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Building a better working world

Ms. Susan M. Cosper
Technical Director
File Reference No. 2016-270
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

27 March 2017

Re: Proposed Accounting Standards Update, *Inventory (Topic 330): Disclosure Framework — Changes to the Disclosure Requirements for Inventory* (File Reference No. 2017-210)

Dear Ms. Cosper:

We appreciate the opportunity to comment on the proposed Accounting Standards Update (ASU) issued by the Financial Accounting Standards Board (FASB or Board).

We support the FASB's disclosure framework project and its objective to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by US GAAP that is most important to users of each entity's financial statements.

We note that most of the recommendations to expand disclosures are based on input from users. Given the extensive user outreach the FASB has performed, we think it would be helpful to constituents to provide added insight into those users' views. We would find it particularly helpful if that input included the following:

- The user type
- How the information would be used by each type of user
- Why the information is not available elsewhere
- How the information would change user behavior

We believe that information would provide constituents with better insight into the FASB's extensive outreach process, and enable constituents to provide more constructive input into a cost-benefit analysis. We are particularly interested in the input received from users of other than public business entity financial statements and how the expanded disclosures would affect their behavior.

The Appendix to this letter provides our responses to the questions posed in the proposed ASU.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst + Young LLP

Appendix — Responses to questions in the proposed ASU

> **Question 1:** Would the amendments in this proposed Update result in more effective, decision-useful information about inventory? Please explain why or why not.

As noted in our cover letter, while we recognize the FASB has obtained significant user input on this project, we believe a more detailed articulation of that input would help other constituents understand how the proposal meets user needs. Ideally, this input would be disaggregated by individual disclosure and include the user type, how the information would be used by each type of user, why the information is not available elsewhere and how the information would change user behavior.

> **Question 2:** Are the proposed disclosure requirements operable and auditable? If not, which aspects pose operability or auditability concerns and why?

We are concerned there may be potential operability and auditability challenges as described below.

<u>Inventory reported under RIM (330-10-50-12 and 330-10-55-15 — 55-17):</u>

We believe that preparing and auditing the proposed disclosures on inventory recorded using retail inventory method (RIM) measurements could be challenging. See our response to Question 7 for details.

<u>Changes in inventory (330-10-50-7 and 330-10-55-14):</u>

Regarding the proposed disclosure requirements for changes in the inventory balance during the period that are from transactions, circumstances or events outside the normal course of purchasing, manufacturing or selling inventory — see our response to Question 4 for details.

<u>Segment reporting:</u>

Annual disclosures (280-10-50-25) — The proposed trigger for the additional inventory disclosures that would be required by Accounting Standards Codification (ASC or the Codification) 280-10-50-25(c) is different from that for the other items currently subject to paragraph 50-25. To avoid confusion, we recommend that the Board make this a separate paragraph rather than part of paragraph 50-25.

Further, we recommend deleting the words "reviewed by" from the proposed requirement so that the disclosure would be triggered when such information is "regularly provided to" the chief operating decision maker (CODM). We believe this would help avoid confusion because "reviewed by" in paragraph 50-25 (and other disclosure requirements in ASC 280) refers to whether the item is included in a measure that is reviewed by the CODM rather than an item that is separately reviewed. Any conforming changes also should be made to Example 4 (Case A in ASC 280-10-55-53 and Case B in ASC 280-10-55-54).

Interim disclosures (280-10-50-32) — We believe that the proposed requirement for the inventory disclosures should be consistent with the principles outlined in ASC 280, which requires that total assets only be presented on an interim basis if there has been a material change from the amount disclosed in the annual report. As discussed in paragraph BC67 in the Basis for Conclusions, the Board decided that if the information is used by the CODM, the inventory segment disclosures would need to be made for both interim and annual periods. We believe this statement is inconsistent with the requirement in ASC 280-10-50-32, which references ASC 280-10-50-25 and requires disclosure if the information is regularly provided to the CODM; it does not require that the information be "used" by the CODM. Further, using the rationale described in BC67, we believe one could argue for a broader expansion of interim disclosures in ASC 280. As such, we do not think the Board has provided a sufficient reason for expanded interim inventory disclosures.

<u>Definition of supplies (330-10-50-8):</u>

The proposed paragraph refers to major components of inventory as "raw materials, work-in-process, finished goods, and supplies," but paragraph 210-10-45-1(b) refers to "inventories of merchandise, raw materials, goods in process, finished goods, **operating supplies, and ordinary maintenance material and parts**" (emphasis added). We recommend that the Board clarify the definition of supplies to be consistent within the Codification.

<u>LIFO inventory (330-10-50-13(b)):</u>

The proposed paragraph requires that an entity applying the last-in, first-out (LIFO) cost flow assumption to all or a portion of its inventory disclose the "effect on **net income** of the liquidation of a portion of an entity's LIFO inventory" (emphasis added). We recommend that the Board revise the proposed amendment to align with the guidance in SEC Staff Accounting Bulletin Topic 11F that requires disclosure of the "amount of **income** realized as a result of the inventory liquidation" (emphasis added) as the proposed disclosure would require entities to calculate and disclose an after-tax amount.

Question 3: Would any of the proposed disclosures impose significant incremental costs? If so, please describe the nature and extent of the additional costs.

We believe that SEC registrants would not incur added cost to provide the proposed disclosures that are consistent with existing SEC requirements. However, we believe that implementing certain of the proposed requirements, including the disclosures for inventory reported under RIM, the disaggregation of existing disclosures and the other than public business entity expanded disclosures, could require significant effort and in turn significant incremental costs. In that regard, we do believe the input from affected preparers is important. Consistent with the discussion in our cover letter, we are supportive of the FASB appropriately weighing the benefits to users (including how the proposed disclosures would affect user behavior) with the related costs to preparers.

