LIFO Election Benefit Analysis Report for

Sample Company

For the 12/31/2023 Year End

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Overview

LIFOPro performs a series of pro forma LIFO calculations using a company's current period product mix to determine whether a company is a good LIFO candidate, if a LIFO election should be made this year (or deferred to a future period), and to identify the most beneficial and practical submethods that should be used (if a current year LIFO election is recommended). The calculations made are as follows:

- Current year internal index calculation using company's actual costs
- Current year external index calculation using Bureau of Labor Statistics Consumer/Producer Price Indexes (BLS CPI/PPI; also known as IPIC method)
- 20 year pro forma IPIC calculation using current period's product mix & inventory balances

Good LIFO Candidate & LIFO Election Recommendation Criteria/Scoring

Using the pro forma LIFO calculation results, the following criteria are tested and scored to determine if a company is a good LIFO candidate and/or if a LIFO election is recommended:

- **Good LIFO Candidate**
  - **Criteria: The following criteria are used to measure whether a company is a good LIFO candidate or not:**
    - **20 Year Average Annual Inflation Rate:** The 20 year average annual inflation rate is measured by assigning BLS CPI/PPI categories to the current period's product mix and calculating a weighted average current year inflation index for this product mix for each of the last 20 years. For example, if a benefit analysis is performed for the 2023 year end, the 20 year average annual inflation rate will be calculated for the '04 – '23 year ends.
    - **20 Year Average Inflation Frequency:** Inflation frequency is measured using the results of the 20 year pro forma IPIC LIFO calculation. For example, if the pro forma 20 year calculations were made for the '04 – '23 year ends and there was inflation calculated in all but 3 years (meaning deflation was calculated in 3 periods), then the 20 year inflation frequency rate would be 85% (17 out of 20 years).
  - **Scoring: A company is a good LIFO candidate if the following criteria are met:**
    - **20 Year Average Annual Inflation Rate:** The 20 year average annual inflation rate must be greater than or equal to 1%. Although this is a general rule of thumb, it's important to confirm that a company's product mix has a long-term history of at least a certain amount of inflation. LIFOPro has set this criterion at 1% because auto dealers & supermarkets both have around a 1% long-term average annual inflation rates (auto dealers & supermarkets are likely the two largest users of LIFO)
    - **20 Year Average Inflation Frequency:** Inflation must be measured in at least 11 or more of the past 20 years. In LIFOPro's experience, companies are much more likely to remain on LIFO if their long-term inflation frequency rate is greater than 50%. For example, if inflation is measured in 18 of the past 20 years, it's a reasonable assumption that LIFO could create a tax benefit in 9 out of the next 10 years.
- **LIFO Election Recommendation**
  - **Criteria: The following criteria are used to measure whether a company should elect LIFO for the current year end or not:**
    - **Good LIFO candidate**
    - **Current vs. 20 Year Average Annual Inflation Rate Multiplier:** The election year inflation rate multiplier is calculated by dividing the current year (or year to date) internal and external index inflation rates against the 20 year pro forma external index (IPIC method) average annual inflation rate.
  - **Scoring**
    - **All Good LIFO candidate criteria met:** A LIFO election will only be made if both the 20 year average annual inflation rate was 1% or more and the 20 year average inflation frequency was greater than 50%.
    - **Current vs. 20 Year Average Annual Inflation Rate Multiplier is greater than or equal to 1:** This ensures that the election year inflation rate is as much or more than the 20 year average annual inflation rate & that the benefits of LIFO outweigh the costs in the election year. For example, if the multiplier is 3 in the election year, there will be three years' worth of tax benefits from LIFO when compared to the long-term averages. LIFOPro will recommend deferring adopting LIFO to a later period if the current vs. 20 year inflation rate multiplier is a negative value or less than 1.

Pro Forma LIFO Calculation Results

Sample Company's 20 Year Pro Forma External Index LIFO Calculation Summary (IPIC Method)

Description	Result	Good LIFO Candidate Criteria	Good LIFO Candidate Criteria Met
3 Year Average Annual Inflation Rate	6.5%		
5 Year Average Annual Inflation Rate	4.7%		
10 Year Average Annual Inflation Rate	3.2%		
20 Year Average Annual Inflation Rate	**2.9%**	**≥ 1%**	**Yes**
Inflation Frequency	**95% (19 of 20)**	**> 50%**	**Yes**
All Good LIFO Candidate Criteria Met?	**Yes**		
Estimated 20 Year LIFO Reserve	**$4,134,087**		
20Y Average Federal + State Tax Rate	30%		
Estimated 20 Year Tax Liability Reduction	**$1,240,226**		

Note: For tax purposes, LIFO is applied prospectively beginning in the year of election. Estimated 20 year LIFO reserve and 20 year tax liability reduction amounts are forecasts of the future LIFO tax benefit and are for analysis purposes only.

Sample Company's 2023 Year End LIFO Calculation Estimate & Inflation Measurement Comparison

Description	Internal Indexes	External Indexes (IPIC Method)	Difference: Internal vs. External
2023 Year End Inventory Balance at Cost	$9,356,684	$9,356,684	-
2022 Year End Inventory Balance at Cost	$8,904,459	$8,904,459	-
2023 Year End Inflation Rate	8.3%	4.6%	3.6%
2023 Year End Inventory Balance at LIFO	$8,642,823	$8,945,725	-$302,902
2023 Year End LIFO Expense/Reserve	**$713,861**	**$410,959**	**$302,902**
2023 Year End Federal + State Tax Rate	**30%**	**30%**	
2023 Year End LIFO Tax Liability Reduction	**$214,158**	**$123,288**	**$90,871**
2023 vs. 20Y Average Inflation Multiplier	**2.9**	**1.6**	
Election Recommendation Criteria	**Inflation Multiplier ≥ 1**		
LIFO Election Recommendation Criteria Met?	**Yes**		

- **20 Year Pro Forma IPIC Method Calculations:** Assuming the same current period product mix & inventory balance of $9.4M for all prior periods, Sample Company's pro forma IPIC LIFO calculation resulted in a 20 year average annual inflation rate of 2.9%, inflation being calculated in 19 of 20 years & a cumulative LIFO reserve of $4.1M being created. Using a 30% combined federal & state tax rate, this represents approximately $1.2M of tax liability reduction from LIFO accumulated over a 20 year period. These results reflect a conservative projection of the potential taxable income reduction & tax liability reduction that could occur from using LIFO over the next 20 years.
- **2023 Year End:**
    - **Internal Indexes -** Sample Company's 2023 year end internal index LIFO calculation estimate resulted in a 8% inflation rate that created $710K of LIFO expense. This represents the amount of taxable income reduction created if the LIFO method were elected for the 2023 year end & internal indexes were to be used. Using a 30% combined federal & state tax rate, this represents approximately $210K of tax liability reduction from electing LIFO this year.
    - **External Indexes (IPIC Method) -** Sample Company's 2023 year end IPIC PPI LIFO calculation estimate resulted in a 8% inflation rate that created $410K of LIFO expense. This represents the amount of taxable income reduction created if the LIFO method were elected for the 2023 year end & the IPIC method were to be used. Using a 30% combined federal & state tax rate, this represents approximately $120K of tax liability reduction from electing LIFO this year.

Good LIFO Candidate & LIFO Election Recommendations

Criteria Type	Criteria Description	Criteria Requirement	Result	Criteria Met?
Good LIFO Candidate	20 Year Average Annual Inflation Rate	Greater than or Equal to 1%	2.9%	Yes
Good LIFO Candidate	20 Year Inflation Frequency	> 50% (11 or more of 20 Years)	95% (19 of 20)	Yes
Election Recommendation	2023 vs. 20Y Average Inflation Multiplier	Greater than or Equal to 1	1.6 - 2.9	Yes

	All Good LIFO Candidate Criteria Met?		Yes
	2023 Year End LIFO Election Recommended?		Yes

All criteria have been met for Sample Company to be considered a good LIFO candidate & for a LIFO election to be recommended for the 2023 year end.

