materials;
  - ✓ Land/Property held for resale;
  - ✓ Etc

# What is not Inventory?

- The following do not constitute inventories:
  - Work-in-progress arising under construction contracts , including directly related contracts;
  - Financial instruments;
  - Farm produce inventories like livestock, agricultural and forest produce;
  - Mineral ores to the extent that they are measured at net realisable in accordance with well established practices in certain industries.

# Cost of Inventories

- The cost element of inventories depends on whether the item of inventory is-
  - ✓ A bought-in inventories or
  - ✓ Internally created inventories.



## Cost of Inventories (Cont'd)

- **Bought-in Inventories;**

The cost of bought-in inventories include:

- The purchase price;
- Import duties and other taxes;
- Transport, handling, and other costs directly attributable to the bought-in inventory; and
- Deductions of trade discounts, rebates and other related items are deducted in determining the cost of purchase.

## Cost of Inventories (Cont'd)

- **Internally created inventories;**

This may be in the form of work-in-process or finished goods. The elements of cost involved include the following:

- Bought-in material cost;
- Conversion cost incurred for transforming the raw material into work-in-process or fully completed product/finished goods. The elements of cost include -
  - ✓ Cost directly related to the units of production such as Material introduced, direct labour.

## Cost of Inventories (Cont'd)

- ✓ Systematic allocation of overhead cost such as fixed/variable overhead cost.
- ✓ Fixed overhead costs are indirect cost of production that remain relatively constant regardless of:
  - The volume of production, such as depreciation, maintenance of factory buildings, the cost of management staff.
- ✓ Variable overhead costs are costs of production that vary directly with the volume of production, such as indirect materials and indirect labour.

## Cost of Inventories (Cont'd)

### ➤ ***Allocation of Fixed/Variable Overhead cost:***

- ✓ Fixed overhead costs are allocated to work-in-process/fully completed goods on a basis of Budgeted Fixed Overhead Costs divided by Budgeted completed goods. The result is referred to as Fixed Overhead Absorption Rate (FOAR)

## **Costs excluded from the cost of Inventories**

- Abnormal amounts of wasted materials;
- Storage costs, unless these costs are necessary in the production process before a further production starts;
- Administrative overheads that do not contribute to bringing inventories to their present location and condition;
- Selling costs;
- Interest and other borrowing costs;
- The foreign exchange fluctuation on the Inventories acquired in foreign currency;
- The difference between the cost of purchase of Inventories under normal credit terms and the amount payable under deferred settlement terms.

# Recognition

- Inventories should be recognized if:
  - ❖ Are controlled by the entity;
  - ❖ They are bought-in or created by the entity (which are attributable to past events);
  - ❖ It is probable that future economic benefits or service potentials associated with the items of inventories will flow to the entity; and
  - ❖ The cost or fair value of the inventories can be measured reliably.

# Recognition (Cont'd)

- When inventories are sold, exchanged, or distributed, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised.
- If there is no related revenue, the expense is recognised when the goods are distributed or the related service rendered.
- The amount of any write-down of inventories and all losses of inventories shall be recognized as an expense in the period the write-down or loss occurs.

# Measurement of Inventories

- Inventories shall be measured at the **lower of cost and net realisable value**, except where inventories are acquired through:
  - ❖ Non – exchange transaction or
  - ❖ They are held at no charge
  - ❖ They are held for consumption in the production
  - ❖ process of goods to be distributed at no charge
- Where Inventories are acquired through a non-exchange transaction, their cost shall be measured at their fair value as at the date of acquisition.



# Measurement of Inventories (Cont'd)

## Net Realisable Value (NRV)

- This refers to the estimated selling price that is realizable in the normal course of business less the estimated cost required to complete and make the sale.
- The cost of inventories may not be recoverable if:
  - ❖ They become obsolete,
  - ❖ They are damaged,
  - ❖ The estimated cost of completion or the estimated cost to be incurred to make the sale, exchange or distribution have increased.

