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June 16, 2008

Mr. Russell G. Golden Director of Technical Application and Implementation Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 31

File Reference: Proposed FSP ARB 43-a

Dear Mr. Golden:

PricewaterhouseCoopers appreciates the opportunity to comment on the proposed FASB Staff Position ARB 43-a, Amendment of the Inventory Provisions of Chapter 4 of ARB No. 43 (the FSP).

We support the Board's efforts to eliminate the inconsistency that exists in the measurement of trading inventory. Entities that report under the AICPA Audit and Accounting Guides for Brokers and Dealers in Securities and Investment Companies generally measure commodity inventories at fair value with changes in fair value recorded in the income statement. However, entities not subject to these guides, but that are engaged in similar business activities, such as those entities with trading operations, generally record such inventories at the lower of cost or market value as required under Chapter 4 of Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins (ARB 43). By recording all trading inventories at fair value, users will be able to better evaluate the performance of trading activities across all types of entities. Furthermore, because trading strategies involving inventories often include derivative instruments that are measured at fair value, we believe that the financial statements will better reflect the economics of the trading strategy if all of its component transactions are measured at fair value. Therefore, we agree with the Board's basic proposal to recognize all trading inventories at fair

We are concerned, however, that the proposed guidance is not entirely convergent with International Financial Reporting Standards (IFRS). International Accounting Standard 2, Inventories, has a similar requirement to recognize trading inventory at fair value, but defines inventories eligible for fair value measurement in the context of commodity broker-traders. Although this definition is broader than the guidance in the AICPA Audit Guide, it appears that it could be narrower than the scope of the proposed FSP. To reduce the chances that entities could be required to reverse the adoption of the proposed FSP if they subsequently move to IFRS, we encourage the Board to give further consideration to any potential convergence issues that the proposed approach could create. While we generally prefer the guidance to be based on the nature of the business activity as proposed by the Board, we would not be in favor of creating a potentially significant new difference with IFRS.

Another area of concern with the proposed guidance is the absence of a clear definition of trading. The proposed FSP requires that an entity's specific facts and circumstances and guidance contained in current GAAP that describes or defines trading activities be used to determine inventories that should be reported at fair value. This raises a number of issues that call into

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question whether the Board's approach to defining trading inventories will yield a consistent application of the standard amongst entities. For example:

- One of the more likely sources of current GAAP is FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities (FAS 115), which states: "Securities that are bought and held principally for the purpose of selling them in the near term (thus held for only a short period of time) shall be classified as trading securities. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price." However, question and answer 34 and 35 of the FASB's A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers, does not preclude trading classification, even if a company does not intend to sell the security in the near term. Therefore, under FAS 115, any security may be classified as trading, regardless of management's intention to sell the instrument. It is unclear in the proposed FSP if that interpretation should likewise be applied in determining trading inventories (i.e., inventory may always be classified as trading, regardless of management's intention for holding the inventory).
- FAS 115 states that transfers of securities into and out of the trading category are expected to be rare, while the proposed FSP appears to allow the unrestricted transfer of inventories between categories, albeit with required supplemental disclosures. The conflict in transferability approaches implies that there is a difference between the concepts underlying the definitions of trading securities and trading inventories. We believe the Board should reconcile these two opposing approaches and consider the impact on the Board's approach to defining trading inventories. We support the position taken in the proposed FSP to allow transfers into and out of the trading inventory category, as such transfers will inevitably be necessary from time to time to ensure the efficient operation of a company's nontrading activities.
- We believe that many preparers define trading activities in the context of the factors set out in EITF Issue No. 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities (EITF 98-10). That approach focuses not only on how the business activity is conducted, but also on a number of other factors, such as the nature of the activity, its counterparties, the transaction volume, compensation arrangements, infrastructure and controls, management reporting, and form of contractual arrangements. Because EITF 98-10 has been superseded by EITF Issue No. 02-3, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities, and the proposed guidance defines trading inventories by reference to current GAAP, a question arises as to whether companies will need to reassess how they define trading activities.

We are concerned that without a sufficiently robust definition of trading, certain inventories may be inappropriately included or excluded from the scope of the proposed FSP, which may not only be misleading, but, in some cases, also have adverse economic consequences. For example, in the absence of further guidance, the regular buying and selling of inventories to manage inventory levels or to more efficiently effect the movement of inventories between company facilities could be construed as trading under the proposed FSP. A classification of such inventories as trading could result in a full or partial loss of the company's last-in first-out income tax election and the incurrence of significant tax liability.

Our responses to the specific questions contained in the Notice for Recipients, together with additional comments on the proposed guidance, are attached in the Appendix to this letter.

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We appreciate the opportunity to express our views on the proposed FSP. If you have questions regarding our comments, please contact John Althoff at (973) 236-7288 or Kenneth Miller at (973) 236-7336.

Sincerely,

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APPENDIX

Proposed FASB Staff Position ARB 43-a Amendment of the Inventory Provisions of Chapter 4 of ARB No. 43

Issue 1: Commodity Inventories

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

No. It would appear unnecessary to limit the scope of the proposed FSP. While it is likely that
the guidance will generally apply only to commodities, limiting the scope of the proposed FSP
to tangible personal property would seem sufficient to address the measurement
inconsistency around trading inventories.

Issue 2: Readily Determinable Fair Values

Would you prefer the 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? Why or why not?

