March 10, 2017

Ms. Susan M. Cosper
Technical Director
File Reference No. 2017-210
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Proposed Accounting Standards Update, Inventory (Topic 330), Disclosure Framework – Changes to the Disclosure Requirements for Inventory

Dear Ms. Cosper:

The Retail Industry Leaders Association (“RILA”) and its Financial Leaders Council (“FLC”) are pleased to respond to the Proposed Accounting Standards Update, Inventory (Topic 330), Disclosure Framework – Changes to the Disclosure Requirements for Inventory, issued on January 10, 2017 (the “Exposure Draft”). RILA is the trade association of the world’s largest and most innovative retail companies. RILA members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than $1.5 trillion in annual sales and millions of American jobs.

RILA commends the Board’s continued commitment and efforts to improve the disclosures in financial statements. We agree that the goal of any changes to the current disclosure system should be to provide useful information to market participants, creditors, and other users of financial information. However, we do not believe that the proposals related to the Retail Inventory Method meet this goal. The proposed changes would be very costly to implement and would not result in more effective decision-making information about inventory. Instead, for the reasons discussed below, we believe the proposed changes will result in unnecessary complexity that may lead to confusion and would also require users of the Retail Inventory Method (“RIM”) to disclose proprietary information that should remain confidential. We thank you for the opportunity to comment on the Exposure Draft.

Our comments focus on the disclosure considerations that arise with respect to inventory reported under the RIM. We discuss, in turn, considerations related to the following: (1) the disclosure of proprietary information; (2) the diversity that exists among retailers in the application of the RIM; (3) lower of cost or market ("LOCOM") issues that would arise under the proposal; (4) the general usefulness of the proposed additional disclosure; (5) critical assumption requirements; and (6) the presentation of markdowns.

Proprietary Information

While we commend the Board’s continued commitment and efforts in improving the disclosures in the financial statements, we disagree with certain of the proposed disclosures targeted to the RIM. More specifically, we agree with the dissenting views of Messrs. Buck and Smith that certain of the proposed
disclosures would mandate the disclosure of proprietary information not required by other inventory methods. The disclosure of cost-to-retail ratios, permanent markdowns, and shrinkage would result in the disclosure of proprietary information not required of companies using an inventory costing method other than the RIM. This, in turn, could create competitive disadvantages depending upon the level of information required to be disclosed. Depending on the granularity of the disclosure, non-RIM retailers could obtain an unfair benefit based on the information disclosed by their RIM competitors.

We also echo Messrs. Buck and Smith’s concerns that the disclosure of the cost-to-retail ratios may have the unintended consequence of being interpreted by the users of the financial statements as prospective financial information, specifically, margins anticipated to be achieved by entities using the RIM. The RIM is simply a systematic method used by retailers to approximate the cost of ending inventory value and is not necessarily representative of future cash flows.

**Diversity in the RIM Application**

There are different versions of the RIM—the conventional (lower-of-average-cost-or-market) method (“FIFO RIM”), the cost method, the LIFO retail inventory method (“LIFO RIM”), and the dollar-value LIFO retail inventory method. While these versions of the RIM are sanctioned by the accounting profession, various retail associations, and the IRS, they produce different measures of ending inventory, and different cost-to-retail ratios.

For example, the illustrative tabular disclosure in the Exposure Draft includes markdowns in order to arrive at goods available for sale. Under the FIFO RIM method, markdowns are not considered in computing the goods available for sale or cost-to-retail ratio. As a result, a retailer using the FIFO RIM method would have a different inventory value and cost-to-retail ratio than a retailer using the identical inputs but a different RIM method. There are other differences in practice as well. For example, in applying the RIM, some retailers include transportation and distribution expenses while others do not.

A further complication is the fact that some retailers apply different methods of the RIM for their different businesses. For example, a retailer may apply the LIFO RIM for certain businesses and FIFO RIM for other businesses. In addition to applying different methods of the RIM, retailers may also apply the weighted average cost to certain businesses. Disclosing separate quantitative and qualitative information for the different methods of applying the RIM would add significant complexity to the disclosure that we do not believe would be useful to the company’s investors, creditors, and other users of the financial statements. As discussed below, this complexity is compounded once LOCOM guidance is considered. We believe the proposed disclosures would likely lead to confusion and not greater clarity.