LIFO Submethods Recommendations

Description	Recommendation
Index Computation Method	Dollar-value
Inflation Comparison Period Method	Link-chain
LIFO Election Scope	All inventories
Inflation Measurement Source	Internal Indexes
Item Definition Method	Most detailed record-keeping unit (SKU)
LIFO Pooling Method	Natural business unit
Number of LIFO Pools	1
Submethods	
New Item Treatment	Reconstruct using index of similar preexisting items
Reconstruction Approach	Systematic using classes
Price Change Outlier Treatment	TBD
Price Change Outlier Criteria	TBD

20 Year Pro Forma IPIC Inflation, LIFO Expense & LIFO Reserve Summary
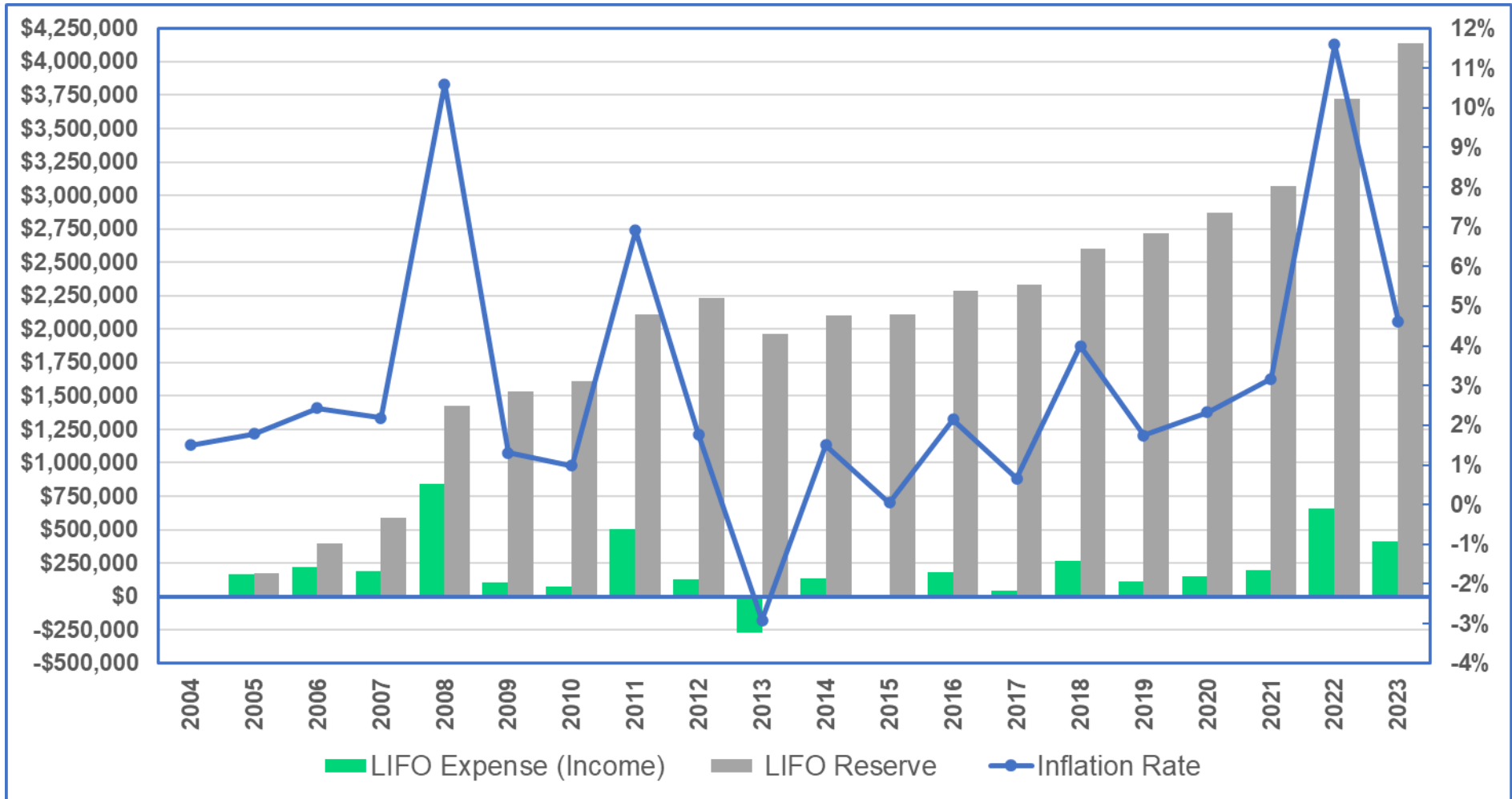
*Note: For tax purposes, LIFO is applied prospectively beginning in the year of election. Estimated 20 year LIFO reserve and 20 year tax liability reduction amounts are forecasts of the future LIFO tax benefit and are for analysis purposes only.

Sample Company's pro forma IPIC calculation created inflation 95% of the time (19 out of 20 years) & a 20 year average annual inflation rate of 2.9%

Inflation Measurement Source – The LIFO calculation was made using the IPIC LIFO method & Bureau of Labor Statistics (BLS) Table 9 Producer Price Indexes (PPI). Under this method, BLS categories are assigned to all inventory items present at year end. LIFO-PRO made the appropriate BLS category assignments to Sample Company's inventories & performed an IPIC LIFO calculation using 12 months PPI inflation for each period shown above.

20 Year Pro Forma IPIC LIFO Taxable Income & Tax Liability Reduction Schedule

Period	Inflation Rate	Taxable Income Reduction (Increase) Current Period	All Periods	Tax Liability Reduction (Increase) 25% Tax Rate Current Period	All Periods	30% Tax Rate Current Period	All Periods	35% Tax Rate Current Period	All Periods
12/31/2004	1.5%	$13,435	$13,435	$3,359	$3,359	$4,031	$4,031	$4,702	$4,702
12/31/2005	1.8%	164,449	177,884	41,112	44,471	49,335	53,365	57,557	62,259
12/31/2006	2.4%	217,564	395,448	54,391	98,862	65,269	118,634	76,147	138,407
12/31/2007	2.2%	192,282	587,730	48,071	146,933	57,685	176,319	67,299	205,706
12/31/2008	10.6%	841,453	1,429,183	210,363	357,296	252,436	428,755	294,509	500,214
12/31/2009	1.3%	102,596	1,531,779	25,649	382,945	30,779	459,534	35,909	536,123
12/31/2010	1.0%	76,216	1,607,995	19,054	401,999	22,865	482,399	26,676	562,798
12/31/2011	6.9%	501,621	2,109,616	125,405	527,404	150,486	632,885	175,567	738,366
12/31/2012	1.8%	126,360	2,235,976	31,590	558,994	37,908	670,793	44,226	782,592
12/31/2013	-2.9%	-272,869	1,963,107	-68,217	490,777	-81,861	588,932	-95,504	687,087
12/31/2014	1.5%	138,449	2,101,556	34,612	525,389	41,535	630,467	48,457	735,545
12/31/2015	0.0%	4,395	2,105,951	1,099	526,488	1,319	631,785	1,538	737,083
12/31/2016	2.1%	179,998	2,285,949	45,000	571,487	53,999	685,785	62,999	800,082
12/31/2017	0.7%	46,022	2,331,971	11,506	582,993	13,807	699,591	16,108	816,190
12/31/2018	4.0%	270,093	2,602,064	67,523	650,516	81,028	780,619	94,533	910,722
12/31/2019	1.7%	115,770	2,717,834	28,943	679,459	34,731	815,350	40,520	951,242
12/31/2020	2.3%	151,126	2,868,960	37,782	717,240	45,338	860,688	52,894	1,004,136
12/31/2021	3.2%	199,687	3,068,647	49,922	767,162	59,906	920,594	69,890	1,074,026
12/31/2022	11.6%	654,481	3,723,128	163,620	930,782	196,344	1,116,938	229,068	1,303,095
12/31/2023	4.6%	$410,959	$4,134,087	$102,740	$1,033,522	$123,288	$1,240,226	$143,836	$1,446,931

2023 amounts shown above are estimates and are not final figures.

Using Sample Company's 2023 product mix & inventory balance of $9.4M for all prior periods, pro forma LIFO calculations were made for each of the past 20 years using external inflation indexes published the Producer Price Index division of the Bureau of Labor Statistics (BLS PPI). These results are a conservative estimate of the potential taxable income reduction & tax liability reduction from LIFO that could occur over the next 20 years by using the current year end inventory balance at cost, product mix & the weighted average BLS PPI inflation rates calculated for the 2004 – 2023 year ends.

