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Technical Director  
Financial Accounting Standards Board

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To the FASB,

I am responding to the Proposed Accounting Standards Update regarding Disclosure Requirements for Inventory. I believe that the proposed disclosures could be expanded to provide additional useful information. All of my comments address Question 8.

Regarding proposed paragraph 8 of ASC 330-10-50, I recommend that the disclosure of the components of inventory be expanded by an additional category for used goods when an entity holds both new and used goods, because each can affect future cash inflows differently. Used goods will otherwise be classified in finished goods or work-in-process (if significant refurbishing is planned).

Used goods were previously sold or leased as new and may have been acquired as a trade-in by the original manufacturer, a competitor manufacturer, a lessee or a reseller. Holding used goods in inventory occurs in industries dealing with automobiles, telecommunications, commercial vehicles and technology equipment. An entity that holds both new and used goods faces different demands for each. A manufacturer can adjust production so that new finished goods inventories match expected market demand, whereas the build-up of used inventories cannot be managed by production planning. Similarly, leasing companies' acquisitions of new goods are driven by market demand but their used inventories are subject to demand risk.

Used goods should be disaggregated because they bear greater uncertainty about the amount and timing of cash realization compared to new finished goods due to turnover often being slower and the start of technical obsolescence and market non-competitiveness. Including new and used goods as one inventory component combines goods with different prospects of future cash inflows. A second reason for disaggregation is that used goods often are measured by net realizable value and/or specific identification. Paragraph BC61 notes that net realizable value may involve 'broad subjective estimates.' Accordingly, used goods should be disaggregated because the assumptions underlying the estimate of their net realizable value often differ from the same firm's accounting conventions to value new goods.

GAAP financial statements are usually presented with comparisons to balances in prior years. Such a presentation is useful to users to explain changes in a business over time. As an example, a significant increase in the amount or mix of used versus new equipment in inventory (possibly from a change in turnover or increased acquisitions of used goods) may signal a deterioration or improvement in an entity's performance or a change in its strategy. In general, the Disclosure Framework could consider the importance of disclosing and comparing the contents of financial statement elements over time.

The risks inherent in used goods have led to the demise of firms. One example is the bankruptcy of Itel Corporation, a computer lessor that owned used IBM equipment that rapidly became technologically
obsolete ('Itel struggles to stay on its feet in technological storm', December 30, 1980, from the archives of the Christian Science Monitor).

Regarding proposed sub-paragraph 7a., it is difficult in practice to distinguish between typical and 'atypical' losses. Because the word 'atypical' is open to interpretation, comparability in disclosure among entities may not be achieved. Moreover, if atypical losses occur for several years, aren't they typical? I recommend that subparagraph a. be changed to delete 'atypical' and that disclosure of inventory losses be required for all losses, including those in the normal course of business.

Regarding paragraph 11, separate disclosure of used inventory is consistent with the objective of that paragraph. It may ease the burden of deciding when and how to disclose the issues presented in paragraph 11 and example 1 regarding significant estimates.

Regarding proposed paragraph 14, losses on firm purchase commitments and losses on owned inventory could both be disclosed on a line(s) in the income statement. One is as meaningful as the other.

Regarding the Statement of Cash Flows
I recommend that the Codification explicitly state that the following matters related to inventory be presented as lines in the operating section of the Statement of Cash Flows when the indirect method is used.

First, changes to inventory balances due to writedowns/reserves should be disclosed on a separate line. It is a non-cash charge. This is not a universal practice under current GAAP; instead, it may be buried in another line such as 'other.' Conceptually, a separate line in the indirect method is an adjustment to cost of sales that is consistent with the amount of cost of sales that would be reported under the direct method.

Second, the amount of trade-ins that increased the inventory balance throughout the entire accounting period should be disclosed as a separate line (even if the trade-ins are not present in the ending inventory balance). Trade-ins are non-cash exchanges. For example, a customer may settle a transaction having a selling price of $100 with a trade-in fair value of $40 and a cash payment of $60. Use of a separate line will have the effect of excluding this non-cash increase to inventory from the line that is normally labeled 'increase or decrease in inventory', which is consistent with the direct method. Conceptually, the use of a separate line for trade-ins is justified because it will disclose how cash flow from customers differs from revenue from customers, which is useful information to users.

Sincerely,

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