Question 4: Paragraph 330-10-50-7 proposes a requirement to disclose certain specific changes in the inventory balance. Is this requirement sufficiently operable? Why or why not? Would a requirement to include a rollforward of inventory impose significantly greater costs? If so, please describe the nature and extent of the additional costs. Would the informational benefit of a rollforward be sufficient to justify the additional costs? Are there other ways to provide users with this information without imposing significant incremental costs, and, if so, what are they?

We believe a narrative should provide useful information to users; however, we do believe that different preparers will reach different conclusions as to what constitutes an "atypical" loss from the subsequent measurement of inventory or shrinkage, spoilage or damage.

We are concerned that the example provided in paragraph 330-10-50-7(e) may be misleading based on existing guidance related to inventories recorded above cost. ASC 330-10-35-15 states that only in exceptional cases may inventories properly be stated above cost. That is, it says: "precious metals having a fixed monetary value with no substantial cost of marketing may be stated at such monetary value; any other exception must be justifiable by inability to determine appropriate approximate cost, immediate marketability at quoted market price, and the characteristic of unit interchangeability." As a result, entities with inventories recorded above cost may, by definition, be unable to determine any related unrealized gains and losses from that inventory. We recommend that the Board eliminate this example from paragraph 330-10-50-7.

Question 5: The proposed amendments would apply to all entities, except for the requirements in paragraphs 280-10-50-25 and 280-10-50-32, which apply only to those public entities subject to the guidance in Topic 280. Is it appropriate to exclude entities that are not public business entities from this guidance? Are there other disclosures for which entities other than public business entities should be allowed a modification?

We agree with the proposed scope for the disclosure requirements in paragraphs 280-10-50-25 and 280-10-50-32.

However, there may be other disclosures (e.g., 330-10-50-7, 50-12, 50-13) for which entities other than public business entities should be exempt. We would find it helpful if the FASB would provide additional insight into the input received from users of other than public business entity financial statements regarding how the information provided by the proposed disclosures would be used, why the information is not available elsewhere, and how the information would change user behavior. We believe the disclosure-by-disclosure analysis of input from other than public business entity financial statement users would help the Board determine which modifications could be appropriate.

Question 6: Paragraph 330-10-50-10 proposes a requirement to disclose a qualitative description of types of costs that an entity capitalizes into inventory. Would this requirement provide useful information to users?

While SEC registrants currently disclose qualitative information regarding the nature of the cost elements included in inventory, we believe it would be helpful to understand the input of users of other than public business entity financial statements in making this assessment.

Question 7: Paragraph 330-10-50-12 proposes a requirement for entities that record inventory using the RIM to disclose qualitative and quantitative information about the critical assumptions used under that method. Is this disclosure requirement incremental to existing guidance for critical accounting estimates and significant accounting policies? Would it be operable and provide useful information to users?

As discussed in our cover letter, we believe it would be helpful for the Board to provide entities with more detailed information about the users' views it considered in developing the proposal to understand how the proposal meets user needs. While RIM disclosures would provide users with additional information, we are concerned that any disclosure sufficient for users to understand an entity's application of RIM may be overly detailed and complex. For example, RIM calculations are typically performed at the department level (e.g., department, department class, department region) rather than at the company level, and the assumptions used for different departments may vary, resulting in the disclosure of information that may not be a meaningful reflection of the business operations.

We also note that the disclosure requirements for RIM inventory are incremental to those for other costing methods. For example, paragraph 330-10-50-12 could require disclosure of all shrinkage for RIM inventory, whereas other inventory costing methods would only require disclosure of "atypical" shrinkage in accordance with paragraph 330-10-50-7. Preparers that use the tabular approach to disclose critical assumptions about RIM inventory as illustrated in proposed paragraph 330-10-55-17 would provide more detail regarding changes in inventory than other costing methods.

We note that markdowns are considered after the determination of goods available for sale in the RIM calculation and not before, as shown in the table in proposed paragraph 330-10-50-17. We are also concerned with the lack of guidance provided for companies that use variations of RIM (e.g., LIFO RIM or first-in, first-out RIM) or costing methodologies other than RIM to account for inventories of different product lines or businesses. For example, it's unclear whether the Board would expect the tabular inventory disclosure to reconcile to total inventory disclosed on the balance sheet.

We recommend that the Board work with at least one large multinational retailer to field test the true costs and benefits before pursuing the RIM portion of the proposal.

Question 8: Are there any other disclosures that should be required by Topic 330 on the basis of the proposed Concepts Statement or for other reasons? Please explain why.

We do not believe any other disclosures should be required at this time.

Question 9: Should the proposed disclosures be required only for the fiscal year in which the requirements are effective and years after that fiscal year, or should prior periods be restated in the year in which the requirements are effective? Please explain why.

We believe that the proposed disclosures should be required prospectively for information not previously disclosed, while allowing optionality for entities to provide comparative disclosures.

Question 10: How much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Should early adoption be permitted? Please explain why.

We believe that preparers are in a better position to respond to this question.

We are concerned about adding these operational challenges when reporting entities will be working on implementing other major new standards on revenue recognition, leases and credit losses. If the Board moves forward with the proposal, we recommend that the Board consider the effective dates of the other new standards when determining the effective date for this standard.

We believe that early adoption should be permitted for all entities.