STAFF PAPER

February 2021

IFRS® Interpretations Committee meeting

Project	**Costs Necessary to Sell Inventories (IAS 2)**		
Paper topic	Initial consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about IAS 2 *Inventories*. The submission asks about the costs an entity includes as part of the estimated costs necessary to make the sale when determining the net realisable value of inventories.

2. This paper:

   (a) provides the Committee with a summary of the matter;

   (b) presents our research and analysis; and

   (c) asks the Committee whether it agrees with our recommendation not to add a standard-setting project to the work plan.

Structure of the paper

3. This paper includes the following:

   (a) background information;

(b) summary of outreach;

(c) staff analysis; and

(d) staff recommendation.

4. There are three appendices to the paper:

(a) Appendix A—proposed wording of the tentative agenda decision;

(b) Appendix B—additional research and analysis; and

(c) Appendix C—submission.

Background information

5. Paragraph 9 of IAS 2 requires entities to measure inventories ‘at the lower of cost and net realisable value’. Paragraph 5 of the Standard defines net realisable value as:

> 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*. (emphasis added)

6. The submitter asks which costs an entity includes as part of the estimated costs necessary to make the sale when determining the net realisable value of inventories. The submitter has observed entities applying two differing views:

(a) View 1—an entity includes *all costs* needed to make the sale (eg ordinary sales staff and advertising costs that are attributable to the inventory); and

(b) View 2—an entity includes only *additional costs* required by the particular conditions of the inventories to make the sale (eg special promotion campaigns).

Appendix C to this paper reproduces the submission, which provides further details about each view.

7. The submitter uses the term ‘additional costs’ in describing View 2, but explains that entities applying this view include only incremental costs in their estimate of costs

necessary to make the sale. In this paper, we consider the term 'additional costs' to have the same meaning as the term 'incremental costs' used in IFRS Standards.[1]

Summary of outreach

8. We sent information requests to members of the International Forum of Accounting Standard-Setters, securities regulators, and large accounting firms. The submission was also made available on our website.

9. The request asked those participating to provide information about:

    (a) how often entities write inventories down to net realisable value;

    (b) when estimating net realisable value, whether the costs necessary to make the sale are generally material for entities; and

    (c) whether entities apply View 1 or View 2 in estimating costs necessary to make the sale.

10. We received 15 responses—seven from national standard-setters, seven from large accounting firms and one from an organisation representing a group of securities regulators. The views received represent informal opinions and do not reflect the official views of those respondents or their organisations.

Findings from outreach

How often do entities write inventories down to net realisable value?

11. Most respondents said writing inventories down to net realisable value is common in some industries (for example, retail and consumer goods), for some types of inventories (for example, seasonal goods) or because of specific circumstances (for example, difficulties in selling particular goods). A few of these respondents said

[1] The term 'incremental costs' is generally used to refer to costs that would not have been incurred if the entity had not entered into a transaction. The term is used, for example, as part of the definitions of 'transaction costs' in IFRS 9 *Financial Instruments*, 'incremental costs of obtaining a contract' in IFRS 15 *Revenue from Contracts with Customers* and 'costs of disposal' in IAS 36 *Impairment of Assets*.

write downs are likely to become more common because of the economic consequences of the Covid-19 pandemic.

12. Some respondents said entities in some industries often write down inventories because they expect to sell some of their inventories at a loss (for example, fashion retailers).

13. A few respondents said writing inventories down to net realisable value is generally not common.

Are costs necessary to make the sale material for entities?

14. Most respondents said costs necessary to make the sale are generally immaterial. However, these respondents said costs could be material for some types of inventory, in some industries and in some circumstances. For example, some respondents said costs could be material if an entity needs to transport inventories to a different location or when sales commissions and incentives are significant. Some respondents said this might also depend on the approach taken by an entity to identify these costs.

15. A few respondents said the estimated selling price is generally the main factor that influences whether an entity writes its inventories down to net realisable value, rather than the costs necessary to make the sale.

