MINUTES

Financial Accounting Standards Board

To: Board Members

From: Nesta (ext. 330)

Subject: Minutes of the May 7, 2003 Board Meeting **Date:** May 9, 2003

cc: Bielstein, Leisenring, Petrone, Smith, Swift, Polley, J. Johnson, Coburn, Tovey, Nesta, Cassel, Kazazean, Thompson, FASB Intranet (e-mail), Vernuccio, Sutay, Gabriele

Topic: Accounting Changes and Inventory Costing

Basis for Discussion: Memoranda dated April 11, 2003, April 14, 2003, and April 21, 2003

Length of Discussion: 12:45 p.m. to 1:15 p.m.

Attendance:

Board members present:	Crooch, Foster, Herz, Schieneman, Schipper, Trott, Wulff
Board members absent:	None
Staff in charge of topic:	J. Johnson
Other staff at Board table:	Bielstein, Leisenring, Cassel, Coburn, Nesta
Outside participants:	None

Summary for ACTION ALERT:

The Board discussed issues related to accounting changes and inventory costing. The Board decided the following:

- To require limited retroactive application in circumstances when the full cumulative effect of an accounting change is not determinable
- That when the effects of retroactive application for particular prior years are not determinable, the cumulative effect on prior years of retroactive application should be recorded directly in opening retained earnings (or other balance sheet caption as appropriate) of the first year presented on the new basis. When an accounting change is made in other than the first interim period, the change should be reported as if it were adopted at the beginning of the fiscal year, as currently required by FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*.
- To converge with the IASB position (and to clarify current U.S. GAAP) that abnormal amounts of idle capacity and spoilage costs should be excluded from the cost of inventory and expensed when incurred.

Matters Discussed and Decisions Reached:

Accounting Changes

Mr. Johnson stated that the first topic of the meeting is a follow-up item to an earlier meeting where the Board decided that they would converge with the IASB position that voluntary accounting changes should be reported using retroactive application. He stated that full retroactive application implies that an entity should report the change as if the new accounting policy had always been used. He noted that there are some types of accounting changes for which it is not practicable to fully apply a new principle retroactively because to do so would require information about prior periods that may not be available. He stated that the staff recommends an alternative whereby an entity would be required to use a limited form of retroactive application when the full cumulative effect of a change cannot be determined. Under limited retroactive application, all periods presented would be adjusted as if the new accounting policy was adopted prospectively as of the earliest date presented in the financial statements.

The Board agreed with the staff recommendation. Board members noted that a limited form of retroactive application allows for greater consistency in an entity's financial statements than would otherwise exist when the full cumulative effect of an accounting change cannot be determined.

Mr. Johnson stated that the second question related to accounting changes concerned the reporting of an accounting change in those instances when the effects of retroactive application for particular prior years are not determinable, but the cumulative effect of the accounting change is known. Mr. Johnson recommended that the cumulative effect be reported as an adjustment to the beginning balance of retained earnings (or other appropriate balance sheet amount, such as accumulated other comprehensive income) in the period in which the accounting change was made. He noted that the staff's recommendation is convergent with the IASB and that under this approach only items of current year net income will be reflected in the income statement. He added that if the Board agreed with the staff's recommendation that the Board would need to determine how the guidance would be applied to interim financial statements.

The Board agreed with the staff's recommendation but noted that if the IASB reconsiders its position on this matter the Board would be willing to reconsider its decision. With regard to interim financial statements, the Board decided that an accounting change made in other than the first interim period should be reported as if it were adopted at the beginning of the fiscal year, as currently required by FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*.

Inventory—Idle Capacity and Storage

Ms. Coburn stated that the inventory costing principles under U.S. GAAP and IAS GAAP are similar. However, she noted that differences between the wording of IAS 2, *Inventories*, and ARB No. 43, *Restatement and Revision of Accounting Research Bulletins*, may lead to inconsistent application of their principles as they relate to idle capacity and spoilage. She stated that the staff recommends that the Board converge with the IASB position (and clarify current U.S. GAAP) that abnormal amounts of idle capacity and costs of abnormal amounts of wasted materials (spoilage costs) should be excluded from the cost of inventory and expensed as incurred.

The Board agreed with the staff's recommendation.

Follow-up Items:
None

General Announcements:
None