APPROVED

by Resolution No. 1 of 18 December 2003 of the Standards Board of the Public Establishment the Institute of Accounting of the Republic of Lithuania

9 BUSINESS ACCOUNTING STANDARD „INVENTORIES“

Version effective as from 5 January 2007 (“Valstybės žinios” (Official Gazette), 2004, No. 20-616; 2007, No. 1-48)

I. GENERAL PROVISIONS

1. The objective of this Standard is to set out how inventories shall be recorded in accounting and presented in financial statements.
2. This Standard establishes a procedure of recording inventories in accounting, determining their cost of purchase, the value of used (sold) inventories and the value of remaining inventories, accounting for inventories and presenting them in financial statements.
3. This Standard is not applicable when accounting for:

3.1. work in progress arising under construction contracts, including services directly related to construction contracts;

3.2. financial instruments;

3.3. biological assets related to agricultural activities;

3.4. mineral resources.

II. KEY DEFINITIONS

Inventories - current assets (raw materials and components, work in progress, finished goods and goods held for resale) used by an entity for generating revenues within one year or within one operating cycle.

Carrying amount of inventories – the value at which inventories are presented in the balance sheet.

Net realisable value – the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Cost of purchase (conversion) – the amount of cash or cash equivalents paid (payable) or the value of other assets given in exchange or consumed when acquiring or producing the asset.

Goods – assets purchased for resale and goods produced for sale by an entity.

Operating cycle – a period between buying inventories for operations and their realisation in cash or other instruments readily convertible into cash.

III. MEASUREMENT OF INVENTORIES

4. On initial recognition inventories are recorded at the cost of purchase and for the purposes of financial statements they are measured at the lower of the cost of purchase (conversion) or net realisable value.

IV. COST OF PURCHASE OF INVENTORIES

5. The cost of purchase of inventories comprises their purchase price adjusted by the amounts of received trade discounts and rebates. Adjustments to the cost of purchase made after the initial

recognition of inventories and related with rebates and discounts are recorded in accounting as follows:

5.1. if inventories have already been sold, the cost of goods sold is adjusted by reducing it by the amount of rebates and discounts;

5.2. if inventories have not been sold yet, the cost of purchase of inventories is adjusted by reducing it by the amount of rebates and discounts attributable to the unsold inventories. When such adjustment is impracticable and the amounts are not likely to result in material misstatements in financial statements, the cost of sold goods is adjusted in the manner described in paragraph 5.1.

6. When estimating the cost of purchase of inventories, their purchase price is summed up with all taxes and charges related to acquisition (except for those subsequently recoverable), transportation, preparation for use and other costs directly attributable to the acquisition of inventories. Costs of transportation and storage of inventories as well as other costs may be recognised as expenses (cost of sales) during the period when they are incurred if the amounts are insignificant.

7. Value added tax is excluded from the cost of purchase of inventories, except for cases when this tax is not subsequently recoverable and its recognition as operating expenses of the reporting period is likely to significantly distort operating results of the entity.

8. Inventories purchased in foreign currency are recorded at the official exchange rate of the national currency of the Republic of Lithuania and foreign currency announced on the day of purchase.

9. When recording the movement of inventories and their balances at the end of the reporting period at the cost of purchase is impracticable, other cost measurement techniques can be used. For example, the retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items that have similar profit margins. In this case the cost of inventories is determined by reducing the sales value of the inventories by the appropriate gross profit margin that is calculated as an average percentage gross profit margin for each type of inventories.

V. COST OF CONVERSION OF INVENTORIES (GOODS)

10. The cost of inventories (goods) produced during the reporting period (cost of conversion) comprises direct and indirect production costs.

11. Direct production costs comprise costs that can be directly attributed to produced goods without incurring significant expenses. As a rule, direct production costs include consumed raw materials, components and direct labour costs.

12. Costs of primary raw materials include raw materials or components consumed in the production process which form the basis of production or are used as component parts of produced goods and can be attributed to particular units of production or their groups without incurring significant expenses.

13. Direct labour costs include the amounts of wages and social insurance contributions of employees directly involved in the production of goods, which can be attributed to particular units of production or their groups without incurring significant expenses.

14. Indirect production costs are indirectly related to the production of goods. They comprise costs of ancillary raw materials, indirect labour costs, depreciation and other production costs which cannot be attributed to particular units of production or their groups without incurring significant expenses.

15. Costs of ancillary raw materials include raw materials consumed in the production process that are related to the production but not directly included in the composition of the product, or even being a component part of the product, they are not significant enough to be attributed to primary raw materials.

16. Indirect labour costs include the amounts of wages and social insurance contributions of employees who are not directly involved in the production of goods, but facilitate it.

17. Other indirect production costs include costs whose connection to produced goods cannot be directly defined. In accounting they are recorded using distribution methods.

18. The criteria for classifying costs into direct and indirect as well as for distributing indirect costs are selected by entities according to the nature of their production. Types of costs that are included in the cost of produced goods shall be disclosed in the accounting policies part of explanatory notes.

19. A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production.

20. Most by-products, by their nature, are immaterial, but can be sold. When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product.

21. In case when it is impracticable to record in accounting the movement of inventories and their balances of the reporting period at the actual cost of conversion, other methods, such as the standard cost method, may be used if the results approximate cost. Under this method, standard levels of using materials, labour and production facilities are estimated and a standard cost of a product unit is determined. The latter is regularly reviewed and, if necessary, revised in the light of current circumstances.

22. In periods of abnormally low production (compared to the normal capacity of production facilities), when the movement of inventories and their balances of the reporting period are recorded at the actual cost of conversion, a part of indirect production costs is not attributed to the cost of produced inventories, but it is recognised as operating expenses. This is done in order to keep the cost of produced goods in different periods relatively stable.

