Epicsense Insights
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Inventories under FRS 2

Cost, write-downs and the provision policy. When the auditor is unable to attend the stock count.

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Inventory is often one of the largest balances on the balance sheet and a frequent source of audit adjustments. This issue summarises the key requirements of FRS 2 and what we need from management.

01

Cost or NRV, whichever is lower

FRS 2 requires inventories to be measured at the lower of cost and net realisable value (NRV). NRV is the estimated selling price in the ordinary course of business, less the estimated costs to complete and to sell.

Cost includes the purchase price, import duties, freight and handling, less trade discounts. For manufacturers, it also includes direct labour and production overheads allocated on normal capacity. Abnormal wastage, storage, administrative overheads and selling costs are excluded.

In plain terms

Inventory is carried at cost, unless it is expected to sell for less. It is then written down to the amount expected to be recovered.

Example: the comparison is made item by item

S$	Cost	NRV	Carried at
Item A	10,000	12,000	10,000
Item B	8,000	5,000	5,000
Item C	6,000	6,500	6,000
Total	**24,000**	**23,500**	**21,000**

Comparing the totals only would show a write-down of S$500 instead of S$3,000. FRS 2 does not permit this.

02

Cost methods permitted

Method	When it is used
Specific identification	Items that are not interchangeable, such as custom-built goods or property units
First-in, first-out (FIFO)	Interchangeable items; closing stock is valued at the most recent costs
Weighted average cost	Interchangeable items; cost is averaged over the period or after each purchase
Last-in, first-out (LIFO)	Not permitted under FRS 2

The same method must be applied to all inventories of a similar nature and use. A change in method is a change in accounting policy, applied retrospectively under FRS 8.

03

Write-downs and write-offs

Common events that require a write-down to NRV, or a write-off:

- physical damage, contamination or defects;
- expired items, or items near expiry;
- obsolete models or discontinued product lines;
- slow-moving or non-moving stock;
- selling prices after year end below cost;
- higher costs to complete or to sell;
- cancelled orders for customised goods;
- loss, theft or count shortages (written off).

A write-down is reversed if NRV later recovers, but inventory is never carried above its original cost.

04

The inventory provision policy

The directors are responsible for the inventory provision. We ask management to prepare a written policy, approved by the directors and applied consistently each year, covering:

- **specific items:** how damaged, expired and discontinued items are written down;
- **ageing:** a rate for each age band, based on the company's own history;
- **selling prices:** a review of sales after year end for items sold below cost;
- **approval:** who reviews the provision and approves write-offs.

For the audit, please also provide the year-end inventory listing (quantity, unit cost, age and location) agreed to the general ledger, the costing workings and the provision calculation.

Tax point

Specific write-downs of identified items are generally deductible; general provisions are not.

05

Stock count alternatives

Where inventory is material, SSA 501 requires the auditor to attend the physical count, unless this is impracticable. Please inform us of your count date early. The alternatives are:

- **Another count date:** we attend a count close to year end and test the movements in between to roll the quantities forward or back.
- **Third-party locations:** we confirm stock held by warehouses or consignees directly with them.
- **Attendance impracticable:** for example, a remote site, or an appointment after year end. We perform a later count with a roll-back, and review sales after year end. If sufficient evidence is still unavailable, the audit opinion will be qualified.

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Facing issues with inventory costing or provisioning?

Reach out to us. Whether or not you are an existing client, we would be glad to help you review your inventory costing, set up a provision policy or plan your year-end stock count.



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Sources. FRS 2 Inventories (equivalent to SFRS(I) 1-2); FRS 8 Accounting Policies, Changes in Accounting Estimates and Errors; SSA 501 Audit Evidence: Specific Considerations for Selected Items.

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