

## Heads Up

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# Simply the Best

## FASB Issues ASU on Simplifying the Measurement of Inventory

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### Introduction

On July 22, 2015, the FASB issued [ASU 2015-11](#),<sup>1</sup> which requires entities to measure most inventory “at the lower of cost and net realizable value,” thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market (market in this context is defined as one of three different measures). The ASU will not apply to inventories that are measured by using either the last-in, first-out (LIFO) method or the retail inventory method (RIM).

### Background

The project on simplifying the subsequent measurement of inventory is part of the FASB’s simplification initiative. Launched in June 2014, the simplification initiative is intended to improve U.S. GAAP by reducing costs and complexity while maintaining or enhancing the usefulness of the related financial statement information. Simplification projects are narrow in scope, involve limited changes to U.S. GAAP, and can be completed quickly.

Under current guidance (i.e., ASC 330-10-35<sup>2</sup> before the ASU), an entity subsequently measures inventory at the lower of cost or market, with market defined as replacement cost, net realizable value (NRV), or NRV less a normal profit margin. An entity uses current replacement cost provided that it is not above NRV (i.e., the ceiling) or below NRV less an “approximately normal profit margin” (i.e., the floor). The analysis of market under current guidance requires the use of these ceilings and floors and is unnecessarily complex. The ASU eliminates this analysis for entities within the scope of the guidance.

### Scope

The ASU applies to entities that recognize inventory within the scope of ASC 330, except for inventory measured under the LIFO or RIM method given certain challenges in applying the lower of cost or NRV approach to those methods.

<sup>1</sup> FASB Accounting Standards Update No. 2015-11, *Simplifying the Measurement of Inventory*.

<sup>2</sup> For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte’s “Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*.”

## Key Provisions of the ASU

Under the ASU, inventory is “measured at the lower of cost and net realizable value,” which eliminates the need to determine replacement cost and evaluate whether it is above the ceiling (NRV) or below the floor (NRV less a normal profit margin). The ASU defines NRV as the “estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.” The Board did not amend other guidance on measuring inventory (e.g., the first-in, first out (FIFO); LIFO; or average cost method).

**Editor’s Note:** In addition to reducing complexity, the proposal would make U.S. GAAP more comparable to IFRSs,<sup>3</sup> under which inventory must be measured at the lower of cost or NRV.

Enhanced inventory disclosures may also be considered as part of the FASB’s disclosure framework project.

## Effective Date and Transition

For public business entities, the ASU is effective prospectively for annual periods beginning after December 15, 2016, and interim periods therein. For all other entities, the ASU is effective prospectively for annual periods beginning after December 15, 2016, and interim periods thereafter. Early application of the ASU is permitted. Upon transition, entities must disclose the nature of and reason for the accounting change.

<sup>3</sup> IAS 2, *Inventories*.

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