FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: July 15, 2014
Comments Due: September 30, 2014

Inventory (Topic 330)

Simplifying the Measurement of Inventory

This Exposure Draft of a proposed Accounting Standards Update of Topic 330 is issued by the Board for public comment. Comments can be provided using the electronic feedback form available on the FASB website. Written comments should be addressed to:

Technical Director
File Reference No. 2014-210

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft and is requesting comments by September 30, 2014. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing a written letter to director@fasb.org, File Reference No. 2014-210
- Sending written comments to "Technical Director, File Reference No. 2014-210, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Do not send responses by fax.

All comments received are part of the FASB's public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

An electronic copy of this Exposure Draft is available on the FASB's website.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Proposed Accounting Standards Update

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Simplifying the Measurement of Inventory

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Comment Deadline: September 30, 2014

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Why Is the FASB Issuing This Proposed Accounting Standards Update and What Are the Main Provisions?

The Board is issuing this proposed Update as part of a Simplification Initiative. The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of the financial statements.

The Board has heard from stakeholders that the guidance on the measurement of inventory is unnecessarily complex because there are several potential outcomes. Topic 330, Inventory, currently requires a reporting entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin.

To simplify the measurement of inventory, the Board proposes that inventory should be measured at the lower of cost and net realizable value. *Net realizable value* is defined in the Master Glossary as the “estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.” The amendments would eliminate the guidance in Topic 330 that requires a reporting entity also to consider the replacement cost of inventory and the net realizable value of inventory, less an approximately normal profit margin.

The proposed Update also would more closely align the measurement of inventory in GAAP with the measurement of inventory in International Financial Reporting Standards. IAS 2, *Inventories,* requires inventory to be measured at the lower of cost and net realizable value. The term *net realisable value* is defined in IAS 2 as “the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale,” which is similar to the definition in GAAP.

Some of the other guidance in Topic 330 is being amended to more clearly articulate the requirements for the measurement and disclosure of inventory. Other than the change in the subsequent measurement guidance from the lower of cost or market to the lower of cost and net realizable value, there would be no other changes to the guidance in measuring inventory. The methods of estimating the cost of inventory under GAAP (for example, average cost; first-in, first-out; last-in, first-out; and the retail inventory method) would not be changed by the amendments in this proposed Update.

What Are the Transition Requirements and When Would the Amendments Be Effective?

The Board expects that the proposed amendments would be applied prospectively for the measurement of inventory in annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early adoption would be permitted. The only disclosures required at transition would be the nature of and reason for the change in accounting principle. An entity would provide that disclosure in the first interim and annual period of adoption.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Should inventory be measured at the lower of cost and net realizable value? If not, what other measurement is more appropriate and why?

Question 2: Should the proposed Update be applied prospectively to the measurement of inventory after the date of adoption?

Question 3: Should the proposed Update be effective in annual periods, and interim periods within those annual periods, beginning after December 15, 2015, with early adoption permitted? Should there be a delay in the effective date for entities other than public business entities and why?

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–16. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Subtopic 330-10

2. Amend paragraphs 330-10-35-1, 330-10-35-6 through 35-8, and 330-10-35-10 through 35-11 and their related heading and supersede paragraphs 330-10-35-2 through 35-5 and 330-10-35-9, with a link to transition paragraph 330-10-65-1, as follows:

Inventory—Overall

Subsequent Measurement

> Adjustments to Lower of Cost <u>and Net Realizable Value</u>~~or Market~~

330-10-35-1 A departure from the cost basis of pricing ~~the~~ **inventory** is required when the ~~utility of the goods is no longer as great as their~~ cost <u>of inventory exceeds its **net realizable value**</u>. Where there is evidence that the ~~utility of goods, in their disposal in the ordinary course of business, will be less than cost~~ <u>net realizable value of inventory is less than cost</u>, whether due to physical deterioration, obsolescence, changes in price levels, or other causes, the difference shall be recognized as a loss <u>in earnings in the period in which it occurs</u> ~~of the current period~~. This is generally accomplished by <u>measuring inventory at the lower of cost and net realizable value</u> ~~stating such goods at a lower level commonly designated as **market**~~.

