

2023 Top LIFO Opportunities & Strategies Guide

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LIFOPro
Software & Turnkey Outsourcing Solutions



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About Us

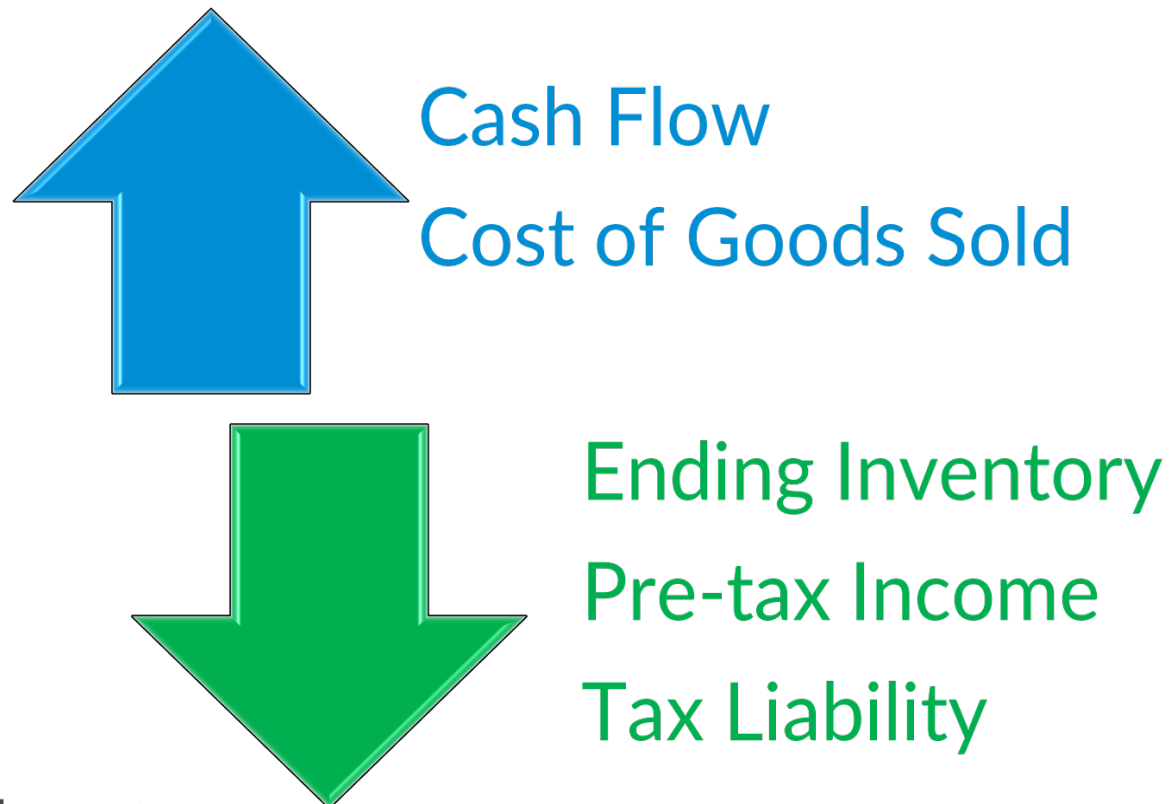
- Leading LIFO subject matter experts, 3rd party service provider & software vendor
- **Provide a complete range of LIFO offerings, including:**
 - **Turnkey outsourcing solutions**
 - Companies directly engage with LIFOPro to serve as their 3rd party LIFO service provider & subject matter expert
 - CPA firms refer their clients to LIFOPro or directly engage with LIFOPro to outsource their client's LIFO calculation at wholesale rate & resell them at retail fee levels to clients
 - CPA firms rely on LIFOPro to offer complimentary, comprehensive resources & training to ensure all their clients LIFO needs are fulfilled
 - **Software**
 - Works for all dollar-value LIFO calculations other than alternative LIFO method inflation calculations for auto dealers
 - Completely automates inflation calculation, LIFO reserve calculation & documentation
 - Licensed directly to both companies & CPA firms
- Have clients of all sizes & industries with inventory balances as low as \$500K & high as \$20B
- **Partner with CPA firms to provide a range of LIFO solutions**
- **Notable clients include:**
 - Walmart
 - Kroger
 - Target
 - Kimberly Clark
 - General Mills