Note 1: 20 year projection is for analysis purposes only to illustrate the potential tax liability reduction from LIFO that could occur over the next 20 years. LIFO adoption is treated prospectively, and change is applied beginning in the year of change. Accordingly, only the 2023 year end tax liability reduction from LIFO shown above would be obtained by electing LIFO this year.
Note 2: 2023 year end calculation assumes a base year of 2022, and accordingly, the 2023 LIFO expense is built off the prior year end inventory balance. All other periods shown above use current period's inventory balance to calculate LIFO expense.

Bureau of Labor Statistics Historical Inflation Rates:
Most Predominant Categories Applicable to Product Mix

PPI Code	02550302	02550305	02550301
BLS PPI Category Description **Inflation Measurement Period**	Nonchocolate-type confectionery products	Other confectionery-type products	Chocolate and chocolate-type confectionery products
9 Months Ended Sep. '23 (YTD)	4.6%	4.8%	2.7%
12 Months Ended Sep. '23	6.5%	4.7%	4.0%
12 Months Ended Dec. '22	11.6%	10.1%	8.7%
12 Months Ended Dec. '21	3.2%	2.8%	-3.0%
12 Months Ended Dec. '20	2.3%	-0.6%	-0.9%
12 Months Ended Dec.'19	1.7%	2.7%	3.9%
12 Months Ended Dec.'18	4.0%	0.1%	1.3%
12 Months Ended Dec.'17	0.7%	3.8%	1.0%
12 Months Ended Dec.'16	2.1%	2.7%	1.5%
12 Months Ended Dec.'15	0.0%	7.6%	0.1%
12 Months Ended Dec.'14	1.5%	1.7%	2.6%
12 Months Ended Dec.'13	-2.9%	9.3%	1.3%
12 Months Ended Dec.'12	1.8%	-0.3%	1.5%
12 Months Ended Dec.'11	6.9%	16.3%	6.8%
12 Months Ended Dec.'10	1.0%	-6.5%	1.6%
12 Months Ended Dec.'09	1.3%	-0.3%	0.7%
12 Months Ended Dec.'08	10.6%	1.3%	15.3%
12 Months Ended Dec.'07	2.2%	1.6%	5.7%
12 Months Ended Dec.'06	2.4%	-1.0%	2.1%
12 Months Ended Dec.'05	1.8%	1.8%	3.0%
12 Months Ended Dec.'04	1.5%	6.4%	0.3%
3 Year Annual Average	**6.7%**	**5.9%**	**2.7%**
5 Year Annual Average	**5.1%**	**4.0%**	**2.5%**
10 Year Annual Average	**3.0%**	**3.4%**	**1.8%**
20 Year Annual Average	**2.8%**	**2.5%**	**2.7%**
Years with Inflation: '04 - '23	**19 of 20**	**15 of 20**	**18 of 20**
YTD vs. 20Y Avg. Inflation Multiplier	**1.6**	**1.9**	**1.0**
% of Total Inventory Balance	**60%**	**20%**	**10%**

Source: Bureau of Labor Statistics (BLS) - Table 9 Producer Price Indexes (PPI)

Inflation rates shown above represent the BLS PPI Table 9 categories that correspond to the most predominant items in Sample Company's inventories. Above figures equals less than 100% of total inventory balance because there are multiple BLS categories not shown above that were assigned to Sample Company's product mix. Approximately 15 BLS PPI categories were assigned to Sample Company's product mix.

Appendix A – How LIFO Works

Overview

The Last-in, First-out method, also known as the LIFO method, is one of the four cost flow assumptions allowed by U.S. GAAP & the IRS (FIFO, average cost & specific identification are the three other acceptable methods). LIFO matches current inventory costs against current sales to provide a better measure of earnings. When there's inflation, the effect of using LIFO is that the value of the most recently purchased, higher cost items are included in cost of goods sold while the older, lower cost goods remain in inventory. In other words, LIFO is designed to move some of the inflationary costs from the balance sheet (inventory) to the income statement (cost of goods sold).

Effect of Inflation on the Balance Sheet & Income Statement

On LIFO

↑ Cost of Goods Sold

↓ Ending Inventory
Pre-tax Income
Tax Liability

Not on LIFO

↑ Ending Inventory
Pre-tax Income
Tax Liability

↓ Cost of Goods Sold

Why Use LIFO?

- **Tax Benefits**
  - **LIFO often creates material long-term tax deferral/savings:** Not just a one-time tax benefit or timing difference between book & tax such as straight-line vs. accelerated depreciation.
  - **During periods of rising costs, LIFO:**
    - Provides more after-tax free cash flow than non-LIFO methods
    - Ensures taxes aren't paid on goods that have been purchased, but have yet to be sold
    - Improves ability to replenish & maintain an adequate level of inventory
  - Some consider LIFO to act as a tax deferral tool that can be thought of as an interest-free loan, while others believe LIFO essentially acts as a permanent form of tax savings if a company is profitable, satisfies the going concern assumption & intends to stay on LIFO
  - **Tax Court opinion regarding LIFO (see IRS Tax Court case: Amity Leather vs. Commissioner):**
    - *The theory behind LIFO is that income may be more accurately determined by matching current costs against current revenues, thereby eliminating from earnings any artificial profits resulting from inflationary increases in inventory costs. At the heart of the LIFO method is the principle that income is more clearly reflected by matching current costs with current revenues.*
- **GAAP accounting method**
  - LIFO is an accounting method permissible under GAAP, not just a tax incentive (LIFO was allowed to be used for financial reporting prior to it becoming permissible for tax purposes)
  - During periods of rising costs, income is most clearly reflected by matching current costs with current revenues
  - Provides a more conservative measure of income compared to non-LIFO methods during periods of rising costs
- **Similar in nature to nominal to real GDP adjustment**
  - When there's inflation, portion of ending inventory balance is transferred to COGS to normalize reported income & tax liability
  - Isn't a tax loophole that always provides a benefit since deflation causes LIFO recapture or additional income to be recognized