330-10-35-2 <u>Paragraph superseded by Accounting Standards Update 2014-XX.</u>~~The cost basis of recording inventory ordinarily achieves the objective of a proper matching of costs and revenues. However, under certain circumstances cost may not be the amount properly chargeable against the revenues of future periods. A departure from cost is required in these circumstances because cost is satisfactory only if the utility of the goods has not diminished since their~~

~~acquisition; a loss of utility shall be reflected as a charge against the revenues of the period in which it occurs. Thus, in accounting for inventories, a loss shall be recognized whenever the utility of goods is impaired by damage, deterioration, obsolescence, changes in price levels, or other causes. The measurement of such losses shall be accomplished by applying the rule of pricing inventories at the lower of cost or market. This provides a practical means of measuring utility and thereby determining the amount of the loss to be recognized and accounted for in the current period.~~

330-10-35-3 Paragraph superseded by Accounting Standards Update 2014-XX.~~The rule of lower of cost or market is intended to provide a means of measuring the residual usefulness of an inventory expenditure. The term *market* is therefore to be interpreted as indicating utility on the inventory date and may be thought of in terms of the equivalent expenditure which would have to be made in the ordinary course at that date to procure corresponding utility.~~

330-10-35-4 Paragraph superseded by Accounting Standards Update 2014-XX.~~As a general guide, utility is indicated primarily by the current cost of replacement of the goods as they would be obtained by purchase or reproduction. In applying the rule, however, judgment must always be exercised and no loss shall be recognized unless the evidence indicates clearly that a loss has been sustained. There are therefore exceptions to such a standard. Replacement or reproduction prices would not be appropriate as a measure of utility when the estimated sales value, reduced by the costs of completion and disposal, is lower, in which case the realizable value so determined more appropriately measures utility.~~

330-10-35-5 Paragraph superseded by Accounting Standards Update 2014-XX.~~Furthermore, when the evidence indicates that cost will be recovered with an approximately normal profit upon sale in the ordinary course of business, no loss shall be recognized even though replacement or reproduction costs are lower. This might be true, for example, in the case of production under firm sales contracts at fixed prices, or when a reasonable volume of future orders is assured at stable selling prices.~~

330-10-35-6 If inventory ~~has been~~ is the hedged item in a fair value hedge, the inventory's cost basis used in applying the lower of cost ~~or market accounting~~ and **net realizable value** guidance shall reflect the effect of the adjustments ~~of~~ to its carrying amount made pursuant to paragraph 815-25-35-1(b).

330-10-35-7 ~~Because of the many variations of circumstances encountered in inventory pricing, the definition of **market** is intended as a guide rather than a literal rule. It shall be applied realistically in light of the objectives expressed in this Subtopic and with due regard to~~The application of the lower of cost and **net realizable value** guidance shall consider the form, content, and composition of the inventory. If adequate markdowns are taken, the estimated cost of inventory under the retail inventory method accomplishes the objectives described in this Subtopic because inventory would not be stated above net realizable value. ~~For~~

~~example, the retail inventory method, if adequate markdowns are currently taken, accomplishes the objectives described herein. It is also recognized that, if a business is expected to lose money for a sustained period, the inventory shall not be written down to offset a loss inherent in the subsequent operations.~~

330-10-35-8 Depending on the character and composition of the inventory, the rule of lower of cost <u>and net realizable value</u> ~~or market~~ may properly be applied either directly to each item or to the total of the inventory (or, in some cases, to the total of the components of each major category). The method shall be that which most clearly reflects periodic income.

330-10-35-9 <u>Paragraph superseded by Accounting Standards Update 2014-XX.</u>~~The purpose of reducing inventory to market is to reflect fairly the income of the period. The most common practice is to apply the lower of cost or market rule separately to each item of the inventory. However, if there is only one end-product category the cost utility of the total stock—the inventory in its entirety—may have the greatest significance for accounting purposes. Accordingly, the reduction of individual items to market may not always lead to the most useful result if the utility of the total inventory to the business is not below its cost. This might be the case if selling prices are not affected by temporary or small fluctuations in current costs of purchase or manufacture.~~

330-10-35-10 ~~Similarly, where more than one major product or operational category exists, the application of the lower of cost or market rule to the total of the items included in such major categories may result in the most useful determination of income. When no loss of income is expected to take place as a result of a reduction of cost prices of certain goods because others forming components of the same general categories of finished products have a market equally in excess of cost, such components need not be adjusted to market to the extent that they are in balanced quantities.~~ <u>For example, if an entity uses three components to produce a finished good, it may conclude that it is most useful to apply the lower of cost and net realizable value guidance to the total cost of inventory related to that finished good. The net realizable value of one of those individual components, on a standalone basis, may decline below its cost. However, if the amount that is expected to be recovered upon sale of the related finished good is in excess of the total cost of inventory related to that finished good, no adjustment is required,</u> ~~Thus, in such cases, the rule of lower of cost or market, may be applied directly to the totals of the entire inventory, rather than to the individual inventory items, if they enter into the same category of finished product and if they are in balanced quantities,~~ provided the ~~procedure~~ <u>guidance</u> is applied consistently from year to year.

