By the Commission.

George A. Fitzsimmons,

Secretary.

July 8, 1981.

[FR Doc. 81-20697 Filed 7-13-81; 8:45 am]

BILLING CODE 8010-01-M

---

17 CFR Part 211

[Release Nos. 33-6325; 34-17912; 35-22116; IC-11845; AS-293; S7-889]

Last-In, First-Out Method of Accounting for Inventories

AGENCY: Securities and Exchange Commission.

ACTION: Issuance of an accounting series release.

SUMMARY: Several recent enforcement cases and the amendments to the Internal Revenue Service regulations concerning the last-in, first-out ("LIFO") book/tax conformity statute have caused the Commission to focus on certain LIFO practices and disclosures. In addition to finding out that some practices being used are inappropriate, the Commission, after careful consideration, has concluded that practices which potentially contradict the conceptual basis of LIFO, i.e., the matching of current costs and current revenues need to be examined.

The Commission also has included guidelines in this release for those LIFO companies who wish to make supplemental non-LIFO income disclosures.

DATE: July 2, 1981.

ADDRESSES: The Commission invites written submissions concerning the practical experience of accountants and registrants in applying the LIFO inventory method. All comments should be filed in triplicate with George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549. Submissions should refer to file No. S7-889 and, unless confidential treatment is authorized, will be available for public inspection and copying at the Commission's Public Reference Room, 1100 L Street, N.W., Washington, D.C.

FOR FURTHER INFORMATION CONTACT: Arthur J. Schmeiser, George Diacont, or David F. Martin (202-272-2130), Office of the Chief Accountant, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. Background

LIFO is an inventory pricing method based on a flow-of-cost assumption that the last item purchased is the first item sold. In times of rising prices, LIFO generally results in higher current costs being charged against income, while older, lower costs are retained in inventory. Of the two fundamental reasons for using LIFO, one is oriented toward financial accounting and the other is income tax oriented. From the standpoint of financial accounting, proponents of LIFO argue that, by charging to expense those costs which more closely reflect the replacement cost of inventory, LIFO tends to reduce the illusionary profits obtained from merely holding inventories and thereby reflects more accurately the "true" income of a company.[1] Most companies that have changed to the LIFO method from other methods in the past decade have indicated that LIFO is a preferable method because of its ability to match current costs with current revenues during periods of rising prices. For income tax purposes many companies prefer LIFO because, during periods of rising prices, it generally reduces taxable income and thereby results in reduced income tax expense.

When LIFO become an acceptable tax method as announced in the Revenue Act of 1938, its application was limited to the specific identification method for raw materials in the inventories of leather tanners and producers and processors of certain nonferrous metals. Since then, the Internal Revenue Service ("IRS") regulations have been amended a number of times and today dollar value LIFO[2] is an acceptable method that can be used for almost all types of inventory goods. While allowing broad usage of the LIFO method, the statute was structured in a unique manner permitting only those taxpayers who use LIFO for financial accounting to use LIFO for tax purposes.

On January 13, 1981, the IRS published amended regulations[3] concerning the LIFO conformity rule. For many years, the IRS strictly enforced the conformity rule and required companies to apply LIFO in most cases identically for book and tax purposes and did not permit companies to disclose supplemental information about alternative methods of inventory pricing.[4] The Commission considers two aspects of the IRS amendments to be significant: (1) Companies may apply LIFO differently for book purposes than for tax purposes as long as they use some acceptable form of LIFO; and (2) companies may provide supplemental non-LIFO disclosures if they are not presented on the face of the income statement.

II. Applying LIFO for Book and Tax Purposes

The Commission believes that the conceptual basis for the LIFO method is the proper matching of current costs with current revenues. However, based on matters which the Commission and its staff have dealt with, we have concluded that when the dollar value method is used, changes in product mix, product prices and inventory pool liquidations can sometimes prevent a proper matching of cost and revenues. Accordingly, the Commission believes that the amended regulations which permit companies to compute LIFO differently for book and tax purposes are very positive. For too long, the application of the LIFO method for financial accounting and reporting has been unduly influenced by the tax application. Most explanations or analyses of LIFO in textbooks and articles have been oriented toward tax implications, rather than financial accounting and reporting. With few exceptions, the accounting profession has deferred to the IRS in this area; indeed, many accountants appear to view IRS LIFO regulations as if they were generally accepted accounting principles ("GAAP"). The Commission disagrees with this approach and believes that since LIFO may now be applied differently for book accounting and tax accounting, it is appropriate for the current practices used in the application of LIFO to be examined.[5]

Activities of the Commission and its staff concerning LIFO include the following: (1) a requirement to disclose the excess of replacement or current cost over LIFO value stated on the balance sheet, if material (Regulation S-

---

[1] The Commission, in Accounting Series release No. 151, January 3, 1974, stated, "[s]uch [inventory] profits do not reflect an increase in the economic earning power of a business and they are not normally repeatable in the absence of continued price level increase."

