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April 13, 2004

Ms. Suzanne Bielstein Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856 Letter of Comment No: 27
File Reference: 1200-100
Date Received: 4/14/04

File Reference No. 1200-100 - Proposed Statement of Financial Accounting Standards, Inventory Costs, an amendment of ARB No. 43, Chapter 4

Dear Ms. Bielstein:

We are pleased to offer comments on the Financial Accounting Standards Board's (FASB) Proposed Statement of Financial Accounting Standards, *Inventory Costs, an amendment of ARB No. 43, Chapter 4* (the Exposure Draft), dated December 15, 2003. We support the Board's efforts to promote international convergence by removing certain individual differences between U.S. GAAP and International Financial Reporting Standards ("IFRS"). We encourage the Board to continue to work closely with the International Accounting Standards Board and other international standard setters to develop high-quality standards that will be applied globally. With regard to the specific Exposure Draft, we generally support its provisions, however there are several matters that we believe should be clarified or reconsidered prior to the issuance of a final standard. Our specific comments on the Exposure Draft are detailed below.

Impact of the Proposed Standard

We believe that the proposed amendment to ARB No. 43 will have a more significant impact on practice than noted by the FASB in paragraph A4 of the Exposure Draft, which states that "...the FASB does not expect that convergence, in this instance, will substantially change practice." We believe the Exposure Draft, as drafted, will result in significant changes to current practice under U.S. GAAP particularly related to the expensing of the following:

- · "Volume variances" as they relate to the allocation of fixed overhead, and
- Items such as double freight and rehandling costs that are currently subject to a "so abnormal" criteria under U.S. GAAP.

We believe the wording changes place additional constraints and limitations on the costs that would be capitalizable as inventory as compared to current U.S. GAAP, and would cause significant changes to inventory costing practices under U.S. GAAP for many companies.

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Thus, we find the statement made in the basis for conclusions that the Exposure Draft is not expected to substantially change practice is inconsistent with our expectation of the impact of the proposed standard.

Suggested Wording Revisions to Achieve Convergence

We suggest a revision to certain language in paragraph 2 of the Exposure Draft which states, "Inventories are *presumed* to be stated at cost" to be revised to "Inventories *should be* stated at cost." We are uncertain as to the FASB's intent for utilizing the *presumed* wording, but believe that the intent of the standard is that inventories *should be* stated at cost.

We believe revision to certain language in paragraph 2 of the Exposure Draft is necessary in order to establish convergence with International Accounting Standards No. 2, Inventories (IAS 2). The Exposure Draft states that "Other items such as double freight, rehandling costs, and abnormal amounts of wasted materials (spoilage) require treatment as current period charges rather than as a portion of the inventory cost." IAS 2 (paragraph 16) states, in part:

"Examples of costs excluded from the cost of inventories and recognized as expenses in the period in which they are incurred are,

(a) abnormal amounts of wasted materials, labor, or other production costs...(emphasis added)"

To achieve convergence, we suggest the following wording change, "Other items such as abnormal double freight, abnormal rehandling costs, and abnormal amounts of wasted materials (spoilage) require treatment as current period charges rather than as a portion of the inventory cost."

Normal Capacity

We believe that the additional language in paragraph 2 of the Exposure Draft regarding "normal capacity" as it relates to allocating fixed production overheads to inventories potentially represents a significant change in inventory costing practices under U.S. GAAP for many companies. Under current U.S. GAAP, fixed production overhead costs are often allocated to units of production based on actual production levels. Unallocated overheads (or overhead absorption variances) are generally included in inventory costs and only charged to current period expense if variances between actual and expected production levels (i.e., idle facility expense) meet the "so abnormal" criteria that is described in the existing language in Chapter 4 of ARB 43.

As proposed, the standard would also result in differing treatments for favorable and unfavorable variances. The result of application of the standard will be that inventories will be carried at cost if actual production levels meet or exceed "normal capacity" levels, whereas inventories will be carried at less than actual cost if actual production levels are less than

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"normal capacity." This result is inconsistent with the stated principle, which is to carry inventories at historical cost. We believe the Board should reconcile this provision with the underlying principle.

In order to avoid confusion regarding the meaning of the concept of "normal capacity", we recommend that the wording in the proposed standard be changed by replacing the term "normal capacity" with the term "normal production levels" or "normal expected production levels."

Determination of Replacement Cost When Evaluating Lower of Cost or Market

We believe that the proposed standard needs to address how replacement cost would be determined in relation to evaluating lower of cost or market. ARB 43 Chapter 4, Statement 6, states, in part:

As used in the phrase lower of cost or market, the term market means current replacement costs (by purchase or by reproduction, as the case may be) except that: (1) Market should not exceed the net realizable value (i.e., estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal); and (2) Market should not be less than net realizable value reduced by an allowance for an approximately normal profit margin.

Additionally, paragraph 9 of that same Statement states, in part:

Utility is indicated primarily by the current cost of replacement of the goods as they would be obtained by purchase or reproduction.

We believe that additional guidance is needed with regard to how replacement cost is determined (i.e., by allocating overhead based on "normal capacity" levels of production, allocating overhead based on actual production levels, or allocating overhead based on production levels expected in the immediate future). We believe replacement cost would be appropriately determined by allocating overhead based on actual production levels, which would result in replacement costs being reflective of the actual costs of reproduction.

Effective Date and Transition

We encourage the Board to carefully consider whether the proposed effective date (fiscal years beginning after December 15, 2004) gives companies sufficient time to make required system and tracking changes.

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We appreciate the opportunity to comment on the Exposure Draft. If you have any questions concerning our comments, please contact William Platt at (203) 761-3755 or Robert Uhl at (203) 761-3705.

Yours truly,

Deloitte & Touche LLP