March 13, 2017

Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2017-210

Submitted via electronic mail to director@fasb.org

Dear Chairman Golden,

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") appreciates the opportunity to comment on the FASB's proposal addressing the application of disclosure requirements for inventory guidance.

FEI is a leading international organization representing approximately 10,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior-level financial executives. CCR is a technical committee of FEI, and reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. CCR member companies represent approximately $6.5 trillion in market capitalization and actively monitor the standard setting activities of the FASB.

This letter represents the views of CCR and not necessarily the views of FEI or its members individually.

Executive Summary

Overall we are supportive of the FASB's efforts to consider how to improve disclosure. We generally support the initiative to align certain areas of the guidance with existing SEC guidance, to the extent these requirements are substantively similar. However, we are concerned that this proposed ASU, and the other proposed ASUs making up the Disclosure Framework Project, will not achieve the broad objectives the Board is seeking with respect to this initiative. We see a significant expansion of the required set of disclosures, increasing the cost of compliance and requiring implementation of new systems and processes to collect the data necessary to support disclosure of the new information. Below, we outline those concerns in greater detail.

Inventory Proposal

Many of our members already disclose certain additional information about inventory within the Management Discussion and Analysis (MD&A) section of their filings when there is an event or condition that is material to the financial statements. It is therefore unclear how duplicating this information within the financial statement notes would incrementally benefit investors. To the extent items are codified in U.S. GAAP, we recommend coordination with the SEC to ensure preparers are not required to unnecessarily duplicate such information.

Specifically we do not support the following aspects of the new proposed guidance:

<u>Composition of Inventory</u>

The proposal requires disclosure of the major components of inventory such as raw materials, work-in-process, finished goods, and supplies for each period presented. This is similar to the requirements in regulation S-X 5-02.6(a), however, under SEC rules such disclosures are only required if practical. We would support this disclosure if aligned with SEC guidance to include a practicability exception as it may not always be practical to disclose major components separately. For example, a manufacturing company that has significant movements of partially-manufactured components and parts between manufacturing plants may not internally measure or have the systems and processes in place to track and provide a meaningful segregation between raw materials and work-in-process. If the Board decides to retain this requirement, we recommend better alignment with existing SEC guidance by including a practicability exception.

<u>Changes to inventory balances</u>

Under the new proposal, changes in inventory balances that are not specifically related to the purchase, manufacture, or sale of inventory in the normal course of business are required to be disclosed. For the majority of companies, this information is immaterial or insignificant. Requiring entities to disclose such information will cause most entities to create new procedures and controls, and incur additional costs to evaluate, conclude and document whether such information is immaterial or insignificant. Furthermore, many systems today are not designed to track the requested information and would need to be modified for the sole purpose of providing support to the auditor as to why such information is immaterial.

We note that current SEC guidance requires MD&A disclosure to discuss significant nonrecurring changes in the inventory balance when there are significant changes that are not in the normal course of business. While we support the fundamental principle behind this change, we also note that the benefit is already received by investors through SEC mandated MD&A disclosures. Therefore, we are supportive of this amendment to the extent that it is aligned with the SEC guidance. However, we do caution the FASB that we do not see the incremental benefit of creating disclosure requirements that will ultimately duplicate information provided to investors.

Furthermore, while not explicitly proposed in the exposure draft, we would disagree with any amendment that would require a comprehensive rollforward of inventory for the same reasons noted above. The incremental benefit of such rollforward would not justify the additional costs, and we do not believe investors are seeking this level of detail.

RIM Disclosure

We are concerned that some of the quantitative and qualitative disclosures for retailers that use the retail inventory method (RIM) as their inventory measurement basis to report information could result in the required disclosure of otherwise proprietary information and have unintended consequences. Furthermore much of this detail is not required by other inventory methods, which could also lead to unintended consequences. For example, disclosure of cost-to-retail ratios could be viewed by the users of the financial statements as prospective financial information, specifically margins anticipated to be achieved by the entities using the RIM. The use of the RIM is simply a systematic method used by retailers to approximate the cost of ending inventory value and is not necessarily representative of future cash flows.

In addition, we believe that the disclosure of permanent markdowns and shrinkage would also require disclosure of proprietary information not required of companies using an inventory costing method other than the RIM. In our experience, our investors do not inquire about this additional information in part due to the fact that they are able to glean financial information to evaluating key inventory metrics (such as Net Days on Hand, Days Payable and Inventory Turnover) from the face of the financial statements.