[2] The dollar value method, in contrast to the specific identification method, values dollar rather than quantity increases in ending inventory and the dollar, rather than the physical item, is the unit of measure. There are four major dollar value methods: double extension, index, link chain and retail.

[3] Treasury Decision 7756, Title 26 CFR 1.472-2(e).

[4] There have been exceptions to this rule, e.g., the IRS issued annual waivers to permit companies to comply with Accounting Series Release No. 190, involving replacement cost, without violating the conformity rule.

[5] The Commission is aware of a task force which has been established by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants to accumulate information about application problems. This type of effort, in addition to self-examination by individual registrants, is appropriate and should assist the Financial Accounting Standards Board in considering these matters.

X CFR 210.5-02-6); (2) a staff accounting bulletin which explicity identifies the need to disclose the amount of income, if material, that has been recorded because a LIFO inventory liquidation has taken place (Staff Accounting Bulletin No. 1)[6], (3) enforcement actions for imporper reporting and (4) meetings and communications with registrants on matters of application and disclosure. This release describes some ot the particular facts and conclusions concerning LIFO issues, that the Commission and its staff have considered, in order to enhance the examination of LIFO practices. These examples, which follow, are limited by the issues which the Commission and its staff have addressed and are not intended to be a complete consideration of concerns about the LIFO method.

Enforcement Issues

The Commission has instituted enforcement actions against a number of registrants that used the LIFO method to report a desired but fallacious result. These enforcement actions involve two distinct topics: new product designation and inventory levels.

New Product Designations

The accounting treatment given products entering an inventory pool for the first time ("new products") can affect financial statement results when they are reported at current cost. This has been noted particularly when the double extension approach to the dollar-value LIFO method is used. When the effects of inflation on the cost of new products are measured by making a comparison with current cost as the base year cost rather than a reconstructed base-year cost,[7] income tends to be increased.

The Commission has noted instances in which companies incorrectly designated pre-existing inventory items as new products and recorded them at current cost. They attempted to justify this treatment by distinguishing between the so-called new product and the same item already contained in the inventory based on insignificant and sometimes arbitrary differences in attributes. For example, new products have been designated because of slight differences in chemical composition, changes in manufacturing or production line location, and differences in supply sources.

[6] Topic 11F of Staff Accounting Bulletin No. 40 (46 FR 11513).

[7] Reconstructed base-year costs are "reasonable" estimates of what a particular inventory item would have cost had it been in the inventory in the base year.

The following examples illustrate instances where the Commission took exception to a registrant's new product policies.

i. Company A treated an item as new product merely because the production of that item was shifted from one plant to another. The change in manufacturing location and the changes in costs associated with the manufacture of that item were given as the major justifications for the new product treatment.

ii. Company B designated part of its nickel inventory as a "new product" because it contained cobalt. Although cobalt did not preclude the use of the nickel in the manufacture of stainless steel, the presence of the cobalt content caused a modification in the manufacturing process and resulted in a lower quality steel. The Commission focused on the apparent contradiction inherent in income being increased (by several million dollars) simply because a particular inventory commodity contained a physical property making it less valuable.

iii. Company C's policy was to treat iron ore obtained from different mine locations as distinct inventory products, arguably because of differences in chemical composition. The Commission objected, however, when Company C increased pre-tax earnings by $4.9 million simply by designating the mixture of three different kinds of iron ore as a new product and recording it at current cost.

Inventory Levels

The Commission has noted where registrants have manipulated the reported level of their inventory or parts of their inventory in order to affect reported earnings. In the following illustrative cases the Commission initiated enforcement actions against registrants because it considered the transactions to be improper.

i. Company D as part of a plan to shift income from 1974, a high income year, to 1975, an expected low income year, recorded the transfer of 1,088 tons of stainless steel from its FIFO to its LIFO inventory. The transfer was recorded on the company's books but the stainless steel was not physically moved. The LIFO effect of the transfer substantially lowered 1974 reported income. In 1975, a book entry was made to transfer the stainless steel back to the FIFO valued inventory, increasing reported earnings for that year.

ii. Company E misclassified some of the raw material in its inventory records. Although this misclassification did not affect the overall inventory quantity, the differences in the LIFO base cost of the misclassified raw materials resulted in reported increases in inventory and earnings.

