

2023 Top LIFO Opportunities & Strategies Guide

LIFO-PRO, Inc.
11620 Arbor St
Omaha, NE 68144
(402) 330-8573 office
(877) 848-6583 fax
lifopro@lifopro.com
www.lifopro.com



LIFOPro
Software & Turnkey Outsourcing Solutions



Table of Contents

| Section | Slide(s) |
|--|----------|
| About Us | 3 |
| Top 2023 LIFO Election Opportunities (for companies not yet on LIFO) | 4 – 9 |
| Top 2023 LIFO Planning Strategies (for companies already on LIFO) | 10 – 13 |
| How LIFO Works | 14 |
| Why Use LIFO? | 15 – 16 |
| Common LIFO Misconceptions | 17 – 18 |
| Dollar-value LIFO Overview | 19 |
| Accounting for LIFO | 20 – 21 |
| Why Perform Analysis or Review? | 22 |
| Complimentary Offerings | 23 |
| Why Outsource LIFO or use LIFO Software? | 24 |
| Turnkey Outsourcing Solutions | 25 - 28 |
| Key Takeaways | 29 |
| Actionable Items | 30 |
| Resources | 31 |



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 indirectly & directly to provide a complete set of LIFO resources & solutions
- **Notable clients include:**
 - Walmart
 - Kroger
 - Target
 - Performance Food Group
 - Eli Lilly



Top 2023 LIFO Election Opportunities

- **2023 LIFO Opportunities In Focus**
 - Above-average inflation has persisted in 2023 for many finished goods & products in the more advanced stages of production
 - The 2023 inflation is highest for wholesalers/distributors and retailers since they primarily carry finished goods
 - ***Because of this, the best 2023 year end LIFO election opportunities & most meaningful tax benefits will occur for wholesalers/distributors and retailers***
 - 2023 LIFO election opportunities exist in selected manufacturing industries, but it's dependent on raw materials carried & proportion of inventory values by stage of production
- **LIFO Forecasting and Risk-Reward Analysis Overview**
 - Historical inflation frequency & historical average annual inflation rates are the two most reliable metrics for estimating the long-term tax benefits of LIFO and weighing LIFO's risks vs. rewards
 - Companies with the highest historical average inflation rates are **good** LIFO candidates because they're guaranteed to create long-term LIFO tax benefits, and meaningful tax savings can be created in a single year
 - Companies with the highest historical inflation frequency are **great** LIFO candidates because LIFO will almost if not always create tax benefits
 - Companies with a combination of high historical inflation frequency and high historical average inflation rates are the **best** LIFO candidates
- **Comprehensive cost-benefit analysis that includes measuring historical inflation frequency & rates is an ESSENTIAL component of the LIFO election due diligence process because:**
 - Allows potential LIFO users to compare the risks and rewards of LIFO against their overall risk appetite profile
 - Allows potential LIFO users to forecast the long-term tax benefits against the perceived costs
 - LIFO is an accounting method & preferability must be established over the existing method, so it should be assumed it will be used in perpetuity
 - Ensures long-term implications are understood rather than only focusing on the election year tax benefit
 - Materially reduces the chance of going off LIFO in the future
- **LIFOPro offers free LIFO election benefit analysis. Learn more here: [LIFO Election Benefit Analysis](#)**



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 hand tools, 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

- **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

• 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)):
 - **Reporting cost of goods sold or operating profit on a non-LIFO basis and reporting LIFO as a nonoperating item in the primary income statement** – Companies are allowed to present cost of goods sold and operating profit on a non-LIFO basis without violating the LIFO conformity rule as long as there's an adjustment so that ending net income is calculated on a LIFO basis. This can be accomplished by including the LIFO adjustment as a nonoperating item on the income statement (supplemental schedule of nonoperating items could be included if there are multiple nonoperating items).
 - **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 using a non-LIFO method, including balance sheet 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)