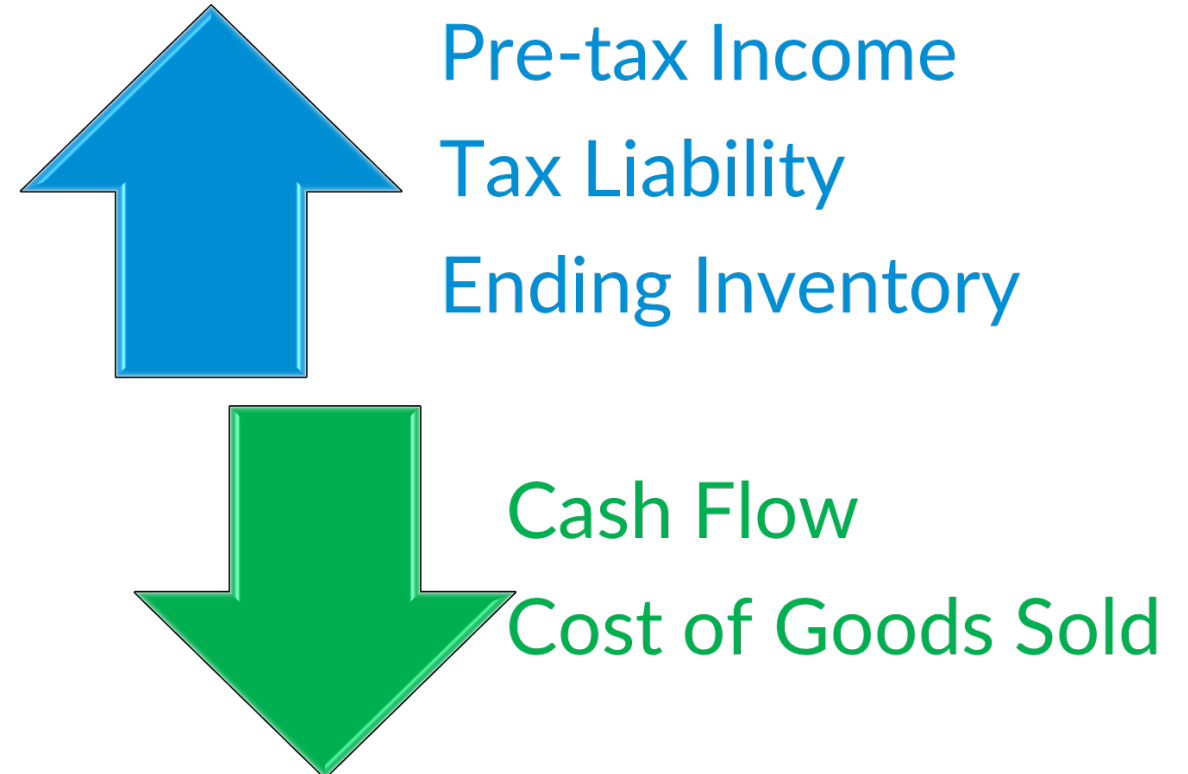
How LIFO Works

Effect of Inflation on Financial Statements & Tax Return

With LIFO



Without LIFO



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 when there's inflation
 - 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
- Others believe that 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 in perpetuity
- **Tax Court opinion regarding LIFO (see 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.

• Preferable accounting method

- LIFO is an accounting method permissible under GAAP, not just a tax incentive
- 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.

• Acts as a mechanism that's 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



Why Use LIFO?

LIFO Cost/Benefit Case Study: Building Products Manufacturer

Company Overview

- Years on LIFO: 6 (2017 = 1st year on LIFO)
- 2022 y/e inventory balance @ Cost: \$15M
- 2022 y/e inventory balance @ LIFO: \$12.1M
- Combined federal + state tax rate: 30%
- Interest rate on debt: 6%
- 2022 y/e LIFO reserve: \$2.9M

Benefits

- **Cumulative after-tax savings:**

2022 y/e LIFO reserve * tax rate = $\$2.9\text{M} * 30\% = \860K

- **Savings on interest expense:**

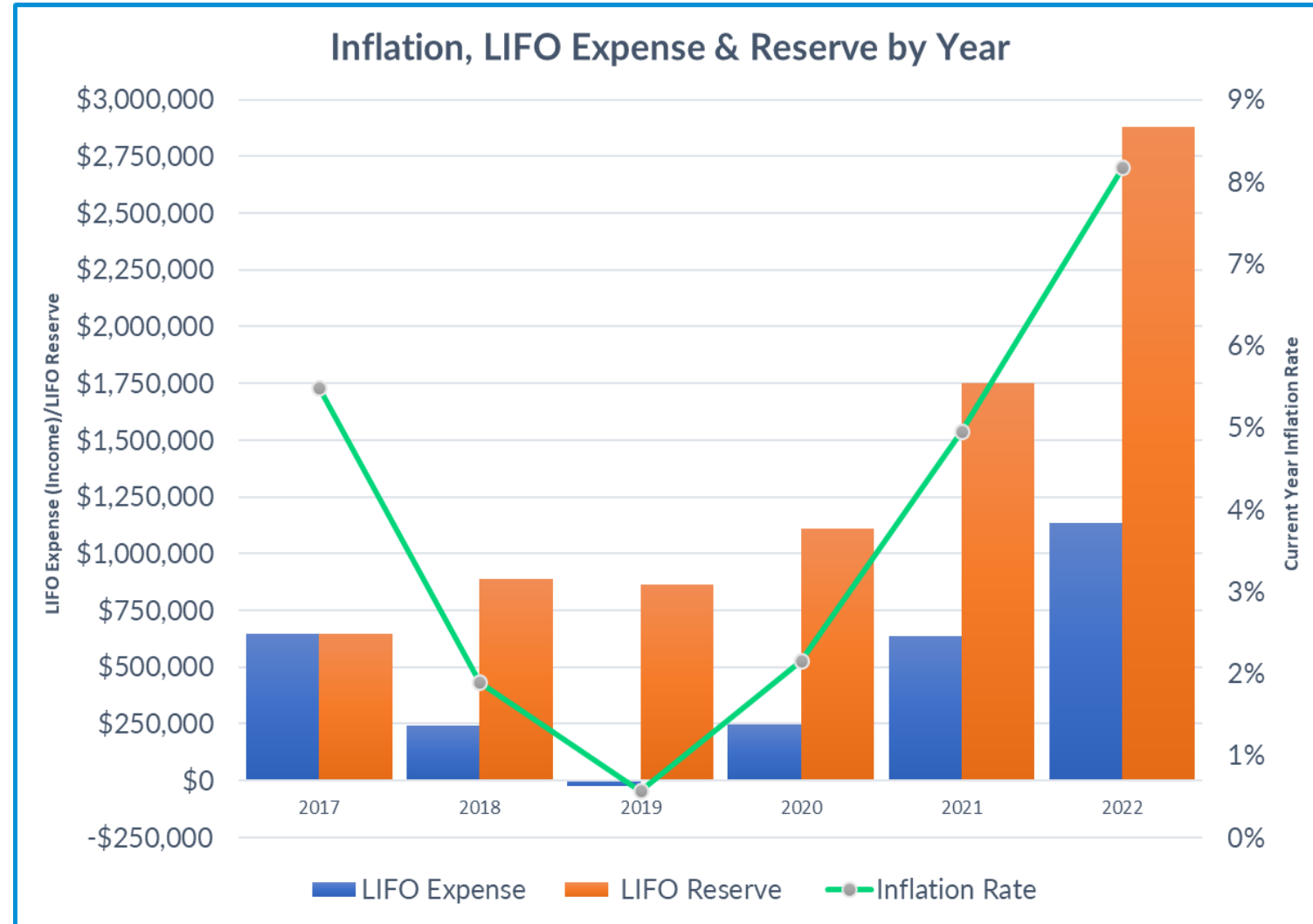
Cumulative after-tax savings * interest rate on debt
= $\$860\text{K} * 6\% = \52K

