

Fitch Ratings

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Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
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LETTER OF COMMENT NO. 9

File Reference: Proposed FSP ARB 43-a

Dear Mr. Golden:

We appreciate the opportunity to comment on the proposed FASB Staff Position (FSP) that would amend ARB No. 43, Chapter 4, "Inventory Pricing" to require that inventories included in an entity's trading activities be initially and subsequently measured at fair value with changes in fair value recognized in earnings.

Overview

Fitch Ratings (Fitch) is a leading global rating agency committed to providing the world's credit markets with independent, timely and prospective credit opinions. Fitch's corporate finance ratings make use of both qualitative and quantitative analyses to assess the business and financial risks of fixed-income issuers. Therefore, Fitch directly relies on the financial statements and that reliance places us in an informed position to comment on information we believe is useful and crucial in the credit evaluation process, which is a critical component of efficient capital markets.

Fitch does not support the adoption of the changes to accounting for trading inventories as proposed in the FSP. Primarily, Fitch is concerned that the ability of an issuer to transfer inventory back and forth between the trading and non-trading category will result in a lack of comparability between periods and issuers.

Fitch is also concerned potential unintended consequences could result if the FSP is adopted as proposed. Allowing an issuer to determine, at will, when to designate and de-designate trading inventory may invite a new form of earnings management that was not possible under the prior standards.

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Fitch understands that certain issuers do not currently hedge their trading positions. There is a concern that upon adoption of the FSP, these issuers may enter into economically unnecessary hedge transactions to limit accounting volatility.

As credit analysts and strong proponents of a single set of global accounting standards, Fitch reviews accounting proposals to ensure they meet two broad goals. First, is there sufficient disclosure to understand the balance sheet, income statement and cash flow effects of affected transactions as a result of the change in accounting? Expansion of the use of fair value in financial statements should be accompanied by robust disclosure to understand both the cash and non-cash impacts of fair value measures in the financial statements. Though the proposal includes detailed disclosure requirements for how a company determines what is included in trading inventory, it does not address Fitch's goal of having information provided about the cash and non-cash impact of using fair value for trading inventory. The detailed disclosures currently contemplated in the financial statement presentation project would provide critical information to understanding the effects of this proposal. Specifically, disclosures similar to the reconciliation of the statement of financial performance with the statement of cash flows would provide credit analysts with key information about the non-cash impact of applying fair value to trading inventories. Accordingly, if the FSP is adopted as proposed, Fitch believes that additional disclosure requirements should be part of the final standard.

Second, does the change prospectively modify accounting standards in such a way as to further convergence efforts between US GAAP and International Financial Reporting Standards? This proposal does not eliminate differences between the two sets of standards, nor does it result in what we perceive as a superior alternative method.

Should the Board move to fair value for companies with trading operations, we would prefer it propose to allow an issuer to make a one-time designation to account for all commodity inventory at fair value.

We address the issues that the Board identified as part of its proposal below:

Issue 1- Commodity Inventories

Would we prefer an alternative approach to limit the scope of the proposed FSP to commodity inventories that are not used in production, wholesale, retail or distribution activities?

Fitch does not believe that this alternative approach would be preferable. We note that certain issuers currently have commodity inventories that are measured at "market value"

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and such inventories are both traded as well as utilized in production, wholesale, retail or distribution activities. We believe that this measurement basis is the most appropriate, and that the alternative approach described above could increase the complexity of the financial statements while limiting comparability across issuers.

Issue 2- Readily Determinable Fair Value

Would we prefer an alternative approach to limit the scope of the proposed FSP to inventories included in an entity's trading activities that have readily determinable fair values?

Fitch does not espouse an alternative approach whereby fair values are utilized only in those circumstances where they are readily determinable.

Issue 3- Trading Items Other than Physical Inventories

Do we believe that the Board should broaden the scope of the project that would include all contract and assets or liabilities within an entity's trading activities even if it would result in significantly delaying the issuance of final guidance?

Fitch would support the Board's expansion of the scope of this project to include all contract and assets or liabilities within an entity's trading activities even if it would delay the current project. We do not think that the changes contemplated in the proposal are of such import as to warrant a narrow "fast track." As noted in the proposal, many non-inventory, executory contracts are not recognized in the financial statements. However, many of these contracts are also subject to hedging arrangements and thus only the derivative portion of the hedge is recognized in the financial statements. Fitch believes that it would be appropriate to examine the accounting for these types of arrangements so that the full economic impact on the issuer would be recognized in the financial statements.

Alternatively, Fitch would recommend a disclosure requirement that would provide the fair value of such trading items for each reporting period.

Issue 4- Accounting Policy Election

Do we believe that the measurement attribute for inventories should be subject to an entity-wide accounting policy election?

Fitch agrees for the reasons outlined above that an entity-wide election would be preferable.

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Issue 5- Implementation Issues

As users of the financial statements, Fitch has no comments on the implementation issues identified in the proposal.

We appreciate the Board's consideration of our comments and would be happy to discuss them at any time.

Yours sincerely,

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