LIFO Election Considerations & Disclaimers

• Considerations

- **LIFO should only be elected for tax purposes when there's inflation**
 - Electing LIFO when there's deflation will increase taxable income, meaning it's best to wait until there's inflation to elect LIFO
 - Some companies may employ a strategy to elect LIFO for book purposes but not tax purposes if there's deflation as it'll create a favorable impact to income on the financial statement & a permanent favorable book vs. tax difference
- **Many companies wait until they're profitable to elect LIFO**
 - Tax benefits of LIFO far outweigh the cost when there's sufficient income to offset
 - Additional losses from LIFO can be carried forward and back, but the perceived tax benefit of LIFO is often less when a company is not profitable
- **All goods don't have to be valued using LIFO**
 - Many companies employ a "selective LIFO election" where only certain inventories are valued under LIFO
 - Companies with multiple locations, divisions or subsidiaries or a diverse product mix are allowed to value some inventories using LIFO, and value others using a non-LIFO method
 - Although best strategy to maximize LIFO tax benefit is to include all inventories in LIFO election scope, it may be more expedient or convenient to exclude certain inventories from scope. Examples include:
 - Immaterial inventories where the burden of including it in LIFO election scope outweigh the tax benefits
 - Newly acquired entity with accounting system complexities or differences from the bulk of the other inventories to be valued under LIFO

• 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:**
 - 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



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

- **Auto Dealers**
 - Can use alternative LIFO method (ALM) using actual invoice costs or IPIC method using Bureau of Labor Statistics Consumer/Producer Price Indexes (BLS CPI/PPI)
 - Prior to 2020, majority of auto dealers used ALM because it created more tax benefits than IPIC method
 - IPIC method has grown exponentially in popularity beginning in 2020 primarily because of materially higher tax benefits
 - Secondary benefit of IPIC method is minimal administrative costs, simplest means for performing interim estimates & more flexibility in terms of meeting LIFO conformity financial reporting requirements when compared to ALM
- **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
 - Inflation calculation is materially more burdensome since invoice costs must be compared on a vehicle-by-vehicle basis
 - Most predominantly utilized for new vehicles
 - Highest administrative burden & outsourcing costs since inflation calculation requires invoice cost comparisons
- **IPIC method**
 - Lowest administrative burden & outsourcing costs since inflation calculation only requires summarized totals
 - 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
 - Many dealers include used vehicles & parts in election scope because inflation calculation is much simpler than ALM
 - Only documentation required to complete LIFO calculation is a breakdown of inventory balances by the following types:
 - New cars
 - New trucks, SUVs & minivans
 - Used vehicles (for CPI; used vehicles must be broken down between cars/trucks if PPI is used)
 - Parts



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)** – By line or class of goods (natural business unit can be used in certain cases)
 - **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



Top 2023 LIFO Planning Strategies

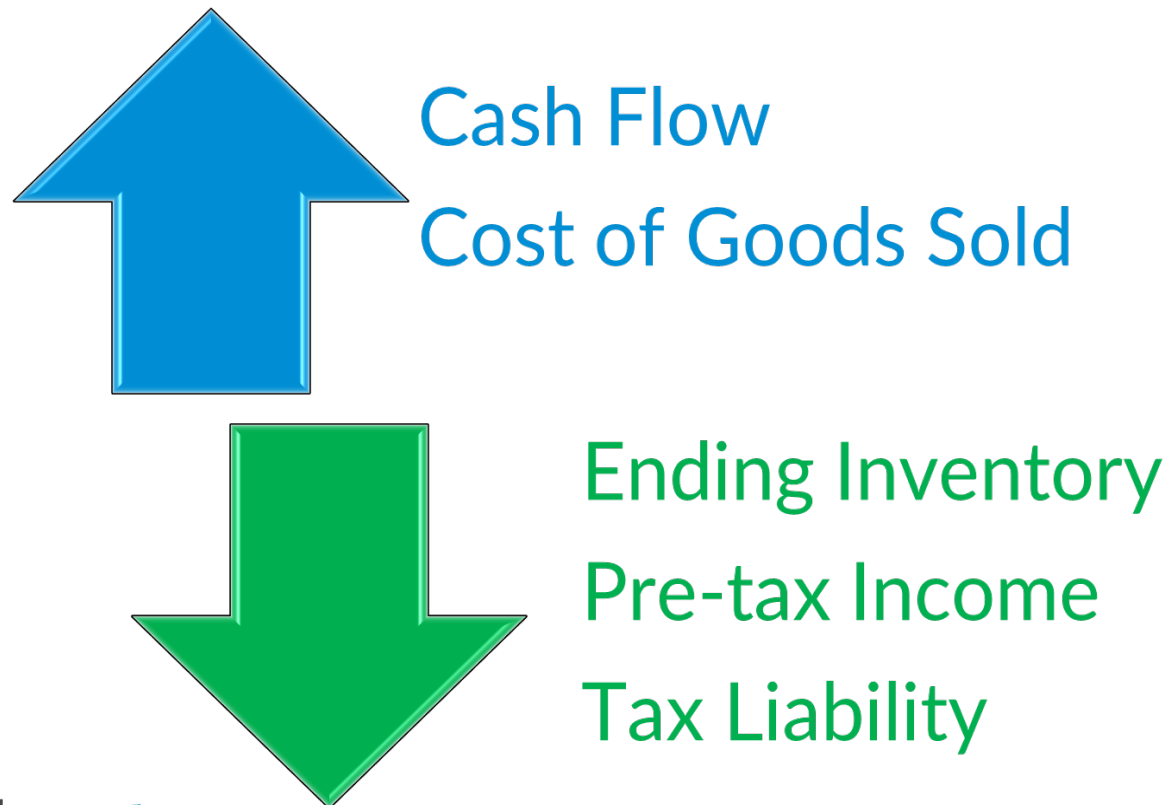
- **Companies who do perform interim LIFO estimates for a wide array of reasons, including:**
 - **Financial reporting compliance** - Under Generally Accepted Accounting Principles, an estimate for the interim cost of sales is required for interim reporting purposes. Because of this, companies issuing 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