Transactions such as those described above represent a perversion of the reporting process. Accordingly, financial statements prepared using these devices will be considered to be misleading.

LIFO Applications

Because of the nature of LIFO, transactions which would have no financial accounting impact if another method were used can significantly change reported income under LIFO. The following is an example of a recent registrant inquiry that was considered by the staff which illustrates this situation.

Company F, a company using LIFO, found itself with raw material commitments which were greater than it could utilize and decided to sell the excess. There was excess supply on the market and the sale was not anticipated to be accomplished by year end. The Company inquired whether the staff would object if a new non-LIFO subsidiary were established to hold and eventually sell the inventory. (This transaction would have occurred at an interim period during the Company's fiscal year and would have involved a bookkeeping transfer without physical movement of the inventory.) Since, for other reasons, the Company's inventory had decreased, the net effect of the transfer would have been to further decrease LIFO inventory causing a further decrement of LIFO layers and a substantial infusion of income. Although the staff did not assert any devious intent, it was concerned about the precedent of a bookkeeping transaction that did not involve a physical event but resulted in reporting considerable income. The Company stated that the IRS had approved of the transaction and that it did not expect the Commission staff to object. The staff informed the Company that it could not consider the transaction acceptable because its reported effect contradicted the economic substance of the situation.

III. Supplemental Disclosures

The other matter which the recent amendments affect is supplemental income disclosures based on non-LIFO inventory methods. Because there appears to be a tendency by some companies using LIFO to infer that FIFO earnings are the "real" earnings, the Commission reminds registrants that disclosures must be considered carefully so as not to result in misleading reporting for financial statement purposes. Those disclosures which

previously were prohibited by the conformity rule should not be presented in financial reports without consideration of their desirability or effect.

The most troublesome disclosures relate to pro-forma income information usually assuming the first-in, first-out ("FIFO") method is used. The asserted reason for these disclosures is usually that they are necessary to permit comparison of companies using LIFO and those using FIFO. The Commission does not believe that FIFO-based supplemental income disclosures by companies using the LIFO method for inventory determination are necessarily the best way to obtain comparable information. A better method would be to use the disclosures prescribed by Statement of Financial Accounting Standard No. 33, "Financial Reporting and Changing Prices." However, when such supplemental disclosures are properly formed and located the Commission has not objected to them.

The Commission's primary concern, the risk of user misinterpretation, is mitigated when registrants providing these disclosures (1) state clearly that the use of LIFO results in a better matching of costs and revenues (i.e., supporting the preferability of this method for their purposes), (2) indicate the reason why supplemental income disclosures are being provided and (3) present essential information about the supplemental income calculation to enable users to appreciate the quality of the information. Also, registrants should be careful of the terminology that they use since terms such as "LIFO reserve" or "LIFO adjustment" may be misunderstood by readers.

The purpose of presenting supplemental FIFO income information will have an impact on the location of the information. If companies present FIFO-based disclosures because they believe users want to have information available for comparison to operating results of companies not on LIFO, the Commission believes such disclosures should not be made in financial highlights, press releases or president's letters, since such analytical data, in the required detail, usually is not included in those places.

These disclosures would be better placed in footnotes to financial statements or management's discussion and analysis of financial condition and results of operations.

By the Commission.

George A. Fitzsimmons,

Secretary.

July 2, 1981.

[FR Doc. 81-20562 Filed 7-13-81; 8:45 am]

BILLING CODE 8010-01-M

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Part 176

[Docket No. 80F-0163]

Indirect Food Additives: Paper and Paperboard Components; 1,2-Dibromo-2,4-Dicyanobutane

AGENCY: Food and Drug Administration.

ACTION: Final rule.

SUMMARY: The Food and Drug Administration (FDA) amends the food additive regulations to provide for the safe use of 1,2-Dibromo-2,4-Dicyanobutane as a slimicide in the manufacture of paper and paperboard intended for food contact use. Calgon Corp. filed a petition requesting such use.

DATES: Effective July 14, 1981; Objections by August 13, 1981.

ADDRESS: Written objections to the Dockets Management Branch (formerly the Hearing Clerk's office) (HFA-305), Food and Drug Administration, Rm. 4-62, 5600 Fishers Lane, Rockville, MD 20857.

FOR FURTHER INFORMATION CONTACT: Julius Smith, Bureau of Foods (HFF-334), Food and Drug Administration, 200 C St. SW., Washington, D.C. 20204, 202-472-5690.