Common Misconceptions

- **Misconception #1: The following burdens & costs outweigh the benefits of LIFO:**
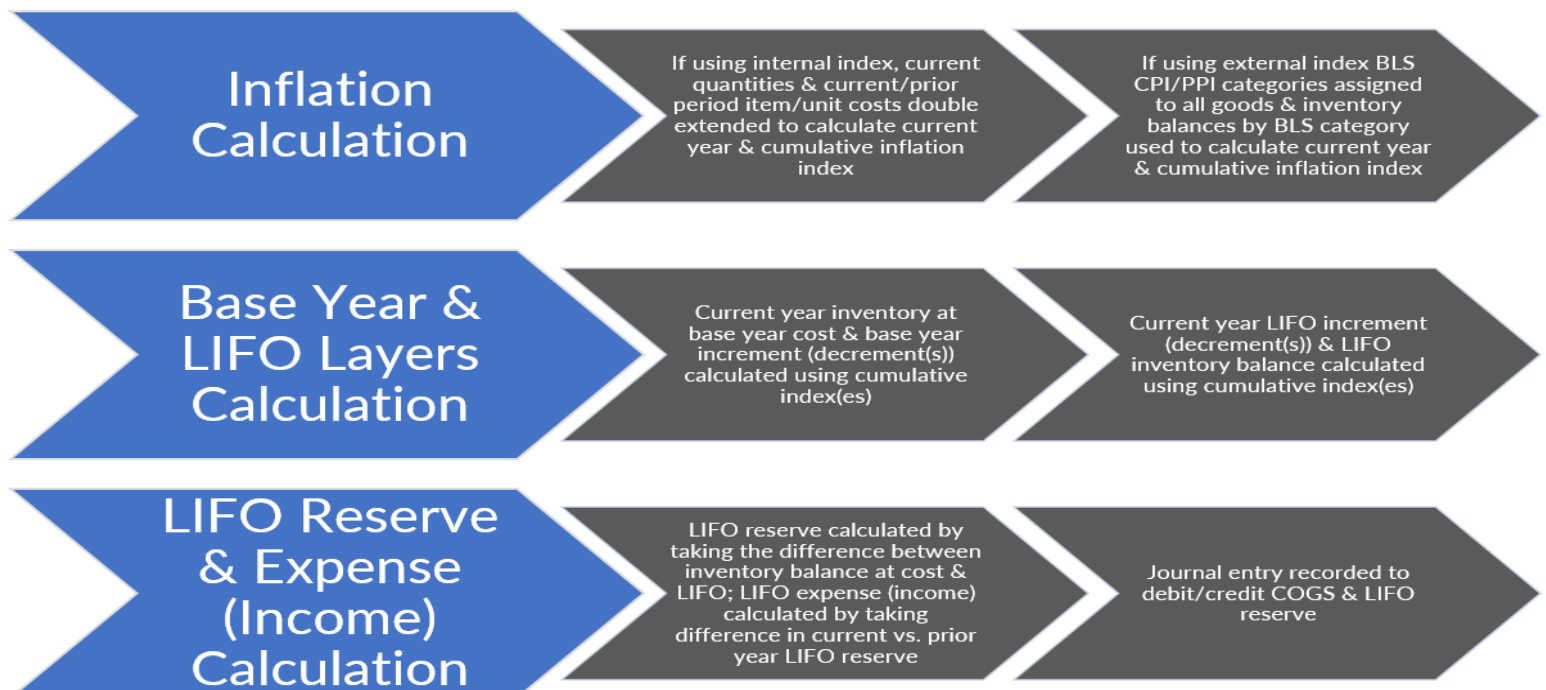 - Management, cost accounting & purchasing/sales functions & responsibilities will be complicated by using LIFO
  - Wholesale changes must be made to accounting system since item costs & the physical flow of goods must be tracked on a LIFO basis
  - **Clarifications**
    - Under the dollar-value method, the LIFO value of inventory is determined outside of the accounting system & a top-side accounting entry is recorded to adjust ending inventory from cost to LIFO & accrue the change in the LIFO reserve
    - Item costs remain being tracked the same way they did prior to electing LIFO & when using dollar-value LIFO & no accounting system changes are required other than adding a LIFO reserve subledger account
- **Misconception #2**
  - Employee compensation & bonuses will be complicated from using LIFO
  - **Clarification:** Internal management reports can be presented on a non-LIFO basis as long as they're only being used internally
- **Misconception #3: Tax savings from LIFO will be minimal because of:**
  - **High inventory turnover or new item rates**
  - **Just in time inventory or lean accounting practices**
  - **Clarifications**
    - Under the dollar-value method, the inflation rate used to calculate the LIFO reserve change is based on a 12 month comparison of current vs. prior year's item/unit costs extended by quantities on hand in ending inventory regardless of the turnover ratio
    - External indexes reconstruct inflation on new items, which ensures the same amount of inflation is applied to new & preexisting items
    - Manufacturers will always have raw materials & WIP; wholesalers/distributors & retailers still must maintain adequate base stock
- **Misconception #4: Internal costs must be used to measure LIFO inflation**
  - **Clarification**: External indexes such as the BLS CPI/PPI can be used to measure inflation, thereby minimizing reliance on accounting information systems (also known as IPIC method)

Dollar-value LIFO Overview

Inflation Calculation	If using internal index, current quantities & current/prior period item/unit costs double extended to calculate current year & cumulative inflation index	If using external index BLS CPI/PPI categories assigned to all goods & inventory balances by BLS category used to calculate current year & cumulative inflation index
Base Year & LIFO Layers Calculation	Current year inventory at base year cost & base year increment (decrement(s)) calculated using cumulative index(es)	Current year LIFO increment (decrement(s)) & LIFO inventory balance calculated using cumulative index(es)
LIFO Reserve & Expense (Income) Calculation	LIFO reserve calculated by taking the difference between inventory balance at cost & LIFO; LIFO expense (income) calculated by taking difference in current vs. prior year LIFO reserve	Journal entry recorded to debit/credit COGS & LIFO reserve

Dollar-value LIFO: Inflation Calculation

Internal Indexes	External Indexes (IPIC Method)
Double extend year end quantities against current & prior period item/unit costs	Assign BLS categories to all items on hand at year end
Account for new item prior year unit cost treatment	Create summary of inventory balances at cost by BLS category
Establish inflation outlier criteria & treatment procedures	Calculate category inflation indexes for each BLS category & calculate harmonic dollars weighted extensions by BLS category
Sum current & prior period extensions and divide the two amounts to calculate current year inflation index	Sum inventory balances at cost & harmonic dollars weighted extensions & divide the two amounts to calculate current year inflation index
Calculate current year cumulative index by multiplying current year inflation index by prior year cumulative index	Calculate current year cumulative index by multiplying current year inflation index by prior year cumulative index

Dollar-value LIFO: Layer Calculations

Base Year Layers

- Calculate current year inventory at base year cost: Current year inventory at cost ÷ Current year cumulative index
- Calculate current year increase (decrease) at base year cost: Current year inventory at base year cost – Prior year inventory at base yar cost
- Determine whether base year increment has been created, or if decrement(s) occurred: Increment created if Current year inventory at base year cost > Prior year inventory at base year cost; decrement(s) occurred if not
- If base year decrement created - Calculate the new inventory at base year costs:
  - If current year decrease at base year cost is less than the most recent period's layer at base year cost: Reduce the most recent base year layer by the amount of the current year decrease at base year cost.
  - If the current year decrease at base year cost is greater than the most recent layer at base year cost: Proceed to reducing remaining base year layers in reverse chronological order until the sum of the prior period(s) base year layer decreases equals the current year base year cost decrease.

LIFO Layers

- If base year increment created - Calculate current period's LIFO layer/increment: Current year base year layer * Current year cumulative index
- If base year decrement(s) created - Calculate the new inventory value at LIFO:
  - If current year decrease at base year cost is less than the most recent period's layer at base year cost:
    - Multiply the most recent base year layer by the most recent base year layer's cumulative index
  - If the current year decrease at base year cost is greater than the most recent layer at base year cost: Proceed to reducing remaining LIFO layers in reverse chronological order by multiplying each preceding base year layer by the cumulative index that was calculated & corresponds with the LIFO layer being eroded until the sum of the prior period(s) base layer decreases equals the current year base year cost decrease.
- Calculate LIFO inventory balance by taking the sum of all LIFO layers

Dollar-value LIFO: LIFO Reserve/Expense (Income) Calculations

- **LIFO Reserve:** Equals the difference between inventory at cost (FIFO or average cost) & inventory at LIFO
- **LIFO Expense (Income):**
    - Equals the current vs. prior year LIFO reserve change
    - Increase in current vs. prior year LIFO reserve change = LIFO expense (reduction to income & increase to COGS)
    - Decrease in current vs. prior year LIFO reserve change = LIFO income (increase to income & decrease to COGS)
- **LIFO Reserve Change Components**
    - LIFO reserve change will consist of 1 or both of the following two components:
        - **Inflation effect LIFO expense (income):** Current year inflation rate * prior year inventory balance at cost
        - **Layer erosion effect LIFO income:** Current year decrease at base year costs * (Current year cumulative index – the average cumulative index of the layers eroded)
    - In most cases, the layer erosion effect LIFO income will create LIFO recapture, but if there was deflation in the prior year & also in the current year, layer erosions can create LIFO expense (LIFO reserve increase)
    - Determining factor on whether one or both of the above will components will be used is dependent on whether an increment or decrement was created. If an increment was created, the LIFO reserve change will only consist of the inflation effect LIFO expense (income). If decrement(s) created, the LIFO reserve change will be the sum of the inflation effect LIFO expense (income) & layer erosion LIFO income. In other words, the layer erosion LIFO income only occurs when a decrement was created.
    - You can project in advance if there will be an increment or decrement for the upcoming year end by taking the product of the current year's expected inflation rate & last year's inventory balance at cost (LIFOPro calls this amount the "zero layer erosion Current Year Cost") and comparing that amount to the projected year end inventory balance at cost. If the projected year end inventory balance at cost is higher than the zero layer erosion Current Year Cost, there will be an increment, but if it's lower, there will be a decrement.
    - In the absence of a complete LIFO calculation becoming available, an easy way to perform a quick LIFO estimate or apply reasonableness testing to the results of your LIFO calculation would be to use the inflation effect LIFO expense (income) formula listed above

