

# INVENTORY VALUATION PRACTICES IN INDIA : RAW MATERIALS AND STORES

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*A major portion of inventories is constituted by raw materials and stores. The method adopted for their valuation has serious implications for disclosure of companies, net worth. Present paper reports the practices followed by Indian Companies in this regard. The study concludes that companies in India follow diverse practices for valuing inventories.*

Inventory constitutes a major portion of current assets and within inventory, raw materials and components account for a significant proportion. The Reserve Bank of India in its Studies on the finances of selected large, non-financial, non-governmental public limited companies (each with a paid-up capital of Rs. 1 crore or above) notes that raw materials and components as one single element of inventory attribute to 28 to 35 percent of inventories. Besides, stores and spares constitute 18 to 20 percent of inventory, while nearly two percent is represented by others including loose tools.

The principal objective of this paper is to examine the corporate practices relating to methods of valuation of raw materials and components, stores, spares and loose tools. A pre-requisite to such an examination of methods of valuation would be to make an in-depth study of the overriding considerations of inventory valuation policy, such as ascertainment of profit, computation of tax liability, and also the type of inventory taking procedures adopted. The findings are based on a survey of 209 Indian Companies of which 178 belonged to private sector and 31 to public sector.

This paper has been divided into three sections. The first one deals with various factors influencing inventory valuation policy and procedures of inventory taking. The second section explains the methods of valuation of raw materials and components, stores and spares and loose tools. This in particular takes into account and disposition of incidental costs like transportation and carriage inwards, octroi duty, salary of the purchasing department and cost of financing the inventories. Finally, concluding remarks are given in section three.

## I. OBJECTIVES KEPT IN VIEW WHILE VALUING INVENTORIES

The present section concentrates on the corporate practices relating to inventory valuation policy, and inventory taking procedures.

Inventory valuation policy may not necessarily be influenced by factors such as ascertainment of profit, computation of tax liability, bank accommodation, etc. This fact has been amply illustrated in Table 1. Out of 209 companies in both public and private sectors under study, 88 (42%) companies specifically stated that they were not guided

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by the above mentioned factors. Another 49 (23%) companies did not specify whether these factors had any bearing on inventory valuation policies. Of the companies which stated that one or the other

factors had a bearing on their inventory valuation policies, the largest number of companies stated that their inventory valuation was not influenced by any consideration.

**Table 1 : Objectives Kept in View while Valuing Inventories**

Objectives	Number of Companies		
	Private Sector	Public Sector	Total
Ascertainment of profit	18	3	21 (10)
Computation of tax-liability	1	2	3
Bank accommodation	2	-	2
Combination of (i) and (ii)	9	1	10
Combination of (i) and (iii)	8	2	10
Combination of (i), (ii) and (iii)	9	-	9
Standard accounting principles	4	-	4
Conservatism	1	-	1
Uniformity	1	-	1
Generally accepted accounting principle	3	2	5
Consistency	1	-	1
Not affected/influenced	76	12	88 (42)
Not specified	41	8	49 (23)
Lower of cost and market	1	-	1
Easy to operate at faster speed	1	-	1
Convention	1	1	2
Purpose	1	-	1
<b>Total</b>	<b>178</b>	<b>31</b>	<b>209</b>

Note : Figures in brackets indicate percentages.



### I.A INVENTORY TAKING PROCEDURE

No uniform inventory taking procedure is followed by companies as depicted by Table 2. A large number of companies, i.e., 153 out of 209 (73%), did not make any distinction between various items of inventory - either on the basis of inventory components, or on selective inventory control (ABC) basis. This includes 76 companies which were adopting perpetual inventory system and 77 companies were following 'periodical' inventory taking system.

There is another category of 51 (24%) companies which classified their inventories on the basis of items and 5 companies followed ABC analysis. Further, 50 out of a

total of 51 companies followed 'perpetual' inventory procedure for stores, spares and raw material and 'periodical' inventory procedure for work-in-progress and finished goods. There was, however, one company in the private sector which was resorting to periodical inventory for raw material and stores and perpetual inventory for work-in-progress and finished goods. Besides this, out of 5 companies using ABC analysis of inventories, 3 adopted perpetual inventory for A and periodical inventory for B and C types of inventories, whereas 2 companies followed perpetual for A and B and periodical inventory systems for C type of inventories. It may be inferred from the above that there is a diversity in accounting practices with regard to inventory taking procedure.