Do entities apply View 1 or View 2?

16. Most respondents said they observed entities applying View 1 and View 2 in determining the net realisable value of inventories. A few respondents said they only observed entities applying View 2. One respondent said, in practice, most entities apply View 2 because it can be difficult to allocate other costs to each item of inventory.

17. Some respondents expressed a preference for one of the two views. Those respondents identified supporting arguments for their preferred view that are broadly similar to the arguments identified by the submitter (see Appendix C to this paper for further details).

18. A few respondents said, in their view, IAS 2 allows different interpretations of what constitutes costs necessary to make the sale.

Staff analysis

The applicable requirements in IAS 2

19. As explained in paragraph 5 of this paper, paragraph 5 of IAS 2 defines net realisable value as:

> 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*. (emphasis added)

20. Paragraph 28 of IAS 2 explains the reasons why it may be necessary for an entity to write inventories down to their net realisable value:

> The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased.

21. Paragraph 28 of IAS 2 also sets out the objective of writing inventories down to their net realisable value:

> The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.

22. Paragraphs 29–33 of IAS 2 include further requirements about how an entity estimates the net realisable value of inventories. These paragraphs do not identify which specific costs are necessary to 'make the sale' of inventories.

Staff view of the application of those requirements

23. In our view, the requirements in IAS 2 set out above:

    (a) do not allow an entity to restrict its estimate of the costs necessary to make the sale to only such costs that are incremental (paragraphs 24–26); and

(b) by including only incremental costs in such an estimate, an entity could fail to achieve the objective set out in paragraph 28 of IAS 2 in the specific context of inventories (paragraphs 27–32).

'Costs necessary to make the sale' vs 'incremental costs'

24. IAS 2 describes the selling costs to be included in the measurement of the net realisable value of inventories as 'the estimated costs necessary to make the sale'. Unlike other IFRS Standards, IAS 2 does not specify that an entity includes *only* incremental selling costs when determining the net amount to be realised from the sale of inventories.

25. IAS 2 includes requirements that specifically apply to inventories and these requirements are different from the requirements that apply to other assets (see further discussion in paragraphs 35–39). We see no basis in these requirements for an entity to restrict its estimate of costs necessary to make the sale to only such costs that are incremental, thereby potentially excluding costs the entity *must* incur to sell its inventories but that are not incremental to a particular sale.

26. In determining the net realisable value of inventories (as defined in IAS 2), an entity includes all costs necessary to make the sale in the ordinary course of business. An entity would use its judgement to determine which costs are necessary to make the sale considering its specific facts and circumstances, including the nature of the inventories.

The objective of writing inventories down to their net realisable value

27. Although IAS 2 includes no requirements that specify exactly which costs are those that are 'necessary to make the sale', paragraph 28 sets out an objective that entities are required to achieve when determining net realisable value—ie the objective of ensuring that inventories are not carried in excess of *amounts expected to be realised from their sale*.

28. In addition to there being no basis for an entity to restrict its estimate of costs to only those that are incremental (see paragraph 24–26), in our view including only incremental costs could fail to achieve the objective set out in paragraph 28 of IAS 2 in the specific context of inventories.

29. By definition, inventories are for sale in the ordinary course of business.[2] Entities engage in selling activities in their ordinary course of business and the costs of such activities are not always incremental to the sale of particular items of inventory. Entities would typically expect the selling price of inventories to cover both the cost of purchasing or producing the inventories and the costs they must incur to sell the inventories (not only incremental costs).

30. To illustrate, assume the following:

    (a) an entity holds inventories—similar items of finished goods—at a carrying amount of CU100. The inventories represent a large proportion, but not all, of the entity's inventories. The entity purchased the inventories with the expectation that it would sell them for CU130. However, because of changes in market conditions since purchasing the items, the entity now expects to sell the inventories for CU100.