Costs

- First year fee including IRS forms prep (2017): \$5K
- Recurring annual outsourcing fee: \$2,500 (years 2 - 6)
- **Cumulative outsourcing costs: \$17,500**

Cost as a percentage of after-tax savings:

$\$17,500 \div \$860\text{K} = 2\%$



Common LIFO 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
 - Under dollar-value LIFO, item costs remain being tracked the same way they did prior to electing LIFO & requires no changes to the accounting system other than adding a contra-inventory subledger account called the LIFO reserve
- **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 not shared externally with third parties
- **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



Common LIFO Misconceptions

- **Common LIFO reserve change misconceptions**
 - This year's LIFO reserve can't grow unless this year's ending inventory balance is as much or higher than last year's ending inventory balance
 - This year's LIFO reserve will decrease if this vs. last year's inventory balance decreases
 - Material LIFO recapture will occur if there's a significant decrease in inventory
- **LIFO reserve change overview**
 - **The LIFO reserve change consists of the following two components**
 - **Inflation effect LIFO expense/income (expense when there's inflation & income when there's deflation)**
 - Equals last year's inventory balance at cost * this year's inflation rate
 - **Layer erosion effect income/expense (typically will create LIFO income, but can create LIFO expense in certain cases)**
 - Equals the current year decrease at base year cost * (current year cumulative index - index of layer(s) being eroded/liquidated)
 - The inflation effect LIFO expense component of the LIFO reserve change is usually the heavier weighting factor because last year's inventory balance at cost is always greater than this year's decrease at base year cost
- **Clarifications**
 - When there's inflation, LIFO reserve can increase even when current vs. prior year inventory balances decrease
 - In most cases, material LIFO recapture only occurs when there is either substantial deflation and/or substantial inventory liquidations
 - Any LIFO recapture (LIFO income) caused by inventory decreases can be partially or fully offset by the LIFO expense created from inflation
- **Learn more at LIFOPro's blog: <https://www.lifopro.com/clarifying-how-lifo-reserve-changes-are-calculated>**

Top 2023 LIFO Election Opportunities

- Companies with high inflation frequency and/or high historical average inflation rates are often ideal LIFO candidates
- Companies with a combination of high inflation frequency and historical average inflation rates are the best LIFO candidates
- **High Inflation frequency:** Common profiles include wholesalers & retailers. Includes some of the most predominant users of LIFO, such as auto dealers & supermarkets.
 - **Pros**
 - LIFO reserve essentially grows in perpetuity & acts as a tax savings annuity since there's rarely (if ever) deflation for industries with highest inflation frequency
 - Often shielded from volatility of raw materials commodities, meaning LIFO recapture rarely if ever happens, and when it does, it's usually immaterial
 - Industries with the highest inflation frequency tend to stay on LIFO the longest
 - Attractive for nearly all risk appetite profiles since there's minimal downside
 - **Cons:**
 - Tend to have lower historical inflation rates & long-term tax benefits from LIFO compared to industries with lower inflation frequency
 - May be less appealing to companies requiring material short-term benefits if the historical average inflation rate is on the lower end of the spectrum
- **High historical average inflation rates & tax benefits:** Common profiles include manufacturers and industries with volatile raw materials such as chemicals, lumber & metal commodities (metal sheet/strip/coil, bars/shapes/pipes etc.)
 - **Pros**
 - Tax benefits of LIFO are highly likely to far outweigh administrative burdens/ costs for industries with the highest historical average inflation rates
 - Largest long-term tax benefits from LIFO are typically found in these industries
 - Massive LIFO reserves can be built in a short amount of time
 - Attractive to companies with high risk appetite
 - **Cons**
 - Tend to have lower historical inflation frequency, which results in a higher probability of taxable income being created from LIFO
 - Not ideal for companies with low risk appetite since material LIFO reserve recapture is a real possibility every so often
 - Industries with the highest historical average inflation rates and low inflation frequency tend to go off LIFO more frequently
- Company-specific metrics such as historical inflation frequency and average annual inflation rates should be included in the LIFO due diligence process to ensure each company's risk/reward profile matches or aligns with the potential short/long term benefits and costs of LIFO



Top 2023 LIFO Election Opportunities

- **Good LIFO Candidate:** LIFOPro has developed a proprietary scoring system to identify good candidates, which requires for the following criteria to be met -
 - **High inflation frequency:** Must have inflation in more than half of the last 20 years (11 or more). Best LIFO candidates have high inflation frequency because the more often inflation is expected to occur, the higher the likelihood that LIFO acts as annuity & the lower the likelihood of deflation/LIFO recapture
 - **Historical average annual inflation rate of 1% or greater:** Ensures an adequate amount of long-term inflation exists for the benefits of LIFO to far outweigh the cost. Most predominant users of LIFO such as auto dealers & supermarkets have a 1% - 2% long-term average inflation rate.
 - **At least \$2M - \$5M of inventory:** Appropriate range dependent on historical inflation rate, tax rate & company's perceived value of LIFO tax benefits
- **Good 2023 LIFO Election Candidate:** Must meet the good LIFO candidate criteria listed above & have an election year inflation rate that's greater than or equal to the historical average annual inflation rate
- **Top 2023 LIFO Election Candidates**
 - Learn more at LIFOPro's blog: [2023 LIFO Election Locks](#)
 - Download our top LIFO election candidates list & client identification tool - [LIFOPro's 2023 Good LIFO Election Candidates & Client ID Tool](#)
- **Election Year LIFO Tax Savings Formula & Example**
 - **Formulas**
 - **Election year taxable income reduction from LIFO (LIFO expense):** Prior year inventory balance at cost * Current year inflation rate
 - **Election year LIFO tax benefit:** Current year LIFO expense * Combined federal & state tax rate
 - **Example:**
 - **Assumptions:** \$5M prior year end inventory balance, 10% current year inflation & 40% tax rate
 - **Results:**
 - **Election year LIFO expense:** $\$5M * 10\% = \$500K$
 - **Election year LIFO tax benefit:** $\$500K * 40\% = \$200K$