**Table 2 : Inventory Taking Procedure followed by the Responding Companies**

Particulars	Number of Companies		
	Private Sector	Public Sector	Total
<b>I. Unclassified inventories</b>			
- Perpetual	66	10	76
- Periodical	66	11	77
<i>Total</i>	132	21	153
<b>II. Classified inventories</b>			
a) On the basis of components			
Store, spares & raw materials			
- Perpetual	40	10	50
- Perpetual	1	-	1
<i>Total</i>	41	10	51

**Table 2 (Contd...)**

<b>Work-in-progress &amp; finished goods</b>			
- Perpetual	1	-	1
- Periodical	40	10	50
<b>Total</b>	<b>41</b>	<b>10</b>	<b>51</b>
<b>(b) On the basis of value systems</b>			
A Type - Perpetual			
B + C Type - Periodical	3	-	3
A+B Type - Perpetual			
C - Periodical	2	-	2
<b>Total</b>	<b>5</b>		<b>5</b>
<b>Grand Total</b>	<b>178</b>	<b>31</b>	<b>209</b>

## II. RAW MATERIAL AND STORES

The following section deals with corporate practices with regards to methods of valuation of raw materials and components, stores, spares and loose tools.

### II.A STORES, SPARES AND LOOSE TOOLS

#### Method of valuation

Table 3 shows that in case of stores and spares, it is the cost basis of valuation which is widely accepted, since 193 out of 209 (92%) companies were following this method. One of the important features of this practice has been that 11 companies in the private and 3 in public sectors were following lower of cost and market method of valuation. Out of 11 companies in the private sector, 9 and all the 3 in public sector

belonged to two industries, namely, chemical and engineering.

Like stores and spares, in case of loose tools as well, the most popular basis of valuation was observed to be 'cost'. It is obvious from Table 3 that 167 out of 209 (80%) companies were valuing loose tools at cost, whereas lower of cost and market was followed by only 12 companies in the private and 3 companies in the public sectors. Among these, most of the companies belonged to chemical and engineering industries.

Accounting Standard 2 of the JCAI in this regard provides as follows: "Inventory of consumable stores and maintenance supplies should ordinarily be valued at 'cost'. In appropriate circumstances, however, this may be valued at below cost"<sup>1</sup>.

<sup>1</sup> The Institute of Chartered Accountants of India, "Valuation of inventories," As2, ASB (New Delhi : Ist, June 1981) Clause 29.1; Also see Clause 24; Revised As 2, Valuation of Inventories", which comes into effect in respect of accounting periods commencing on or after 1.4.99 and is mandatory in nature.



**Table 3 : Methods of valuation—Stores, Spares, Loose Tools, and Raw Materials and Components**

S. No.	Inventory	(i) Private Sector										(ii) Public Sector						(i) + (ii)		
		Breweries	Tobacco	Rubber	Sugar	Paper	Cement	Basic Metals	Textiles	Chemical	Engineering	Total	Paper	Cement	Basic Metals	Textiles	Chemicals	Engineering	Total	Total
<b>1.</b>	<b>Stores and spares</b>																			
	- Cost	1	1	6	9	5	5	11	33	36	59	166	1	-	5	3	6	12	27	193
	- Lower of cost and market	1	-	-	1	-	-	-	-	4	5	11	-	-	-	-	1	2	3	4
	- Not realizable value	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
	- Not specified	-	-	-	-	-	-	-	-	1	-	1	-	1	-	-	-	-	1	2
	<b>Total</b>	<b>2</b>	<b>1</b>	<b>6</b>	<b>10</b>	<b>5</b>	<b>5</b>	<b>11</b>	<b>33</b>	<b>41</b>	<b>64</b>	<b>178</b>	<b>1</b>	<b>1</b>	<b>5</b>	<b>3</b>	<b>7</b>	<b>14</b>	<b>31</b>	<b>209</b>
<b>2.</b>	<b>Loose tools</b>																			
	- Cost	1	1	5	9	4	5	11	24	29	54	143	-	-	5	2	5	12	24	167
	- Lower of cost and market	1	-	1	1	-	-	-	-	4	5	12	-	-	-	-	1	2	3	15
	- Not realizable value	-	-	-	-	-	-	-	-	8	1	9	-	-	-	-	-	-	-	9
	- Not specified	-	-	-	-	1	-	-	9	-	4	14	1	1	-	1	1	-	4	18
	<b>Total</b>	<b>2</b>	<b>1</b>	<b>6</b>	<b>10</b>	<b>5</b>	<b>5</b>	<b>11</b>	<b>33</b>	<b>41</b>	<b>64</b>	<b>178</b>	<b>1</b>	<b>1</b>	<b>5</b>	<b>3</b>	<b>7</b>	<b>14</b>	<b>31</b>	<b>209</b>
<b>3.</b>	<b>Raw materials and components</b>																			
	- Cost	1	1	5	7	4	5	9	17	21	45	115	1	1	5	2	6	11	26	141
	- Lower of cost and market	1	-	1	3	-	-	2	16	20	16	59	-	-	-	1	1	3	5	64
	- Not realizable value	-	-	-	-	-	-	-	-	-	2	2	-	-	-	-	-	-	-	2
	- Not specified	-	-	-	-	1	-	-	-	-	1	2	-	-	-	-	-	-	-	2
	<b>Total</b>	<b>2</b>	<b>1</b>	<b>6</b>	<b>10</b>	<b>5</b>	<b>5</b>	<b>11</b>	<b>33</b>	<b>41</b>	<b>64</b>	<b>178</b>	<b>1</b>	<b>1</b>	<b>5</b>	<b>3</b>	<b>7</b>	<b>14</b>	<b>31</b>	<b>209</b>

