



Technical Advisory Group Issue Paper

AGENDA ITEM: TAGCP09-01

2 June 2020 – Online

Presentation of Financial Statements

Summary	The measurement of inventory held for use or distribution has been identified as a specific issue for non-profit organisations. This paper brings together material gathered from national and international standard setters.
Purpose/Objective of the paper	To allow TAG members to consider the nature of the issue, potential ways forward and text for inclusion in the Consultation Paper.
Other supporting items	None
Prepared by	Paul Mason
Actions for this meeting	Advise on: <ul style="list-style-type: none">• The description of the issue and its relationship with other topics• Links to other international standard developments, national standards or other guidance• The need for any further input

Presentation of Financial Statements

Part 1 – Advice Sought

1. Consultation Paper Draft

- 1.1 At the first meeting of the Practitioner Advisory Group in December 2019 it advised that inventory should be included in the short list of issues to be included in the Consultation Paper given significant measurement issues.
- 1.2 The TAG considered a paper related to this issue at its meeting on February 10, 2020 and agreed that an additional separate paper considering the measurement of inventory held for use or distribution should be prepared. This paper has been prepared as a separate Chapter of the Consultation Paper as the issues covered are different from those that arise in respect of the measurement of non-current assets held for their service potential.

#	Question
1	What comments does the TAG have on Sections 1 and 2?
2	Do the summaries of national-level and international guidance in Sections 3 and 4, together with Annex A, accurately reflect the current standards/ guidance? Is the TAG aware of any other guidance on narrative reporting issued by national standard setters or other regulatory bodies that should be included in the Consultation Paper?
3	Does the TAG agree with the presentation of the key issues in section 5, which link to other topics for inclusion in the Consultation Paper?
4	What comments does the TAG have on the proposed SMCs in relation to this topic and are there other specific SMCs that could be raised?

2. Next steps

- 2.1 The text drafted below will be included in the Consultation Paper subject to any further comments from the TAG. The Practitioner Advisory Group will be consulted on any specific issues raised by the TAG further to this discussion.

#	Question
5	Is there specific input to be sought from the PAG?

May 2020



Measurement of Inventory Held for Use or Distribution

Part 2 - Draft Consultation Paper Text

1. Description of the issue

- 1.1 The NPO sector holds a wide variety of inventory. Examples include medical supplies, textbooks, food, clothing, fuel, furniture, equipment, and leaflets. NPOs may hold inventory for commercial purposes, for example items held for sale in shops to generate revenue to support the work of the NPO. NPOs may also hold inventory to be used directly in meeting their objectives. Such inventory may be held for distribution to services users or may be held for use by the NPO in delivering services.
- 1.2 An NPO may produce the inventory itself, taking raw materials and developing them into a finished product, for example using paper and inks to produce information leaflets. In such examples the NPO will need to determine which costs are relevant to value such items, their materiality and stock levels.
- 1.3 NPOs can receive donations of low value/high volume inventories provided for resale. NPOs may not have inventory management systems that allow them to record each item and it may be impractical to do so. NPOs may therefore have difficulty in both keeping records of items and assigning a value to each item.
- 1.4 NPOs can also receive donations that are intended for onward distribution to service users. For example, pharmaceutical organisations can donate vaccinations to be used as part of aid programs, or food can be donated to provide meals for the homeless. These kinds of donations can be made when the item being donated needs to be used within a defined because it has a short expiry date. There may therefore be only a short period where such items have value as inventory. Whilst it might be easier to keep records for these items it may not be possible for an NPO to estimate whether they can all be used.
- 1.5 Work-in-progress associated with the provision of services, for example pro-bono legal work, can give rise to inventories held for use or distribution. Unless record keeping systems (such as timesheets) are in place, NPOs may find it difficult to determine the cost of these items of inventory.

- 1.6 The value of inventory, whether held for sale or held for use or distribution, will need to be updated as new inventory is added or as inventory is sold, distributed, or used. For some items of inventory (e.g., services such as pro-bono legal work) individual values may be recorded, but for most items this will not be practicable. In other cases, it may not be possible. For example, where an NPO stores all its fuel in a tank, it will not be possible to separately identify the fuel that relates to a particular delivery. Where individual records are not appropriate, a costing formula will need to be used. Formulas that are commonly used are first in, first out (FIFO) and weighted average.
- 1.7 NPOs may as a consequence find it difficult to assess the value of some items of inventory. These difficulties may lead to differences in how inventory is reflected in NPO financial statements. Stakeholders may find it difficult to understand how an NPO is delivering its services if an NPO does not record such inventory and NPOs may not be able to demonstrate the value that comes from such donations and the need for them to continue.