Contrasting Dollar-value LIFO vs. Tracking Item Costs & the Physical Flow of Goods

- Under the specific goods or unit LIFO submethodology, the value of ending inventory is determined by tracking item costs & the physical flow of goods on a LIFO basis.
- Although taxpayers are allowed to use unit LIFO, the vast majority of businesses use what's called dollar-value LIFO because it avoids all the undesirable characteristics of unit LIFO.
- Under dollar-value LIFO, the method used to determine the value of ending inventory is completely decoupled & independent from the method used to track item costs & the physical flow of goods. In other words, item costs & the physical flow of goods are tracked & valued within your accounting system under the same cost flow method used prior to going on LIFO when dollar-value is used.
- For example, a company who used FIFO prior to adopting dollar-value LIFO would continue tracking item costs using FIFO after switching to LIFO. The same can be said for companies using average cost, weighted average cost or standard cost & subsequently adopt dollar-value LIFO.
- This is because under dollar value LIFO, a side calculation is made at the end of the year to adjust the value of ending inventory from cost to LIFO. After this side calculation is made, a journal entry is recorded to adjust the cost of goods sold & LIFO reserve balances. Under dollar value LIFO, the only change that's made to your accounting system after adopting LIFO is to add a contra-inventory subledger account called the LIFO reserve. This balance sheet account represents the difference between the value of inventory at cost & inventory at LIFO. It's the vehicle for reducing the ending inventory balance, increasing cost of goods sold, reducing pre-tax income & generating tax liability reduction from LIFO.
- Under dollar-value LIFO, the LIFO reserve balance is never allocated at the item level, and no changes are required in terms of how item costs are valued or how the physical flow of goods are tracked.

Accounting for LIFO & Recording LIFO Adjustments

For dollar-value LIFO method users, a company will continue tracking inventory costs within their accounting database using the same method that was used prior to adopting LIFO. This means that beginning inventory, purchases, sales & cost of goods sold recorded during the reporting period continues to be valued any of the available non-LIFO methods (i.e. FIFO, average cost, earliest acquisitions etc.). Illustration 2 below provides an example of common inventory activity occurring during the course of a reporting period using FIFO or average cost:

Illustration 1. Accounting for Inventory Activity Under LIFO – Year 1 on LIFO

Year 1 on LIFO Activity: 2021 Year End						
	Using FIFO			**Using Average Cost**		
Description	**Units on Hand**	**Unit Cost**	**Balance**	**Units on Hand**	**Unit Cost**	**Balance**
Beginning Inventory at Cost	5,000,000 units	$5.50/unit	$27,500,000	5,000,000 units	$5.00/unit	$25,000,000
	Account Name	**Dr.**	**Cr.**	**Account Name**	**Dr.**	**Cr.**
Purchase 8,000,000 units at $6/unit	Inventory	48,000,000		Inventory	48,000,000	
	Accounts payable		48,000,000	Accounts payable		48,000,000
Sell 7,000,000 units at $12/unit	Accounts receivable	84,000,000		Accounts receivable	84,000,000	
	Cost of goods sold	39,500,000		Cost of goods sold	39,307,692	
	Sales		84,000,000	Sales		84,000,000
	Inventory		39,500,000	Inventory		39,307,692
	Units on Hand	**Unit Cost**	**Balance**	**Units on Hand**	**Unit Cost**	**Balance**
Ending Inventory at Cost	6,000,000 units	$6.00/unit	$36,000,000	6,000,000 units	$5.62/unit	$33,692,308

Year 1 Balances Before LIFO Calculation: 2021 Year End	
FIFO	**Average Cost**
Inventory	**Inventory**
27,500,000	25,000,000
48,000,000	48,000,000
39,500,000	39,307,692
36,000,000	33,692,308
Cost of Goods Sold	**Cost of Goods Sold**
-	-
39,500,000	39,307,692
39,500,000	39,307,692

The LIFO reserve contra account is shown with a zero balance because this example assumes that the company will be adopting LIFO for the 2021 year end. The main consideration is to realize that companies on LIFO continue using some non-LIFO method such as FIFO or average cost to account for current period inventory activity. Once the period has been closed and all inventory related activity has been posted, the side calculation to compute the required LIFO values can now be made. Once the current year index is computed, the ending inventory balance at cost (i.e., FIFO, average cost etc.) is used along with the current period inflation index to compute the current period LIFO inventory, LIFO expense & reserve values. Using the same inventory data from Illustration 1, an example is shown below of the period end side calculation made to compute the LIFO inventory, expense & reserve balances as well as the general ledger adjusting journal entry required to account for the difference between

inventory at cost & LIFO (LIFO expense is the difference in cost of goods sold between LIFO vs. cost & is the difference between the current & prior period's LIFO reserve):

Illustration 2. LIFO Calculation & General Ledger Adjusting Journal Entry Year 1 on LIFO

Year 1 LIFO Calculation Summary: 2021 Year End		
Description	FIFO	Average Cost
Current Period Inventory Balance at Cost	$36,000,000	$33,692,308
Prior Period Inventory Balance at Cost	27,500,000	25,000,000
Current Period Inflation Index	1.091	1.123
Current Period LIFO Inventory Balance	33,525,000	30,692,308
Current Period LIFO Expense/Reserve	2,475,000	3,000,000

Note: Above figures portray a simplified version of a LIFO calculation & does not show the detailed math required to calculate current period inflation index, LIFO inventory & LIFO reserve/expense balances.

Year 1 Post LIFO Calculation Journal Entry: 2021 Year End						
Description	Using FIFO			Using Average Cost		
	Account Name	Dr.	Cr.	Account Name	Dr.	Cr.
Adjust ending inventory balance from FIFO or average cost to LIFO	Cost of Goods Sold	2,475,000		Cost of Goods Sold	3,000,000	
	LIFO Reserve		2,475,000	LIFO Reserve		3,000,000

As shown in the calculation summary above, the LIFO inventory balance is between $2 - $3 million less than the current period end inventory balance at cost. This difference represents the LIFO expense (current – prior period LIFO reserve) & LIFO reserve balances (inventory at cost – LIFO inventory). It also represents how LIFO transfers inflationary inventory costs from the balance sheet (inventory) to the income statement (cost of goods sold). The debits and credits in the journal entry shown above represent increases to both cost of goods sold and the LIFO reserve contra inventory account. Since the LIFO reserve account is a contra inventory account, ending inventory gross of LIFO reserve represents inventory at cost & while ending inventory net of LIFO reserve represents inventory at LIFO. The cost of goods sold account is essentially the vehicle that allows LIFO taxpayers to reduce their taxable income. Using the data from the illustrations above, the example below shows the 2021 year end balances after the LIFO general ledger adjusting journal entry has been made:

Illustration 3. Post LIFO Calculation Inventory Balances Year 1 on LIFO

Year 1 Balances After LIFO Calculation: 2021 Year End					
FIFO			Average Cost		
Inventory			Inventory		
27,500,000			25,000,000		
48,000,000			48,000,000		
		39,500,000			39,307,692
@ FIFO	36,000,000		@ Average Cost	33,692,308	
Less: LIFO Reserve		2,475,000	Less: LIFO Reserve		3,000,000
@ LIFO	33,525,000		@ LIFO	30,692,308	

Cost of Goods Sold		Cost of Goods Sold	
39,500,000		39,307,692	
2,475,000		3,000,000	
41,975,000		42,307,692	

LIFO Reserve		LIFO Reserve	
	-		-
	2,475,000		3,000,000
	2,475,000		3,000,000

As shown above in Illustration 3, the cost of goods sold account is now $2 - $3 million higher after the LIFO calculation. Aside from any other adjusting entries required after the LIFO calculation, this will be the amount used for financial reporting and tax purposes. Although the cost of goods sold account balance will be closed out after recording the closing entries, the LIFO reserve contra inventory account is a permanent account that will be carried forward into the next reporting period.