SUPPLEMENTARY INFORMATION: In a notice published in the Federal Register of June 3, 1980 (45 FR 37524), FDA announced that a food additive petition (FAP OB3495) had been filed by Calgon Corp., P.O. Box 1346, Pittsburgh PA 15230, proposing that § 176.300 *Slimicides* (21 CFR 176.300) be amended to provide for the safe use of 1,2-dibromo-2,4-dicyanobutane as a slimicide in the manufacture of paper and paperboard intended for food contact use.

FDA has evaluated data in the petition and other relevant material and concludes that the proposed food additive use is safe and that § 176.300 should be amended as set forth below.

The Commissioner of Food and Drugs has carefully considered the potential environmental effects of this proposed action and has concluded that the action will not have a significant impact on the human environment and that an environmental impact statement therefore will not be prepared. The Commissioner's finding of no significant impact and the evidence supporting this finding contained in an environmental assessment (pursuant to 21 CFR 25.31, proposed December 11, 1979; 44 FR 71742) may be seen in the Dockets Management Branch (HFA-305), Food and Drug Administration (address above) between 9 a.m. and 4 p.m., Monday through Friday.

Therefore, under the Federal Food, Drug, and Cosmetic Act (secs. 201(s), 409, 72 Stat. 1784-1788 as amended (21 U.S.C. 321(s), 348)) and under authority delegated to the Commissioner of Food and Drugs (21 CFR 5.10), Part 176 is amended in § 176.300(c) by alphabetically inserting a new item in the list of substances, to read as follows:

§ 176.300 Slimicides.

* * * * *

(c) * * *

List of substances	Limitations
* * * * *	
1,2-Dibromo-2,4-dicyanobutane (CAS Reg. No. 35691-65-7).	At a maximum level of 0.005% of dry weight fiber.
* * * * *	

Any person who will be adversely affected by the foregoing regulation may at any time on or before August 13, 1981 submit to the Dockets Management Branch (HFA-305), Food and Drug Administration (address above), written objections thereto and may make a written request for a public hearing on the stated objections. Each objection shall be separately numbered and each numbered objection shall specify with particularity the provision of the regulation to which objection is made. Each numbered objection on which a hearing is requested shall specifically so state; failure to request a hearing for any particular objection shall constitute a waiver of the right to a hearing on that objection. Each numbered objection for which a hearing is requested shall include a detailed description and analysis of the specific factual information intended to be presented in support of the objection in the event that a hearing is held; failure to include such a description and analysis for any particular objection shall constitute a waiver of the right to a hearing on the objection. Four copies of all documents shall be submitted and shall be identified with the docket number found in brackets in the heading of this regulation. Received objections may be

seen in the office above between 9 a.m. and 4 p.m., Monday through Friday.

Effective date. This regulation shall become effective July 14, 1981.

(Secs. 201(s), 409, 72 Stat. 1784–1788 as amended (21 U.S.C. 321(s), 348).)

Dated: July 2, 1981.

William F. Randolph,

Acting Associate Commissioner for Regulatory Affairs.

[FR Doc. 81-20336 Filed 7-13-81; 8:45 am]

BILLING CODE 4110-03-M

---

21 CFR Part 320

[Docket No. 75N-0051]

Bioavailability and Bioequivalence Requirements; Updating of Drug List

AGENCY: Food and Drug Administration.

ACTION: Final rule.

SUMMARY: The Food and Drug Administration (FDA) is amending the bioavailability regulations by revising the list of drug products for which bioavailability data are not waived (21 CFR 320.22(c)). Since these regulations were issued in January 1977, the agency has published individual Drug Efficacy Study Implementation (DESI) notices stating that certain drug products determined to be effective for at least one indication have known or potential bioavailability problems. The names of these drug products are now being added to the list of drugs with such problems.

DATES: Effective July 14, 1981; comments by September 14, 1981.

ADDRESS: Written comments to the Dockets Management Branch (formerly the Hearing Clerk's office) (HFA–305), Food and Drug Administration, Rm. 4–62, 5600 Fishers Lane, Rockville, MD 20857.

FOR FURTHER INFORMATION CONTACT: Eileen Hodkinson, Bureau of Drugs (HFD–30), Food and Drug Administration, 5600 Fishers Lane, Rockville, MD 20857, 301–443–3650.

SUPPLEMENTARY INFORMATION: FDA is amending the list of specific drug products with known or potential bioavailability problems contained in § 320.22(c) (21 CFR 320.22(c)). Since January 7, 1977, when the list was issued as a final regulation (42 FR 1638), the agency has published a number of DESI notices which included a bioavailability requirement for effective drug products. This list is being updated to include all such drug products.