330-10-35-11 To the extent, however, that <u>certain goods or</u> ~~the stocks of particular~~ materials ~~or components~~ are excessive in relation to others, ~~the more widely recognized procedure of applying~~ the lower of cost ~~or market~~ <u>and **net realizable value** guidance shall be applied</u> to the individual items constituting the excess ~~shall be followed. This would also apply in cases in which the items enter~~

~~into the production of unrelated products or products having a material variation in the rate of turnover~~. Unless an effective method of classifying <u>the</u> categories <u>of inventory not constituting the excess</u> is practicable, the ~~rule~~ <u>guidance</u> shall be applied to each item in the inventory.

3. Amend paragraph 330-10-50-2 and its related heading, with a link to transition paragraph 330-10-65-1, as follows:

Disclosure

> Losses from Application of Lower of Cost <u>and Net Realizable Value</u> ~~or Market~~

330-10-50-2 ~~When substantial~~<u>Substantial</u> and unusual losses ~~result~~ from the application of the ~~rule of~~ lower of cost <u>and **net realizable value** guidance should be disclosed in the financial statements.</u> ~~or **market** it will frequently be desirable to disclose the amount of the loss in the income statement as a charge separately identified from the consumed **inventory** costs described as cost of goods sold.~~

4. Amend paragraph 330-10-55-2 and its related heading, with a link to transition paragraph 330-10-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > ~~Market~~ <u>Net Realizable Value</u> Decline in Interim Period

330-10-55-2 If near-term price recovery is uncertain, a decline in the ~~**market** price~~ <u>**net realizable value**</u> of inventory below cost during an interim period shall be accounted for <u>consistent with annual periods, except as described in paragraph 270-10-45-6.</u> ~~as follows. Paragraph 270-10-45-6 requires that the inventory be written down to the lower of cost or market unless either of the following conditions is met:~~

a. <u>Subparagraph superseded by Accounting Standards Update 2014-XX.</u> ~~Substantial evidence exists that market prices will recover before the inventory is sold.~~
b. <u>Subparagraph superseded by Accounting Standards Update 2014-XX.</u>~~In the case of last-in, first-out (LIFO) inventory, substantial evidence exists that inventory amounts will be restored by year-end.~~

~~A write-down is generally required unless the decline is due to seasonal price fluctuations.~~

5. Add paragraph 330-10-65-1 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2014-XX, *Inventory (Topic 330): Simplifying the Measurement of Inventory*

330-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2014-XX, *Inventory (Topic 330): Simplifying the Measurement of Inventory:*

a. The pending content that links to this paragraph shall be effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted.
b. An entity shall apply the pending content that links to this paragraph prospectively to the measurement of inventory after the date of adoption.
c. An entity shall disclose the nature of and reason for the change in accounting principle in the first interim and annual period of adoption.

Amendments to Subtopic 270-10

6. Amend paragraph 270-10-45-6, with a link to transition paragraph 330-10-65-1, as follows:

Interim Reporting—Overall

Other Presentation Matters

270-10-45-6 Practices vary in determining costs of inventory. For example, cost of goods produced may be determined based on standard or actual cost, while cost of inventory may be determined on an average, first-in, first-out (FIFO), or last-in, first-out (LIFO) cost basis. While entities ~~shall~~ generally shall use the same inventory pricing methods and make provisions for writedowns to ~~market~~ **net realizable value** at interim dates on the same basis as used at annual inventory dates, the following exceptions are appropriate at interim reporting dates:

a. Some entities use estimated gross profit rates to determine the cost of goods sold during interim periods or use other methods different from those used at annual inventory dates. These entities shall disclose the method used at the interim date and any significant adjustments that result from reconciliations with the annual physical inventory.
b. Entities that use the LIFO method may encounter a liquidation of base period inventories at an interim date that is expected to be replaced by the end of the annual period. In ~~such cases~~ those cases, the inventory at the interim reporting date shall not give effect to the LIFO liquidation, and cost of sales for the interim reporting period shall include the expected cost of replacement of the liquidated LIFO base.
c. Inventory losses from ~~market~~ declines in net realizable value shall not be deferred beyond the interim period in which the decline occurs.

Recoveries of such losses on the same inventory in later interim periods of the same fiscal year through ~~market price~~ recoveries in net realizable value shall be recognized as gains in the later interim period. Such gains shall not exceed previously recognized losses. ~~Some market~~ However, some declines in net realizable value at interim dates~~,~~ ~~however,~~ can reasonably be expected to be restored in the same fiscal year. ~~Such~~ Those temporary ~~market~~ declines in net realizable value need not be recognized at the interim date ~~since~~ because no loss is expected to be incurred in the fiscal year.

d. Entities that use standard cost accounting systems for determining inventory and product costs should generally follow the same procedures in reporting purchase price, wage rate, usage, or efficiency variances from standard cost at the end of an interim period as followed at the end of a fiscal year. Purchase price variances or volume or capacity cost variances that are planned and expected to be absorbed by the end of the annual period, should ordinarily be deferred at interim reporting dates. The effect of unplanned or unanticipated purchase price or volume variances, however, shall be reported at the end of an interim period following the same procedures used at the end of a fiscal year.