    (b) sales personnel are needed to sell the inventories. The entity could either hire agency personnel to do this (who would sell only these inventories) or use a portion of the time of its sales staff (who would sell these inventories as well as other inventories). For economic reasons, the entity expects to use a portion of the time of its sales staff to sell the inventories rather than hiring agency personnel—the estimated cost of those sales staff's time needed to sell the inventories is CU20.

31. The entity in this fact pattern has no means of realising CU100 for the inventories without incurring costs on sales personnel to sell the inventories—whether by hiring agency personnel or using a portion of the time of its sales staff. The costs incurred on sales personnel are 'necessary to make the sale' of the inventories. Therefore, applying IAS 2, in our view the entity writes the inventories down to their net realisable value of CU80 (CU100 – CU20).

[2] Paragraph 6 of IAS 2 defines inventories as 'assets (a) held for sale in the ordinary course of business, (b) in the process of production for such sale, or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services'.

32. Applying View 2 (incremental costs only) to the example above could result in differing outcomes depending on whether the entity:

(a) hires agency sales personnel or remunerates sales staff for selling the inventories on a commission basis (considered to be costs necessary to make the sale); or

(b) remunerates sales staff via a fixed salary (not considered to be costs necessary to make the sale).

This would be the case even though the entity is unable to realise CU100 for the inventories without incurring sales personnel costs to sell the inventories.

Why we disagree with View 2

33. As mentioned above, IAS 2 does not specify which costs an entity includes in its estimate of the 'costs necessary to make the sale'. Proponents of View 2 therefore think that entities may interpret this term as referring only to incremental costs directly attributable to selling the asset, for the following reasons:

(a) this interpretation is consistent with how other IFRS Standards define 'costs to sell' (or 'costs of disposal');

(b) non-incremental costs may also serve other purposes or relate to other inventory items—including such costs may result in an entity recognising future operating losses; and

(c) net realisable value is usually determined on an item-by-item basis and it may not be possible to allocate non-incremental costs to individual inventory items.

34. We have analysed each of these reasons in the following paragraphs.

Consistency with other IFRS Standards

35. Proponents of View 2 say interpreting 'costs necessary to make the sale' as including only incremental costs is consistent with how other IFRS Standards define 'costs to sell' (or 'costs of disposal'). In particular, they note that IAS 36 *Impairment of Assets*—which includes requirements designed to ensure that assets are carried at no

more than their recoverable amount—defines costs of disposal as ‘incremental costs directly attributable to the disposal of an asset…’.

36. In our view, an entity does not refer to IAS 36 in applying ‘costs necessary to make the sale’ within IAS 2’s definition of net realisable value because:

    (a) the term used in IAS 36 (costs of disposal) is *not* the same as that used in IAS 2 (costs necessary to make the sale); and

    (b) the assets within the scope of IAS 36 differ in one key aspect from inventories—they are *not* assets held for sale in the entity’s ordinary course of business.

37. The requirements in IAS 36 were not designed to apply to inventories. Therefore, in our view, referring to the requirements in that Standard in the context of measuring the net realisable value of inventories could fail to achieve the objective described in paragraph 28 of IAS 2—ie to ensure that inventories are not carried in ‘excess of amounts expected to be realised from their sale’. As discussed above in paragraph 28, to sell inventories, entities typically incur costs on sales activities in the ordinary course of business that are not incremental to a particular item of inventory. The nature of these costs is different from the nature of costs that an entity would incur, for example, in a potential sale of a cash-generating unit (CGU). The costs of selling a CGU would generally be incremental because such a sale is not part of an entity’s ordinary course of business.

38. Proponents of View 2 also note that both IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 41 *Agriculture* define ‘costs to sell’ as incremental costs. Therefore, in their view it is appropriate to interpret ‘costs necessary to make the sale’ in a manner consistent with those other IFRS Standards.