How LIFO Reduces Taxable Income & Tax Liability

As illustrated above, the cost of goods sold account was increased, which represents the mechanism for companies on LIFO to reduce their taxable income & tax liability, which results in tax liability reduction. Using the 2021 year end (year 1) data from the illustrations above, the example below shows the tax liability reduction from LIFO.

Illustration 4. Tax Liability Reduction Created from Year 1 on LIFO

Year 1 LIFO Tax Benefits: 2021 Year End		
Description	FIFO	Average Cost
Gross Receipts	$ 84,000,000	$ 84,000,000
Cost of Goods Sold Before LIFO Calculation	(39,500,000)	(39,307,692)
Current Period LIFO Expense	(2,475,000)	(3,000,000)
Cost of Goods Sold After LIFO Calculation	(41,975,000)	(42,307,692)
Gross Income Before LIFO Calculation	44,500,000	44,692,308
Gross Income After LIFO Calculation	42,025,000	41,692,308
Deductions & Expenses	(20,000,000)	(20,000,000)
Taxable Income Before LIFO Calculation	24,500,000	24,692,308
Taxable Income After LIFO Calculation	22,025,000	21,692,308
Inc. Tax Liability Before LIFO Calc: 40% Rate	9,800,000	9,876,923
Inc. Tax Liability After LIFO Calc: 40% Rate	8,810,000	8,676,923
Year 1 LIFO After-Tax Cash Benefit	$ 990,000	$ 1,200,000

Accounting for LIFO in Periods Subsequent to Adoption

Once elected, a LIFO calculation must be made annually at year end. This allows for LIFO to be a taxable income reduction tool that accrues benefits in perpetuity & not just a one-time deduction. Using the data from the illustrations above, the examples shown below illustrate how inventory costs will be tracked when going from the first to the second reporting period on LIFO:

Illustration 5. Accounting for Inventory Activity Under LIFO – Year 2 on LIFO

Year 2 on LIFO Activity: 2022 Year End						
Description	Using FIFO			Using Average Cost		
	Units on Hand	Unit Cost	Balance	Units on Hand	Unit Cost	Balance
Beginning Inventory	6,000,000 units	$6.00/unit	$36,000,000	6,000,000 units	$5.62/unit	$33,692,308
	Account Name	Dr.	Cr.	Account Name	Dr.	Cr.
Purchase 7,000,000 units at $7/unit	Inventory	49,000,000		Inventory	49,000,000	
	Accounts payable		49,000,000	Accounts payable		49,000,000
Sell 8,000,000 units @13/unit	Accounts receivable	104,000,000		Accounts receivable	104,000,000	
	Cost of goods sold	50,000,000		Cost of goods sold	50,887,574	
	Sales		104,000,000	Sales		104,000,000
	Inventory		50,000,000	Inventory		50,887,574
	Units on Hand	Unit Cost	Balance	Units on Hand	Unit Cost	Balance
Ending Inventory	5,000,000 units	$7.00/unit	$35,000,000	5,000,000 units	$6.36/unit	$31,804,734

Year 2 Balances Before LIFO Calculation: 2022 Year End

FIFO				Average Cost	
Inventory				**Inventory**	
36,000,000				33,692,308	
49,000,000				49,000,000	
	50,000,000				50,887,574
@ FIFO Cost 35,000,000			@ FIFO Cost	31,804,734	
Less: LIFO Reserve	2,475,000		Less: LIFO Reserve		3,000,000
@ LIFO Cost 32,525,000			@ LIFO Cost	28,804,734	

Cost of Goods Sold			Cost of Goods Sold	
-			-	
50,000,000			50,887,574	
50,000,000			50,887,574	

LIFO Reserve			LIFO Reserve	
	2,475,000			3,000,000
	2,475,000			3,000,000

As shown above, beginning inventory, purchases, sales & cost of goods sold continue being valued at cost throughout the course of the second period on LIFO (will remain the case for all subsequent periods on LIFO). As explained earlier, the LIFO reserve contra inventory account remains in place because the beginning inventory balance net of LIFO reserve represents inventory at LIFO cost. The example below illustrates the year 2 LIFO calculation results along with the adjusting journal entries and post-LIFO calculation general ledger inventory balances:

Illustration 6. LIFO Calculation, General Ledger Adjusting Journal Entry & Account Balances – Year 2

Year 2 LIFO Calculation Summary: 2022 Year End

Description	FIFO	Average Cost
Current Period End Inventory Balance	$35,000,000	$31,804,734
Prior Period End Inventory Balance	36,000,000	33,692,308
Current Period Inflation Index	1.167	1.132
Current Period LIFO Inventory Balance	27,444,522	25,145,782
Prior Period LIFO Inventory Balance	33,525,000	30,692,308
Current Period LIFO Reserve	7,555,478	6,658,952
Prior Period LIFO Reserve	2,475,000	3,000,000
Current Period LIFO Expense	$ 5,080,478	$ 3,658,952

Note: Above figures portray a simplified version of a LIFO calculation & does not show the detailed math required to calculate current period inflation index, LIFO inventory & LIFO reserve/expense balances.

Year 2 Post LIFO Calculation Journal Entry: 2022 Year End

Description	Using FIFO			Using Average Cost		
	Account Name	Dr.	Cr.	Account Name	Dr.	Cr.
Adjust ending inventory balance	Cost of Goods Sold	2,475,000		Cost of Goods Sold	3,000,000	
from FIFO or average cost to LIFO	LIFO Reserve		2,475,000	LIFO Reserve		3,000,000

As shown above, the current period LIFO calculation resulted in 17% & 13% inflation for each of the two calculations that resulted in approximately $5 million & $3.7 million of LIFO expense (increase to cost of goods sold). Although the LIFO inventory balance is the difference between ending inventory gross and net of the current period LIFO reserve, the LIFO expense is the difference between the current & prior period LIFO reserve and represents the current period increase to cost of goods sold. Using the data from the illustrations above, the example below shows the 2023 year end balances after the LIFO general ledger adjusting journal entry has been made:

Illustration 7. Post LIFO Calculation Inventory Balances - Year 2 on LIFO

Year 2 Balances After LIFO Calculation: 2022 Year End				
FIFO			**Average Cost**	
Inventory			**Inventory**	
36,000,000			33,692,308	
49,000,000			49,000,000	
	50,000,000			50,887,574
@ FIFO Cost 35,000,000		@ FIFO Cost	31,804,734	
Less: LIFO Reserve	7,555,478	Less: LIFO Reserve		6,658,952
@ LIFO Cost 27,444,522		@ LIFO Cost	25,145,782	

Cost of Goods Sold		Cost of Goods Sold	
50,000,000		50,887,574	
5,080,478		3,658,952	
55,080,478		54,546,526	

LIFO Reserve			LIFO Reserve		
	2,475,000	Beginning Balance		3,000,000	Beginning Balance
	5,080,478	Y2 LIFO Expense		3,658,952	Y2 LIFO Expense
	7,555,478	Ending Balance		6,658,952	Ending Balance

LIFO Election Requirements & Disclaimers

- **Election Requirements**
  - **LIFO Conformity Rule:** Must value inventory using LIFO on financial statements beginning with the same period LIFO is elected & reported on the tax return (although financial statements must show inventory & income reported under LIFO, disclosures can be made in notes to financial statements to present amounts such as ending inventory and income using non-LIFO method for comparative purposes)
  - Election scope or the goods to be valued under LIFO for tax purposes cannot be greater than inventories valued under LIFO for financial reporting (can have more goods on LIFO for book than for tax, but not vice versa)
  - **Must take Non-LIFO reserves into income over 4-year period beginning with year of election, such as:**
    - Lower of cost or market reserve
    - Slow-moving/obsolete reserve
    - Arbitrary write-downs other than shrink
- **Disclaimers**
  - **Portions or all of LIFO reserve may be taken back into income if the following occurs:**
    - Portion of LIFO reserve may be taken back into income in periods where one or both of the following occurs (also known as LIFO recapture):
      - Deflation
      - Material inventory liquidations (for example, a 50% decrease in the current vs. prior year's ending inventory balance at cost)
  - **All of LIFO reserve will be taken back into income when either of the following occurs:**
    - C to S Corp conversions
    - Business asset sales
  - **Terminating LIFO:**
    - Must pay $12K IRS User's fee & complete change prior to year end if terminating LIFO election less than five years before original year of adoption (automatic approval to terminate LIFO election after you've been on LIFO for five years, and no IRS User's fee is required)
    - LIFO reserve must be ratably recaptured into income over a 4 year period starting in termination year