No. We believe that applying a measurement threshold by limiting the scope only to those items that have a readily determinable fair value is inconsistent with the underlying concepts in FASB Statement No, 157, Fair Value Measurement (FAS 157). If the Board believes that fair value is the most appropriate measurement attribute for trading inventories, then FAS 157 should be applied irrespective of whether there is a readily determinable fair value. Additionally, limiting the scope of the proposed guidance to inventories with readily determinable fair values would likely preclude fair value measurement for most trading inventories, as we believe the valuations of most commodities will not be based on Level 1 inputs as defined under FAS 157. Based on our experience with entities that currently recognize inventories at fair value, we do not expect that the proposed FSP will raise significant measurement concerns.

Issue 3: Trading Items Other Than Physical Inventories

Do you believe that the Board should consider a broader scope project that would include all contracts and assets or liabilities within an entity's trading activities even if it would result in significantly delaying the issuance of final guidance? Why or why not?

- No. We believe the diversity in practice for measuring trading inventories should be addressed in the short term. Expanding the scope of the project will likely cause a significant delay in addressing this issue.
- We understand that some preparers consider emissions allowances to be trading inventory.
 While we interpret the proposed guidance to exclude emissions allowances from its scope, we believe this practice should be specifically acknowledged in the final guidance.

Issue 4: Accounting Policy Election

Do you believe that the measurement attribute for inventories should be subject to an entity-wide accounting policy election? Why or why not?

No. Providing an accounting policy election that could potentially be applied to all inventories
would significantly expand the scope of this project and would necessitate a comprehensive



reconsideration of the measurement basis for all inventories by the Board. We do not believe the Board should undertake such a project at this time.

Issue 5: Implementation Issues

Are the transition provisions of this proposed FSP appropriate?

In our view, it would be helpful if the final guidance clarified that the forecasted purchase of
inventory that will be classified as trading following the adoption of this proposed FSP would
no longer be eligible for cash flow hedge accounting under FASB Statement No. 133,
Accounting for Derivative Instruments and Hedging Activities. In addition, we recommend that
the transition provisions address the disposition of amounts in Other Comprehensive Income
for previous cash flow hedges of inventory that will be classified as trading under the
proposed FSP.

Other Comments

- Certain of the proposed disclosures are likely to be operationally challenging, potentially costly to generate, and in our view, provide questionable value to users. In particular, the requirement to disclose the profit margin that would have resulted had the inventory been in production since inception for transfers from trading to non-trading would require preparers to track specific items of inventory and rerun their last-in first-out/ first-in first-out/ average-cost calculation each time such a transfer occurs. Similarly, the need to determine the typical holding period presumes that entities track specific items of inventory. For commodity inventory, this is often not the case. We believe entities should be required to disclose the amount and income statement line item where fair value changes on trading inventories are recorded, as this information is likely to be helpful to users.
- We believe the impact of the proposed FSP on the accounting for inventories by entities within the scope of the AICPA Audit and Accounting Guide, Agricultural Producers and Agricultural Cooperatives, and AICPA Statement of Position 85-3, Accounting by Agricultural Producers and Agricultural Cooperatives, ("Existing Agricultural Guidance") should be clarified. Paragraphs 7 and 8 of the proposed FSP suggest that those entities would also need to distinguish between trading and nontrading inventories, and apply the guidance in the proposed FSP for trading inventories instead of the Existing Agricultural Guidance that measures inventories at sales price less estimated costs of disposal. If this is the Board's intent, we believe the FSP should specifically identify amendments to Existing Agricultural Guidance. Furthermore, while the last sentence of paragraph 8 indicates that entities would continue to measure nontrading inventories under Existing Agricultural Guidance, the example that follows requires nontrading inventories of such entities to be measured at the lower of cost or market under ARB 43. The example should be amended to eliminate this contradiction.
- Paragraph 3 of the proposed FSP describes the confusion that exists among entities applying
 the AICPA Audit and Accounting Guides for Brokers and Dealers in Securities and
 Investment Companies as to the appropriate measurement attribute for commodity
 inventories. While the proposed FSP suggests amending ARB 43, no changes appear to be
 under consideration for those guides. The statement in that paragraph would appear to
 necessitate clarification of the measurement attribute for commodity inventories for entities in
 the scope of those guides.
- The amendments proposed to ARB 43 may have unintended consequences for certain
 entities. Specifically, we are aware that a limited number of entities apply the exception to the
 required lower of cost or market measurement attribute contained in Chapter 4, Statement 9
 of ARB 43. This provision states: "exceptions must be justifiable by inability to determine
 appropriate approximate costs, immediate marketability at quoted market price, and the



characteristic of unit interchangeability." Consequently, by deleting this text, entities that historically relied on this exception due to the existence of such circumstances would no longer be able to apply a fair value measurement attribute to inventory that does not qualify as trading inventory under this guidance.

- The examples that follow paragraph 8 and 9 of the proposed FSP would appear to suggest that the nature of the counterparty is determinant when considering if inventories should be considered nontrading or trading. In the example after paragraph 8, the fact that the commodity assets are to be sold to a wholesale distributor appears pivotal to the conclusion that those assets are considered nontrading. In the example after paragraph 9, the fact that sales of commodity assets are to parties other than the entity's retail sales operation or a wholesaler appear pivotal to the conclusion that those assets are considered trading. We do not believe that the nature of the counterparty should be the determining factor, but rather could be an indicator as to whether an asset is nontrading or trading. Furthermore, the distinction between a "wholesale distributor" and a "wholesaler" is unclear as those terms are applied in the examples.
- The examples included in the proposed FSP may be interpreted as implying that certain industries inherently hold trading inventory. For example, in the summary, the example provided in parenthesis for instances of trading inventories that would be accounted for at fair value, regardless of the type of reporting entity, refers to a broker-dealer versus an oil refiner. Care should be taken not to infer that certain types of entities are presumed to have trading inventory.
- The meaning of the term "distribution," discussed in paragraph 8, is unclear to us and how it differs from "retail" and "wholesale."