39. In our view, an entity would also not refer to IFRS 5 or IAS 41. Again, we note that the terms used in IFRS 5 and IAS 41 are *not* the same as the term in IAS 2 (costs necessary to make the sale) and again we note that:

    (a) similarly to IAS 36, the requirements in IFRS 5 were not designed to apply to the measurement of assets that an entity sells in its ordinary course of business (see paragraphs 36–37 above); and

(b) IAS 41 includes requirements that were designed to address the specific characteristics of agricultural activity and the related assets within its scope.[3] We note that:

(i) entities measure biological assets and agricultural produce at the point of harvest at fair value less costs to sell as the ongoing measurement basis; such measurement is not a mechanism to ensure that cost does not exceed net realisable value; and

(ii) IAS 41 used the term 'point-of-sale costs' before the Board amended the Standard in 2008 and replaced that term with 'costs to sell'. Paragraph BC3 of the Basis for Conclusions on IAS 41 explains the reason for the change, stating that the terms 'meant the same thing *in the context of IAS 41*' (emphasis added) and that 'the word 'incremental' in the definition of 'costs to sell' excludes costs that are included in the fair value measurement of a biological asset, such as transport cost.' Therefore, the Board concluded that incremental costs is appropriate *in the specific context* of IAS 41.

Non-incremental costs may also serve other purposes

40. Proponents of View 2 say non-incremental costs may also serve other purposes or relate to other inventory items. An entity will incur such costs regardless of whether it sells a particular inventory item. Therefore, including such costs in an entity's estimate of the net realisable value of inventories may result in an entity recognising future operating losses through the write down of inventories.

41. We disagree with the argument above. In our view, by reflecting all costs necessary to sell its inventories—instead of only those that are incremental—the entity is simply estimating the net amount it is able to realise from sale of the inventory in its ordinary course of business. Whether a cost also contributes to the sale of other inventory items does not make it unnecessary for the sale of a particular inventory item. If a cost

[3] Paragraph BC4(c) of the Basis for Conclusion on IAS 41 states 'the nature of agricultural activity creates uncertainty or conflicts when applying traditional accounting models, particularly because the critical events associated with biological transformation (growth, degeneration, production, and procreation) that alter the substance of biological assets are difficult to deal with in an accounting model based on historical cost and realisation.'

contributes to selling other inventories as well as the inventories for which net realisable value is being determined, then the entity would allocate a portion of the total cost to the inventories in question.

42. As mentioned in paragraph 28 of this paper, entities would typically expect the selling price of inventories to cover costs incurred on sales activities in the ordinary course of business. Changes in conditions during the current reporting period may affect the entity's estimate of the selling price, costs of completion or costs it will incur to make the sale. Therefore, any resulting write-down of inventories to net realisable value relates to that period; it is not future operating losses.

Net realisable value is usually determined on an item-by-item basis

43. Paragraph 29 of IAS 2 states that 'inventories are usually written down to net realisable value item by item'. Proponents of View 2 therefore say it may not be possible to allocate non-incremental costs to individual inventory items.

44. We disagree that, because entities usually write down inventories to net realisable value item by item, the costs necessary to make the sale should include only incremental costs. Regardless of whether an entity writes down inventories to net realisable value item by item—or in relation to a group of similar items—entities still reflect the costs necessary to make the sale in their measurement of net realisable value for the reasons discussed in paragraphs 19–32 of this paper. This would be the case even if, to do so, an entity is required to allocate the costs to individual inventory items.

Additional research and analysis

45. Appendix B to this paper include additional research and analysis of materials related to the question asked by the submitter. That additional research and analysis did not change our conclusion on the application of IAS 2 as discussed in paragraphs 19–44 of this paper.

Staff conclusion

46. Based on our analysis above, we conclude that the requirements in IAS 2 do not allow an entity to restrict its estimate of the costs necessary to make the sale to only such costs that are incremental. Instead, in determining the net realisable value of inventories, an entity includes all costs necessary to make the sale in the ordinary course of business. An entity would use its judgement to determine which costs are necessary to make the sale considering its specific facts and circumstances, including the nature of the inventories.

Question 1 for the Committee
1. Does the Committee agree with our analysis of the requirements in IAS 2, outlined in paragraphs 19–45 of this paper and summarised in paragraph 46?