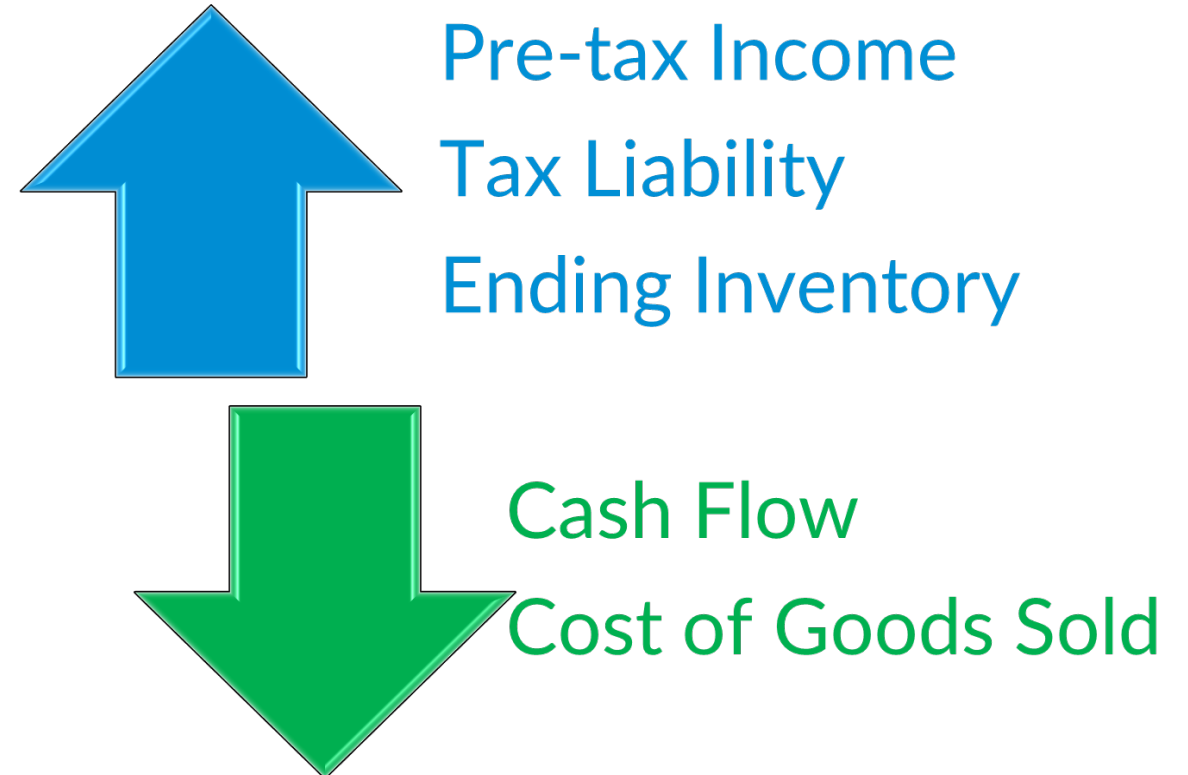
How LIFO Works

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:**