The principal consideration behind the above recommendation seems to be that loose tools, stores and spares are generally not to be sold and are to be used in manufacturing operations, and therefore, these should normally be valued at cost and not at 'lower of cost and market'. A departure from cost basis is permitted only when an item has lost its utility or deteriorated in terms of its value to the business or has become partially or wholly obsolete. In such circumstances, it would be necessary to write down the inventory below cost on a conservative basis or valuation.

Thus, it may be mentioned that valuation of stores and spares and loose tools in the case of chemical and engineering industries at lower of cost and market does not seem to be justified in view of the aforesaid recommendations of ICAI.

### **Cost flow assumption used**

As regard the cost flow assumption used by the responding companies, it may be seen from Table 4 that 65 (31%) companies were using 'weighted average' method, followed by 52 (25%) companies following the 'first-in, first-out, (FIFO) formula.

## **II.B RAW MATERIALS AND COMPONENTS**

### **Method of valuation**

In case of raw materials and components, 141 out of 209 (67%) companies were following 'cost' method, whereas 64 (31%) companies were using lower of cost and market' principle and only 2 companies were following 'net realizable value' basis of valuation, as in revealed by Table 3.

A salient feature of such valuation practice is that in case of textile industry, 17 out of 33 (52%) companies and in chemical

industries 21 out of 41 (51%) companies were following 'cost' as their basis of inventory valuation. It is important to note that the remaining 16 out of 33 (48%) companies in textiles, and 20 out of 41 (49%) companies in chemical were adopting the 'lower of cost and market' method. In case of textiles, it was observed that the term 'market' in lower of cost and market' for raw materials and components implied replacement cost, since the raw material and was meant for replenishment rather than for sale.

Further, the 'net realizable value' method of valuation as followed by 2 companies in chemical industry in the private sector may not be regarded as an appropriate method of valuation for raw materials and component inventory as the raw materials are used rather than sold in the normal course of business.

### **Disposition of incidental costs**

Disposition of incidental cost with regard to inventory costing may be analyzed in the light of definition of the term 'cost' as provided in AS 2 which states as follows: "Historical cost represents an appropriate combination of the (a) cost of purchase; (b) cost of conversion; and (c) other cost incurred in the normal course of business in bringing the inventories up to their present location and condition." Revised Accounting Standard 2 on similar lines states "The cost of inventories should comprise all cost of purchase, costs of conversion and other costs incurred in bringing. The inventories to their present location and condition.