Should the Committee add a standard setting project to the work plan?

Is it necessary to add to or change IFRS Standards to improve financial reporting?[4]

47. Based on our analysis in paragraphs 19–46 of this paper, we conclude that the principles and requirements in IAS 2 provide an adequate basis for an entity to determine the costs it includes as part of the estimated costs necessary to make the sale when determining the net realisable value of inventories.

Staff recommendation

48. Based on our assessment of the work plan criteria in paragraph 5.16 of the *Due Process Handbook* (discussed in paragraph 47 of this paper), we recommend that the Committee does not add a standard-setting project to the work plan. Instead, we recommend publishing a tentative agenda decision that outlines how an entity

[4] Paragraph 5.16(b) of the *Due Process Handbook*.

determines the costs it includes as part of the estimated costs necessary to make the sale when determining the net realisable value of inventories.

49. Appendix A to this paper sets out the proposed wording of the tentative agenda decision. In our view, the proposed tentative agenda decision (including the explanatory material contained within it) would not add or change requirements in IFRS Standards.[5]

Questions 2 and 3 for the Committee
2. Does the Committee agree with our recommendation not to add a standard-setting project to the work plan? 3. Does the Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

[5] Paragraph 8.4 of the *Due Process Handbook* states: 'Agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Standards. Instead, explanatory material explains how the applicable principles and requirements in IFRS Standards apply to the transaction or fact pattern described in the agenda decision.'

Appendix A—proposed wording of the tentative agenda decision

Costs Necessary to Sell Inventories (IAS 2 *Inventories*)

The Committee received a request about the costs an entity includes as the ‘estimated costs necessary to make the sale’ when determining the net realisable value of inventories. In particular, the request asked whether an entity includes all costs necessary to make the sale or only those that are incremental to the sale of an inventory item.

Paragraph 5 of IAS 2 defines net realisable value as ‘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’. Paragraphs 28–33 of IAS 2 include further requirements about how an entity estimates the net realisable value of inventories. Although those paragraphs do not identify which specific costs are necessary to sell inventories, paragraph 28 of IAS 2 describes the objective of writing inventories down to their net realisable value—that objective is to avoid inventories being carried ‘in excess of amounts expected to be realised from their sale’.

The Committee observed that, when determining the net realisable value of inventories, IAS 2 requires an entity to estimate the costs ‘necessary to make the sale’. This requirement does not allow an entity to restrict such costs to only those that are incremental, thereby potentially excluding costs the entity must incur to sell its inventories but that are not incremental to a particular sale. The Committee also observed that, by definition, inventories are for sale in the ordinary course of business. Entities engage in selling activities in their ordinary course of business and the costs of such activities—which are necessary to make the sale of inventories—are not always incremental to the sale of particular items of inventory. Therefore, including only incremental costs could fail to achieve the objective set out in paragraph 28 of IAS 2 in the specific context of inventories.

The Committee concluded that, when determining the net realisable value of inventories, an entity includes all costs necessary to make the sale in the ordinary course of business. An entity would use its judgement to determine which costs are necessary to make the sale considering its specific facts and circumstances, including the nature of the inventories.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the costs it includes as the estimated costs necessary to make the sale when determining the net realisable value of inventories. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Appendix B—additional research and analysis

B1. This appendix includes additional research and analysis of material related to the questions asked by the submitter, including material in the: (a) basis for conclusions on IAS 2 and earlier versions of the Standard; and (b) basis for conclusions on IAS 36.

Basis for Conclusions on IAS 2 and earlier versions of the Standard

B2. We researched the Basis for Conclusions on IAS 2 to determine whether it might provide additional insights about the rationale for the requirements on net realisable value in the Standard.

B3. The Basis for Conclusion on IAS 2 explains only the Board's considerations in reaching its conclusions on revising the Standard as part of the amendments included in *Improvements to International Accounting Standards* (issued in December 2003). The Board did not reconsider the requirements related to net realisable value as part of that project. We therefore found no further information about the rationale for the requirements in IAS 2.