LIFO Financial Reporting Disclosure Requirements & Alternatives

- **LIFO Disclosures**
    - Face of the annual or year end income statement must present income, profit or loss using the LIFO method beginning no later than the year that LIFO is adopted for tax purposes
    - Once LIFO has been elected for tax purposes, income, profit or loss must be computed using LIFO on the face of all subsequent annual financial statements (unless LIFO is terminated for tax purposes)
- **Non-LIFO Disclosures**
    - The following non-LIFO disclosures and information are allowed while also maintaining LIFO conformity compliance (see IRS Regs. §1.472-2(e)):
        - Supplemental and explanatory information using a non-LIFO method - Includes anything other than the primary presentation of the income statement, which includes the following:
            - Notes to the income statement
            - Appendices & supplements to the income statement
        - Other reports included in the financial reports, such as:
            - Management's discussion and analysis
            - Statement of changes in financial position
            - Letters to shareholders, partners or other stakeholders
            - Summary of key figures
        - Inventory asset value disclosures
- **Internal Management & Interim Reports**
    - **Internal Management Reports -** The use of a non-LIFO method is allowed on all portions of internal management reports as long as the reports will not be issued or released to parties outside of the organization. Examples include earnings projections, budgets, and sales forecasts.
    - **Interim reports –** If issued in accordance with GAAP, same LIFO disclosure rules described above apply. If not issued in accordance with GAAP, then interim reports are not required to be presented on a LIFO basis (exception is a series of interim reports that can be used to ascertain income, profit & loss by combining those reports)

Interim LIFO Estimate Best Practices

- Companies perform interim LIFO estimates for a wide array of reasons, including:
    - **Financial reporting compliance -** Under Generally Accepted Accounting Principles, an estimate for the interim cost of sales is required for interim reporting purposes. Because of this, companies issuing GAAP financial statements include an estimated LIFO adjustment in their interim reports. Also, some companies are required by their lenders or suppliers to issue interim financial reports, and as a result, companies may also be required to include an estimated LIFO adjustment in their interim estimates.
    - **Tax compliance –** Although tax law defines LIFO as an annual calculation, many companies perform interim estimates in order to incorporate the LIFO effect into their quarterly estimated tax payments
    - **Forecasting and planning –** Many companies perform at least one interim LIFO estimate in order to properly forecast and plan the estimated LIFO effect on their bottom line. An added benefit of doing so is to smooth out the effect of the estimated LIFO reserve change over the course of the year as opposed to booking a single LIFO adjustment at year end. An added benefit of forecasting & planning is that one can avoid material or unexpected surprises from LIFO at year end.
    - **Maximize the LIFO reserve increase (or minimize the decrease) -** When there's inflation, a minimum "Current-year cost" balance is required to avoid what is known as layer erosion effect LIFO income (Current-year cost can be thought of as inventory at cost i.e., FIFO or average cost). If the Current-year cost balance is below the minimum required amount, layer erosion effect LIFO income can erode or completely wipe out the LIFO expense created by inflation for that period (or in some cases, a net LIFO reserve decrease can occur from substantial layer erosion income). Because of this, some companies will plan their year end purchases to achieve the most desirable LIFO results to minimize the effects of layer-erosion LIFO income.
- Companies that don't issue interim financial reports are not required to perform interim LIFO estimates
- Companies that issue non-GAAP interim reports are also not required to perform interim LIFO estimates
- **LIFOPro offers solutions to make quickly obtain accurate interim LIFO estimates**
- **Up to 3 interim estimates are included in LIFOPro's outsourcing engagements for companies using the IPIC method**

LIFO Method Alternatives & Best Practices

- **LIFO Index Computation Method:**
  - **Dollar value method** – Under this method, the LIFO value is accounted for as a top-side adjustment rather than at the item level. Unit costs & the physical flow of goods are tracked the same way they were prior to electing LIFO. Side computation made outside of accounting system to calculate inflation, layers (decrements), inventory @ LIFO, LIFO reserve & LIFO expense (income).
  - **Specific Goods Method (Unit LIFO)** – LIFO value of inventory is accounted for at the item level. Unit costs & the physical flow of goods are tracked on a LIFO basis within accounting system
  - **Best practice:** Use dollar-value LIFO because it avoids many undesirable characteristics of LIFO & offers materially higher long-term tax benefits when compared to unit LIFO
- **Inflation Comparison Period:**
  - **Link-Chain Method-** Compare current year-end prices to prior year-end prices
  - **Double-Extension Method-** Compare current year-end prices to base-year prices
  - **Best practice:** Use Link-chain LIFO because it's absent of the inherent flaws built into double-extension method & link-chain precludes the need to reconstruct base year costs for new items
- **LIFO Election Scope:** can be selective (by stage of production, product groups, departments, business segment, parent on LIFO but subsidiary is not, etc.) with these exceptions:
  - Manufacturers using Natural Business Unit Pools (NBU)
  - If IRS Technical Advice Memorandum would prevent selective elections within IPIC pooling method
  - **Best practice:** Include all inventories in LIFO election because the LIFO reserve grows proportionately to the value of the inventory on LIFO (more inventory on LIFO = higher LIFO reserve)
- **Current Year Cost & Layer Valuation Method:**
  - Latest acquisitions (FIFO)
  - Earliest acquisitions (EAC)
  - 12-month moving average or rolling-average (i.e. weighted-average or average cost)
  - Specific identification
  - Retail inventory method (RIM; for retailers only)
  - **Best practice:** Use the same method employed by accounting system to track item costs prior to electing LIFO to prevent wholesale changes to accounting system or IT burden associated with tracking multiple methods
- **Inflation Measurement Source:**
  - **Internal indexes**
    - **New item treatment**
      - Set new item prior year unit cost equal to current year unit cost (results in no inflation)
      - **Reconstruct new item cost using one of the following methods:**
        - Using inflation of similar preexisting or non-new items (product hierarchy is recommended to be present using this approach as it allows for systematic approach to reconstruction to occur. Examples of product hierarchies include categories, classes, groups, types, lines, departments etc.)
        - Judgmental (requires itemized approach to reconstruction)
      - **Best practice:** Reconstructing new item costs as this will yield the most favorable tax benefit when there's inflation
    - **Price Change outlier treatment**
      - Include outliers in inflation calculation
      - Manually review outliers & exclude as needed (or investigate outliers & correct accordingly)
      - Establish outlier criteria & apply one of the following approaches to items exceeding criteria:
        - Exclude outliers from inflation calculation
        - Reconstruct prior year item cost using the inflation of similar preexisting non-outliers
      - **Best practice:** Recommended to at least review outliers, but considerations such as materiality and administrative burden should be made to best fit the needs of each company
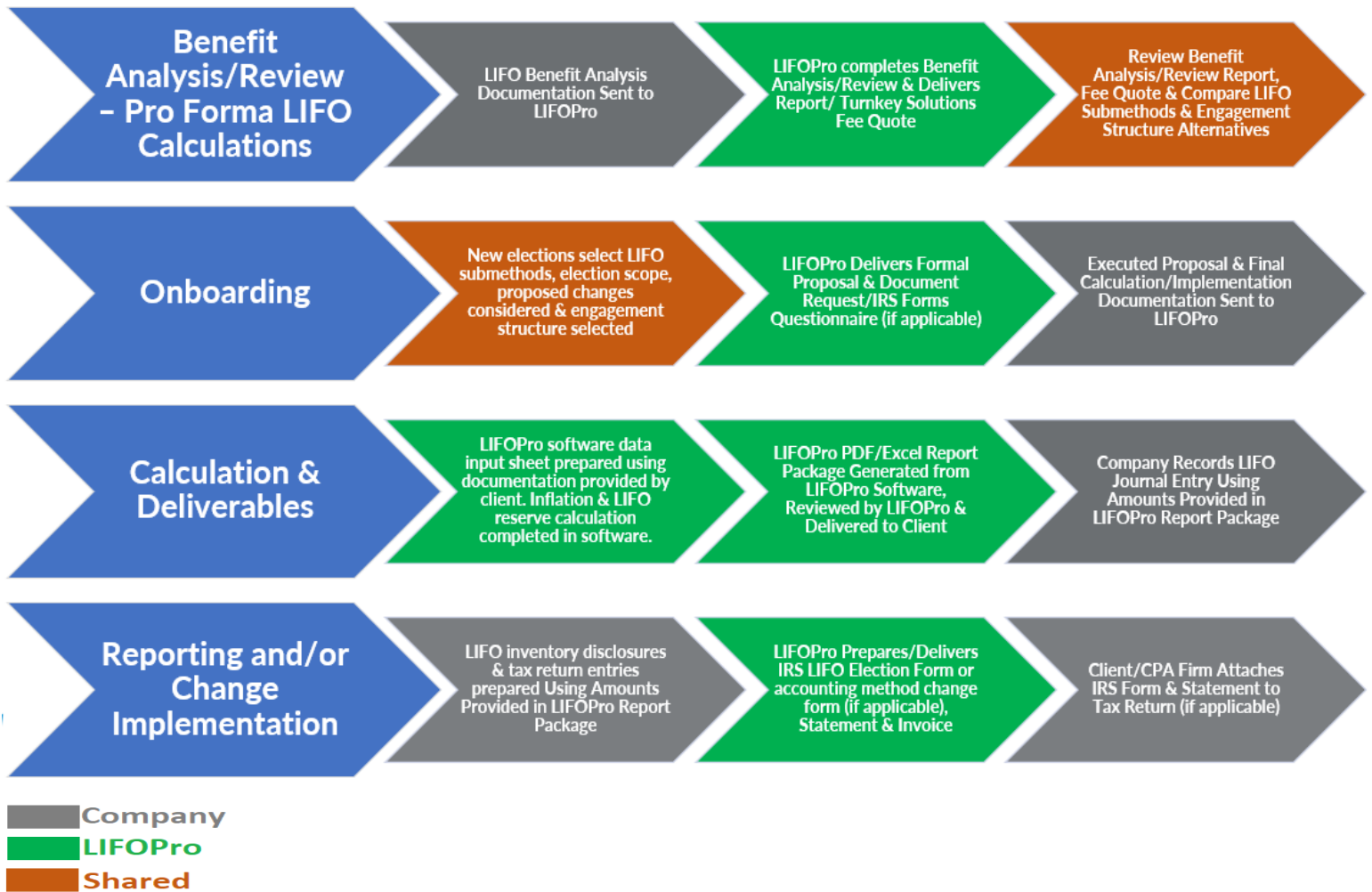
- **Inflation measurement sources, continued**
  - **External indexes - IPIC method:**
    - **BLS Index Selection:**
      - Consumer Price Indexes (CPI)
      - Producer Price Indexes (PPI)
    - **Index timeframe selection:**
      - Final Indexes
      - Preliminary Indexes
    - **Weighted-Average pool index calculation method:**
      - 10% method
      - Non 10% method (aka Most detailed category method)
  - **Best practice:** Common to use the method that'll provide the most favorable tax position (inflation), but ultimately varies by industry, product mix & many other company-specific considerations
- **LIFO Pooling Method:**
  - **Resellers (retailers & wholesalers)-** By line, type or class of goods
  - **Manufacturers:**
    - Natural Business Unit pools (separate pool required for parts purchased for resale)
    - Raw materials content pools
    - Multiple pools
  - IPIC pooling method using Consumer/Producer Price Index major groups (for IPIC method taxpayers)
  - **Best practice:** Utilize the method expected to create/require the least amount of LIFO pools to minimize likelihood of LIFO recapture caused by inventory liquidations
- **Item Definition Method:**
  - **Internal index**
    - Most detailed record or available in accounting system (such as stock-keeping unit or SKU)
    - Fungible commodities measured in gallons, pounds, board feet, etc.
  - **External index:** BLS categories applicable to goods included in election scope