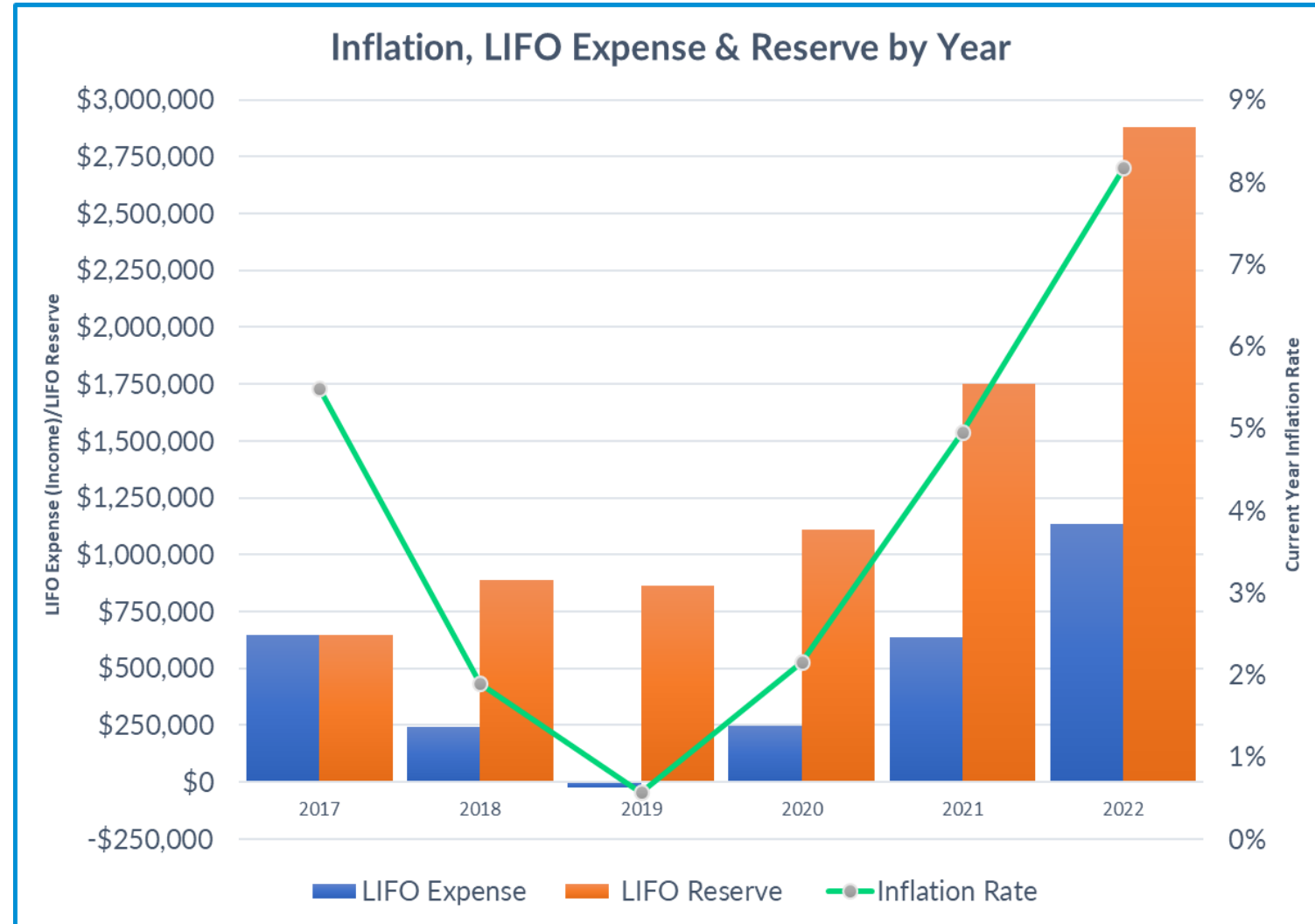
Cumulative after-tax savings * interest rate on debt
= $\$860\text{K} * 6\% = \52K