B4. Further, we researched earlier versions of IAS 2 and found that the current definition of net realisable value is not significantly different from the definitions included in the original Standard (issued in December 1993) and IAS 2 *Valuation and Presentation of Inventories in the Context of the Historical Cost System* (issued in October 1975).[6]

Basis for Conclusions on IAS 36

Definition of costs of disposal

B5. The Basis for Conclusions on IAS 36 includes no discussion of the reason for the definition of 'costs of disposal' in IAS 36 specifying only incremental costs.

[6] Both versions of IAS 2 defined net realisable value as 'the estimated selling price in the ordinary course of business less costs of completion and less costs necessarily to be incurred in order to make the sale'.

Reasons for not using 'net realisable value' and excluding inventories from the scope of IAS 36

B6. Paragraphs BCZ38–BCZ39 of the Basis for Conclusions on IAS 36 explains the considerations of the International Accounting Standards Committee (IASC) in deciding not to use the term 'net realisable value'—as defined in IAS 2—for the purposes of determining the recoverable amount applying IAS 36. Paragraph BCZ38 states:

> For the purpose of determining recoverable amount, IASC decided not to use the term 'net realisable value' as defined in IAS 2 because:
>
> (a) IAS 2's definition of net realisable value does not refer explicitly to transactions carried out on an arm's length basis.
>
> (b) net realisable value refers to an estimated selling price in the ordinary course of business. In certain cases, net selling price will reflect a forced sale, if management is compelled to sell immediately.
>
> (c) it is important that net selling price uses, as a starting point, a selling price agreed between knowledgeable, willing buyers and sellers. This is not explicitly mentioned in the definition of net realisable value.[7]

B7. Paragraph BCZ39 explains the IASC's conclusion:

> In most cases, net selling price and net realisable value will be similar. However, IASC did not believe that it was necessary to change the definition of net realisable value used in IAS 2 because, for inventories, the definition of net realisable value is well understood and seems to work satisfactorily.

B8. Further, paragraph BCZ4 explains the following about the exclusion of inventories from the scope of IAS 36:

> IAS 2 *Inventories* requires an enterprise to measure the recoverable amount of inventory at its net realisable value. IASC

[7] The term 'net selling price' was later replaced in IAS 36 by 'fair value less costs to sell'.

> believed that there was no need to revise this requirement because it was well accepted as an appropriate test for recoverability of inventories. No major difference exists between IAS 2 and the requirements included in IAS 36 (see paragraphs BCZ37–BCZ39).

B9. In our view, these paragraphs clarify that there are *intended* differences between the measurement requirements in IAS 2 and IAS 36 because of the particular characteristics of inventories vis-à-vis other assets. Further, in our view, the statement that there are no major differences between the Standards cannot be read to imply that the IASC considered 'costs necessary to make a sale' as equivalent to 'costs of disposal'. Having specifically considered the measurement requirements in IAS 2 and IAS 36, the IASC decided to provide a definition of 'costs of disposal' in IAS 36 but leave the requirements in IAS 2 unchanged.

Appendix C—submission

C1. We have reproduced the submission below:

Agenda Item Request: Costs necessary to make the sale (IAS 2)

1. In the retail sector the volume of inventories may fluctuate in response to different factors including changing market demand. Issuers [entities] may react to increasing levels of inventories with promotional campaigns aiming at reducing the stock held of certain products, especially for those that are more obsolete and expected to be sold at a discount.

2. In such cases, when determining the net realisable value as required by paragraph 6 of IAS 2 for the purpose of measuring inventories pursuant to paragraph 9 of that Standard, issuers may consider different factors, for example: the costs necessary to undertake special promotional campaigns that are necessary to sell the entire inventory (or the oldest portions thereof) and other costs that are ordinarily needed to sell inventories.

