

Proposed FSP to amend ARB 43 for inventories included in trading activities¹

Recently issued proposed FASB Staff Position (FSP) ARB 43-a, "Amendment of the Inventory Provisions of Chapter 4 of ARB No. 43," would require inventories included in an entity's trading activities to be initially and subsequently measured at fair value, with changes in fair value recognized in earnings. The FASB is addressing this issue to eliminate an inconsistency between the inventory measurement guidance in ARB 43, Restatement and Revision of Accounting Research Bulletins, and the guidance in two AICPA Audit and Accounting Guides.

The proposed FSP's requirement to carry inventory at fair value would apply only to:

- Inventory as defined in ARB 43, Chapter 4, Statement 1, which is limited to inventory of tangible personal property, tangible personal property is defined as Assets other than real estate that physically exists. Business equipment and vehicles are tangible personal property. Assets such as stock certificates and franchises only represent value and are therefore intangible property. For example, if an entity has a natural gas trading operation, the natural gas inventory would be subject to the proposed FSP, but because any related storage or transportation contracts are not considered tangible personal property, these items would not be subject to the amended guidance. (For example if an entity has property from which minerals are derived, the property would be subject to the proposed FSP, but any related mineral rights are not considered tangible personal property, these items would not be subject to the amended guidance.)
- Inventory included in an entity's trading activities. An entity would identify trading inventories based on its specific facts and circumstances, using guidance in GAAP that describes or defines trading activities. Trading inventories include inventory purchased and sold on the open market to profit from price changes. Nontrading inventories, which are outside the scope of the proposed FSP, include those held for production or sold to an end-user in an entity's retail sales operation or to a wholesaler.

If an entity transfers inventory to or from the trading inventory, the transferred inventory would be recorded at fair value on the reclassification date, with the change in fair value included in earnings.

The proposed FSP would require disclosure of management's basis for concluding that the inventory is part of the entity's trading activity, a description of that activity, and the typical holding period. An entity would also be required to disclose the effect on financial performance of transfers between nontrading and trading categories.

The proposed guidance would be effective for financial statements issued for fiscal years beginning after November 15, 2008 and for interim periods within those fiscal years. Early adoption would not be permitted. Entities would recognize the cumulative effect of adopting the proposed FSP, with an offsetting charge to opening retained earnings.

What Is the Effect of This Proposed FSP on Convergence with International Financial Reporting Standards?

International Accounting Standard (IAS) 2, Inventories, which requires that inventory be measured at the lower of cost and net realizable value, provides a scope exception for entities that are considered commodity broker-traders. Commodity broker-traders measure their trading positions at fair value. The Board considered but rejected an approach to provide a similar scope exception in ARB 43. The Board believes that the principles-based guidance in this proposed FSP that focuses on an activity (that is, the trading activity in this case) would be preferable to an industry-based scope exception.

As per **Accounting standard 2 on Inventories, issued by the Institute of Chartered Accountants of India**, Inventory is required to be measured at the lower of cost and net realisable value.

Source: FASB

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