

MINUTES



**To:** Board Members

**From:** Short-Term Convergence—Phase I  
Varian (ext. 353)

**Subject:** Minutes of the August 11, 2004 Board Meeting **Date:** August 13, 2004

**cc:** Bielstein, Smith, Leisenring, Swift, Polley, Gabriele, Intranet (email),  
Project Team (J. Johnson, McKenna, Varian, Vincent), McGeachin  
(IASB via e-mail)

*The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.*

Topic: Inventory Costs

Basis for Discussion: Memorandum dated July 29, 2004

Length of Discussion: 9:00 a.m. to 9:20 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Schieneman,  
Schipper, Seidman, and Trott

Board members absent: None

Staff in charge of topic: McKenna

Other staff at Board table: Beilstein, Cassel, J.Johnson (by phone),  
Varian

Outside participants: Leisenring

Summary of Decisions Reached:

The Board began its redeliberations of the December 2003 FASB proposed Statement, *Inventory Costs* (an amendment of ARB 43, chapter 4). The Board decided:

1. To proceed with the issuance of a final Statement promulgating the changes to inventory cost procedures proposed in the Exposure Draft. (Some comment letter respondents had suggested the Board defer making those changes until it undertook a comprehensive project on inventory accounting.)
2. To clarify the meaning of the term *normal capacity* (as requested by comment letter respondents).
3. To retain, but not further define, the following terms in the final Statement: *fixed* and *variable production overheads*, *double freight*, *rehandling costs*, *low production*, and *idle plant*. However, the Board decided to amend a sentence from paragraph 5 of ARB No. 43, *Restatement and Revision of Accounting Research Bulletins*, as follows:

Certain other items, when abnormal, require treatment as current period charges rather than as a portion of inventory costs. Examples of such items are freight, handling costs, and wasted materials (spoilage).

4. The Board decided that the proposed Statement will apply to inventory costs incurred during fiscal years beginning after December 15, 2004.

The staff will develop the clarifying guidance related to the term *normal capacity* in consultation with comment letter respondents and members of the Small Business Advisory Committee. *The Board expects to issue a final Statement in the fourth quarter of 2004.*

Objective of Meeting:

The objective of the Board meeting was to redeliberate the remaining issues related to the Exposure Draft.

Matters Discussed and Decisions Reached:

Ms. McKenna began by stating that some respondents requested that the Board decline to issue the proposed Statement unless and until a more comprehensive project on inventory accounting is undertaken. She recommended that the Board proceed with the issuance of the proposed Statement but include several modifications to clarify the proposed Statement's intent.

Mr. Trott stated that he agreed with the staff recommendation to continue with this project under short-term convergence because he does not foresee a more comprehensive project on inventory accounting to be on the Board's agenda in the near future. All Board members agreed.

Next, Ms. McKenna stated that many respondents interpreted the proposed Statement to require that all unfavorable production variances should be treated as period costs, while all favorable production variances should be included in inventory. Because that was not the Board's intent, Ms. McKenna recommended that the final Statement clarify the term *normal capacity* by inserting a footnote such as the following:

Normal capacity refers to a range of production levels. Some variation in production levels from period to period is expected and establishes the range of normal capacity. The range of normal capacity will vary based on business- and industry- specific factors. Judgment is required to determine when a production level is abnormally low (that is, outside the range of expected variation in production.) Examples of factors that might be anticipated to cause an abnormally low production level include significantly reduced demand, labor and material shortages, and unplanned facility or equipment down time.

Ms. McKenna stated that the staff had contacted certain comment letter respondents and members from the Small Business Advisory Committee to confirm that the above footnote provides adequate clarification. She also stated that the constituents who responded to date generally believe that the clarification is helpful and will not result in significant changes in practice. However, the staff will continue to communicate with constituents about the exact wording of the footnote. Mr. Trott asked if the staff confirmed that the IASB felt that the definition was appropriate, even though it does not appear in their literature. Ms. McKenna said that the staff did confirm this with the IASB. Mr. Trott recommended that the staff ask the IASB to also provide this definition, in some form, to their constituents since this a convergence project. All Board members agreed with the staff recommendation pending further communication with constituents.

Ms. McKenna stated that some respondents requested that the Board provide definitions in the proposed Statement to clarify the meaning of several terms. Those terms include: *fixed and variable production overheads, double freight, rehandling costs, low production, and idle plant*. She recommended that these terms be retained in the final Statement but not be further defined because each of those terms has been used in practice for some time and the Board does not intend for the proposed Statement to change their meanings. However, she recommend that a sentence from paragraph 5 of ARB 43 be amended to clarify that amounts of freight, handling, and waste (spoilage) that are considered to be abnormal would be period expenses. The proposed amendment is as follows:

Certain other items, when abnormal, require treatment as current period charges rather than as a portion of inventory costs. Examples of such items are freight, handling costs, and wasted materials (spoilage).

She also stated that, although the some of the respondents she talked to still requested explicit definitions, they believed that this clarification is a sufficient improvement. Mr. Cooch stated that he was surprised this clarification is necessary since the terms *double freight* and *rehandling costs* have been used in practice for years. Mr. Trott questioned whether this revision is consistent with IAS 2 and, furthermore, whether it is more consistent than ARB 43 was before this amendment. Ms. McKenna stated that, although the wording is not the same as the wording in IAS 2, it is consistent with the intent of IAS 2. All Board members agreed with the staff recommendation.

Ms. McKenna stated that some respondents requested that the Board clarify the transition provisions of the proposed Statement. She recommended that the proposed Statement be applied to inventory costs incurred during annual and interim periods beginning after March 15, 2005. Mr. Trott stated that he did not understand why they would have to defer the effective date to March 15, 2005, for such minor changes. He also stated that if there were changes, it would be more appropriate to reflect that for all periods in a single fiscal year. Therefore, he recommended that proposed Statement be effective for inventory costs incurred during fiscal years beginning after December 15, 2004. All Board

members agreed with Mr. Trott's recommendation pending the outcome of the issue on the clarification of *normal capacity*.

Mr. Cassel asked whether the final Statement should include a reminder that the disclosures required by paragraph 19 of APB Opinion No. 20, *Accounting Changes*, are applicable if significant changes to an entity's inventory accounting result from the adoption of the final Statement. All Board members agreed.

Follow-up Items:

The staff was instructed to continue discussing with contacted constituents the clarification of *normal capacity* and the amendment to the sentence from paragraph 5 of ARB 43. In addition, the staff was asked to request that the IASB communicate the definition of *normal capacity* to their constituents.

General Announcements:

None.