Furthermore, the level of detail being required through this proposal would only serve to confuse investors as detailed information about the RIM would likely be useful to only those users with a deep understanding of the model. We believe that the disclosure of entity wide RIM information would not result in more effective, decision-useful information, and oversimplifies metrics such as the cost-to-retail ratio that would not be representative of true economics of retail companies. We further considered whether a presentation of more disaggregated RIM information would be more appropriate.

Finally, given the complexity and diversity of many retailers using RIM, including geographical span and high-volume and varied nature of inventory carried, we do not believe it is possible to present RIM information at a sufficiently disaggregated level in a manner that is meaningful to users of financial statement without compromising the usefulness of the disclosure. Furthermore, such a requirement goes beyond what is required of others who may use other costing methods.

Qualitative information

We are concerned that the qualitative information required by the proposal including disclosure of the types of costs capitalized in inventory will generate boilerplate compliance-oriented disclosures and therefore be of little value to investors.

Segment information

The ASU would require an entity to disclose, in both annual and interim periods, inventory by reportable segment and by component for each reportable segment to the extent that information is regularly provided to the chief operating decision maker (CODM). We disagree with a requirement to provide inventory disaggregated by segment. Furthermore, we do not believe it is appropriate to address this matter in this project as it would be better addressed as part of Topic 280, Segment Reporting. However, if the Board moves forward we do agree that this information need not be presented if it is not provided to the chief operating decision maker.

Given these concerns we recommend the Board not move forward with finalizing this proposed ASU. Please see our additional comments on the overall disclosure effectiveness project and path forward below.

Summary Position on Disclosure Framework Project

Now that the Board has completed and exposed the four proposed ASUs as a proof of concept under the Disclosure Framework project, we believe the Board should step back and assess the overall efficacy of the proposals in meeting the broad objectives of this major project. We are not convinced that the overall set of proposed disclosure enhancements will improve disclosure effectiveness. It is clear that the proposed changes will create a significant net addition to disclosures, many of which are not particularly relevant. On balance, we do not believe the collective set of proposals improves financial reporting. As the status of this project is reevaluated, we recommend the Board focus on developing clear disclosure objectives that demonstrate what the required information will be used for, and how it will help financial statement users make investment decisions. We understand this may include a minimum set of required disclosures. However, we recommend that the Board consider what elements of existing requirements could be eliminated in favor of a principles-based approach.

As we have noted in previous comment letters on this project, we foresee significant issues with a framework that continuously adds to a prescriptive set of required disclosures and places most of the burden on preparers to determine whether each element of the disclosure set is relevant and/or material and, if not, having to prepare documentation to support why it is immaterial. This approach perpetuates the existing compliance-driven disclosure checklist mentality that plagues today's disclosure regime. In addition, as the decision to remove disclosures is largely a voluntary exercise, preparers must weigh the time, effort, and risks associated with removing immaterial information in comparison with the time and effort of collecting, analyzing and disclosing all of the required information, regardless of materiality. In weighing those two alternatives, the information in the disclosure set must be collected and analyzed in order to make the decision about whether or not it is material. Given the prescriptive nature of the requirements, the heavy checklist-oriented focus by auditors, and the resulting documentation burdens, we expect that many will simply choose to report the information and not avail themselves of the discretion provided in the Entity Decision process. As a result, we have significant concerns that this project will meet its objective of "disclosure effectiveness" and will not be sustainable over the long term.

We believe that the Board should actively consider whether it should do more to add rigor and discipline to the Board model and whether the prescriptive disclosure approach should continue to be the centerpiece of the preparer model, given all of its flaws in perpetuating the wrong compliance mindset. Until such time as these issues are addressed we do not recommend finalizing any of the proposed ASUs that have been put forward under the Disclosure Framework umbrella. If these issues cannot be addressed satisfactorily, then we would recommend dropping the project and not finalizing any of the proposed ASUs, as we are concerned that they do not represent an improvement in financial reporting and unnecessarily lead to further duplication and disclosure of immaterial information in financial statements.

Considerations for Improvement

1. Add clarity and rigor to the Board Framework

In the Board's proposed Statement of Financial Accounting Concepts, Conceptual Framework for Financial Reporting Chapter 8: Notes to Financial Statement, in the section entitled "How This Chapter of the Framework Would Be Used," the FASB states:

> *This chapter of the framework would identify, by design, a broad range of possibilities for the Board to consider when deciding on the disclosures related to a particular topic that is required under U.S. GAAP. From that intentionally broad set, the Board would identify a more narrow (and, in many cases, a far more narrow) set of disclosures about that topic to be required*.

