new york state society of
NYSSCPA
certified public accountants
530 fifth avenue, new york, ny 10036-5101
www.nysscpa.org

April 9, 2004

Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

By email: director@fasb.org

Re: File Reference 1200-100

Exposure Draft: Proposed Statement of Financial Accounting Standards, *Inventory Costs, an amendment of ARB No. 43, Chapter 4*

Dear Ms. Bielstein:

The New York State Society of Certified Public Accountants, the oldest state accounting association, represents approximately 30,000 CPAs that will implement the provisions proposed in the captioned exposure draft. NYSSCPA thanks FASB for the opportunity to comment on its exposure draft.

The NYSSCPA Financial Accounting Standards Committee deliberated the exposure draft and prepared the attached comments with the consultation of the International Accounting and Auditing Committee. If you would like additional discussion with the committee, please contact Robert A. Dyson, chair of the Financial Accounting Standards Committee, at (212) 842-7565, or Robert Colson, NYSSCPA staff, at (212) 719-8350.

Sincerely,

Jeffrey R. Hoops
President

Attachment

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NEW YORK STATE SOCIETY OF

CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON FASB EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards, *Inventory Costs, an amendment of ARB No. 43, Chapter 4*

File Reference No. 1200-100

April 9, 2004

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Joseph F. Schick
Robert A. Dyson
Robert N. Waxman

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COMMENTS ON FASB EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards, *Inventory Costs, an amendment of ARB No. 43, Chapter 4*

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While the concept of converging U.S. accounting standards and international standards is commendable, this Exposure Draft (ED) proposes changes that do not result in substantive improvements in accounting for inventory. The Committee recommends that the FASB further research the implications of these matters and either revise the current proposal or submit a new proposal for public comment reflecting the following concepts.

The diversity of financial reporting, both in the United States and the world in general, could be reduced by FASB issuing a glossary that defines such terms as “idle capacity”, “ abnormal capacity”, “double freight”, and "rehandling costs.” Within the Committee, there was disagreement over the exact meaning of those terms when applied to specific circumstances. This glossary should also provide a more precise definition of “normal capacity.” The ED defines “normal capacity” as “… the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity from planned maintenance.” The concept of “normal capacity” is closely related to “normal sales” which drives production, and “idle capacity.” Accordingly, we recommend that these relationships be reflected in the definition. A more precise definition of “normal capacity” will narrow alternative methods of classifying costs as either inventory costs or charges to periodic income.

The ED, through its definition of normal capacity, requires expensing of production-line set-up time, which is generally not measured separately in small and medium sized businesses and is absorbed in overhead, except possibly for vacation period shut-downs. This requirement might adversely affect small and medium sized businesses, which are less likely to have production lines dedicated to single or similar products.

The ED also requires the allocation of variable production overhead to each unit of production on the basis of the actual use of production facilities. While such allocation may be common given the current predominance of capital intensive manufacturing, it should not be mandated. Accordingly, we recommend that any standard on inventory should clarify that variable production overhead <u>may be</u> allocated to each unit of production on the basis of actual use of production facilities or <u>direct labor hours.</u>

The ED contains wording that lacks clarity, which may result in diverse practices. For example, the ED includes the following sentences:

> "The actual level of production may be used if it approximates normal capacity. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost."

This concept would be clearer if the end of this sentence were changed as follows: "…., the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost <u>measured at normal capacity."</u> An appendix illustrating the application of this concept would be useful.

The ED also includes the following sentence:

> "The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant."

This sentence should be revised as follows: "….fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant <u>and, therefore, costs associated with low production and idle plant should be reflected as a component of cost of goods sold."</u> This would provide positive guidance on the proper classification of such costs, as opposed to prohibitions against certain classifications.