23. Irrespectively of methods of measurement applied, in financial statements inventories shall be measured at the actual cost or net realisable value.

VI. NET REALISABLE VALUE

24. The cost of inventories at the end of the reporting period may be higher than their net realisable value if those inventories were damaged, if they have become wholly or partially obsolete, if their selling prices have declined, or the estimated costs of completion or costs necessary to make the sale have increased. The practice of writing inventories down to net realisable value is consistent with the view that the carrying amount of assets should not be carried in excess of amounts expected to be realised from their sale or use during the operating cycle.

25. Inventories are usually written down to net realisable value on an item by item basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down based on a classification of inventories, for example, finished goods, or all the inventories in a particular industry or geographical segment.

26. Estimates of net realisable value are based on the most reliable evidence available at the time when the estimates are made. These estimates of net realisable value take into consideration fluctuations of price or cost directly relating to events occurring after the end of the reporting period until the reporting date and confirm conditions existing at the end of the period.

27. Estimates of net realisable value also take into consideration the purpose for which inventories are held. For example, the net realisable value of the quantity of inventories held to satisfy sales or service agreements is based on the contract price set in the signed agreements. If the

sales agreements are for less than the inventory quantities held, the net realisable value of the excess is definable according to average selling price or to comparable market price.

28. Raw materials and other supplies held for use in the production of goods cannot be written down below cost if the finished products in which they are incorporated are expected to be sold at or above cost, unless the entity has a surplus of these raw materials or other supplies compared to the amount necessary for regular operations of the entity.

29. However, when a decline in the price of materials indicates that the cost of finished products will exceed their net realisable value (for example, when the demand decreases for both the finished products and the raw materials used in production), the materials are written down to net realisable value. In such circumstances, the replacement cost of these materials may be the best available measure of their net realisable value.

30. When the circumstances that previously caused inventories to be written down below cost no longer exist, the amount of the write-down is reversed so that the new carrying amount of the inventories is equal to the lower of the cost of purchase (conversion) or the revised net realisable value. The value of inventories after the reversal cannot be higher than their cost of purchase (conversion).

31. All write-downs of inventories to net realisable value and all inventory losses shall be recognised as operating expenses of the same period when write-downs were performed and (or) losses suffered.

32. Any reversals of inventory write-downs arising from an increase in the net realisable value reduce operating expenses of the corresponding period.

33. Inventories, the net realisable value of which is estimated in foreign currency, shall be recorded at the official exchange rate valid at the time of assessing net realisable value.

VII. COST OF INVENTORIES OF A SERVICE PROVIDER

34. If it is necessary for an entity's operations, a service provider can accumulate costs related to rendering services in inventories. The cost of inventories of a service provider consists primarily of the labour and other costs directly related to providing the service as well as indirect costs attributable to them.

VIII. INVENTORIES APPRAISAL METHODS

35. When calculating the cost of inventories used in production or the cost of sold inventories, an entity may apply FIFO (assuming that the items of inventories that were purchased or produced first are used first), LIFO (assuming that the items of inventories that were purchased or produced last are used first), weighted average cost, specific identification of cost or other appraisal methods, depending on the movement of inventories in the entity and other conditions.

36. The FIFO method assumes that the items of inventories that were purchased first are sold or used first, and consequently the items remaining in inventories at the end of the period are those most recently purchased or produced. This method is also recommended in cases when it is impossible to estimate what inventories were used first.

37. The LIFO method can be used only in cases when the items of inventories which were purchased or produced last are sold or used first, and consequently the items remaining in inventories at the end of the period are those purchased or produced first.

38. If inventories are mixed and it is impossible to separate which of them are purchased or produced first, they can be assessed using the weighted average of the cost. Under the 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 period. The average may be calculated on a periodic basis, or as each additional shipment is received (depending on how inventories are used in each entity).

39. The cost of items of inventories that are not ordinarily interchangeable, goods produced and services provided for a specific purpose can be estimated using the specific identification of cost method. Under this method specific costs are attributed to identified items of inventory. This is an appropriate treatment for items that are designated for a specific project. However, specific identification of costs is inappropriate when there are large numbers of inventory items, which are ordinarily interchangeable.

IX. ACCOUNTING METHODS FOR CONSUMPTION (SELLING) OF INVENTORIES

40. In accounting consumption or selling of inventories can be recorded on a periodic or constant basis. Under the constant inventory accounting method every transaction related to consumption or selling of inventories is recorded in accounting. If it is impracticable to use the constant inventory accounting method, the periodic inventory accounting method can be used, when the cost of remaining inventories and the cost of sold goods are recorded in accounting at the end of the reporting period upon the completion of stock taking.

X. DISCLOSING INFORMATION IN FINANCIAL STATEMENTS

41. In complete explanatory notes the following information shall be disclosed:

41.1. accounting policies adopted for measuring inventories, including the cost measurement method used;

41.2. the total carrying amount of inventories and the carrying amount according to the type of inventories;

41.3. the carrying amount of inventories stated at net realisable value;

41.4. the amount of write-down to net realisable value;

41.5. the amount of any reversal of the write-down, circumstances or events that led to the reversal;

41.6. the carrying amount of pledged inventories;

41.7. inventories held by a third party;

41.8. if the LIFO method was used in accounting, the inventories shall be presented applying the LIFO method and the FIFO or net realisable value methods (depending on which value is lower). The difference of these values shall also be disclosed.

XI. FINAL PROVISIONS

42. This Standard shall be effective for financial statements covering periods beginning on or after 1 January 2004.