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CNOCP
Conseil de normalisation des comptes publics

Opinion n° 2015-04 of 15 January 2015 relating to Standard 8 of the Central Government Accounting Standards Manual "Inventories"

On 15 January 2015, the Public Sector Accounting Standards Council adopted this Opinion relating to Central Government Accounting Standard 8 "Inventories".

This new version of Standard 8 does not introduce changes to recognition and measurement principles. It clarifies requirements for inventories acquired, produced or held by Central Government in the course of its mission of public service, and improves the definition of inventories of a military nature.

MINISTÈRE DES FINANCES
ET DES COMPTES PUBLICS

1. Specific characteristics of Central Government inventories

The Standard defines reporting date measurement requirements for inventories of goods used, exchanged or distributed at no charge or for a nominal charge. These inventories continue to be carried at their acquisition cost and are not measured at the lower of cost and net realisable value on the reporting date. Where all or part of the inventory is damaged or obsolete impairment is recognised.

The Standard also defines accounting requirements for work in progress of services to be distributed at no charge or for a nominal charge. Costs related to these services are not recognised in inventory but as expense in the period in which they are incurred.

Lastly, the definition of Central Government inventories has been clarified, in particular for ammunition and spare parts essential to maintaining its military equipment in operational condition.

2. Drafting amendments

Following the publication of a new version of Central Government Accounting Standard 6[1] “Tangible Assets,” the wording of the original version of Standard 8 was clarified.

3. Qualification of the change

This Opinion clarifies accounting requirements for inventories without changing their substance.

These drafting amendments are not within the scope of Standard 14 “Changes in Accounting Policy, Changes in Accounting Estimates and Corrections of Errors” of the Central Government’s Accounting Standards Manual.

[1] Opinion n° 2014-01 of the Public Sector Accounting Standards Council of 17 October 2014 relating to the classification and reporting date measurement of Central Government’s tangible assets.

4. Effective Date

The Public Sector Accounting Standards Council proposes immediate application of the Opinion.

STANDARD 8
INVENTORIES

STANDARD 8 – INVENTORIES

INTRODUCTION

The Standard defines the accounting requirements for Central Government inventories. It sets out the relevant definitions, recognition criteria, and measurement bases applicable on initial recognition and on the reporting date.

I. DEFINITION

I.1. Definition

Inventories are assets.

They include finished goods or work in progress produced by Central Government as well as materials and supplies acquired for consumption in the production process of goods and services or for use in the course of its operations. Inventories not used for internal purposes are held for ultimate sale or distribution at no charge or for a nominal charge.

Inventories also include individual items of work in progress of services of a commercial nature. This work in progress relates to services for sale at normal market conditions either on an individual basis or as part of other works or services of a commercial nature.

Central Government inventories may include[1]:

> consumable stores;

> ammunition, except ammunition classified as a nuclear deterrent, and therefore by definition not intended for use;

> spare parts essential to maintaining its military equipment in operational condition and other spares intended for tangible assets[2];

> strategic stockpiles if they meet the definition of inventories;

> finished goods or work in progress;

> work in progress of individual services of a commercial nature (for example: a study for sale to a sponsor or engineering work carried out for a third party);

> inventories held by third parties which are under Central Government control.

[1] This non-exhaustive list, is not intended to be used for defining asset classification for the purposes of presenting the balance sheet or the notes in accordance with § 4.2 of the requirements of this Standard below.

[2] See paragraph I.3.4. Spares and safety stocks, of Standard 6 "Tangible Assets".

I.2. Materiality thresholds

Central Government may fix materiality thresholds per unit[3], and determine them, for example, by class of items, or production process for goods or services or type of activity.

II. RECOGNITION AND MEASUREMENT

II.1. Specific characteristics of Central Government inventories

The recognition of inventories is an accounting technique that enables business entities to match revenue and the related expenditure in the same accounting period.

This technique is also applicable in the public sector to goods and services for sale at normal market conditions. According to this technique, the carrying value of products, materials and supplies is recognised as an expense when an item of inventory is sold (or consumed in the production process of goods or services). Similarly, the cost of individual items of work in progress of services of a commercial nature is recognised as an expense when the service is performed.

However, one of the characteristics of the public sector is the distribution of goods and services to users at no charge or at a price totally unrelated to the actual cost of these goods and services.

In this non-market environment, inventory techniques are useful for the physical monitoring of products, materials and supplies. However, the matching of revenue and expenditure is not applicable. It is therefore necessary to define specific rules applicable to the recognition and measurement of these inventories, as well as the timing of the recognition of expense incurred for their distribution, use or exchange.

- Products, materials and supplies used, exchanged or distributed at no charge or for a nominal charge are recognised as inventories according to the requirements of this Standard. Their cost is recognised as an expense when these goods are used, exchanged or distributed. Inventories are carried at acquisition cost although they do not generate revenue except of a nominal amount. However, where inventories are damaged or become obsolete, impairment is recognised to reflect the loss of service potential for Central Government.
- The production cost of services provided at no charge or for a nominal charge comprises mainly labour and related costs incurred to provide the service. By definition, there is no requirement to match these costs with expected revenue. Therefore, expenses related to the production of non-commercial services are not work in progress. They are recognised as expense in the accounting period in which they are incurred.