Top 2023 LIFO Election Opportunities

- The timing of the LIFO election is key, making it important to understand the best & worst time to elect LIFO
- The tax benefits from LIFO **are primarily driven by the amount of inflation** measured in any given year
- One of the best possible times to elect LIFO is in a year where the inflation will be at least at or above the historical average because:
 - Ensures the benefits of LIFO outweigh the administrative burden and related costs in the year of election
 - In cases where the election year inflation is higher than the historical average:
 - Tax benefit from LIFO will represent multiple years worth of inflation in the election year alone when compared to a normal period of inflation
 - Can reduce or largely minimize the chance of material or complete LIFO reserve recapture occurring in the future (see below)

10-year LIFO Reserve Comparison: Differential Between Electing in an Average vs. High Inflation Period

High Inflation Period - 10% election year inflation (2022)

Period	Inventory at Cost	Current Year Inflation Rate	Cumulative Inflation Rate	Inventory at LIFO	LIFO Reserve	LIFO Expense (Income)
12/31/2021	20,000,000	-	-	20,000,000	-	-
12/31/2022	25,000,000	10.0%	10.0%	23,000,000	2,000,000	2,000,000
12/31/2023	26,500,000	2.0%	12.2%	24,000,000	2,500,000	500,000
12/31/2024	25,000,000	1.0%	13.3%	22,267,133	2,732,867	232,867
12/31/2025	24,000,000	-3.0%	9.9%	22,016,956	1,983,044	-749,823
12/31/2026	25,000,000	-1.0%	8.8%	23,256,958	1,743,042	-240,002
12/31/2027	26,000,000	1.5%	10.5%	23,881,958	2,118,042	375,000
12/31/2028	28,000,000	-1.5%	8.8%	26,271,958	1,728,042	-390,000
12/31/2029	30,000,000	3.0%	12.1%	27,431,958	2,568,042	840,000
12/31/2030	30,500,000	2.5%	14.9%	27,188,056	3,311,944	743,902
12/31/2031	31,000,000	4.0%	19.5%	26,512,634	4,487,366	1,175,422

Average Inflation Period - 2% election year inflation (2023)

Period	Inventory at Cost	Current Year Inflation Rate	Cumulative Inflation Rate	Inventory at LIFO	LIFO Reserve	LIFO Expense (Income)
12/31/2022	25,000,000	-	-	25,000,000	-	-
12/31/2023	26,500,000	2.0%	2.0%	26,000,000	500,000	500,000
12/31/2024	25,000,000	1.0%	3.0%	24,267,133	732,867	232,867
12/31/2025	24,000,000	-3.0%	-0.1%	24,016,956	-16,956	-749,823
12/31/2026	25,000,000	-1.0%	-1.1%	25,256,958	-256,958	-240,002
12/31/2027	26,000,000	1.5%	0.4%	25,881,958	118,042	375,000
12/31/2028	28,000,000	-1.5%	-1.1%	28,271,958	-271,958	-390,000
12/31/2029	30,000,000	3.0%	1.9%	29,431,958	568,042	840,000
12/31/2030	30,500,000	2.5%	4.4%	29,188,056	1,311,944	743,902
12/31/2031	31,000,000	4.0%	8.6%	28,512,634	2,487,366	1,175,422
12/31/2032	31,500,000	0.5%	9.1%	28,857,634	2,642,366	155,000



Top 2023 LIFO Election Opportunities

- **Processed foods & feeds, including:**
 - Meats, poultry & fish
 - Processed fruits & veggies
 - Sugar & confectionary
 - Beverages & beverage materials
- **Petroleum products, including Crude/refined petroleum products & Gasoline**
- **Chemical products, including:**
 - Soaps, detergents, polishing & other sanitation goods
 - Cosmetics & other toilet preparations
- **Machinery & equipment**
 - Construction machinery & equipment
 - Power-driven handtools, including parts and attachments
 - **General purpose machinery & equipment, including:**
 - Heating, ventilation & air-conditioning (HVAC) machinery & equipment
 - Pumps, compressors & equipment
 - Industrial material equipment & handling equipment
 - Fluid power equipment (hydraulics)
 - Metal valves
 - Electrical machinery & equipment
- **Nonmetallic mineral products, including Glass, Concrete & Clay goods**
- **Transportation equipment, including New cars/trucks, Aircraft, Boats, Vehicle trailers, ATVs/UTVs**
- **Toys, sporting goods & small arms**
- **Medical, surgical & personal aid devices**



Top 2023 LIFO Election Opportunities

• LIFO Conformity

- 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 to be made within the financial reports while 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, sales 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)



