# FASB Interpretation No. 1

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## Accounting Changes Related to the Cost of Inventory

an interpretation of APB Opinion No. 20

June 1974

Financial Accounting Standards Board
of the Financial Accounting Foundation
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# FIN 1: Accounting Changes Related to the Cost of Inventory

## an interpretation of APB Opinion No. 20

## INTRODUCTION

1. *Accounting Principles Board (APB) Opinion No. 20* specifies how changes in accounting principles should be reported in financial statements and what is required to justify such changes. Under that Opinion, the term *accounting principle* includes "not only accounting principles and practices but also the methods of applying them."

2. Paragraph 5 of Chapter 4 of *Accounting Research Bulletin No. 43* states "there is a presumption that inventories should be stated at cost," which is "understood to mean acquisition and production cost." It further states that "the exclusion of all overheads from inventory costs does not constitute an accepted accounting procedure."

3. Internal Revenue Service (IRS) Regulation 1.471-11, adopted in September 1973, specifies how certain costs should be treated in determining inventory costs for income tax reporting. Under IRS Reg. 1.471-11, some costs must be included in inventory or excluded from inventory for income tax reporting *regardless* of their treatment for financial reporting. Other costs must be included in inventory or excluded from inventory for income tax reporting *depending upon* their treatment for financial reporting, "but only if such treatment is not inconsistent with generally accepted accounting principles." Among the costs listed in IRS Reg. 1.471-11 in this last category are taxes other than income taxes, depreciation, cost depletion, factory administrative expenses, and certain insurance costs.

4. Taxable income and accounting income are based on common information about transactions of an enterprise. However, the objectives of income determination for Federal income taxation and the objectives of income determination for financial statements of business enterprises are not always the same.

## INTERPRETATION

5. A change in composition of the elements of cost included in inventory is an accounting change. A company which makes such a change for financial reporting shall conform to the requirements of *APB Opinion No. 20*, including justifying the change on the basis of preferability as specified by paragraph 16 of *APB Opinion No. 20*. In applying *APB Opinion No. 20*, preferability among accounting principles shall be determined on the basis of whether the new principle constitutes an improvement in financial reporting and not on the basis of the income tax effect alone.

## EFFECTIVE DATE

6. This Interpretation shall be effective on July 1, 1974.

*This Interpretation was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board following submission to the members of the Financial Accounting Standards Advisory Council.*

Marshall S. Armstrong, *Chairman*
Donald J. Kirk
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