2. Financial reporting challenges

- 2.1 Inventory is normally reported as an asset in the balance sheet and measured so that its value does not exceed the value that can be obtained from the inventory. For NPOs the challenge is in determining values for its types of inventory (whether this value derives from sales, distribution, or use).
- 2.2 The starting point for measuring inventory is its cost. Where an NPO acquires inventory by purchasing the inventory itself, the cost of the inventory will be straightforward to determine and there are no issues that are unique to NPOs. Similarly, while there may be challenges for some NPOs in determining the cost of own produced inventory, issues are unlikely to be unique to NPOs.
- 2.3 There are more significant challenges in measuring donated inventory as there is no purchase cost. For an NPO to measure the value of inventory that has been donated it needs to know the date that it took control of each item, and be able to determine a reliable estimate of its value at this date. If an NPO cannot obtain a reliable measurement it may not be able to recognise the item in its financial statements.
- 2.4 Inventory donated for resale is typically high in volume and low in value. Where it is impracticable for the NPO to determine a reliable estimate of the value of an asset, it may not be possible to recognise such donations in the financial



statements at the point that they are received. There is also the question of whether / how to account for donations that are not suitable for resale.

- 2.5 Similar issues can arise for items donated for distribution to service users. Practical difficulties can arise in determining whether all of the items donated have a value, making it difficult to prepare a reliable estimate of their value. For example if donated items have a short useful life, it may not be possible to estimate whether all of the items donated can be used and even if the value of each item is known, an estimate of the value of the inventory may be too uncertain.
- 2.6 It is possible that inventory is not recorded in an NPO's financial statements because of the difficulty in measuring the item at the point of donation or subsequently if there are no proceeds (i.e. because the item has been given away or used in an aid program). This may create financial reporting challenges concerning the stewardship of an NPO's resources and transparency about how those resources have been used.
- 2.7 Where the carrying amount of the inventory exceeds its value to the entity, the inventory is written down (impaired). Impairing inventory relies on being able to determine the value to the entity. For some of the reasons identified above this may also create a financial reporting challenge.
- 2.8 The value to the entity of inventory held for commercial purposes (for example, greetings cards purchased for resale) can be assessed by reference to the expected sales proceeds. However, there may be no, or nominal, sales proceeds associated with inventory held for use or distribution in meeting an NPO's objectives. An alternative method of assessing the value of the inventory to the NPO could be required.
- 2.9 If inventory is not recorded in the financial statements, this will impact how the use of the inventory is recognised (expense) and the value of the donation provided (income). This is considered in the chapter on gifts in-kind and, where there are stipulations attached to the inventory, the chapter on incoming cash transfers.
- 2.10 Assessing the value of the inventory to the NPO may impose costs or administrative burdens on some NPOs. Some NPOs may find the keeping of inventory records challenging, particularly if they do not have an inventory control system. The cost of assessing the value to the NPO might be disproportionate to the value of the item and exceed the benefit derived from having the more accurate measure of that value.