It would be evident from Table 5 that in case of transportation costs and carriage inwards to godown, octroi duty and insurance of goods in transit, most of the responding companies in both the sectors were including them in the cost of raw

Table 4 : Cost Flow Assumption Used by the Responding Companies

Particular	Industries										Total	Per cent
	Breweries	Tobacco	Rubber	Sugar	Paper	Cement	Basic Metals	Textiles	Chemical	Engineering		
<b>Stores and spares</b>												
a) Weighted average	1	-	-	-	-	-	7	9	19	29	65	31.10
b) First-in-first Out	-	-	4	5	-	-	3	11	11	18	52	24.89
c) Simple average method	-	-	2	4	5	-	1	2	5	4	23	11.00
d) Moving average	-	-	-	-	-	1	3	-	6	13	23	11.00
e) Specific identification	-	-	-	1	-	-	-	3	-	-	4	1.91
f) Standard rate	-	-	-	-	-	-	-	-	1	1	2	.96
g) Not specified	1	1	-	-	1	5	2	11	6	13	40	19.14
Total	2	1	6	10	6	6	16	36	48	78	209	100.00
<b>Raw Material and Components</b>												
a) First-in-first Out	1	-	4	5	1	2	3	15	14	24	69	33.01
b) Weighted average	1	1	-	-	-	1	3	6	18	29	59	28.22
c) Simple average	-	-	2	5	4	3	5	7	6	9	41	19.62
d) Moving average	-	-	-	-	-	-	2	1	5	13	21	10.05
e) Standard rate	-	-	-	-	-	-	-	-	4	2	6	2.87
f) Specific identification	-	-	-	-	-	-	1	5	1	-	7	3.35
g) Last-in-first out	-	-	-	-	1	-	1	-	-	1	3	1.44
h) Not specified	-	-	-	-	-	-	1	2	-	-	3	1.44
Total	2	1	6	10	6	6	16	36	48	78	209	100.00

Table 5 : Disposition of Incidental Costs by the Responding Companies

Incidental Cost	(i) Transportation & carriage						(ii) Octroi duty						(iii) Insurance of goods in transit						(iv) Storing cost of Raw Materials					
	Private		Public		Total		Private		Public		Total		Private		Public		Total		Private		Public		Total	
Sector	No. of Cos.	Per cent	No. of Cos.	Per cent	No. of Cos.	Per cent	No. of Cos.	Per cent	No. of Cos.	Per cent	No. of Cos.	Per cent	No. of Cos.	Per cent	No. of Cos.	Per cent	No. of Cos.	Per cent	No. of Cos.	Per cent	No. of Cos.	Per cent	No. of Cos.	Per cent
a) Included in raw materials & stores	157	88.20	28	90.32	185	88.52	148	83.15	23	74.19	171	81.82	119	66.85	21	67.74	140	66.99	22	12.36	7	22.58	29	13.88
b) As a component of overhead to be apportioned to Work in progress and finished goods	6	3.37	-	-	6	2.87	6	3.37	1	3.23	7	3.35	19	10.67	3	9.88	22	10.53	85	47.75	15	48.39	100	47.85
c) To be transferred to income statement	10	5.62	1	3.23	11	5.26	4	2.25	2	6.45	6	2.87	28	15.73	2	6.45	30	14.35	56	31.46	6	19.35	62	29.67
d) Not specified	5	2.81	2	6.45	7	3.35	20	11.24	5	16.13	25	11.96	12	6.74	5	16.13	17	8.13	15	8.43	3	9.68	18	8.61
Total	178	100.00	31	100.00	209	100.00	178	100.00	31	100.00	209	100.00	178	100.00	31	100.00	209	100.00	178	100.00	31	100.00	209	100.00



Table 5 (Contd.)

	(v) Cost of receiving and inspecting raw materials						(vi) Salary of the Purchasing Agent/Department						(vii) Cash discount adjustment				(viii) Cost of financing the inventories							
a) Included in raw materials and stores	21	11.80	7	22.58	28	13.40	13	7.30	5	16.13	18	8.61	117	65.73	17	54.84	134	64.11	11	6.18	3	9.68	14	6.70
b) As a component of overhead to be apportioned to work in progress and finished goods	78	43.82	14	45.16	92	44.02	77	43.26	14	45.16	91	43.54	7	3.93	-	-	7	3.35	23	12.92	5	16.13	28	13.40
c) To be transferred to income statement	60	33.71	5	16.13	65	31.10	64	35.96	3	9.68	67	32.06	28	15.73	4	12.90	32	15.31	129	72.47	17	54.84	146	69.86
d) Not specified	19	10.67	5	16.13	24	11.48	24	13.48	9	29.03	33	15.79	26	14.61	10	32.26	36	17.22	15	8.43	6	19.35	21	10.05
Total	178	100.00	31	100.00	209	100.00	178	100.00	31	100.00	209	100.00	178	100.00	31	100.00	209	100.00	178	100.00	31	100.00	209	100.00

materials and components. These percentages are 89, 82 and 67, respectively. With regard to cost of insurance of goods in transit, only 6 companies stated that they were including only specific cost of insurance of goods in transit in the raw materials cost, whereas unspecified cost of insurance was to be considered as a component of overhead item of cost to be apportioned to work-in-progress and finished goods.