3. As part of their monitoring and supervisory activities, ESMA and national enforcers have identified divergent application of the abovementioned requirements of IAS 2 for what concerns, in particular, the reading of the terms “cost necessary to make the sale”. ESMA understands that such diversity may exist in multiple jurisdictions. ESMA also notes that IAS 2 does not provide explicit guidance about the definition of the costs to be included in the determination of the net realisable value.

4. As a result, ESMA has observed that the following accounting policies in practice:

    a. All costs needed to make the sale are included in the determination of the net realisable value (view 1); and

    b. Only additional costs required by the particular conditions of the inventories to make the sale (e.g. special promotion campaigns) are included in the determination of the net realisable value (view 2).

View 1: All sale costs needed are included in the determination of the net realisable value

5. Proponents of view 1 understand the requirement in paragraph 6 of IAS 2 to indicate that all costs necessary to make the sale shall be included in the calculation of the net realisable value. This includes the costs necessary to make the sale of the entire inventory and not only any additional costs, that would be necessary to put in place selling efforts that are specific to particularly obsolete and discounted portions of the inventory.

6. According to view 1, there would be no basis in IAS 2 to selectively exclude sales costs that the entity bears as part of its ordinary business, e.g. ordinary sales staff costs and advertising costs that are attributable to the inventory and, therefore, all sales costs have to be allocated to the entire inventory, including those parts relating to obsolete or discounted products. Incidentally, proponents of view 1 note that views may vary on whether costs associated to the lease of sale stores should be considered as part of sale costs.

7. Proponents of view 1 believe this broader interpretation is similar to treatment in other IFRS Standards such as the recent amendment to IAS 37.68 regarding onerous contracts and the definition of “unavoidable costs”.

8. While proponents of view 1 do not generally support the inclusion of general advertising cost as part of the cost necessary to make the sale, they believe that when such costs are attributable to inventories (or portions thereof), these costs should also be included and not only when targeted campaigns are in place to specifically sell the concerned inventory (or a portion thereof).

View 2: Only additional costs required by the particular conditions of the inventories to make the sale (e.g. special promotion campaigns) are included in the determination of the net realisable value

9. On the other hand, proponents of view 2 consider a more restrictive notion of the costs necessary to make the sale under IAS 2 and would only consider the incremental costs attributable to the sale of the inventory in question, thus including only additional costs to those ordinarily borne by the entity and that would exist in relation to the sale of that particular portion of the inventory.

10. Under this approach, for example, costs that can be directly attributable – although they are not direct costs of the inventory strictly speaking – would be excluded from

the determination of the net realisable value. These costs include ordinary advertising and marketing costs as well as costs for staff responsible for sales in store.

11. On the contrary, proponents of view 2 would include only the costs of any promotional campaign and the related staff costs that are specifically needed to sell a particular inventory item (or a portion thereof). Proponents of this view argue that other costs than direct ones may serve other purposes than only the sale of the inventory and therefore shall not be included when calculating the net realisable value. Net realizable value is generally written down to net realizable value item by item (IAS 2 para 29) and this may not be possible for such promotional expenses.

12. Proponents of view 2 believe this narrower interpretation is similar to treatment in other IFRS standards such as IAS 36 paragraph 6 (Definition of "costs of disposal") and BCZ39, IAS 41 paragraph 5 (Definition of "costs to sell") and IFRS 5 App-A – definition of "costs to sell" and IFRS 15 (IFRS 15 para 92, para IE 189 (Example 36)).

Request

13. ESMA seeks clarification on how to determine which costs should be included as part of the cost necessary to make the sale when determining the net realisable value in accordance with IAS 2.

14. ESMA is of the view that the lack of clarity of the wording of IAS 2 leads to divergent practices, including within the European jurisdictions. In particular, ESMA is concerned that different outcomes can emerge depending on whether a more conservative or narrower notion of the 'necessary' costs to make the sale is adopted.

15. ESMA has already observed different views expressed and applied in the market. Consequently, ESMA suggests that the IFRS IC clarifies the respective requirements.