3. Current international guidance

- 3.1 Currently international guidance on the measurement of inventory held for use or distribution is included in the following standards:
- IAS 2 *Inventories*
 - Section 13 *IFRS for SMEs*
 - IPSAS 12 *Inventories*
- 3.2 IAS 2 and Section 13 of IFRS for SMEs require inventory to be measured at the lower of cost and estimated selling price less costs to complete and sell (also referred to as net realisable value). Entities are required to assess whether the cost of the inventory exceeds its estimated selling price less costs to complete and sell at each reporting date. Where the cost is greater than the estimated selling price less costs to complete and sell, the inventory is written down to the estimated selling price less costs to complete and sell. IFRS for SMEs refers to this as impairment, but the process is the same in both IAS 2 and IFRS for SMEs.
- 3.3 IPSAS 12 has similar requirements, however, IPSAS 12 does not apply to work-in-progress of services to be provided for no or nominal consideration. Entities are required to develop their own accounting policies for such transactions, for example, expense the work as it is undertaken.
- 3.4 The measurement requirements in IPSAS 12 are the same as IAS 2, with two exceptions. Donated inventory is measured at fair value (this is discussed in the chapter on gifts in-kind). Inventory held for use or distribution is measured at the lower of cost and current replacement cost.
- 3.5 Under IAS 2, Section 13 of IFRS for SMEs and IPSAS 12, the value of inventory is assessed at the end of the reporting period. Where the value of inventory is below its cost, it is written down to its selling price less costs to complete and sell (or, in the case if inventory held for use or distribution under IPSAS 12, its current replacement cost). The amount of the write-down, which is referred to as the impairment loss in IFRS for SMEs, is recognised as an expense.
- 3.6 IAS 2, Section 13 of IFRS for SMEs and IPSAS 12 provide guidance on the elements of the cost of inventory, and on allocating overheads. Fixed overheads are allocated based on normal capacity; variable overheads are allocated based on actual usage. They permit the use of techniques such as the standard costing method or the retail method where these approximate to cost.



- 3.7 Where items of inventory are not valued individually, IAS 2, Section 13 of IFRS for SMEs and IPSAS 12 require the use of either the FIFO or weighted average cost formulas. The last in first out formula (LIFO) is not permitted.

4. National-level guidance

- 4.1 Annex A shows the different approaches to the measurement of inventory for distribution in national-level guidance. While national standards can be converged on IFRS, IFRS for SMEs or IPSAS, or set independently of international standards, there is consistency on the core principles around accounting for inventory. There are, however, differences between national standard setters about the measurement of inventory held for use or distribution. The chapter on gifts in-kind provides additional information about approaches taken by national standard setters to donated inventory.
- 4.2 One national standard is based on IAS 2, with some amendments for not for profit entities. The national standard does not apply to work-in-progress of services to be provided for no or nominal consideration. Guidance is provided for measuring donated inventory. Inventories held for use or distribution are measured at cost, adjusted (i.e. impaired) when applicable for any loss of service potential. The guidance notes that for many items of inventory, “a loss of service potential would be identified and measured based on the existence of a current replacement cost that is lower than the original acquisition cost or other subsequent carrying amount.”
- 4.3 One national standard is based on IFRS for SMEs, with some amendments. Guidance is provided for measuring donated inventory. Inventories held for use or distribution are measured at cost, adjusted (impaired) when applicable for any loss of service potential.
- 4.4 One national standard is based on IPSAS 12 with guidance provided for measuring donated inventory. Unlike IPSAS 12, inventory held for use or distribution is measured at cost, adjusted (impaired) when applicable for any loss of service potential.
- 4.5 One national standard setter has issued a general standard on inventories that is not based on international standards but is broadly consistent with IAS 2 and IFRS for SMEs. This standard setter has also issued a separate standard on inventories held by not-for-profit organisations. This standard includes guidance on donated inventories. Inventories held for use or distribution are

measured at the lower of cost and current replacement cost (in other words, inventory is impaired when the current replacement cost is lower than the cost of the inventory).

- 4.6 One national standard that is not based on international standards is broadly consistent with IAS 2 and IFRS for SMEs, although it permits the use of the last in first out (LIFO) costing formula, albeit with specific impairment provisions. The scope of the standard does not provide any specific guidance for NPOs.

5. Alternative financial reporting treatments

- 5.1 Both international and national accounting standards adopt similar principles for accounting for inventories. Differences between the standards relate to whether specific provisions are required for donated assets, the application of the standard to work-in-progress of services provided at no cost, and the measurement (impairment) of inventory held for use or distribution.
- 5.2 Some standards do not include specific guidance on the measurement (impairment) of inventory held for use or distribution. Where guidance is included, the two approaches adopted are to measure inventory at the lower of cost and current replacement cost; and to measure inventory at cost, adjusted when applicable for any loss of service potential. In some cases, a loss of service potential will be indicated by a current replacement cost that is lower than cost, so there is some overlap in the approaches adopted in the standards. These approaches have informed the development of the alternative approaches in this chapter.
- 5.3 Measuring work-in-progress of services to be provided at no cost may be challenging for some NPOs. For this reason, the alternative approaches that include specific provisions for inventory held for use or distribution permit such work-in-progress to be expensed as incurred.
- 5.4 The initial measurement of donated inventory is also included in the chapter on gifts in-kind and, where there are stipulations attached to the inventory, the chapter on incoming cash transfers.
- 5.5 Alternative 1 is based on the requirements of IAS2 and IFRS for SMEs, with additional guidance for NPOs, but no divergence from the requirements of these standards. This guidance could cover situations where it may be more practical for NPOs to apply general materiality principles and expense items as they are acquired.



