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AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO FLASH REPORT
FASB

SUBJECT

FASB ISSUES ASU TO SIMPLIFY THE MEASUREMENT OF INVENTORY

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SUMMARY

The FASB recently issued ASU 2015-11[1] as part of its simplification initiative. The amendments require inventory within the scope of the ASU to be measured using the lower of cost and net realizable value. The changes apply to all types of inventory, except those measured using LIFO or the retail inventory method. The new standard takes effect in 2017 for calendar year-end entities and is available here.

DETAILS

Main Provisions:

Under the new guidance, the subsequent measurement of inventory depends on the cost method used:

- Inventory measured using any method other than last-in, first-out (LIFO) or the retail inventory method (*within the scope of the ASU*)
- Inventory measured using LIFO or the retail inventory method (*excluded from the scope of the ASU*)

The ASU amends some of the other guidance in Topic 330 to more clearly articulate the requirements for the measurement and disclosure of inventory. However, those amendments are not intended to result in any changes to current practice.

Inventory within the scope of the ASU (e.g. FIFO or average cost) should be measured at the lower of cost and net realizable value. Net realizable value is defined as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.

[1] *Inventory (Topic 330): Simplifying the Measurement of Inventory*

Prior to the ASU, U.S. GAAP required an entity to measure inventory at the lower of cost or market. Market is measured using replacement cost unless it is above net realizable value (commonly referred to as "ceiling") or below net realizable value less an approximately normal profit margin (commonly referred to as "floor"). For inventory within its scope, the ASU eliminates the notions of replacement cost and NRV less a normal profit margin, which is intended to simplify the accounting for inventory.

Inventory excluded from the scope of the ASU (i.e., LIFO or the retail inventory method) will continue to be measured at the lower of cost or market. That is, there is no change to current practice in these circumstances.

Effective Date and Transition:

The amendments are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016. For all other entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2016, and for interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted as of the beginning of an interim or annual reporting period.

The amendments in this Update should be applied prospectively. If an entity has previously written down inventory (within the scope of the ASU) below its cost, that reduced amount is considered the cost upon adoption.

Upon adoption, the change from the lower of cost or market to the lower of cost and net realizable value for inventory within the scope of the ASU will be accounted for as a change in accounting principle. Only the nature and reason for the change in accounting principle is required to be disclosed in the first interim and annual period of adoption.