Top 2023 LIFO Planning Strategies

- **Switch to IPIC method (using Bureau of Labor Statistics Consumer/Producer Price Index)**
 - **Tax deferral maximization:** Often creates more inflation than actual internal product costs or internal index inflation for the following reasons:
 - BLS PPI inflation will be greater than internal index inflation on goods that were imported or purchased for resale products sourced from abroad because BLS PPI only measures U.S. or domestic production & domestically produced goods inflation rates have historically been materially higher than imported goods
 - When the IPIC method is used, new items are given preexisting item inflation since BLS only measures price changes on preexisting items (or they reconstruct the cost on any newly-introduced item). With internal indexes, new items' prior year costs are often set to equal to its current year cost since reconstruction is often burdensome/subjective & IRS Regs. prohibit new items from being excluded from the inflation calculation. As a result, during periods of inflation, new items will reduce the overall current year inflation rate when internal indexes are used. This becomes more pronounced when there's high item turnover and/or high inflation.
 - **Much quicker, simpler means of performing interim estimates than internal indexes**
 - **Minimize IRS scrutiny upon audit or reduce audit risk**
 - IPIC method is IRS safe harbor method, which affords taxpayers less scrutiny from IRS upon audit compared to taxpayers using internal indexes since inflation calculation relies on external government indexes & internal indexes rely on the taxpayer's accounting records/systems
 - Switch to IPIC method from internal indexes to IPIC method provides audit protection from prior period calculation errors
 - Can also provide a safe harbor for companies with LIFO books & records audit risk. See [IRS LIFO Records Practice Unit](#)
 - **Simplify LIFO calculation & reduce volatility**
 - **IPIC method can simplify inflation calculation for manufacturers because:**
 - Reduces reliance on accounting information systems & appropriate allocation of item cost components such as materials, labor & overhead since inflation is measured using BLS PPI, not current & prior/base period item/unit costs
 - Inflation for WIP inventories are calculated by assigning the applicable finished goods PPI code to the WIP items
 - IPIC method can reduce volatility because BLS surveys thousands of producers & eliminates extreme cost fluctuations that could occur within any single company
 - **Automatic approval to change to IPIC method & is applied on a cutoff basis**
 - Affords audit protection from LIFO reserve overstatements since change is applied beginning in year of change & built from pre-change LIFO reserve
 - Only means of automatically changing from double-extension to link-chain (double-extension = current vs. base year cost comparison; link-chain = current vs. prior year cost comparison; advanced approval change to switch from double-extension to link-chain internal index)



Learn more about the IPIC method here: [IPIC LIFO Advantages](#)

Top 2023 LIFO Planning Strategies

• LIFO value pricing method

- **Specific goods (“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
- **Dollar-value:** 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 at actual cost (FIFO, average cost or specific ID) or standard cost. Side computation made outside of accounting system to calculate inflation, layers (decrements), inventory @ LIFO, LIFO reserve & LIFO expense (income)
- **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

• LIFO index computation timeframe selection

- **Link-chain:** Current quantities are extended against current & prior period item/unit costs to calculate current year inflation index (one year measurement period)
- **Double-extension:** Current quantities are extended against current & base period unit costs to calculate current year cumulative index (all years on LIFO measurement period)
- **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

• Inflation measurement source

- **Internal indexes:** Current year inflation index measured using actual costs paid/incurred to acquire/procure the goods
- **External indexes:** aka Inventory Price Index Computation or IPIC method. Bureau of Labor Statistics Consumer/Producer Price Indexes assigned to goods to calculate current year inflation index
- **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

• Current-year cost & layer valuation method

- Latest acquisitions (FIFO), 12-month moving average or rolling-average cost (aka weighted average cost), Earliest acquisitions, specific ID or other method that’s clearly reflective of income
- **Best practice:** For first-time elections, 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 measuring multiple methods

• Pooling method

• Resellers (retailers & wholesalers/distributors)

• Manufacturers/producers

- Natural business units (separate pool required for manufactured vs. purchased for resale goods)
- Raw materials content
- Multiple pools

• IPIC LIFO method users

- **IPIC Pooling method:** pools established for each BLS major group assigned 5% or more of the total inventory balance at cost
- Any non-IPIC pooling method listed above that matches your industry type (i.e., manufacturers using IPIC method could use natural business unit pooling method)

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



Learn more here: [LIFO Methods, Rules & Regulations](#)

Top 2023 LIFO Planning Strategies

- **Auto Dealers**
 - **Alternative LIFO method (ALM)**
 - Measures inflation based on comparing current & prior period's invoice costs
 - Item definition is specific to each vehicle/VIN, meaning inflation must be calculated for each vehicle, not just by make or type (car, truck, SUV)
 - Inflation calculation is materially more burdensome since invoice costs must be compared on a vehicle-by-vehicle basis
 - Most predominantly utilized for new vehicles
 - Historically created more tax deferral than IPIC method until 2020
 - Highest administrative burden & outsourcing costs since inflation calculation requires invoice cost comparisons
 - **IPIC method**
 - Measures inflation by using Bureau of Labor Statistics Consumer/Producer Price Indexes (BLS CPI/PPI)
 - Precludes the need to calculate inflation for each vehicle since government indexes are used to calculate inflation
 - Only documentation required to complete LIFO calculation is a breakdown of inventory balances by the following types:
 - **CPI**
 - New cars
 - New trucks, SUVs & minivans
 - Used vehicles
 - Parts
 - **PPI:** Same as above except used vehicles also need to be broken down between cars and trucks/SUVs/minivans
 - Many dealers include used vehicles & parts in election scope because inflation calculation is much simpler than ALM
 - Has grown exponentially in popularity beginning in 2020 primarily because of materially higher inflation/tax benefits
 - Secondary benefit has always been lower administrative costs, simpler means for performing interim estimates & more flexibility in terms of meeting LIFO conformity requirements than ALM
 - Lowest administrative burden & outsourcing costs since inflation calculation only requires summarized totals



Top 2023 LIFO Planning Strategies

- **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. These types of estimates come in many shapes and forms in terms of frequency, including mid-year estimates, ones made towards the end of the year, and some even perform estimates on a monthly basis (monthly estimates are the least common interim estimate frequency)
 - **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



Why Perform Analysis or Review?