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- 5.6 Alternative 2 is based on the requirements of IPSAS 12 and allows work in progress for no or nominal consideration to be expensed and provides for inventory for distribution to be valued at the lower of cost and current replacement costs, with additional guidance for NPOs.
- 5.7 Alternative 3 is based on the requirements of IPSAS 12 (as alternative 2) but requires that inventory for distribution is valued at the lower of cost and current service potential. This valuation technique is not permitted by any current international standards. As with alternatives 1 and 2, additional guidance would be provided.



	Description	Advantages	Disadvantages
Alternative 1 – Measure all inventory at the lower of cost or net realisable value with additional NPO-specific guidance	<ul style="list-style-type: none"> Inventory measured at the lower of cost or selling price (less costs to complete) No specific provisions for the measurement of donated inventory and inventory held for use or distribution Additional NPO specific guidance and examples on applying the general provisions for inventory; on measuring inventory held for use or distribution; and on when inventory could be expensed as acquired on materiality grounds. 	<p>Technical</p> <ul style="list-style-type: none"> Allowed by IFRS and IFRS for SMEs. <p>Practical</p> <ul style="list-style-type: none"> Specific guidance may assist NPOs in their potentially complex arrangements. <p>Cost/benefit</p> <ul style="list-style-type: none"> Guidance may assist in cost of preparation. 	<p>Practical</p> <ul style="list-style-type: none"> NPOs may not have the systems needed to capture all inventory. Challenge of determining materiality as a means to not recognise inventory. <p>Stakeholder</p> <ul style="list-style-type: none"> May lead to inconsistent treatments and obscure transparency. <p>Cost/benefit</p> <ul style="list-style-type: none"> Measuring work-in-progress of services to be provided at no cost and inventory held for use or distribution may be costly.
Alternative 2 – Require inventory held for use or distribution to be measured at the lower of cost or current replacement cost	<ul style="list-style-type: none"> Inventory held for use or distribution is measured at the lower of cost or current replacement cost. No specific provisions for the measurement of donated inventory. Permit work-in-progress of services to be provided at no or nominal cost to be expensed as incurred Additional NPO specific guidance and examples on applying the general provisions for inventory; and on when inventory could be expensed as acquired on materiality grounds. 	<p>Technical</p> <ul style="list-style-type: none"> Allowed by IPSAS. Current replacement cost is more appropriate than estimated selling price where inventory is not sold <p>Practical</p> <ul style="list-style-type: none"> Specific guidance may assist NPOs in their potentially complex arrangements. <p>Stakeholder</p> <ul style="list-style-type: none"> Provides a consistent approach to measuring inventory held for use or distribution. <p>Cost/benefit</p> <ul style="list-style-type: none"> Guidance may assist in considering cost/benefit of approaches. 	<p>Technical</p> <ul style="list-style-type: none"> May not be consistent with IFRS and IFRS for SMEs. <p>Practical</p> <ul style="list-style-type: none"> NPOs may not have the systems needed to capture all inventory. Current replacement cost may be difficult to determine where donated. <p>Stakeholder</p> <ul style="list-style-type: none"> May lead to inconsistent treatment of work-in-progress of services to be provided at no or nominal cost. Transparency may be impacted without disclosures on inventory not recognised in the financial statements.