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

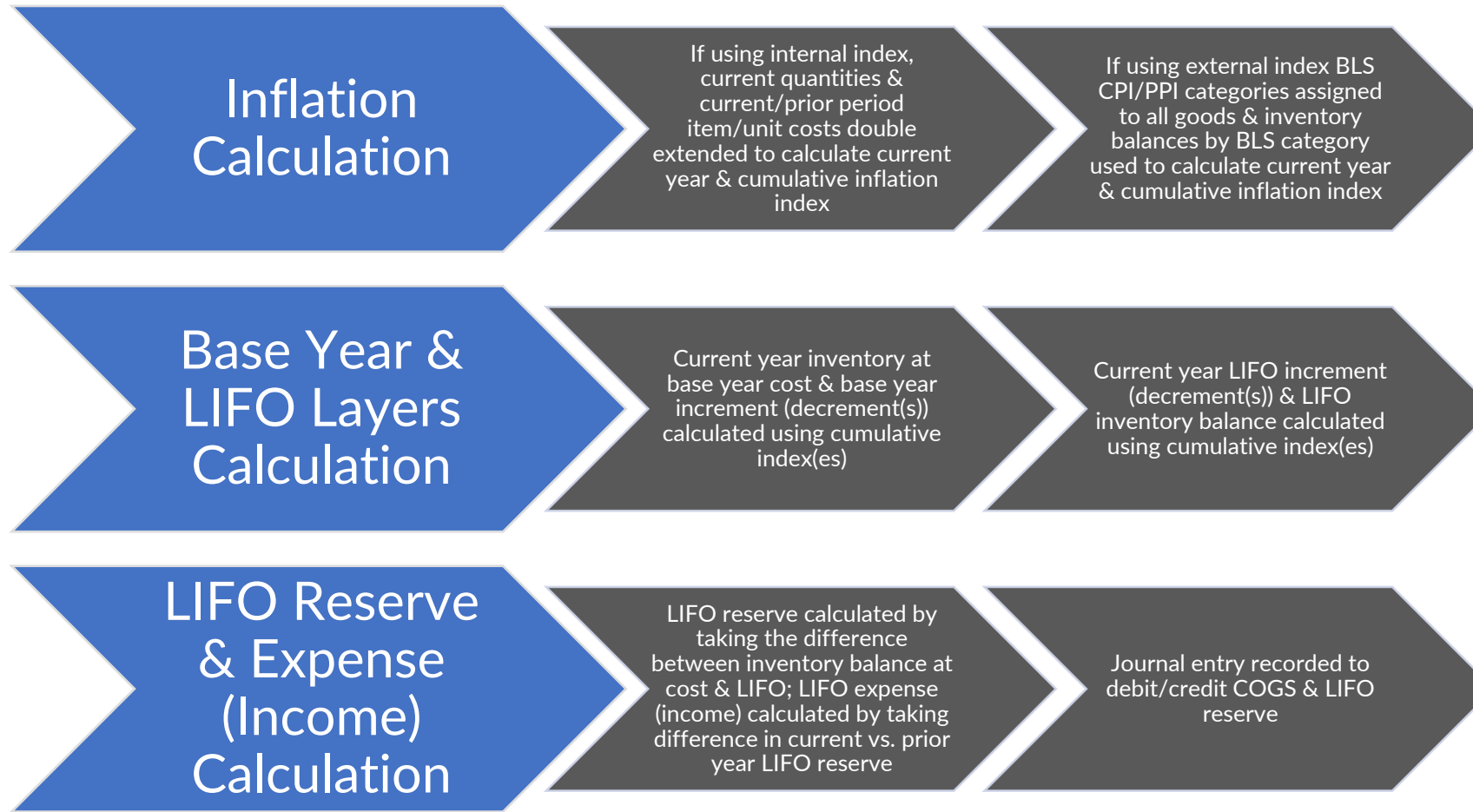


Common LIFO Misconceptions

- **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: [Clarifying How LIFO Reserve Changes are Calculated](#)**

Dollar-value LIFO Overview

- Accounting system continues tracking inventory costs the same way before and after LIFO is adopted, meaning LIFO is never applied at the item level (unit costs are never converted to LIFO)
- Annual post year-end side calculation made outside of accounting system to calculate CY vs. PY LIFO reserve change
- Top side journal entry recorded to adjust LIFO reserve contra-inventory balance sheet account
- Only change is to add a LIFO reserve subledger account to enable the annual adjustment to be recorded & account for the difference between inventory at cost in accounting system (FIFO, average cost etc.) & inventory at LIFO