Amendments to Subtopic 275-10

7. Amend paragraph 275-10-05-7 and the pending content for that paragraph, with a link to transition paragraph 330-10-65-1, as follows:

Risks and Uncertainties—Overall

Overview and Background

275-10-05-7 Estimates inherent in the current financial reporting process inevitably involve assumptions about future events. For example, accruing income for the current period under a long-term contract requires an estimate of the total profit to be earned on the contract. For another example, carrying inventories at the lower of cost and **net realizable value** ~~or market~~ is based on an assumption that there will be sufficient demand for that product in the future to be able to sell the quantity on hand without incurring losses on the sales or, if ~~market~~ net realizable value is used, that it can be estimated. Making reliable estimates for ~~such~~ those matters is often difficult even in periods of economic stability; it is more so in periods of economic volatility. Although many users of financial statements are aware of that aspect of financial reporting, others often assume an unwarranted degree of reliability in financial statements. The disclosure required by this Subtopic should help dispel any ~~such~~ of those erroneous assumptions.

Transition Date: *(P) December 15, 2016; (N) December 15, 2018* | **Transition Guidance: 606-10-65-1**

275-10-05-7 Estimates inherent in the current financial reporting process inevitably involve assumptions about future events. For example, estimating and constraining estimates of variable consideration to be included in the **transaction price** for a **contract** with a **customer** in accordance with paragraphs 606-10-32-5 through 32-14 and measuring progress toward complete satisfaction of a **performance obligation** in accordance with paragraphs 606-10-25-31 through 25-37. For another example, carrying inventories at the lower of cost and **net realizable value** ~~or market~~ is based on an assumption that there will be sufficient demand for that product in the future to be able to sell the quantity on hand without incurring losses on the sales or, if ~~market~~ net realizable value is used, that it can be estimated. Making reliable estimates for ~~such~~ those matters is often difficult even in periods of economic stability; it is more so in periods of economic volatility. Although many users of financial statements are aware of that aspect of financial reporting, others often assume an unwarranted degree of reliability in financial statements. The disclosure required by this Subtopic should help dispel any ~~such~~ of those erroneous assumptions.

Amendments to Subtopic 360-10

8. Amend paragraph 360-10-55-21, with a link to transition paragraph 330-10-65-1, as follows:

Property, Plant, and Equipment—Overall

Implementation Guidance and Illustrations

Impairment or Disposal of Long-Lived Assets

> Illustrations

360-10-55-21 An entity owns a manufacturing facility that together with other assets is tested for recoverability as a group. In addition to long-lived assets (Assets A–D), the asset group includes inventory, which is reported at the lower of cost and **net realizable value** ~~or market~~ in accordance with Topic 330, and other current assets and liabilities that are not covered by this Subtopic. The $2.75 million aggregate carrying amount of the asset group is not recoverable and exceeds its fair value by $600,000. In accordance with paragraph 360-10-35-28, the impairment loss of $600,000 would be allocated as shown below to the long-lived assets of the group.

Asset Group	Carrying Amount (in $ 000s)	Pro Rata Allocation Factor	Allocation of Impairment (Loss) (in $ 000s)	Adjusted Carrying Amount (in $ 000s)
Current assets	$ 400	-	$ -	$ 400
Liabilities	(150)	-	-	(150)
Long-lived assets:				
Asset A	590	24%	(144)	446
Asset B	780	31	(186)	594
Asset C	950	38	(228)	722
Asset D	180	7	(42)	138
Subtotal—long-lived assets	2,500	100	(600)	1,900
Total	$ 2,750	100%	$ (600)	$ 2,150

Amendments to Subtopic 705-10

9. Amend paragraph 705-10-25-2, with a link to transition paragraph 330-10-65-1, as follows:

Cost of Sales and Services—Overall

Recognition

> Inventory

705-10-25-2 See paragraphs 330-10-35-1 through 35-11 for adjustments affecting cost of sales and services resulting from remeasuring inventory to the lower of cost and **net realizable value** ~~or market~~.