Other Considerations

- **Using different book & tax LIFO methods**
  - Companies sometimes have differences in the financial reporting vs. tax value of inventories. Examples include:
    - **Different book vs. tax base year that occurs as the result of a transaction or event that necessitated a change for financial reporting purposes, but not tax and vice-versa. Examples include:**
      - C to S Corp conversion requires LIFO recapture for tax purposes, but not for financial reporting purposes
      - Merger or acquisition that required fresh start accounting to occur for book LIFO purposes, but was a non-event for tax purposes
    - **Differences in book vs. tax LIFO methods used**
  - Having a different book & tax LIFO basis requires separate book & tax LIFO calculations to be made
  - In most cases, companies will use uniform book & tax LIFO methods for consistency & to minimize the administrative burden
  - In certain cases, it's desirable to optionally select different book and tax LIFO methods from the onset to create the lowest book LIFO reserve & largest tax LIFO reserve. Such an approach is usually the result of the need to minimize the LIFO effect on earnings (which can be desirable when lender covenants are required to be met).
  - The most common approach for achieving the goal of minimizing the book LIFO reserve & maximizing the tax LIFO reserve is to use an internal index for book purposes & external index for tax purposes
  - LIFOPro can support performing separate book & tax LIFO calculations as needed (additional fees apply)
- **Electing LIFO during a period of deflation to create a favorable book vs. tax LIFO reserve difference**
  - In most cases, companies will wait until there will be a tax benefit to elect LIFO (LIFOPro recommends doing so)
  - For companies seeking to minimize book LIFO reserve & tax LIFO reserve, a strategy could be employed to accomplish a favorable book vs. tax LIFO difference by electing LIFO for financial reporting purposes only during a period of deflation and subsequently elect LIFO for tax purposes once it's favorable from a tax perspective to do so (LIFO can be used for financial reporting purposes prior to being used for tax purposes, but not vice versa)

LIFO Implementation & Turnkey Solutions Process Flow: First Year

Benefit Analysis/Review – Pro Forma LIFO Calculations
- LIFO Benefit Analysis Documentation Sent to LIFOPro
- LIFOPro completes Benefit Analysis/Review & Delivers Report/ Turnkey Solutions Fee Quote
- Review Benefit Analysis/Review Report, Fee Quote & Compare LIFO Submethods & Engagement Structure Alternatives

Onboarding
- New elections select LIFO submethods, election scope, proposed changes considered & engagement structure selected
- LIFOPro Delivers Formal Proposal & Document Request/IRS Forms Questionnaire (if applicable)
- Executed Proposal & Final Calculation/Implementation Documentation Sent to LIFOPro

Calculation & Deliverables
- LIFOPro software data input sheet prepared using documentation provided by client. Inflation & LIFO reserve calculation completed in software.
- LIFOPro PDF/Excel Report Package Generated from LIFOPro Software, Reviewed by LIFOPro & Delivered to Client
- Company Records LIFO Journal Entry Using Amounts Provided in LIFOPro Report Package

Reporting and/or Change Implementation
- LIFO inventory disclosures & tax return entries prepared Using Amounts Provided in LIFOPro Report Package
- LIFOPro Prepares/Delivers IRS LIFO Election Form or accounting method change form (if applicable), Statement & Invoice
- Client/CPA Firm Attaches IRS Form & Statement to Tax Return (if applicable)

Legend:
- **Company** (Gray)
- **LIFOPro** (Green)
- **Shared** (Orange)

Turnkey Outsourcing Solutions Process Flow Chart: Recurring

Interim (Optional)
- For external index (IPIC method) users, up to three interim estimates provided at no cost using prior year end product mix & year to date BLS index inflation
- For internal index users, interim estimates provided upon request of client.
- LIFO calculation service reminder sent 30- 60 days prior to client's year end containing year end calculation documentation requirement list

Legend:
- **Client** (Gray)
- **LIFOPro** (Green)

Year End
- Client sends item detail report and trial balance, balance sheet or inventory schedule showing all GL subledger inventory accounts to LIFOPro
- LIFOPro assigns BLS categories (if applicable), prepares software data input sheet template, calculation completed, reviewed, LIFOPro report package emailed to client
- Client records year end LIFO journal entry using amounts shown in LIFOPro PDF report package