[3] The thresholds apply only to goods on an individual basis.

II.2. Measurement principles

Inventories are initially recognised at acquisition cost, production cost or at market value. This Standard provides a basis for the measurement of inventories. In particular, a distinction is made between interchangeable and non-interchangeable items.

Goods and work in progress of goods and services for sale in normal market conditions are measured at the lower of acquisition cost and inventory value[4]. Inventory value is the higher of market value and value in use. These terms are defined in this Standard.

Inventories of goods intended to be used, exchanged or distributed at no charge or a nominal charge are carried at acquisition cost, subject to any damage or obsolescence of all or part of the inventory.

II.3. The components of the cost of inventories

At their date of entry into the Central Government's balance sheet, inventories are recognised at acquisition cost, production cost or, failing that, at market value.

The cost of inventories is made up of acquisition or production cost or market value whichever is applicable, and conversion and other costs incurred in bringing the inventories to their present location and condition. Borrowing costs, abnormal losses and wastage are excluded.

II.4. Cost formulas for interchangeable items

The Standard allows two different formulas for determining the cost of interchangeable items:

- First-in – first-out, or
- Weighted average cost.

It also allows two alternative methods for measuring the cost of interchangeable items: either standard cost or retail method.

The use of standard costs is strictly regulated by the authorities responsible for producing the accounts of Central Government.

The retail method is relevant for commercial activities including the sale of small articles. These activities are very marginal for Central Government and this method is only to be used in exceptional circumstances, such as when it is difficult to determine acquisition or production cost.

II.5. Impairment of inventories

General impairment rules apply to inventories.

However, impairment of inventories used, exchanged or distributed at no charge or for a nominal charge is only recognised when the latter are damaged or become obsolete, to reflect the loss of service potential for Central government.

4 Inventory value is a concept similar to current value used in the General Chart of Accounts (PCG).

III. POSITION COMPARED TO OTHER STANDARDS

III.1. Position compared to the General Chart of Accounts

This Standard adopts the main general accounting requirements.

However, this Standard defines requirements for the reporting date measurement of goods used, exchanged or distributed at no charge or a nominal charge for which there are no specific provisions in the General Chart of Accounts. These inventories are carried at acquisition cost and not at the lower of cost and net realisable value. Impairment is only recognised when all or part of the inventories are damaged or become obsolete.

Central Government does not benefit from the option to capitalise borrowing costs in inventories available under the Commercial Code and the General Chart of Accounts (C. com. art. R 123-178-2 and PCG, art. 313-9.1). This option was not introduced because Central Government loans are not allocated to specific assets.

III.2. Position compared to international accounting standards

This Standard is consistent with the main requirements of IPSAS 12 Inventories, which is itself based on IAS 2 Inventories.

Like IPSAS 12, this Standard deals with inventories of goods distributed at no charge or a nominal charge which are a specific feature of the public sector.

This Standard also provides guidance on work in progress of services to be distributed at no charge or for a nominal charge and stipulates that the related costs are recognised as expense in the accounting period in which they are incurred. It differs in this respect from IPSAS 12 which stipulates that “the inventories referred to in paragraph 2(d) *(i.e. Work-in-progress of services to be provided for no or nominal consideration directly in return from the recipients)* … are excluded from the scope of this Standard because they involve specific public sector issues that require further consideration”.

Unlike in IPSAS 5 Borrowing Costs, which identifies circumstances in which borrowing costs are included in the cost of inventories, this option is not available to Central Government for the reasons referred to above in the comparison of this Standard to the requirements of the General Chart of Accounts.

STANDARD 8 – INVENTORIES

REQUIREMENTS

1. DEFINITION

Inventory is an asset.

Inventories include goods acquired, produced or held by Central Government:

> For sale or distribution at no charge or for a nominal charge in the normal course of its operations or for use in its activities,

> Or materials or supplies for consumption in the process of production of goods or services.

Inventories also include individual items of work in progress of services of a commercial nature for sale at normal market conditions.

2. RECOGNITION

An element is recognised as inventory provided it meets both of the following conditions:

> It is controlled by Central Government;

> Its cost or value can be measured with sufficient reliability.

Control generally takes a specific legal form (ownership or right of use, etc.) and is characterised by the ability to govern the conditions of use of the asset, on the one hand, and the ability to govern the service potential and/or future economic benefits derived from using the asset, on the other.

The fact that the Central Government bears the risks and expenses associated with holding the asset also constitutes a presumption of control.

Recognition of an element of inventory takes place on the date control is transferred, which is usually the date of the transfer of the risks and rewards associated with holding the asset.

3. MEASUREMENT

3.1 Measurement on initial recognition

On initial recognition in the Central Government's balance sheet, inventories are measured at acquisition cost, production cost, or failing that, at market value.

The cost of inventories is made up of acquisition or production cost or market value, whichever is applicable, and conversion and other costs incurred in bringing the inventories to their present location and condition. Borrowing costs, abnormal losses and wastage are excluded.