Amendments to Subtopic 830-10

10. Amend paragraphs 830-10-55-8 through 55-9, 830-10-55-15, and 830-10-55-18 through 55-19 and their related headings and supersede paragraphs 830-10-55-17 and 830-10-55-20 through 55-22 and their related headings, with a link to transition paragraph 330-10-65-1, as follows:

Foreign Currency Matters—Overall

Implementation Guidance and Illustrations

> Implementation Guidance

> > Remeasuring Inventory Not Recorded in the Functional Currency

830-10-55-8 The lower of cost and **net realizable value** guidance ~~rule of cost or market, whichever is lower~~ (as described in Subtopic 330-10)~~330-10),~~ requires special application when the books of record are not kept in the functional currency. Inventories carried at cost in the books of record in another currency should be first remeasured to cost in the functional currency using historical exchange rates. Then, historical cost in the functional currency is compared with ~~market~~ net realizable value as stated in the functional currency. Application of the ~~rule~~ guidance in functional currency may require write-downs to ~~market~~ net realizable value in the functional currency statements even though no write-down has been made in the books of record maintained in another currency. Likewise, a write-down in the books of record may need to be reversed if ~~market~~ net realizable value exceeds historical cost as stated in the functional currency. If inventory has been written down to ~~market~~ net realizable value in the functional currency statements, that functional currency amount shall continue to be the carrying amount in the functional currency financial statements until the inventory is sold or a further write-down is necessary. An asset other than inventory may sometimes be written down from historical cost. Although that write-down is not under the ~~rule of cost or market, whichever is~~ lower of cost and net realizable value guidance, the approach described in this paragraph might be appropriate. That is, a write-down may be required in the functional currency statements even though not required in the books of record, and a write-down in the books of record may need to be reversed before remeasurement to prevent the remeasured amount from exceeding functional currency historical cost.

830-10-55-9 Literal application of the ~~rule of cost or market, whichever is lower,~~ lower of cost and net realizable value guidance may require an inventory write-down in functional currency financial statements for locally acquired inventory if the value of the currency in which the books of record are maintained has declined in relation to the functional currency between the date the inventory was acquired and the date of the balance sheet. Such a write-down may not be necessary, however, if the net realizable value ~~replacement costs or selling prices~~ expressed in the currency in which the books of record are maintained ~~have~~ has increased sufficiently so that ~~market~~ net realizable value exceeds historical cost as measured in the functional currency. Cases A and B in Example 2 (see paragraphs 830-10-55-15 through ~~55-22~~55-16 and paragraphs 830-10-55-18 through 55-19) illustrate this situation. This paragraph is not intended to preclude recognition of gains in a later interim period to the extent of inventory losses recognized from ~~market~~ declines in net realizable value in earlier interim periods if losses on the same inventory are recovered in the same year, as provided by paragraph 270-10-45-6(c). An inventory write-down also may be required for imported inventory.

> > Example 2: Remeasuring Inventory Not Recorded in the Functional Currency

830-10-55-15 The following Cases illustrate this Section’s implementation guidance on remeasurement of inventory not recorded in the functional currency (see paragraphs 830-10-45-18 and 830-10-55-8 through 55-9):

a. ~~Market based on current replacement cost (Case A)~~Historical cost exceeds net realizable value (Case A)
    1. Subparagraph superseded by Accounting Standards Update 2014-XX.~~Historical cost exceeds market based on current replacement cost (Case A1).~~
    2. Subparagraph superseded by Accounting Standards Update 2014-XX.~~Market based on current replacement cost exceeds historical cost (Case A2).~~

b. ~~Market based on net realizable value reduced by normal profit margin (Case B)~~ Net realizable value exceeds historical cost (Case B).

830-10-55-16 Cases A and B share all of the following assumptions:

a. BR is the currency in which the books of record are maintained.
b. FC is the functional currency.
c. When the rate is BR 1 = FC 2.40, a foreign subsidiary of a U.S. entity purchases a unit of inventory at a cost of BR500 (measured in functional currency, FC 1,200).
d. At the foreign subsidiary's balance sheet date, the current rate is BR 1 = FC 2.00

~~> > > Case A: Market Based on Current Replacement Cost~~

830-10-55-17 Paragraph superseded by Accounting Standards Update 2014-XX.~~Cases A1 and A2 share both of the following additional assumptions:~~

~~a. Net realizable value is BR 630 (measured in functional currency, FC 1,260).~~
~~b. Net realizable value reduced by an allowance for an approximately normal profit margin is BR 550 (measured in functional currency, FC 1,100).~~

~~> > > > Case A1~~> > > Case A: Historical Cost Exceeds Net Realizable Value~~Market Based on Current Replacement Cost~~

830-10-55-18 Assume the ~~current replacement cost~~ net realizable value of the unit of inventory is BR 560 (measured in functional currency, FC 1,120). Because ~~current replacement cost~~ net realizable value as measured in the functional currency (FC 1,120) is less than historical cost as measured in the functional currency (FC 1,200), an inventory write-down of FC 80 is required in the functional currency financial statements.

