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certified public accountants

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June 16, 2008

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

By e-mail: director@fasb.org

**Re: Proposed FASB Staff Position (FSP) Amendment of the Inventory Provisions of Chapter 4 of ARB No. 43**
**File Reference: Proposed FSP ARB 43-a**

The New York State Society of Certified Public Accountants, representing 30,000 CPAs in public practice, industry, government and education, submits the following comments to you regarding the above captioned release. NYSSCPA thanks the FASB for the opportunity to comment.

The NYSSCPA's Financial Accounting Standards Committee deliberated the proposed staff position and drafted the attached comments. If you would like additional discussion with us, please contact Edward P. Ichart, Chair of the Financial Accounting Standards Committee, at (516) 488-1200, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

Sharon Sabba Fierstein

Sharon Sabba Fierstein
President

Attachment

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**NEW YORK STATE SOCIETY OF**
**CERTIFIED PUBLIC ACCOUNTANTS**

# COMMENTS ON PROPOSED FSP ARB 43-A—*AMENDMENT OF THE INVENTORY PROVISIONS OF CHAPTER 4 OF ARB NO. 43* (ISSUED 05/01/08)

**File Reference: Proposed FSP ARB 43-a**

**June 16, 2008**

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**Fred R. Goldstein**
**Edward P. Ichart**

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# New York State Society of Certified Public Accountants

## Financial Accounting Standards Committee

## Comments on FSP ARB 43-a—*Amendment of the Inventory Provisions of Chapter 4 of ARB No. 43* (issued 05/01/08)

### File Reference: Proposed FSP ARB 43-a

### General Comments

The rationale for the amendment of ARB No. 43 described in this proposed FASB Staff Position ("FSP") is based upon applying concepts established in FASB No. 157, *Fair Value Measurements*, to inventory valuation and measurement. We are concerned that providing for "carve out" of trading activities in which inventories are valued based upon fair value rather than in accordance with the concepts established in ARB No. 43 before this proposed amendment will not represent an improvement in accounting and disclosure for inventory.

We are concerned that the proposed change to prescribe valuing inventories at fair value would make it more difficult for readers of financial statements to understand the performance of entities engaged in the manufacture, wholesale, retail and distribution of inventories in the ordinary course of their business because it would create unnecessary "noise" in monitoring entity performance related to such traditional metrics as gross profit margins and inventory turnover. We do not believe that the "enhanced" disclosures relating to inventory movements between trading and non-trading categories suggested in the proposed FSP would benefit a financial statement reader in overcoming such "noise" in determining an entity's financial performance.

We are also concerned that this FSP represents a "tweaking" of the accounting rules that may lead to abuses as companies change categorizations of inventory between trading and non-trading activities to enhance reported profits not actually earned in the ordinary course of manufacturing, wholesale, retail and distribution of inventory, or may exaggerate declines in profitability on the downside of economic cycles. History is replete with recent and past lessons of customizing rules through interpretations that are not needed that produce unanticipated results. One need only reflect on the impact of problems still being sorted out in collateralized debt obligations ("CDO") accounting and in a variety of asset-backed and auction-rate securities to question the need for this proposed FSP at this time.

There is no need to rush to make a change to inventory accounting on the basis that the accounting established for securities investments under FASB 115, *Accounting for Certain Investments in Debt and Equity Securities*, would work as well for inventories as it does for investments. FASB 115 was designed under the premise that transfers between categories would be rare. We are not convinced that concepts established in the proposed FSP would lead to only "rare" transfers between trading and non-trading activities. While the trend in accounting standards might be away from "industry-oriented" guidance, we believe that currently existing guidance appears to be adequate as it relates to more specialized inventories. For example, adequate guidance, as presented in the current Audit Guides, exists for commodity brokers, oil and gas companies and others.

We always appreciate the opportunity to comment on proposed rules and interpretations. We remain concerned about the potential impact of an FSP such as this on mainstream accounting and how short the response time is in which to develop comprehensive, substantive comments. We hope that the FASB gives proper consideration to the timing of a release and the timetable for responses.

**Specific Comments on Enumerated Issues**

**Issue 1. Commodity Inventories**

**The Board considered but rejected an alternative that would limit the scope of this proposed FSP to commodity inventories that are not used in production, wholesale, retail or distribution activities. This alternative was considered because the primary reason for undertaking this project is to resolve conflicting guidance as to whether traded commodity inventory can be accounted for at fair value. This alternative places an emphasis on the nature of the inventory (that is, commodity inventory versus other ARB 43 inventory) as compared with the proposed approach in that most commodities have interchangeable/fungible units, and therefore, generally have readily determinable fair values. In this context, the phrase *readily determinable fair value* is intended to include fair value estimates that use Level 1 inputs as described in FASB Statement No. 157, *Fair Value Measurements.)***

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

<u>Response:</u> As discussed above under our "General Comments," we would prefer to limit the scope of this FSP to commodity inventories that are not used in production, wholesale, retail or distribution activities.

