

Notice for Recipients of This Draft EITF Abstract

July 7, 2005

This draft abstract for EITF Issue No. 04-13, "Accounting for Purchases and Sales of Inventory with the Same Counterparty," addresses the following issues:

Issue 1— The circumstances under which two or more transactions with the same counterparty should be viewed as a single nonmonetary transaction within the scope of Opinion 29

Issue 2— Whether there are circumstances under which nonmonetary exchanges of inventory within the same line of business should be recognized at fair value.

The attached draft abstract reflects the Task Force's tentative conclusions reached at the March 17 and June 15-16, 2005 EITF meetings.

The Task Force invites general comments on the draft abstract and specifically requests that constituents provide comments on the following questions:

- a. Is the "in contemplation" model for identifying when to combine two or more inventory transactions with the same counterparty operational? If not, is there an alternative approach to evaluating such arrangements that you believe the Task force should consider?
- b. Should indicators for identifying whether inventory transactions were entered into in contemplation of one another be included in the consensus?
- c. Are the indicators for identifying whether inventory transactions were entered into in contemplation of one another, appropriate? Are there additional indicators that should be included?
- d. Is the proposed effective date appropriate?

Comments will be considered by the Task Force at the September 14–15, 2005 EITF meeting.

Responses from interested parties wishing to comment on the draft abstract, must be received in writing by August 20, 2005. Interested parties should submit their comments by email to director@fasb.org, File Reference No. EITF0413. Responses should not be sent by fax.

EITF Abstracts (DRAFT¹)

Issue No. 04-13

Title: Accounting for Purchases and Sales of Inventory with the Same Counterparty

Dates Discussed: November 17–18, 2004; March 17, 2005; June 15–16, 2005; September 14–15, 2005

References: FASB Statement No. 49, *Accounting for Product Financing Arrangements*
FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*
FASB Statement No. 153, *Exchanges of Nonmonetary Assets*
AICPA Accounting Research Bulletin No. 43, Chapter 4, "Inventory Pricing"
APB Opinion No. 29, *Accounting for Nonmonetary Transactions*
Statement 133 Implementation Issue No. K1, "Miscellaneous: Determining Whether Separate Transactions Should Be Viewed as a Unit"
Statement 133 Implementation Issue No. K3, "Miscellaneous: Determination of Whether Combinations of Options with the Same Terms Must be Viewed as Separate Option Contracts or as a Single Forward Contract"
AICPA Technical Practice Aids, Section 5100.46, "Nonmonetary Exchanges of Software (Part 1)"
AICPA Technical Practice Aids, Section 5100.47, "Nonmonetary Exchanges of Software (Part II)"

ISSUE

1. An entity may sell inventory to another entity in the same line of business from which it also purchases inventory. The purchase and sale transactions may be pursuant to a single contractual arrangement or separate contractual arrangements, and the inventory purchased or sold may be in the form of raw materials, work-in-process (WIP), or finished goods. Questions have been raised about the accounting for those types of transactions.

2. The issues are:

Issue 1—The circumstances under which two or more inventory transactions with the same counterparty should be viewed as a single nonmonetary transaction within the scope of Opinion 29

¹ This draft abstract was prepared to facilitate discussion of the guidance on which the Task Force reached its tentative conclusions and contains all substantive aspects of those tentative conclusions.

Issue 2— Whether there are circumstances under which nonmonetary exchanges of inventory within the same line of business should be recognized at fair value.

3. The scope of this Issue excludes inventory purchase and sales arrangements that (a) are accounted for as derivatives under Statement 133 or (b) involve exchanges of software or exchanges of real estate. The FASB staff observes that this Issue does not address whether transactions that are reported at fair value qualify for revenue recognition.

EITF DISCUSSION

Issue 1—The circumstances under which two or more inventory transactions with the same counterparty should be viewed as a single nonmonetary transaction within the scope of Opinion 29.