This action is taken, in part, in response to a citizen petition from G. D. Searle & Co. requesting the agency to amend 21 CFR 320.22(c)(1) to incorporate specific reference to "Spironolactone tablets" under the heading "Anti-Hypertensive/Diuretic." The agency granted the petition in a letter to G. D. Searle & Co. on November 26, 1980. A copy of the petition and the agency's response are on file under Docket No. 79N–0206/CP in the Dockets Management Branch (address above).

When the bioavailability regulations were published, they required the submission of in vivo bioavailability data in each new drug application (NDA) or abbreviated new drug application (ANDA) or the submission of information sufficient to justify a waiver. However, certain DESI effective drugs, subject to known or potential bioavailability problems were listed as drugs for which no waiver would be granted. The regulations were amended (21 CFR 320.22(c)(3)) (42 FR 42311; August 23, 1977) to state that a waiver would not be granted for a drug product for which an initial DESI effective notice which contained a bioavailability requirement was published after January 7, 1977. Further, the agency stated that any drug product subject to such a DESI notice would be added to § 320.22(c) at periodic updates of that section. Any person who has submitted a full or abbreviated new drug application, or a supplemental application proposing any of the changes set forth in § 320.21(b), for one of those drug products has been required to submit evidence demonstrating the in vivo bioavailability of the drug product that is the subject of the application or supplement.

FDA is now updating § 320.22(c) to include all drug products for which a DESI notice has set forth a bioavailability requirement as a condition for NDA, ANDA, or supplemental NDA approval.

No new requirements are intended to be imposed by this amendment. Rather, its purpose is to consolidate into one list the names of the DESI effective drugs that are solid oral dosage forms (other than enteric coated or controlled release) for which in vivo bioavailability data are required. Updating this list will make it easier for prospective applicants and holders of approved NDA's and ANDA's to determine what information must be included in their applications or supplements. Other DESI drugs, evaluated as less-than-effective, are undergoing reviews and further proceedings before final effectiveness determinations can be made. If any of these drug products are upgraded to effective, they then will be evaluated for bioavailability/bioequivalence problems, and further updating of the list set out in § 320.22(c) (1) and (2) may be indicated.

The agency is also amending the list by deleting the heading "Miscellaneous" and reassigning each of the five drugs (imipramine hydrochloride tablets, isoproterenol sublingual tablets, methyltestosterone tablets, probenecid tablets, sodium sulfoxone tablets) now listed as "Miscellaneous" to a category that is more descriptive. Further, the name of one drug product, salicylazosulfapyridine, is being changed to reflect the change in its established name, now sulfasalazine.

The agency has determined pursuant to 21 CFR 25.24(b)(22) (proposed December 11, 1979; 44 FR 71742) that this action is of a type that does not individually or cumulatively have a significant impact on the human environment. Therefore, neither an environmental assessment nor an environmental impact statement is required.

§ 320.22 [Amended]

Therefore, under the Federal Food, Drug, and Cosmetic Act (secs. 501, 502, 505, 701(a), 52 Stat. 1049–1053 as amended, 1055 (21 U.S.C. 351, 352, 355, 371(a))) and under authority delegated to the Commissioner of Food and Drugs (21 CFR 5.10 (formerly 5.1; see 46 FR 26052; May 11, 1981)), paragraph (c)(1) of § 320.22 *Criteria for waiver of evidence of in vivo bioavailability* is amended as follows:

1. By adding alphabetically a new heading "Androgens" and adding "Methyltestosterone tablets" under it.

2. By adding alphabetically a new heading "Anti-Cholinergic" and adding "Diphemanil methylsulfate tablets" under it.

3. By adding alphabetically a new heading "Anti-Depressants" and adding "Imipramine hydrochloride tablets" under it.

4. By adding alphabetically a new heading "Anti-Emetic" and adding "Trimethobenzamide capsules" under it.

5. Under the heading "Anti-Hypertensive/Diuretics," by adding alphabetically "Chlorthalidone tablets," "Guanethidine sulfate tablets" and "Spironolactone tablets."

6. Under the heading "Anti-Infectives," by changing the entry "Salicylazosulfapyridine tablets" to read "Sulfasalazine tablets" in accordance with the change in its established name, and adding alphabetically "Sodium sulfoxone tablets."

7. Under the heading "Anti-Neoplastics," by adding alphabetically "Cyclophosphamide tablets."