The storage cost of raw materials and components, cost of receiving and inspecting raw materials and salary of the purchasing agent or department are not to be considered in the computation of value of raw materials, since these items of expenditure do not help bringing an inventory to its present location and condition. Thus, to treat these expenses as a component of raw materials cost, would be in contravention of GAAP. Such companies were 29, 28, 18 in number in respect of all these items respectively. However, it may be appropriate to consider these items as an element of overhead cost to be apportioned to work-in-progress and finished goods inventories. Companies resorting to such practice in case of storage cost of raw material, cost of receiving and inspecting raw materials, salary of the purchasing department or agent were: 100 (48%), 92 (44%) and 91 (44%) respectively, in both the private and public sectors.

Treatment of cash discount as an adjustment of purchase cost of inventories is justifiable, as the inventories are deemed to be recorded at net cost incurred. Out of 209 companies, 134 (64%) were adjusting the cash discount towards the cost of raw materials and components, 32 (15%) were crediting this concession to income statement while 7 companies were passing this benefit to work-in-progress and finished

goods inventories.

The cost of financing the inventories normally does not help in bringing the inventories up to their present location and condition and therefore it is excluded from the valuation of inventories. In both sectors, 14 companies were including it in the raw materials cost, whereas 28 were loading the work-in-progress and finished goods inventories as a component of overhead cost. Such treatments are not regarded to be in accordance with generally accepted accounting principles. The cost of financing the inventories may justifiably be considered as a component of product cost only in cases like timber and whisky, where such costs add to the value of the product over a period of time and thus help in bringing the inventories to their present location and condition. In other situations, the cost of financing is expenses in the period to which it pertains.

#### **Disposition of variance between actual and estimated incidental costs**

If any of the above mentioned incidental costs are related to raw materials or as a component of overhead item of cost to be apportioned to work-in-progress and finished goods on an estimated basis, as the final invoice has not been received, the difference between the estimated and actuals at the end of the year may either be transferred to income statement or to respective account head. Table 6 depicts that out of a total of 79 such companies, 17 attributed convenience, 33 materiality, 22 significance, and 7 convenience and significance, as reasons.

#### **Cost flow assumption Used**

It will be seen from Table 4 that the highest number of companies, i.e., 69 (33%) were following 'first-in, first-out' cost formula. This

Table also reveals that weighted average was the next popular cost computation principle as 59 (28%) companies were adhering to this principle in one form or the other (weighted, monthly, quarterly or annually). Besides, 'simple average method' was also being used in practice and the number of companies using this method was 41 (20%).

It is important to note that only 3 companies,

one each in paper, basic metals and engineering, were following last-in, first out (LIFO). It may be stated that though the LIFO method has the sanction of AS 2, yet this is not permitted by the existing tax law. In *Minister of National Revenue v Anaconda American Brass Ltd.* (1956, 30 ITR 84) the value of the stock according to LIFO was rejected as it was not reflective of true profit for income-tax purposes.

**Table 6 : Disposition of Actual and Absorbed Incidental Costs — A Corporate Practice**

S. Treatment No.	Number of Companies		
	Private sector	Public sector	Total
<b>I. Transfer to Income Statement because of</b>			
Convenience	15	2	17
Materiality	31	2	33
Significance	18	4	22
Convenience and significance	7	-	7
<b>Total</b>	<b>71</b>	<b>8</b>	<b>79</b>
<b>II. Transfer to Respective Account Heads</b>			
If the difference			
is substantial	5	-	5
Reasons not Specified	41	-	41
<b>Total</b>	<b>46</b>		<b>46</b>

**Application of lower of cost and market**

It would be seen from Table 7 that there was no uniformity in applying the lower of cost and market rule in respect of raw materials and stores. Out of 64 companies in both the sectors following lower of cost and market, (39%) companies were applying this doctrine for each item separately, 17 (27%) for group items taken

together and 9 (14%) were comparing the cost of raw materials with market price on overall basis, also known as 'Global method'. However, in 13 (20%) companies, the basis of such application was not specified.