- **Election Benefit Analysis (for companies not on LIFO, but considering adoption)**
 - Thorough LIFO Due diligence should be considered essential
 - **Failing to perform thorough LIFO due diligence can lead to the following:**
 - Materially lower tax benefits being obtained in the long-term as a result of selecting suboptimal methods
 - Impermissible methods unknowingly being used & audit risk being created
 - Utilizing methods that are more error-prone or burdensome than simpler, less time-intensive alternatives
 - Higher likelihood of eventually terminating LIFO election due to lack of benefits and/or excessive administrative costs/resources
 - **Outsourcing due diligence work to a LIFO subject matter expert ensures the following:**
 - Historical inflation studied to predict long-term impact of LIFO to illustrate potential future benefits & risks
 - All method alternatives are considered & best practices are considered/employed
 - Best possible tax answer is achieved while ensuring compliance
 - Responsibilities & requirements incident to electing are clearly defined
- **Review (for companies already on LIFO)**
 - The majority of calculations & methods we review either contain errors, have compliance issues or utilize suboptimal methods
 - Most compliance issues & suboptimal methods usage results from a lack of thorough due diligence being performed at the time of election
 - Very few CPA firms have software to quickly automate LIFO calculations, confirm calculation accuracy & easily identify errors
 - No CPA firm other than LIFOPro works exclusively with LIFO 100% of the time, meaning that they're unable to provide thorough due diligence
 - **Obtaining a review from a LIFO subject matter expert ensures the following:**
 - Calculation errors that had gone undetected for many years are identified & prevented from occurring in the future
 - Compliance issues & suboptimal methods usage are identified and best practices feedback & recommendations are provided
 - Strategies for reducing or eliminating IRS audit risk are provided



Complimentary Offerings

- **Companies not on LIFO: LIFO Election Benefit Analysis**
 - **Comprehensive LIFO election case study packaged in the form of a PDF report containing the following:**
 - Election year estimated tax LIFO benefits, including comparisons between internal vs. external inflation measurement source
 - 20 year pro forma IPIC LIFO calculation using Bureau of Labor Statistics Consumer/Producer Price Indexes to determine inflation frequency, long-term historical average annual inflation rate & whether a company is a good LIFO candidate
 - Election recommendations including which submethods should be used
 - How LIFO Works appendix covering all the essentials
 - LIFOPro also provides turnkey outsourcing solution fee quote showing election year & recurring costs
 - [Sample LIFO Election Benefit Analysis Report](#)
- **Companies on LIFO: Calculation, Methods & Best Practices Review**
 - **Comprehensive calculation review & guide packaged in the form of a PDF report containing the following:**
 - Calculation review
 - Methods review
 - **Best practices feedback, including:**
 - Optimization strategies & tax deferral maximization opportunities
 - Errors & IRS audit risk areas identified
 - Strategies for reducing IRS audit risk and/or obtaining audit protection
 - Recommendations & implementation steps provided for applying recommended changes
 - Same LIFOPro report package provided to outsourcing clients & fee quote also provided in addition to review report
 - Companies can also receive complimentary LIFOPro software trial
 - [Sample LIFO Calculation, Methods & Best Practices Review Report](#)



Why Outsource LIFO or License LIFO Software?

- **In-house calculations made WITHOUT software**
 - Inflation calculation can be very complex when performed in spreadsheets
 - Important steps may be overlooked or left out altogether when manually performed in-house, such as:
 - Including new items in calculation ensure compliance or reconstructing new item cost to avoid inflation dilution that'd otherwise occur
 - Performing inflation calculation reasonableness testing, setting criteria for identifying inflation outliers & establishing standard procedures for handling outliers
 - Uniform BLS category assignment to new items to ensure the same BLS indexes are applied to similar new vs. preexisting items
 - Calculating layers & decrements can be complex because it's unknown whether there'll be an increment or decrement in any given year & different math steps are required to calculate an increment vs. decrement(s)
 - Calculation errors become more inevitable the longer you've been on LIFO as decades worth of LIFO layers accumulate
- **Outsourced calculations or those made in-house WITH software**
 - Make being on LIFO as simple as possible with outsourcing & minimize time spent on LIFO in-house with software
 - Reduces control & detection risk since all aspects of the calculation is automated using LIFOPro software
 - Simplifies audit procedures by providing comprehensive, user-friendly documentation
 - CPA firms & companies can rely on LIFOPro to serve as their LIFO subject matter expert rather than having to develop & maintain in-house expertise
 - Guarantee calculation accuracy & eliminate IRS audit risk
 - Easily obtain interim estimates to focus on forecasting & planning
 - Avoid getting bogged down with compliance work & getting hit with big LIFO surprises at year end
- **All of LIFOPro's offerings come with the assurance of a SOC 1 Type II Report**