~~> > > > Case A2~~> > > Case B: ~~Market Based on Current Replacement Cost~~ Net Realizable Value Exceeds Historical Cost

830-10-55-19 Assume the ~~current replacement cost~~ net realizable value at the foreign subsidiary's balance sheet date is ~~of~~ BR620. Because ~~market~~ net realizable value as measured in the functional currency (BR 620 x FC 2.00 = FC 1,240) exceeds historical cost as measured in the functional currency (BR 500 x

FC 2.40 = FC 1,200), an inventory write-down is not required in the functional currency financial statements.

~~> > > Case B: Market Based on Net Realizable Value Reduced by Normal Profit Margin~~

830-10-55-20 Paragraph superseded by Accounting Standards Update 2014-XX.~~Assume the current replacement cost of the unit of inventory is BR 560 and that selling prices in terms of the currency in which the books of record are maintained have increased so that both of the following conditions exist:~~

- ~~a. Net realizable value is BR 720.~~
- ~~b. Net realizable value reduced by an allowance for an approximately normal profit margin is BR640.~~

830-10-55-21 Paragraph superseded by Accounting Standards Update 2014-XX.~~In that situation, because replacement cost measured in functional currency (BR 560 x FC 2.00 = FC 1,120) is less than net realizable value reduced by an allowance for an approximately normal profit margin measured in functional currency (BR 640 x FC 2.00 = FC 1,280), market is FC 1,280.~~

830-10-55-22 Paragraph superseded by Accounting Standards Update 2014-XX.~~Because market as measured in the functional currency (FC 1,280) exceeds historical cost as measured in the functional currency (BR 500 x FC 2.40 = FC 1,200), an inventory write-down is not required in the functional currency financial statements.~~

Amendments to Subtopic 905-330

11. Amend paragraphs 905-330-35-1 through 35-3 and 905-330-35-5, with a link to transition paragraph 330-10-65-1, as follows:

Agriculture—Inventory

Subsequent Measurement

General

> Growing Crops

905-330-35-1 Costs of growing **crops** shall be accumulated until the time of harvest. Growing crops shall be reported at the lower of cost and **net realizable value** ~~or market~~.

> Developing Animals

905-330-35-2 Developing animals to be held for sale shall be valued at the lower of cost and net realizable value ~~or market~~.

> Animals Available and Held for Sale

905-330-35-3 Animals held for sale shall be valued at either of the following:

a. The lower of cost and net realizable value ~~or market~~
b. ~~At sales price less estimated costs of disposal~~ Net realizable value, if all of the following conditions exist:
   1. The product has a reliable, readily determinable, and realizable market price.
   2. The product has relatively insignificant and predictable costs of disposal.
   3. The product is available for immediate delivery.

~~Inventories of harvested crops and **livestock** held for sale and commonly referred to as valued at market are actually valued at **net realizable value**.~~

> Harvested Crops

905-330-35-4 Inventories of harvested crops shall be valued using the same criteria as animals held for sale in the preceding paragraph.

Cooperatives

905-330-35-5 The inventories for a **pooling cooperative** shall be accounted for at either of the following:

a. ~~the~~The lower of cost and **net realizable value**~~or market or at~~
b. Net**{remove glossary link}**~~**net**~~ **realizable value{remove glossary link}**.

When **assigned amounts** are used, they should approximate estimated market of unprocessed products delivered by patrons. See Example 1 (paragraph 905-330-55-1) for an illustration.

12. Amend paragraphs 905-330-55-2 through 55-4, with a link to transition paragraph 330-10-65-1, as follows:

[Note: For ease of readability, changes to the tables are not struck through or underlined. The phrase *or market* has been replaced with *and net realizable value*.]

Implementation Guidance and Illustrations

Cooperatives

> Illustrations

> > Example 1: Accounting by Pooling Cooperatives for Products Received from Patrons

905-330-55-1 This Example illustrates the guidance in paragraphs 905-330-25-6 through 25-7 and 905-330-35-5.