4. The Task Force reached a consensus on Issue 1 that inventory purchase and sales transactions with the same counterparty that are entered into in contemplation of one another should be combined for purposes of applying Opinion 29. The Task Force agreed that in situations in which an inventory transaction is legally contingent upon the performance of another inventory transaction with the same counterparty, the two are in contemplation of one another and should be combined for purposes of applying Opinion 29. The Task Force also agreed that the issuance of invoices and the exchange of offsetting cash payments is not a factor in determining whether two or more inventory transactions with the same counterparty should be considered as a single nonmonetary inventory transaction within the scope of Opinion 29. The Task Force also reached a consensus that in situations in which an inventory transaction is not legally contingent upon the performance of another inventory transaction with the same counterparty, the following factors may indicate that a purchase transaction and a sales transaction were entered into in contemplation of one another:

- *There is a legal right of offset of obligations between counterparties involved in inventory purchase and sales transactions.*
The ability to offset the receivable(s) and payable(s) related to the separately documented inventory transactions indicates that there is a link between them and, therefore, it is an indicator that the separately documented inventory transactions were entered into in contemplation of one another.
- *Inventory purchase and sales transactions with the same counterparty are entered into simultaneously.*
If an inventory purchase transaction is simultaneously entered into with an inventory sales transaction with the same counterparty, that is an indication that the transactions were entered into in contemplation of one another.
- *Inventory purchase and sales transactions were at off-market terms.*
If a company enters into an off-market inventory transaction with a counterparty, that is an indication that the transaction is linked to, and entered into, in contemplation of another inventory transaction with that same counterparty. This indicator may be more relevant for transactions with products that have readily determinable market prices, such as exchange-traded commodities, than for transactions with products that are subject to greater discretionary pricing.

- *Relative certainty that reciprocal inventory transactions with the same counterparty will occur.*

A company may sell inventory to a counterparty and enter into another arrangement with that same counterparty whereby that counterparty may, but is not contractually required to, deliver an agreed-upon inventory amount. The more certain it is that both inventory transactions will occur, the stronger the indication that the two inventory transactions were entered into in contemplation of one another.

5. The Task Force agreed that none of the factors individually are determinative nor is the list all-inclusive.

6. If two or more inventory transactions are combined for the purposes of applying Opinion 29, an entity should apply the guidance in Issue 2.

Issue 2—Whether there are circumstances under which nonmonetary exchanges of inventory within the same line of business should be recognized at fair value.

7. The Task Force reached a consensus on Issue 2 that a nonmonetary exchange whereby an entity transfers finished goods inventory in exchange for the receipt of raw materials or WIP inventory within the same line of business is not an *exchange transaction to facilitate sales to customers* as described in paragraph 20(b) of Opinion 29, as amended by Statement 153,² and, therefore, should be recognized by the entity at fair value if (a) fair value is determinable within reasonable limits and (b) the transaction has commercial substance (paragraphs 20 and 21 of Opinion 29). All other nonmonetary exchanges of inventory within the same line of business should be recognized at the carrying amount of the inventory transferred. That is, a nonmonetary exchange within the same line of business involving (a) the transfer of raw materials or WIP inventory in exchange for the receipt of raw materials, WIP, or finished goods inventory or (b) the transfer of finished goods inventory for the receipt of finished goods inventory should not be recognized at fair value.

8. The Task Force also reached a consensus that the classification of inventory as raw materials, WIP, and finished goods for purposes of this Issue should be the same classification that an entity uses for external financial reporting purposes. The Task Force also agreed that an entity should disclose the amount of revenue and costs (or gains and losses) associated with inventory exchanges recognized at fair value.

² Any final consensus on this Issue will be reached after the effective date of Statement 153. Statement 153 amends Opinion 29 to require nonmonetary transactions to be accounted for at fair value unless (a) fair value is not determinable, (b) the exchange transaction is to facilitate sales to customers, which this Issue interprets, or (c) the exchange transaction lacks commercial substance.

Transition

9. The Task Force agreed that the consensus in this Issue should be applied to transactions completed in reporting periods beginning after March 15, 2006, whether pursuant to arrangements that were in place at the date of initial application of the consensus or arrangements executed subsequent to that date. The carrying amount of the inventory that was acquired under these types of arrangements prior to the initial application of the consensus and that still remains in an entity's statement of financial position at the date of initial application of the consensus should not be adjusted for this consensus. Early application is permitted in periods for which financial statements have not been issued.

Board Ratification

10. At its [September 28, 2005] meeting, the Board ratified the consensus reached by the Task Force in this Issue.

STATUS

11. No further EITF discussion is planned.