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Letter of Comment No: 7
File Reference: 1200-100
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April 12, 2004

Ms. Suzanne Q. Bielstein Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Exposure Draft: Proposed FASB Statement, Inventory Costs - an amendment of ARB No. 43, Chapter 4 (File Reference No. 1200-100)

Dear Ms. Bielstein:

We support the Board's ongoing efforts to improve U.S. generally accepted accounting principles and, for the topic identified for short-term convergence, to converge U.S. GAAP with international accounting standards. We agree with the proposal to amend paragraph 5 of ARB 43, Chapter 4, *Inventory Pricing*, to adopt language similar to the language in IAS 2 *Inventories*. Additionally, we agree with the Board's conclusion that the IASB's wording more clearly articulates the principle that underlies both the U.S. standard and IFRS. We believe that this amendment would improve financial reporting by reducing the possibility of inconsistent application by entities that prepare financial statements using either U.S. GAAP or IFRS. Additionally, we recommend, to the extent practicable, that the Boards continue to strive not only to achieve converged *language*. The remainder of the letter contains specific comments about the proposal.



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Rehandling and Double Freight

The proposal would require that all costs for rehandling be recognized as an expense regardless of whether the cost is incurred for abnormal or normal rehandling. Just as the Board distinguished between normal and abnormal spoilage in determining whether costs are appropriately included in inventory, we suggest that the Board clarify whether it intends for all rehandling costs to be recognized as expense regardless of whether the cost relates to normal or abnormal rehandling. For example, we envisage that normal rehandling would occur in connection with quality review procedures, and that those rehandling costs could qualify for inventoriable costs.

In addition, the proposal would require double freight cost to be recognized as a current period expense. We are uncertain whether or how double freight is different from rehandling. If the Board determines that normal rehandling costs are inventoriable costs, we recommend that the Board define double freight to avoid the potential for misinterpretation of the standard.

General and administrative expenses

The proposed revision of paragraph 5 of ARB 43, Chapter 4, states, "general and administrative expenses should be included as period charges, except for the portion of such expenses that may be clearly related to production and thus, constitute a part of inventory charges (product charges)." We believe that costs that clearly are related to production are production overhead costs that would be inventoried, not general and administrative expenses. Costs that are properly categorized as general and administrative expenses cannot be clearly related to production. If the phrase general and administrative expenses is retained, we suggest that the Board delete the portion of that sentence after the words "period charges." Alternatively, in the final standard, the Board could revise the wording to distinguish between overhead and general and administrative costs.

If you have questions about our comments or wish further to discuss any of the matters addressed herein, please contact John Guinan at (212) 909-5449 or Paul Munter at (212) 909-5567.

Sincerely,

KPMG LLP