Turnkey Outsourcing Solutions – Features & Benefits

• Features

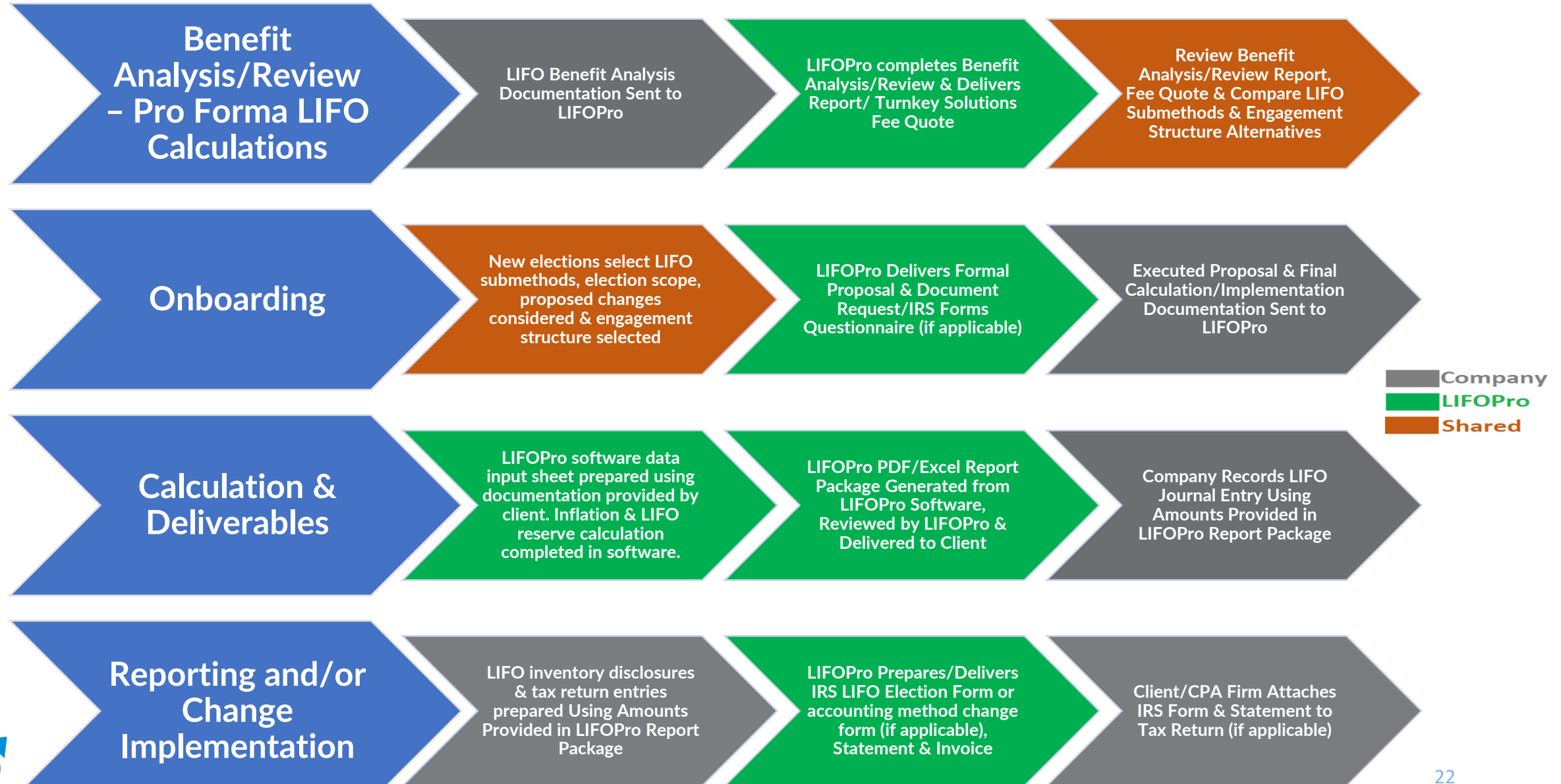
- All tasks related to LIFO calculation & documentation outsourced to & managed by LIFOPro, including:
 - BLS category assignments (if applicable)
 - Inflation calculation, including new item cost reconstruction, exceptions & outlier analysis
 - LIFO reserve calculation
 - LIFO calculation documentation & storage
 - LIFOPro report package preparation
- All clients receive LIFOPro report package electronically containing comprehensive calculation documentation, including summary amounts required to record LIFO-related accounting entries & tax return line items
- Clients using external indexes (IPIC method) receive up to three interim estimates at no additional cost (using prior year product mix & year to date BLS inflation rates)
- Flexible engagement structures to include supplemental services
- Includes up to 40 hours of audit support

• Benefits

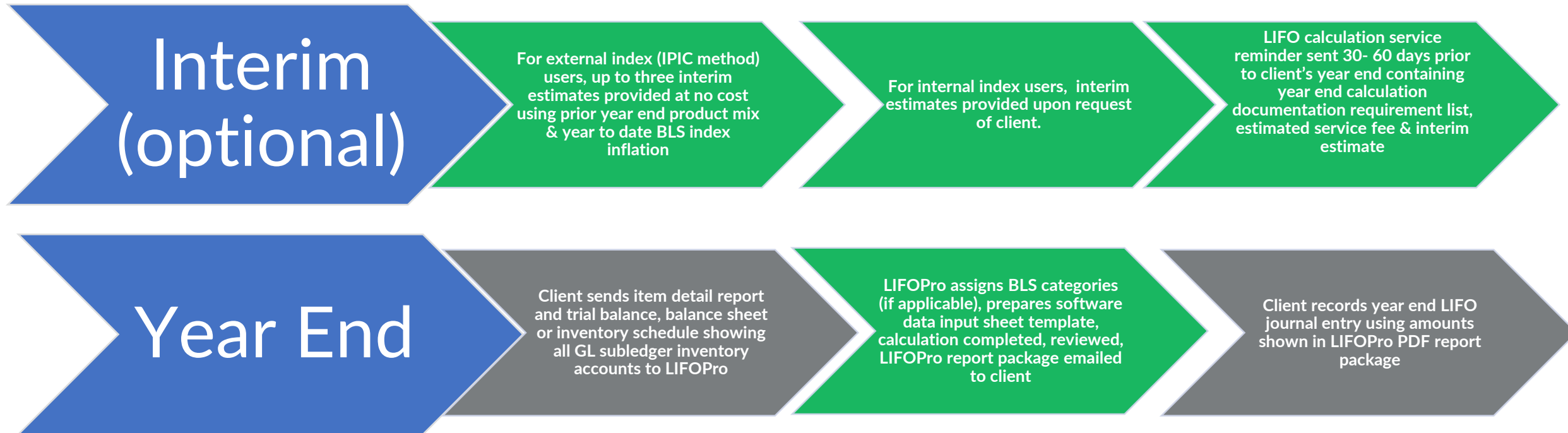
- Make being on LIFO as simple as possible
- Simplifies audit procedures for companies & auditors by providing them with comprehensive, standardized documentation
- Increase transparency & understandability by converting many years worth of files & documentation into a single user-friendly LIFO report package containing comprehensive documentation
- Eliminate error-prone Excel spreadsheets, guarantee calculation accuracy & eliminate audit risk
- Free up time to focus on LIFO forecasting & planning by eliminating time spent preparing/documenting calculation