Accounting for LIFO Using the Dollar-value Method

| Year 1 on LIFO Inventory Physical Cost Flow Activity: 2021 Year End | | | | | | |
|---|---------------------|-------------|--------------|---------------------|-------------|--------------|
| Description | Using FIFO | | | Using Average Cost | | |
| | 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 |
| Purchase 8,000,000 units at \$6/unit | Account Name | Dr. | Cr. | Account Name | Dr. | Cr. |
| | 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 |
| 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 | |



Accounting for LIFO Using the Dollar-value Method

| 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 |

| 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 |

| 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 |

Note: Above example assumes LIFO was elected for the 2021 year end. LIFO reserve represents the cumulative difference between inventory at cost & the LIFO inventory value. The current vs. prior year LIFO reserve change is known as LIFO expense (income). LIFO expense & reserve amounts are only the same in the year of election.



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**

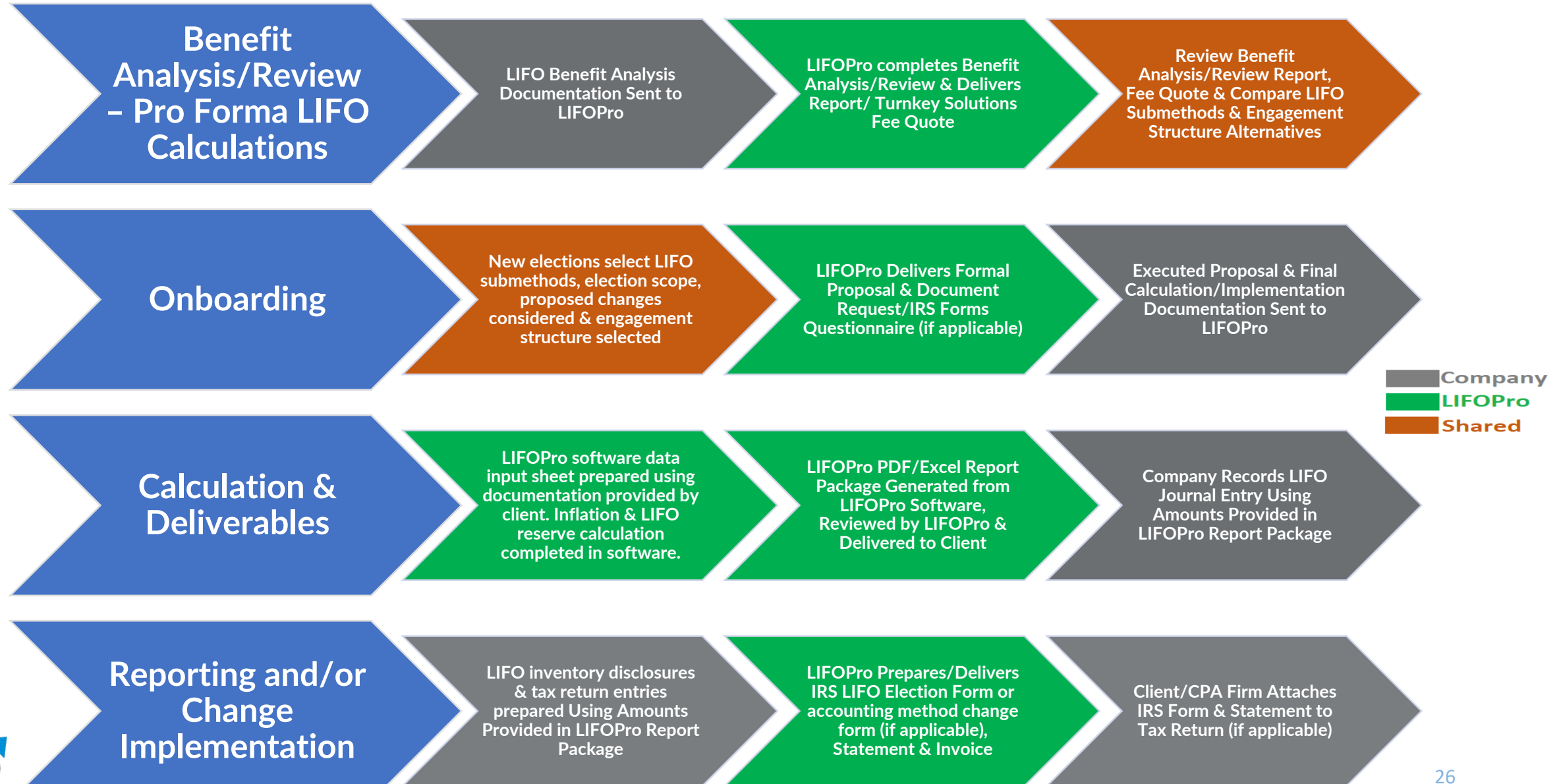
- All tasks related to LIFO calculation & documentation outsourced to & managed by LIFOPro, including:
 - BLS category assignments (if applicable)
 - Inflation calculation, including new item cost reconstruction, exceptions & outlier analysis
 - LIFO reserve calculation
 - LIFO calculation documentation & 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