**LOCOM Considerations**

Many retailers maintain their inventory subledgers using the FIFO RIM even if they have elected the LIFO RIM as their inventory method for financial reporting purposes. In order to report inventory balances under the LIFO RIM, the FIFO RIM is converted to the LIFO RIM as part of the period end reporting process. For purposes of the LOCOM analysis subsequent to the inventory being converted to LIFO, retailers often assume that the inventory cost applying the FIFO RIM would represent the inventory replacement cost (i.e., market), assuming appropriate LOCOM evaluations were performed for the FIFO RIM balances.
In a period of declining prices, inventory generally is carried on the balance sheet at replacement cost. When prices are declining, application of the LIFO RIM results in an inventory cost that is greater than the inventory cost that would result through the application of the FIFO RIM. In periods where inventory cost under the LIFO RIM is greater than market, LOCOM guidance requires that the inventory be presented in the financial statements at market. This result is obtained through an LOCOM adjustment that reduces the LIFO RIM cost to the FIFO RIM cost. In this scenario, the LOCOM adjustment eliminates the difference between the higher LIFO RIM cost and the market cost. As a result, the inclusion of specific quantitative disclosures related to the LIFO RIM may be misleading to the financial statement users because the application of the LIFO RIM may result in an amount that is different from what would be reflected in the financial statements. Additional reconciliation related to the LOCOM adjustment that was applied would be required to reconcile the LIFO RIM quantitative disclosure to the actual inventory value reflected in the financial statements. This issue, together with the fact that different retailers use different RIM methods and some retailers use different RIM methods for different businesses, would significantly complicate the inventory disclosure making it difficult for even seasoned financial statements users to understand.

**Critical Assumption Considerations**

One of the characteristics of the RIM is that it has an averaging effect on varying rates of gross profit. To arrive at a more precise inventory value and to narrow the impact of the averaging effect, retailers apply the RIM method at a department level or to a merchandise class or category that share similar gross profit. The illustrative example in the Exposure Draft requires that the companies disclose the company-wide average cost-to-retail ratio, also commonly referred to as cost complement, as a critical assumption in applying the RIM. Question 1 of the Exposure Draft seeks input as to whether the amendments would result in more effective, decision-useful information about inventory. We believe that disclosure of the average cost-to-retail ratio would not result in more effective, decision-useful information. To the contrary, we believe it would result in disclosure of an oversimplified metric that would not be representative of the true economics of the retail company.

We further considered whether the presentation of more disaggregated cost-to-retail ratios would be more appropriate. Many of our member retailers sell millions of different items that are grouped into numerous different departments when applying the RIM and their business spans across thousands of stores. For some, their business also encompasses a number of countries. All departments, countries, and banners are potentially unique and drive different economic results. We do not believe that there is an effective way to disaggregate the cost-to-retail ratio or other quantitative elements of the RIM for such complex retailers that would present more meaningful information to financial statement users. Additionally, much of the disaggregated information would be proprietary and, therefore, is not appropriate for disclosure. This would be particularly problematic given that the same type of proprietary information concerning inventory would not be required of companies using a different inventory method.

**Presentation of Markdowns**

We have concerns that the disclosure of permanent markdowns may lead the users of financial statements to believe that in all cases where permanent markdowns are disclosed, market is necessarily lower than cost, and that a decline of the utility of the inventory has occurred. This is not always the case. Markdowns, in large part, depend upon the retail strategy of the company.
General Usefulness of Information

We appreciate the Board’s objective to provide more useful information to present and potential investors, creditors, donors and other capital market participants. However, we respectfully urge the Board to consider whether the proposed additional RIM disclosures are, in fact, necessary to attain that objective. We do not believe that they are. In support of our view, we point the Board to the Exposure Draft’s basis for conclusion regarding the additional RIM disclosures. Importantly, the Board noted that some users of financial statements “acknowledged that any disclosure sufficient for understanding a company’s application of the RIM may be too complex and detailed to be practical.” BC39. Perhaps most importantly, however, the “Board acknowledged that detailed information about the RIM would likely be useful to only those users with a deep understanding of the model.” BC41. Accordingly, while there may be a small population of financial statement users who might benefit from the proposed additional disclosures, we believe that this tenuous benefit does not justify the significant additional time, effort and cost that would be incurred and the more likely confusion that would result. Instead, we believe the users of financial statements are already able to glean financial information important to evaluating key inventory metrics (such as Net Days on Hand, Days Payable and Inventory Turnover) from the face of the financial statements.

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We hope that these comments have been helpful in understanding our concerns with certain provisions in the Exposure Draft. We appreciate the opportunity to comment on this proposal and our members stand willing to continue to work with the Staff and the Board to ensure that the proprietary information of users of the RIM is not compromised, the costs of any changes do not outweigh any perceived benefit, and that proposal does not result in significant unintended consequences.

Sincerely,

[Signature]

Sandy Kennedy
President
Retail Industry Leaders Association