905-330-55-2 This Example has the following assumptions:

Sales	$ 129,630
Beginning inventory	
Net realizable value	31,128
Lower of cost and net realizable value	28,380
Assigned value of ~~patron's~~patrons' raw product received	56,500
Ending inventory	
Net realizable value	35,596
Lower of cost and net realizable value	32,360
Income taxes	1,250
Other costs and expenses	56,580
Amounts paid to ~~patron's~~patrons, retains, and nonpatronage earnings	74,430
Amounts due patrons at beginning of year	
Lower of cost and net realizable value method	8,910
Net realizable value method	11,748

905-330-55-3 The following tables illustrate the statement of net earnings prepared under each of two possible methods of accounting for inventories (columns A and B), the statement of net proceeds prepared under the **net realizable value** method (column C), and the respective statements of amounts due patrons, if such latter statement is included in the financial statements. Column A demonstrates the lower of cost ~~or market~~ and net realizable value method with patrons' raw product being charged to cost of production at **assigned amounts**. Column B demonstrates the net realizable value method with patrons' raw product being charged to cost of production at assigned amounts. Column C demonstrates the net realizable value method when no amounts are assigned to patrons' raw product; therefore, there is no charge to cost of production for patrons' raw product.

	Inventories Valued At		
	Lower of Cost and Net Realizable Value (Column A)	Net Realizable Value (Column B)	Net Realizable Value (Column C)
Sales	$ 129,630	$ 129,630	$ 129,630
Costs and expenses (I)	109,100	108,702	52,202
Earnings before income taxes	20,530	20,928	-
Proceeds before income taxes	-	-	77,428
Income taxes	1,250	1,250	1,250
Net earnings	$ 19,280	$ 19,678	
Net proceeds			$ 76,178
I. Beginning inventory	$ 28,380	$ 31,218	$ 31,218
Assigned value of patrons' raw product received	56,500	56,500	-
Ending inventory	(32,360)	(35,596)	(35,596)
Other costs and expenses	56,580	56,580	56,580
	$ 109,100	$ 108,702	$ 52,202

Statement of Amounts Due Patrons

	Inventories Valued At		
	Lower of Cost and Net Realizable Value (Column A)	Net Realizable Value (Column B)	Net Realizable Value (Column C)
Amounts due patrons at beginning of year	$ 8,910	$ 11,748	$ 11,748
Net earnings	19,280	19,678	-
Net proceeds	-	-	76,178
Assigned value of patrons' raw product received	56,500	56,500	-
	84,690	87,926	87,926
Less amounts paid to patrons, retains, and nonpatronage earnings	74,430	74,430	74,430
Amounts due patrons at end of year	$ 10,260	$ 13,496	$ 13,496

905-330-55-4 Under the two inventory methods presented, the difference in amounts due patrons at the end of the year results from the difference in the ending inventory valuations, illustrated as follows.

Inventories of finished goods and goods in process at:		
Net realizable value	$	35,596
Lower of cost and net realizable value		(32,360)
		3,326
Amounts due patrons at end of year on lower of cost and net realizable value basis		10,260
Amounts due patrons at end of year on net realizable value basis	$	13,496

Amendments to Subtopic 905-360

13. Amend paragraphs 905-360-30-1 through 30-2, with a link to transition paragraph 330-10-65-1, as follows:

Agriculture—Property, Plant, and Equipment

Initial Measurement

> Developing Animals

905-360-30-1 All direct and indirect costs of developing animals shall be accumulated until the animals reach maturity and are transferred to a productive function. All direct and indirect development costs of animals raised for sale shall be accumulated, and the animals shall be accounted for at the lower of cost ~~or market~~ and **net realizable value** until they are available for sale.

> Animals Available and Held for Sale

905-360-30-2 Agricultural producers shall report animals available and held for sale either:

a. At the lower of cost and net realizable value ~~or market~~
b. In accordance with established industry practice at net realizable value ~~sales price, less estimated costs of disposal~~, if all of the following conditions exist:
    1. There are reliable, readily determinable, and realizable market prices for the animals.
    2. The costs of disposal are relatively insignificant and predictable.
    3. The animals are available for immediate delivery.

Amendments to Subtopic 905-405

14. Amend paragraph 905-405-25-1, with a link to transition paragraph 330-10-65-1, as follows:

Agriculture—Liabilities

Recognition

Cooperatives

> Pooling Cooperatives

905-405-25-1 If the boards of directors of agricultural marketing cooperatives operating on a pooling basis with no obligation to pay **patrons** fixed prices (pooling cooperatives) assign amounts that approximate estimated market to unprocessed products received from patrons, the **assigned amounts** shall be credited to amounts due patrons. When assigned amounts are used, they should approximate estimated market of unprocessed products delivered by patrons (an example of inventories at lower of cost ~~or market~~ <u>and **net realizable value**</u> is provided in Example 1 (see paragraph 905-330-55-1)).

