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Ms. Suzanne Q. Bielstein  
Director of Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
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File Reference 1200-100 – Inventory Costs

Dear Ms. Bielstein:

I do not support the issuance of a Statement of Financial Accounting Standards on “Inventory Costs.” I urge the FASB to withdraw this proposal and wait until it can address inventory costs on a comprehensive basis. The changes that would be required by this proposal would affect nearly all companies that manufacture items for resale. Those changes would not improve financial reporting for inventories and they would be very costly to implement.

This proposed standard purports to be a minor wording amendment to ARB 43 in order to remove a possible inconsistent application of the IASB’s inventory standard vs. U. S. GAAP. However, as explained below, this amendment could affect nearly all companies that manufacture inventory and, thus, would have consequences far beyond what the FASB apparently intends.

The ED would remove language from ARB 43 (“may be so abnormal”) that is ambiguous and may be applied differently by different accountants. However, significant ambiguity remains because the new wording says “Other items such as” and then follows those words with three

specific examples. There is no objective or principle stated so accountants are left with the challenge of figuring out what are the “other items” that are sufficiently similar to the three examples to be considered period costs rather than inventory costs.

The Summary of the ED refers only to this editorial difference between IASB GAAP and that of ARB 43. However, the actual proposal would add about six new sentences to ARB that don’t seem to be related to the “abnormal costs” matter. Those sentences appear to try to provide guidelines for the allocation of fixed production overhead costs to inventory. The sentences would base that allocation on “normal capacity.” If production is higher than normal, overhead allocation would be limited to the actual amount of cost incurred – in other words, reduce the application rate. However, the application rate wouldn’t be increased in periods of low production or idle plant. Thus, some part of actual overhead wouldn’t be allocated to inventory in those cases. While the FASB may feel that these several sentences are consistent with the “Other items such as” language mentioned above, I believe the Board is getting inappropriately involved in cost accounting here and would be creating substantial new problems.

It seems to me that the general principle for inventory costs ought to be “include all actual costs incurred as long as the result is not in excess of market.” However, the procedure mentioned above of excluding negative manufacturing variances from inventory cost would change that principle. The Board has not provided any reasoning for why such a substantial change to practice is desirable, nor do I believe a sufficient rationale could be found. It would be far better, in my view, to simply eliminate the notion of “may be so abnormal” from the inventory accounting literature rather than making the change in the ED.

The Board also would bring forward from ARB 43 language relating to when G&A costs might be allocated to inventory: “Also, general and administrative expenses should be included as period charges, except for the portion of such expenses that may be clearly related to production and thus constitute a part of inventory costs (product charges).” My understanding is that the only companies that include G&A in inventory are some government contractors who argue that the government agrees to reimburse those costs per contract so that such inventory accounting is correct. However, I suspect that at least some companies would look at this new

document and think that they should be considering treating G&A costs as part of inventory in more cases.

I can only remember one case of the “so abnormal” wording coming up as a practice problem in my 40 plus years of accounting experience. But through this standard the FASB would force all companies to think about the matter and probably change their accounting. It doesn't seem worth it to me to put all of corporate America through such an exercise just because of what you believe are minor wording differences between U. S. and international standards. Thus, I strongly believe this proposal should be dropped.

I know that the FASB has been asked on many occasions to fix inventory accounting by eliminating all of the alternatives, etc. Such a project may well have merit and should be considered by the Board. However, it would be a serious mistake to disrupt practice so substantially in the guise of a minor wording change to achieve convergence. Please reconsider this proposal.

Sincerely,

Dennis R. Beresford  
Ernst & Young Executive Professor of Accounting