

**Sue Lloyd  
Chair of the IFRS IC  
Columbus Building  
7 Westferry Circus  
Canary Wharf, London E14 4HD  
United Kingdom**

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

Dear Ms Lloyd,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that enhances the protection of investors and promotes stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. In the context of ESMA's supervisory convergence work in the area of financial reporting, I would like to raise with you the following issue related to the application of IAS 2 *Inventories*.

As a result of work carried out by national competent authorities and ESMA's coordination activities regarding financial information prepared in accordance with IFRS, ESMA has identified diversity in the application of the requirements of IAS 2. In particular, the issue relates to the identification of which costs shall be included as part of the estimated costs necessary to make the sale, when determining the net realisable value of inventories. ESMA notes that this issue is rather common in the retail industry and that the observed divergence in practice does not support the comparability of financial statements of issuers.

Accordingly, ESMA kindly suggests that the IFRS Interpretations Committee (IFRS IC) considers clarifying the relevant accounting requirements. A detailed description of the case is set out in the appendix to this letter.

In case you have any questions or comments regarding this letter, I suggest you contact Evert van Walsum, Head of the Investors and Issuers Department ([Evert.vanWalsum@esma.europa.eu](mailto:Evert.vanWalsum@esma.europa.eu)).

Yours sincerely,



Steven Maijoor

## APPENDIX – DETAILED DESCRIPTION OF THE ISSUE

1. In the retail sector the volume of inventories may fluctuate in response to different factors including changing market demand. Issuers 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.