3.1.1. Acquisition costs of inventories acquired for purchase consideration

Acquisition costs of inventories are made up of:

- The purchase price, including non-recoverable import duties and other taxes, after deducting trade discounts, rebates, payment discounts and similar items;
- Transport, handling and other costs directly attributable to the acquisition of finished goods, raw materials and services.

Administrative overheads are excluded from acquisition cost.

3.1.2. Production costs of inventories and work in progress produced by Central Government

Production costs of inventories and work in progress include:

- Costs directly related to the units of production, such as direct labour;
- A systematic allocation of fixed and variable production overheads incurred in converting materials into finished goods.

Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as:

- Depreciation and maintenance of factory buildings and equipment including, where applicable, the depreciation of dismantling, and site clearance and restoration costs;
- A share of the depreciation of intangible assets such as development costs and software.

Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

Administrative overheads are excluded from production costs.

As a matter of convenience, Central Government may decide on an exceptional basis to use two alternative techniques for determining cost for specific activities, if the results approximate cost: either the standard cost or the retail method.

3.1.3. Market value of inventories acquired free of charge or in an exchange

Inventories acquired free of charge or in an exchange are recognised at market value.

3.2. Cost formulas applicable to items of inventory

These formulas enable disposal cost as well as the cost of the remaining inventory to be determined where items of inventory are used, sold or exchanged. For this purpose, cost is determined differently according to whether the items of inventory are interchangeable (non-identifiable) or non-interchangeable (identifiable).

3.2.1. Non-interchangeable items

Non-interchangeable (or identifiable) items are articles or individual classes of items which are not fungible. They also include physically identified items segregated for specific projects. The actual cost is determined for each individual article or class.

3.2.2. Interchangeable items

Interchangeable (or fungible) items are those items within each class that cannot be individually identified after entering the stores.

The cost of interchangeable items is determined by using the weighted average cost or first-in, first-out formulas.

The formula must be applied consistently. Consequently, the same formula is applied to inventories having the same nature and use to Central Government.

3.3. Measurement on the reporting date

3.3.1. Goods and work in progress of goods and services for sale at normal market conditions

On the reporting date, goods and work in progress of goods and services for sale at normal market conditions are measured at the lower of acquisition cost and inventory value[6].

Inventory value is the higher[7] of market value and value in use.

Inventories, including work in progress, are measured on a unit by unit basis or by class of item, where the inventory unit is the smallest part that can be inventoried for each article.

Where inventory value is lower than acquisition cost, impairment is recognised as an expense of the period, in accordance with normal impairment rules for assets.

If it appears during the period that the impairment provision is no longer required it is reversed through surplus/deficit.

[6] Inventory value is a concept similar to current value used in the General Chart of Accounts (PCG).

[7] However, only one of these values is applicable (either market value, or value in use) according to the purpose for which the inventory is held:

- market value, if the inventory is for sale in its current condition. It is the amount which could be obtained, at the reporting date, for the sale of finished goods or merchandise in their current condition.
- value in use, if the inventory is to be used in a production process. As a general rule, it is determined on the basis of expected net cash flows, including not only the estimated selling price but also expected completion and distribution costs.

3.3.2. Goods for distribution at no charge or a nominal charge or for use in the course of Central Government's operations

Goods for distribution at no charge or a nominal charge or for use in the course of Central Government's operations are carried at acquisition cost. An impairment loss is recognised for damaged or obsolete inventories.

3.3.3. Inventories for which a binding sale agreement exists

When a binding sale agreement exists for goods or work in progress but performance of the contract will take place at a later date, the inventories are measured at acquisition cost on the reporting date provided the agreed selling price covers the latter and outstanding costs to complete the sale.

The same applies to purchases used for the production of goods for which a binding sale agreement exists, provided these purchases are individually identified and the agreed selling price fully covers the cost of purchase, conversion and outstanding costs to complete the sale.

3.3.4. Difficulties in determining acquisition or production cost

In circumstances that must remain exceptional, it may not be possible to determine acquisition or production cost. In these circumstances, inventories are measured by reference to the acquisition or production costs of similar assets, observed or estimated at a date as close as possible to the actual acquisition or production date of the said assets. If this approach proves impracticable, the inventories are measured at market value on the reporting date.

If these methods entail an undue administrative burden for Central Government, the inventories are measured using the retail method.

3.4. Recognition of inventory change

The balance of the inventory change accounts represents the total change in value[8] of inventories between the beginning and the end of the accounting period.

These accounts may have a credit or debit balance. They are presented in the surplus deficit statement as an adjustment to purchases of goods and supplies on the one hand or to the production of finished goods on the other.

[8] Excluding any impairment.

4. DISCLOSURES IN THE NOTES

4.1. Accounting policies

The accounting policies adopted for inventories are disclosed in the notes, including those adopted for:

> measurement, including the cost formulas used;

> impairment.

4.2. Financial information

The notes mention:

> the gross amount by class appropriate to Central Government's operations;

> the amount of impairment for the same classes.