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, estimated service fee & interim estimate

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



LIFOPro Outsourcing Fee Range

- Fees are based on company size & billable hours
- Wholesale fee rates & volume discounts offered to CPA firms directly engaging with us
- First year fees shown below assumes client is adopting LIFO & includes IRS Form 970 preparation
- All engagements are for a one-year period with optional annual renewal
- LIFOPro guarantees a three-year recurring fee lock
- All engagements include free unlimited training & audit support services

| 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, so the timing of the LIFO election is key which makes it extremely important to incorporate LIFO into year end tax planning and annually ID clients that are good LIFO candidates
- Because of this, CPA firms should annually ID clients that are good LIFO candidates as a part of the year end tax planning process to maximize the election year LIFO tax benefits
- CPA firms play a key role in advocating for their clients to explore adopting LIFO because **NO ONE ELSE WILL!**
- Due diligence should be performed prior to electing LIFO to weigh risks/rewards, set long-term expectations, ensure compliance, select the most appropriate submethods & maximize tax benefits
- **LIFO reviews should be periodically performed for companies already on LIFO for the following reasons**
 - Identify opportunities to utilize more optimal methods
 - Identify errors & compliance issues
 - Quantify potential audit exposure and learn how certain changes can reduce/eliminate audit risk
- **LIFOPro's resources provide CPA firms with all their LIFO needs**
 - Generate or maximize revenues by engaging us directly & reselling our services to clients
 - Enhance ability to provide LIFO as a tax planning strategy without incurring costs & resources to do so
 - Place reliance on a LIFO subject matter expert and resource who can also serve as their client's 3rd party LIFO service provider without firms or their clients having to maintain in-house LIFO expertise
- **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 our 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
 - [Schedule a free LIFO discovery call](#) to learn more about LIFO, our outsourcing solutions & our LIFO election benefit analysis
- **Companies on LIFO**
 - Obtain a complimentary [LIFO Review](#), fee quote(s), sample LIFOPro report package or software trial
 - [Schedule a free LIFO introductory call](#) to learn more about our offerings & our best LIFO practices methods reviews
- **Documentation requirements**
 - **LIFO Election Benefit Analysis & fee quote (for clients not on LIFO)**
 - **Companies other than dealerships:**
 - Current & prior period's **item detail reports** (see document request list & sample templates contained in above file)
 - Completed questionnaire – [LIFO Benefit Analysis Document Request List](#)
 - **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



Complimentary Resources & Tools

- CPA firm resources
 - [CPA Firm Partnership Playbook](#)
 - [LIFOPro's 2023 Good LIFO Election Candidate List & Client ID Tool](#)
 - [LIFOPro Discovery Call Presentation Slide Deck](#)
- LIFO election resources & tools
 - [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 Election Benefit Analysis Request Form](#)
 - [LIFO Tax Savings Calculator](#)
 - [How LIFO Works](#)
 - [How to Easily Implement LIFO](#)
- Other LIFO resources
 - [LIFO Financial Reporting Disclosure Requirements & Alternatives](#)
 - [Exploring Interim LIFO Estimate Approaches Blog](#)
 - [IPIC LIFO Advantages](#)
 - [LIFO Methods, Rules & Regulations](#)

Visit our website: <https://www.lifopro.com>

Email us at lifopro@lifopro.com

Call us at 402-330-8573 M – F 8am – 5pm CDT