Amendments to the Master Glossary

15. Amend the following Master Glossary term, with a link to transition paragraph 330-10-65-1, as follows:

Direct Effects of a Change in Accounting Principle

Those recognized changes in assets or liabilities necessary to effect a change in accounting principle. An example of a direct effect is an adjustment to an inventory balance to effect a change in inventory valuation method. Related changes, such as an effect on deferred income tax assets or liabilities or an impairment adjustment resulting from applying the ~~lower-of-cost-or-market test~~ <u>lower of cost and net realizable value guidance</u> to the adjusted inventory balance, also are examples of direct effects of a change in accounting principle.

16. Supersede the following Master Glossary Term, with a link to transition paragraph 330-10-65-1, as follows:

~~Market~~ (second definition)

~~As used in the phrase lower of cost or market, the term market means current replacement cost (by purchase or by reproduction, as the case may be) provided that it meets both of the following conditions:~~

~~a. Market shall not exceed the **net realizable value**~~
~~b. Market shall not be less than net realizable value reduced by an allowance for an approximately normal profit margin.~~

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The Board is issuing this proposed Update as part of a Simplification Initiative. The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of the financial statements.

Measurement

BC3. To simplify the measurement of inventory, the Board proposes that inventory should be measured at the lower of cost and net realizable value*. Net realizable value* is defined in the Master Glossary as the "estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation." The amendments would eliminate the guidance in Topic 330 that requires a reporting entity measuring inventory at lower of cost or market to consider the replacement cost of inventory and the net realizable value of inventory less an approximately normal profit margin along with net realizable value in determining the lower market value.

BC4. The Board considered requiring inventory to be measured at the lower of cost and fair value because some stakeholders said that the fair value of inventory generally would be similar to the net realizable value and that the term *fair value* is more commonly used in recently issued guidance than net realizable value. However, the use of fair value would require a reporting entity to consider all of the requirements of Topic 820, Fair Value Measurement. While a measurement based on fair value often may yield a similar result to net realizable value, it is possible that those measurement bases could yield different results and that the cost to estimate fair value may be higher than the cost to estimate net realizable value. To meet the objective of simplifying the measurement of inventory, the Board chose net realizable value over fair value because net realizable value currently is one of the inputs used to measure inventory and because reporting entities understand how to determine the net realizable value of inventory. The Board anticipated that net realizable value would be less costly to apply than fair value.

Disclosure

BC5. The Board considered whether to add or remove disclosure requirements about the subsequent measurement of inventory. The Board decided that the existing disclosure requirements applicable to inventory measurement estimates in Topic 330 and Topic 275, Risks and Uncertainties, are sufficient.

Other Codification Amendments

BC6. Some of the guidance in Topic 330 is being amended to more clearly articulate the requirements for the measurement and disclosure of inventory. Other than the change in the measurement guidance from the lower of cost or market to the lower of cost and net realizable value, there would be no other changes to the guidance in measuring inventory. The methods of estimating the cost of inventory under GAAP (for example, average cost; first-in, first-out; last-in, first-out; and the retail inventory method) would not be changed by this proposed Update.

Effective Date and Transition

BC7. The Board expects that the amendments in the proposed Update would be effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015, with early adoption permitted. The final effective date will depend on feedback from stakeholders on the proposed Update and the issuance date of any final Accounting Standards Update. Because the amendments in this Update are intended to simplify the guidance for all entities, and the amendments are not expected to be costly to implement, the Board decided that it was not necessary to delay the effective date for entities other than public business entities.

BC8. The Board decided that an entity should apply the proposed guidance prospectively to the measurement of inventory after the date of adoption. The Board decided that the costs of requiring or permitting retrospective application of the guidance would not justify the benefits. Additionally, retrospective application might require the use of hindsight, which would reduce some of the benefits of restating prior periods. Furthermore, retrospective application may not result in a significant change to the previous measurement of inventory for some entities.

BC9. The Board decided that the only disclosures required at transition would be the nature of and reason for the change in accounting principle. The Board decided that the costs of a quantitative disclosure about the change from the lower of cost or market to the lower of cost and net realizable value would not justify the benefits because a reporting entity would be required to measure inventory using both existing requirements and the requirements in the proposed Update in the year of adoption and because the change would not be significant for some entities.

Benefits and Costs

BC10. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC11. The proposed Update would reduce cost and complexity because the current inventory measurement guidance involves estimating replacement cost, net realizable value, and net realizable value less an approximately normal profit margin, whereas the proposed Update involves only estimating net realizable value. The proposed Update should not increase cost and complexity for any entity because net realizable value is necessary to apply the current guidance.

BC12. The proposed Update would increase the consistency of measuring inventory among entities. Additionally, inventory measurement in the proposed Update is more consistent with the measurement of other nonfinancial assets.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (UGT). We welcome comments on these proposed changes to the UGT through ASU Taxonomy Changes provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the UGT will be made available for public comment at www.fasb.org and finalized as part of the annual release process.