Turnkey Outsourcing Solutions Process Flow: First Year



Turnkey Outsourcing Solutions Process Flow: Recurring



LIFOPro Outsourcing Fee Range

Inventory Balance at Cost on LIFO	Internal Indexes		External Indexes (IPIC CPI/PPI)	
	First Year	Recurring	First Year	Recurring
< \$1 million	\$500 - \$1,500	\$500 - \$1,000	\$500 - \$1,500	\$500 - \$1,000
\$1M - \$19M	\$1,500 - \$7,500	\$500 - \$1,500	\$1,500 - \$7,500	\$1,000 - \$5,000
\$20M - \$99M	\$3,500 - \$15,000	\$1,500 - \$7,500	\$3,500 - \$15,000	\$2,000 - \$12,500
\$100M - \$499M	\$7,500 - \$20,000	\$3,500 - \$10,000	\$7,500 - \$20,000	\$5,000 - \$15,000
\$500M - \$999M	\$10,000 - \$30,000	\$7,500 - \$15,000	\$10,000 - \$40,000	\$7,500 - \$30,000
\$1B or more	\$12,500 - \$50,000	\$10,000 - \$25,000	\$12,500 - \$50,000	\$10,000 - \$50,000



Key Takeaways

- LIFO tax benefits are primarily driven by inflation & with well above average or record high inflation, 2022 will be one of the best periods to elect LIFO in the last four decades
- CPA firms should be proactive with identifying good election candidates & advocating for their clients to explore adopting LIFO
- Due diligence should be performed prior to electing LIFO to ensure compliance & maximize tax benefits
- **LIFO reviews should be periodically performed for companies already on LIFO for the following reasons**
 - Identify errors & compliance issues
 - Quantify potential audit exposure and learn how certain changes can reduce/eliminate audit risk
 - Identify opportunities to utilize more optimal methods
- **LIFOPro's resources provide CPA firms with all their LIFO needs**
 - Firms can advocate for the use of LIFO without having to develop in-house expertise and resources required to accommodate their clients LIFO needs
 - Firms can streamline identifying the top election candidates using our resources
 - Firms can rely on LIFOPro to provide LIFO training to their clients and firm
- **LIFOPro's offerings provide companies with all their LIFO needs**
 - Companies can make being on LIFO as simple as possible with LIFOPro's turnkey outsourcing solutions
 - Companies can minimize time spent in-house on LIFO & guarantee accuracy with the LIFOPro software



Actionable Items

- **Companies not on LIFO:**
 - **Identify good LIFO election candidates:** Download [LIFOPro's Good LIFO Election Candidate Client ID Tool](#) Excel file & follow steps to identify good candidates
 - Advocate exploring/electing LIFO to clients
 - Obtain complimentary LIFO election benefit analysis & obtain turnkey outsourcing solutions fee quote from LIFOPro
- **Companies on LIFO:** Obtain a complimentary [LIFO Review](#), fee quote(s), sample LIFOPro report package or software trial
- **Documentation requirements**
 - **LIFO Election Benefit Analysis & fee quote (for clients not on LIFO)**
 - **Companies other than dealerships:**
 - Completed questionnaire – [LIFO Benefit Analysis Document Request List](#)
 - Current & prior period's item detail reports (see document request list & sample templates contained in above file)
 - **Dealerships**
 - Completed questionnaire OR current & prior year trial balance or balance sheet schedules
 - [Auto dealer questionnaire](#)
 - [All other dealers questionnaire](#) (RV, ag/farm, construction, powersports, etc.)
 - **Review, fee quote, sample LIFOPro report package or software trial (for clients on LIFO)**
 - LIFO calculation documentation from the last period closed: See [LIFO Review Document Request List](#)
 - **Document delivery options**
 - Secure File Transfer Portal: <https://www.lifopro.com/resources/send-files-to-lifo-pro/>
 - Email (if combined file size is 20MB or less): lifopro@lifopro.com
 - LIFOPro will email you analysis report & fee quote within one week of receiving above documents (expedited delivery available)
- LIFOPro will also offer a free discovery call/online meeting to discuss report findings, recommendations & fee quote
- For outsourcing clients, LIFOPro will turn around final calculation & deliver PDF report package as quickly as needed



Complimentary Resources & Tools

- LIFO election resources & tools
 - [LIFO Election Benefit Analysis Request Form](#)
 - [LIFOPro's Good LIFO Election Candidate Client ID Tool](#)
 - [LIFO Election Benefit Analysis Document Request List](#) - for companies other than auto dealers
 - [Auto Dealer LIFO Election Benefit Analysis Questionnaire](#) - for auto dealers only (or send CY/PY trial balance schedules)
 - [All Other Dealer LIFO Election Benefit Analysis Questionnaire](#) - for auto dealers only (or send CY/PY trial balance schedules)
 - [LIFO Tax Savings Calculator](#)
 - [How LIFO Works](#)
 - [How to Easily Implement LIFO](#)
- Other LIFO resources
 - [Auto Dealer IPIC Benefit Analysis Questionnaire](#)
 - [LIFO Methods, Rules & Regulations](#)
 - [IPIC LIFO Overview](#)
 - [Bureau of Labor Statistics Producer & Consumer Price Index Inflation History](#)

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