	Description	Advantages	Disadvantages
<p>Alternative 3 – Require inventory held for use or distribution to be measured at cost, adjusted when applicable for any loss of service potential, with disclosure of the accounting policy and impact on service delivery</p>	<ul style="list-style-type: none"> • Inventory held for use or distribution is measured at cost, adjusted when applicable for any loss of service potential • Permit work-in-progress of services to be provided at no or nominal cost to be expensed as incurred • Require disclosure relating to the calculation of the loss of service potential, (including where this reduces service potential to zero) and the significance to the meeting of organisational objectives. • Additional NPO specific guidance and examples on applying the general provisions for inventory; and on when inventory could be expensed as acquired on materiality grounds. 	<p>Practical</p> <ul style="list-style-type: none"> • Adjusting cost for loss of service potential (e.g., obsolescence) may be easier to determine than current replacement cost. <p>Stakeholder</p> <ul style="list-style-type: none"> • Provides a consistent approach to measuring inventory held for use or distribution. • More relevant information for stakeholders • Improved transparency about the impact on service delivery <p>Cost/benefit</p> <ul style="list-style-type: none"> • Guidance may assist in considering cost/benefit of approaches. 	<p>Technical</p> <ul style="list-style-type: none"> • May not be consistent with IFRS, IFRS for SMEs and IPSAS. <p>Practical</p> <ul style="list-style-type: none"> • Determining service potential may be challenging. <p>Stakeholder</p> <ul style="list-style-type: none"> • May lead to inconsistent treatment of work-in-progress of services to be provided at no or nominal cost. • Differing assessments of loss of service potential may lead to inconsistent treatments and obscure transparency.

Specific Matters for Comment

Do you agree that the list of alternative treatments that should be considered is exhaustive? If not, please describe your additional proposed alternatives, and explain why they should be considered.

Do you agree with the advantages and disadvantages articulated for each alternative accounting treatment? If you do not agree, please set out the changes you propose, and why these should be made.

Please identify the alternative treatment that you favour, and the reasons for your view.

[Draft generic questions for further discussion]

Annex A – Measurement of Inventory Held for use or distribution

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
Alternative 1 – Measure all inventory at the lower of cost or net realisable value with additional NPO-specific guidance	IAS 2 and Section 13 of IFRS for SMEs include requirements for accounting for inventory.					<p><i>Although the US standards are not based on international standards, the requirements are similar, and the US standards do not provide any exceptions to the general principles.</i></p> <p>There is no specific guidance applicable to not-for-profit entities.</p>
Alternative 2 – Require inventory held for use or distribution to be measured at the lower of cost or current replacement cost	IPSAS 12 includes requirements for accounting for inventory, including a requirement that inventory held for use or distribution is measured at the lower of cost and				Sections 3031 and 3032 include requirements for accounting for inventory, including a requirement that inventory held for use or distribution is measured at the	

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
	current replacement cost. IPSAS 12 does not apply to work-in-progress of services to be provided at no or nominal cost.				lower of cost and current replacement cost.	
Alternative 3 – Require inventory held for use or distribution to be measured at cost, adjusted when applicable for any loss of service potential, with disclosure of the accounting policy and impact on service delivery		FRS 102 Section 13 includes requirements for accounting for inventory, including a requirement that inventory held for use or distribution is measured at cost, adjusted when applicable for any loss of service potential.	AASB 102 includes requirements for accounting for inventory, including a requirement that inventory held for use or distribution is measured at cost, adjusted when applicable for any loss of service potential. AASB 102 allows work-in-progress of services provided at no or nominal cost to be expensed.	PBE IPSAS 12 includes requirements for accounting for inventory, including a requirement that inventory held for use or distribution is measured at cost, adjusted when applicable for any loss of service potential. PBE IPSAS 12 does not apply to work-in-progress of services to be provided at no or nominal cost.		

	IFRS and IPSAS	UK	Australia	New Zealand	Canada	USA
Standards References	IAS 2 <i>Inventories</i> , Section 13 <i>IFRS for SMEs</i> , IPSAS 12 <i>Inventories</i>	FRS 102 Section 13 <i>Inventories</i>	AASB 102 <i>Inventories</i>	PBE IPSAS 12 <i>Inventories</i>	CPA Canada Handbook - Accounting, Sections 3031 <i>Inventories</i> and 3032 <i>Inventories held by not-for-profit organizations</i>	Accounting Standards Codification (ASC) 330-10 (<i>Inventories- Overall</i>), 330-10-15- 3-a (<i>Scope and Scope Exceptions- Entities</i>)