The proposed FSP does not define "trading account," which would make distinguishing between inventory held for trading and non-trading purposes by non-financial service firms almost impossible and subject to much manipulation. Non-trading firms for purpose of discussion of this comment include those who use inventory for production, retail, wholesale and similar purposes.

The proposed FSP does not reflect that many non-trading firms are opportunistic in that they might, for sound business reasons at the time of acquisition, end up with inventory in excess of their non-trading needs and try to dispose of that inventory in a transaction very similar in appearance to firms engaging in inventory trading activities

**Issue 2. Readily Determinable Fair Value**

**The Board considered but rejected an alternative that would limit the scope of this proposed FSP solely to inventories included in an entity's trading activities that have *readily determinable fair values.* The Board decided that such a threshold would be inconsistent with the framework of Statement 157. Similarly, FASB Statement No. 133, *Accounting for Derivatives and Hedging Activities,* does not have a minimum reliability threshold for fair value of commodity-based derivative instruments, which often are part of an entity's trading portfolio.**

**This alternative would limit the scope to inventories included in an entity's trading activities that have readily determinable fair values based on the notion that fair value should only be used when reliable measurement can be obtained.**

**Would you prefer the alternative approach to limit the scope of this proposed FSP to inventories included in an entity's trading activities that have readily determinable fair values? Why or why not?**

<u>Response:</u> We would prefer that the scope of this FSP be limited to inventories included in an entity's trading activities that have readily determinable fair values, and, in particular, quoted market prices with few, if any, exceptions. That is consistent with the views we expressed in our General Comments above.

**Issue 3. Trading Items Other Than Physical Inventories**

**The Board considered but rejected an alternative that would expand this proposed FSP to include trading items other than inventories within the scope of ARB 43. This alternative would result in all items that are included in an entity's trading activities being measured at fair value with changes in fair value recognized in earnings, not just ARB 43 inventories. This alternative focuses on the nature of activity (that is, trading) and not just classification of the item as inventory. For example, an entities natural gas trading operation often will include non-inventory executory contracts (many of which are not currently recognized in financial statements), such as storage and transportation contracts along with physical inventory. The executory contracts may not be traded separately, but, in many cases, are a necessary component of the trading strategy. Such a broader scope also would include certain assets that are currently not accounted for at fair value.**

**The Board rejected this alternative because of the limited-scope objective for this project, that is, to address the inconsistency between ARB 43 and that in certain AICPA Audit and Accounting Guides with respect to accounting for inventory.**

**Do you believe 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?**

Response: We do not believe the Board should consider a broader scope project that would include all contracts and assets or liabilities within an entity's trading activities. We do not see a benefit in adding a project that would add to complexity in an environment in which complexity has led to catastrophic conditions in the financial marketplace regarding valuation of financial instruments such as CDO'S and asset-backed and auction-rate securities. Caution is highly advisable.

**Issue 4. Accounting Policy Election**

**The Board considered but rejected an alterative that would allow an entity to make an irrevocable, entity-wide accounting policy election for all commodity inventories to be measured at fair value or the lower of cost or market. Under this alternative, an entity's commodity inventory in its entirety would be measured using the same measurement attribute regardless of whether the inventory is part of its trading, production, distribution or other type activity. The Board rejected this alternative because it was not ready to consider the broader effects of such a change, including the effect of revenue recognition for a manufacturer. However, the Board believes that fair value is always the appropriate measurement attribute for inventories included in trading activities.**

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

Response: We do not believe that the measurement attribute for inventories should be subject to an entity wide accounting policy election. We have great concerns about comparability. Financial statement users may have difficulty understanding underlying company performance due to "noise" created in financial statements, in particular, between entities with similar businesses that would have different inventory accounting models. We are more concerned that any FSP 43-a "carve out" related to trading activities in inventory should require that the entity is presumed to have a separately established inventory trading department to qualify for accounting for inventories as a trading activity at fair value, that the activity is measurable through earnings, and that the entity identifies the activity in its financial statement disclosures.

**Issue 5. Implementation Issues**

**The Board also requested comments on the following issues:**

a. **What costs could be incurred to implement this proposed FSP?**

Response: We expect costs to implement the FSP would be manageable, but we do not view its implementation as a needed improvement in the accounting for inventories.

**b. Are the transition provisions of this proposed FSP appropriate?**

**c. Given this proposed FSP's comment period, the Board expects to issue a final FSP in the third quarter of 2008. Does this expected issuance date provide sufficient time for entities to understand and apply the requirements of this proposed FSP, which could be effective for fiscal years (and interim periods within those fiscal years) beginning after November 15, 2008?**

Response (to b. & c.): We are concerned that the transition provisions and the effective dates are designed principally for a limited number of entities eagerly awaiting finalization of a rule whose implementation we do not see as an improvement in the accounting for inventories.