We would recommend that the items considered for disclosure in the Disclosure Framework be narrowed, as the proposed disclosure guidance associated with this and other projects do not appear consistent with how this chapter of the framework should be used. We are concerned that the Board is going beyond the boundaries of its own proposed disclosure framework in the very projects designed to test the efficacy of that proposed Disclosure Framework document. Also, we believe the Framework should specifically rule out requiring disclosures of nonfinancial information such as environmental, social, and corporate governance (ESG) disclosures.

2. Focus on objectives, not prescriptive requirements

When the Board took on the disclosure effectiveness project initially we were in favor of the project as we saw it as an opportunity to eliminate unnecessary information from financial statements. We believed that this project could achieve simplification while also providing a framework for more meaningful disclosure for the benefit of investors. However, we have observed in the Board's model a decision framework that eliminates very little from consideration for potential disclosure, while at the same time widening the scope of potential additions to the prescriptive disclosure set. It appears as though all things that <u>could</u> be material are making their way through the Board Decision process unfiltered leaving the role of filtering solely to the Entity Decision process. As discussed above, this places enormous stress on the Entity Decision process, and is not sustainable over the long term.

We could understand and accept the need for a minimum set of required disclosures. However, the Board has taken an approach that adds to the prescriptive disclosure set and presumptively considers all information material unless otherwise proven to be immaterial. In many cases, the additional required information is likely to be immaterial for most companies yet is now part of the required set of disclosures. For example, for most corporations, "*changes in inventory balances that are not specifically related to the purchase, manufacture, or sale of inventory in the normal course*" will not be material, yet this has now found its way onto the required set of disclosures. Rather than designing a disclosure objective that captures abnormal changes to inventory when significant events occur, the prescriptive set grows to enforce this requirement across all companies in all reporting periods. We also observe that such an approach does not encourage innovation and the creation of new forms of disclosure that better meet investor needs.

We believe that the Board should revisit whether the broader objectives of this project could be met with an objectives based approach that is supplemented by the existing detailed set of disclosures available as one way, but by no means the only way, to satisfy the objective. We observe that the SEC's requirements for MD&A are an excellent example of a materiality-focused, principles-based disclosure framework that has stood the test of time and generally has served preparers and users well. In fact, disclosure of any material changes in inventory balances, both in and outside the normal course of business are already required under the SEC's MD&A guidelines.

3. *Improve interim disclosure requirements*

As we have indicated in prior responses, we recommend the Board focus on improving interim disclosure requirements. We note that a disproportionate amount of the disclosure burden is experienced in interim reporting, where filing deadlines are very compressed and disclosure obligations continue to grow. Over the past decade, many of the Board's decisions on disclosures have resulted in the same requirements for interim and annual financial statements. We have urged the Board to adopt a change in the model that would view interim filings as an update to the last annual filing, and to embrace a model where interim disclosures are provided in areas where there has been a significant change from the last annual financial statements. However, we have observed that this topic has been sequenced after the Board and entity decision frameworks. We believe that change is urgently needed in this area.

Conclusion

Based on the foregoing, we recommend the Board not move forward with the inventory disclosure proposal as drafted as we see little benefit but significant effort and cost being incurred by preparers to produce the additional required information.

More broadly we recommend the Board acknowledge that the best path to improved reporting is not through continuous updating of prescriptive set of disclosure requirements. Instead the Board should consider a more rigorous and disciplined approach to filtering what information should be disclosed through the Board Decision process, including a requirement to consider what information should be eliminated from a required minimum set of disclosures coupled with an objectives-based approach that captures relevant and material additional disclosure that include, but is not limited to, existing elements of today's disclosure set. Said differently, we understand that a certain minimum set of required disclosures will be necessary but should be accompanied by clearly defined objectives designed to capture incremental information when warranted.

Finally, considering the evolving circumstances in the regulatory environment, we recommend that the Board be vigilant in ensuring that the scope of the Disclosure Framework does not overreach (e.g., by expanding requiring disclosures to include new types of environmental, social, and corporate governance disclosures). In this current environment with a focus on lowering the regulatory impact on companies, we believe strongly that it is important for the Board to exercise discipline in decelerating the impact of disclosure burden on preparers.

Should you have any questions, we welcome the opportunity to discuss our comments further.

Sincerely,

Richard Levy

Richard Levy
Chairman
Committee on Corporate Reporting
Financial Executives International