## Measurement of Inventories (Cont'd)

- Inventories shall be measured at the lower of cost and current replacement cost where they are held for:
  - Distribution at no charge or nominal charge
  - Consumption in the production process of goods to be distributed at no charge or for a nominal charge

# Methods of Measurement

- Inventories held in the stores may have been bought-in in a number of batches each at a separate price.
- At the time the items of inventory are issued from store to the users in the organisation, the cost of inventories are measured using one of the following methods:
  - Specific Identification
  - First-in first-out (FIFO)
  - Weighted average cost

## Methods of Measurement (Cont'd)

### ***Specific Identification Method:***

- This is used when items issued from store are not ordinarily interchangeable and are specifically segregated for a specific project.

### **FIFO Method:**

- This method assumes that inventories purchased or produced first are issued first, thereby the items remaining in custody at the close of accounting period are those items of Inventory that have been most recently purchased or produced.

## Methods of Measurement (Cont'd)

### ***Weighted Average Cost Method:***

- The Cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period, and the cost of similar items purchased or produced during the accounting period.

# Disclosure

- Inventory is to be disclosed on the face of the Statements of Financial Position under Current Assets.
- In addition, an entity shall disclose in the notes to the GPFS the following:
  - The accounting policies adopted in measuring Inventories including the method used;
  - The total carrying amount of Inventories and the carrying amount in classifications appropriate to the entity;
  - The carrying amount of Inventories carried at fair value less cost to sell;

# Disclosure Cont'd

- The amount of any written down inventories recognized as an expense in the period;
- The amount of any reversal of any write-down that is recognised in the statement of financial performance in the period;
- The circumstance or events that led to the circumstances of write-down of Inventories; and
- The carrying amount of Inventories pledged as security for liabilities.

# ***Understand store management.***

- ***The Responsibility of Management Accountant or Store Ledger Officer.***
- *In most Agencies, the functions of the Management Accountant or the store ledger Officer is being handled by the Store Officer which contravenes the principle of internal check and control.*
- *Inventories are important asset in any organization thereby a whole standard (IPSAS 12) was allocated to it for proper handling.*
- *The few number of staff in the store section made it possible for such lack of control which gives room for corruption and fraud. Segregation of duties in the store is very important and is should be encouraged.*



## *Ideal Operation of Store Section*

- **Head of Store:** *It is the responsibility of the Head of Store to receive all correspondences regarding receipts and issues of store items.*
- *The store items should to be grouped and each group are to be handled by an Officer e.g. Stationeries store, Equipment store, etc. let assume that we have two major groups.*
- *All Store Receipt Vouchers and Store Issue Vouchers can only be found with the Head of store.*

# **Sources of Receipts of Store Items**


- *There are various sources of receipt of store items:*
- **Local Purchase Order (LPO)** : *This is a printed authority use to purchase store item in an organization. It is always in four copies. Original and duplicate will be given to the Supplier or Contractor who is expected to return the original with his invoices and delivery note while he keeps the duplicate for his record purpose, third copy to Finance and Accounts department to take the liability of the contract in the Vote Book, while the last copy is retained in the booklet.*
- **Transfer from other Stores**; *this is store transfer from one store to another. It is mandatory that store receipt voucher must be issued to acknowledge the receipt of the items.*

- **Conversion and Manufacture;** this occur in an Agency where there is workshop where some store items are constructed and change to another form. eg Plank recorded as such in the ledger, use to construct tables and chairs, the new constructed items will be taken on store charge.
- **Contract Award;** these are store items purchase through the award of contract. In most case this must pass through the Tender Board Committee of the agency.
- **Returned Store;** any store items issued out in excess of requirement, the unused item need to be returned and it has to be taken on store charge.
- **Excess taken on charge;** this occurs during the inspection of store or audit of the store, any surplus found during the audit , Store Receipt Voucher will be issue of which the original will be taken away by the Inspector.