It may be pointed out in this context that while the comparison of historical cost of raw material component of inventory in the former two cases is permissible under

**Table 7: Application of 'Lower of Cost and Market' to Raw Materials**

Treatment	(i) Private Sector										(ii) Public Sector							(i) + (ii)				
	Breweries	Tobacco	Rubber	Sugar	Paper	Cement	Basic Metals	Textiles	Chemical	Engineering	Total	Percent	Paper	Cement	Basic Metals	Textiles	Chemical	Engineering	Total	Per cent	Total	Per cent
i) Each item separately	1	-	1	3	-	-	-	5	3	10	23	38.98	-	-	-	1	1	-	2	40.00	25	39.06
ii) Group items	-	-	-	-	-	-	1	7	4	4	16	27.13	-	-	-	-	-	1	1	20.00	17	26.56
iii) Global Method	-	-	-	-	-	-	1	4	1	1	7	11.86	-	-	-	-	-	2	2	40.00	9	14.06
iv) Not specified	-	-	-	-	-	-	-	-	12	1	13	22.03	-	-	-	-	-	-	-	-	13	20.32
<b>Total</b>	<b>1</b>	<b>-</b>	<b>1</b>	<b>3</b>	<b>-</b>	<b>-</b>	<b>2</b>	<b>16</b>	<b>20</b>	<b>16</b>	<b>59</b>	<b>100.00</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1</b>	<b>1</b>	<b>3</b>	<b>5</b>	<b>100.00</b>	<b>64</b>	<b>100.00</b>



GAAP, the use of overall basis of comparison of historical cost of all dissimilar and non-interchangeable items with the aggregate of the market price of all those items is not regarded as prudent as it amounts to setting off anticipated losses against unrealized profit (AS2 clauses 18 to 25).

### III CONCLUSIONS

The main finding of this paper has been that there is a diversity in accounting practices with regard to methods of valuation of raw materials, stores and spares, and loose tools, and also in the treatment of incidental expenses like cost of financing the inventories and salary of the purchasing department in respect of raw materials and components. This divergence in accounting practice does not arise because of the type of sector and pattern of performance of companies, even though some sort of relationship could be established between type of industry and methods of valuation followed.

In textiles and chemical industries, it was observed that both 'cost' as well as 'lower of cost and market' methods of valuation had almost equal acceptance for valuation of raw materials and components. Further, in textile industry the term 'market' in the context of valuation of raw materials implied in almost all cases as 'replacement cost' since raw materials were meant for replacement rather than for sale in the ordinary course of business.

As regards the valuation of stores and spares, and loose tools the widely accepted method of valuation was found to be 'cost' as it was followed in most of the responding companies. Such treatment is in consonance with the accredited accounting principles as laid down in AS 2.

Regarding cost flow assumptions used in respect of stores and spares, raw materials and components, it was noticed that in the case of stores and spares, 'weighted average' method was adopted in large number of companies and in the case of raw materials and components, 'first-in, first out' method was observed to be used by the companies generally. An important feature of accounting practices is that LIFO was found to be followed by three companies, one each belonging to paper, basic metals and engineering industries.

While applying the 'lower of cost and market' in respect of raw materials and components, it was found that a significant majority of companies was applying the principle to individual items or groups of similar items, and only a small proportion of the total companies was using the 'Global' method for this principle, a basis which is not recommended by the accounting principles as governed by AS 2, since it amount to setting off losses against unrealized profit.

Finally, it may be stated that the 'cost' basis for stores and spares, and loose tools while 'lower of cost and replacement cost' for raw materials and components appear to be appropriate methods of valuation. Further, the treatment of incidental costs, such as carriage inwards to godown, octroi duty, specific insurance of goods in transit, are includable in ascertaining the cost of raw materials and components as these expenses help in bringing such inventories up to their present condition and location. In contrast to this, expenditure incurred in cost of receiving and inspecting raw materials, salary of the purchasing agent or department, and cost of financing the inventories do not help in bringing these inventories to their existing condition and location; thus inclusion of these expenses in the cost of raw materials and components

is not in accordance with accepted accounting principles. However, these items of cost, except for the cost of financing the inventories which is normally considered as expense of the year in which it is incurred, may be incorporated in the overheads to be apportioned to work-in-progress and finished goods inventories. Cost of financing

the inventories may justifiably be included as a component of product cost only in special types of industry like 'timber' and 'whisky', where financing costs add to the value of product over a period of time and thus directly help in bringing inventories up to their present location and condition.