# *Management of the Store*

*Management of store is very crucial as any store not properly management can lead to loss of funds; therefore, it is the responsibilities of Store Officer to always carry out the following tasks:*

- ➔ Checking, handling and storage- of store items received.*
- ➔ Issue of stores supported by authorized vouchers and ensures that such issues are checked and properly packed.*
- ➔ Observing First-in-first-out (FIFO) so that items of old stock are issued before the new stock.*
- ➔ Issue of store receipt voucher for all store received into the store.*

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- ➔ *Maintain the prescribed stock level as regard minimum and maximum limit (recorder level*
  - ➔ *Avoidance of waste of stores and irregular issues.*
  - ➔ *Ensuring that the store room is clean and properly ventilated.*
  - ➔ *Report when the store room is not in good condition.*
  - ➔ *Ensure adequate security for the store item in respect of strong burglary proof and fireproof.*
  - ➔ *He is solely responsible for the keys and no delegation of duties of locking up is permitted.*

# *How stores are checked by Inspector.*

- *In store management, it is important for surprise check to put the officer at alert at any particular time.*
- *Inspection is carrying out either by the Internal Auditor, Inspectorate from Accountant's Office and also from Auditor General Office.*
- *These are steps to be taken by the Inspectors;*
- *Carry out physical survey of the store items and let the store-keeper sign the survey sheet.*
- *A test comparison of the ledger balances with the physical and the Tally Cards balances.*
- *A test verification of the ledger entries with receipt and issues vouchers.*
- *An examination of the condition of the stock and manner of storage.*
- *A scrutiny of the books and register in use, which should be up to date and relevant voucher properly filed.*

- *An examination of security measures in the stores premises including adequate firefighting appliance which should be provided and maintained in a serviceable condition.*
- *Test-checking to confirm physical existence of the highly marketable items which can be easily removed.*
- *Any surplus found after the checking should be taken on charge by issuing of SRV to cover the items in excess and the SRV should be taken away by the Auditor or Checker,*
- *Any deficit should be made good together with any necessary recommendations.*

# **The Role of Procurement officer**

- ▶ ***All contract documentations must be carried out.***
- ▶ ***Four copies of the Letter of awards must be produced which should be differentiated by using stamp pad; Original, Duplicate, Triplicate Quadruplicate.***
- ▶ ***Ensure that the triplicate copy of the award letter get to the Director of Finance and Accounts.***
- ▶ ***Ensure that the Minutes of Procurement planning committee are kept.***



# Illustration

- **Bought –in inventories:**
- Public Sector Entity A Issued Purchase Order to Supplier XY to supply 50,000 units of stationery worth ₦500,000. The consignment was supplied accordingly on the 5<sup>th</sup> of March 20x3. The supplier was paid 50% of the money as at the close of the financial year.

# Accounting Entries

Details	Dr	Cr	Remarks
Inventory Account	500,000		To recognise receipt of supplies by the supplier XY
Account Payable		500,000	
Account Payable	250,000		Upon Payment of 50% Instalment to Supplier XY
Bank		250,000	

## Illustration 2

- In addition to the illustration 1 above , a consignment of 100,000 units were received from another supplier valued at ~~₦~~1,500,000. The supplier was fully paid . As at the close of the year only 130,000 units were issued from store to the user department. The entity adopts FIFO method of valuing stock.

# Accounting Entries

Details	Dr	Cr	Remarks
Inventory Account	1,500,000		To recognise receipt of supplies
Account Payable		1,500,000	
Account Payable	1,500,000		Upon Payment to the New Supplier
Bank		1,500,000	
Inventory Expense/ Consumption Account	1,700,000		To Recognise the Consumption of Stationeries using FIFO Method
Inventory Account		1,700,000	

# Conclusion

- Inventories represent a sizeable portion of the cost of running public sector entities.
- It must be accounted for in compliance with relevant provisions of IPSAS;
- By properly disclosing the value and condition of inventories remaining in custody as at the close of the financial year will improve accountability and transparency in the public sector entities.



Thank You

**Questions & Answers**