

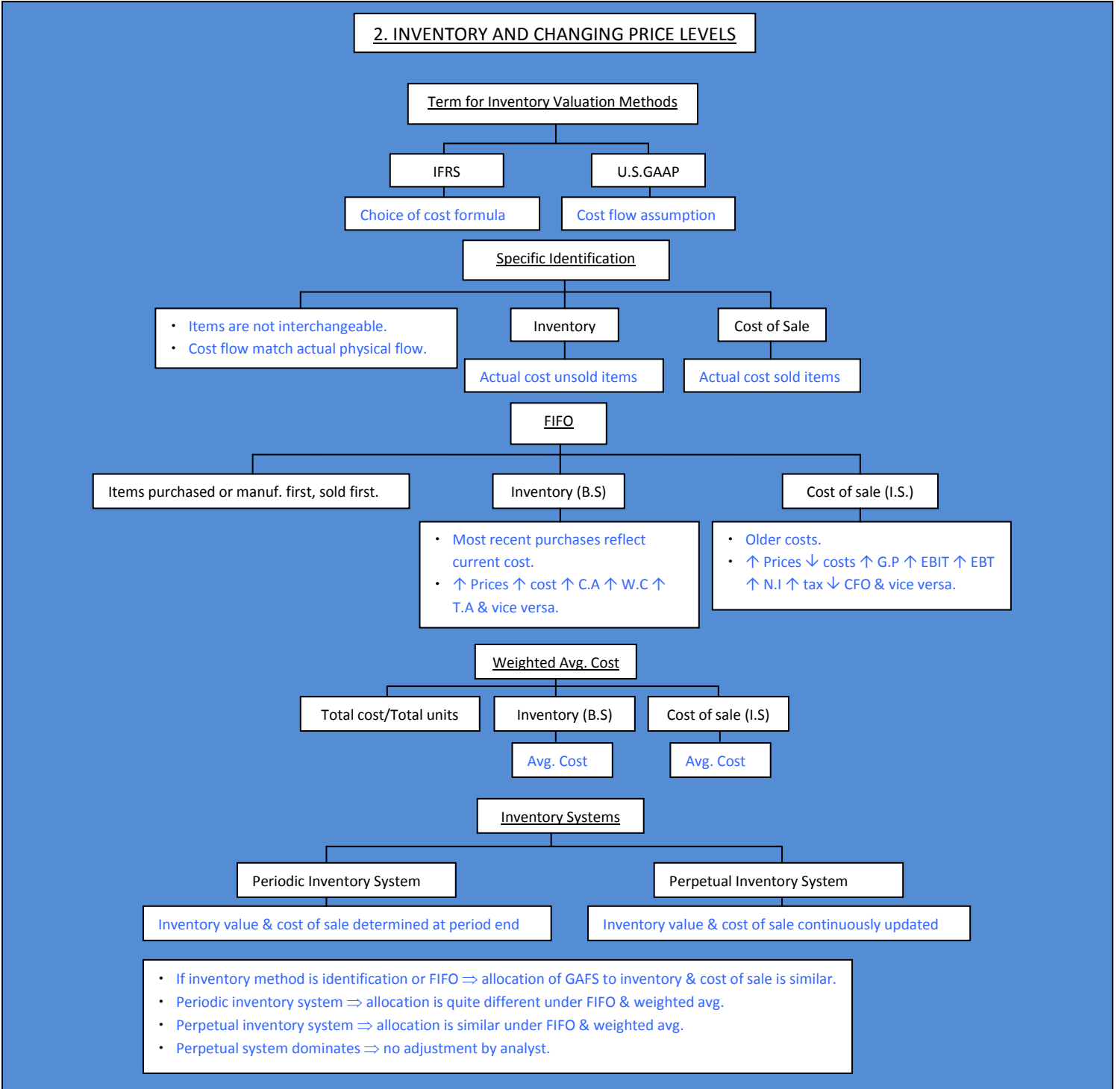
“INVENTORIES: IMPLICATIONS FOR FINANCIAL STATEMENTS AND RATIOS”

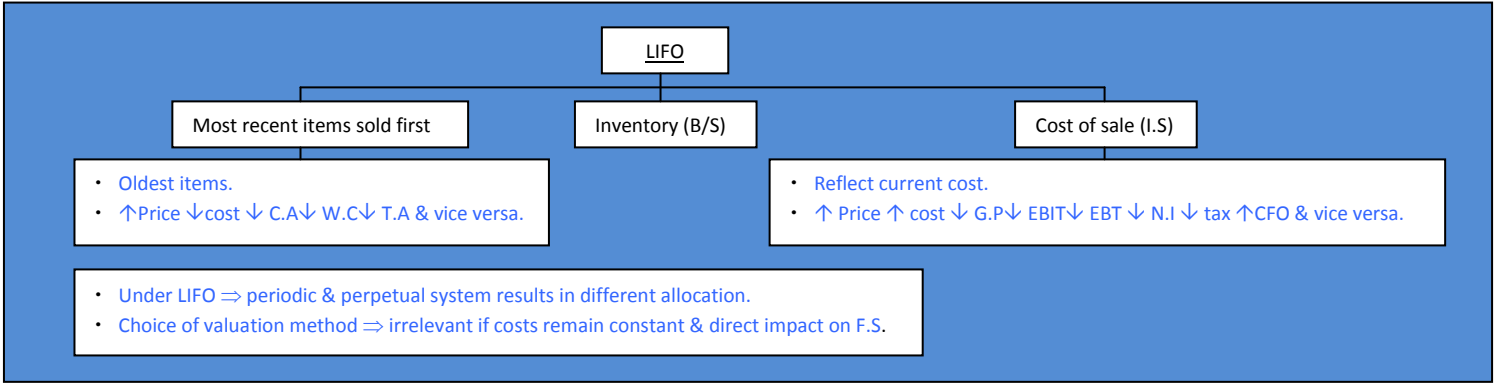
IFRS = International Financial Reporting Standards
 U.S.GAAP = United States Generally Accepted Accounting Principles.
 GAFS = Goods Available for Sale.
 C.A = Current Assets.
 W.C = Working Capital.
 CFO = Cash Flow from Operations.
 FIFO = First-in-First-Out
 LIFO = Last-in-First-Out
 B.S = Balance Sheet
 I.S = Income Statement.

F.S = Financial Statements.
 I.T = Income Tax.
 EBIT = Earnings before Interest & Tax
 NRV = Net Realizable Value
 W-I-P = Work-in-Progress
 C.V = Carrying Value
 COGS = Cost of Goods Sold
 T.A = Total Assets
 N.I = Net Income.
 EBT = Earnings before Tax
 G.P = Gross Profit

1. INTRODUCTION

- Choice of inventory valuation method \Rightarrow different amounts to inventory & cost of sales.
- IFRS \Rightarrow specific identification, FIFO, weighted Avg. cost method.
- U.S.GAAP \Rightarrow same three as above and also a fourth method LIFO.





3. THE LIFO METHOD

- LIFO conformity rule ⇒ LIFO method for both tax & reporting purpose.
- If prices ↑ ⇒ ↓ current ratio ↑ debt to equity ratios ↓ profitability ratios.
- If prices ↓ ⇒ LIFO is not suitable for tax purpose ⇒ ↓ COGS ↑ N.I ↑ taxes.
- Proposed adoption of IFRS ⇒ elimination of LIFO method ⇒ immediate I.T liabilities in year of transition.

3.1 LIFO Reserve

- Companies using LIFO method requires disclosure about LIFO reserve.
- LIFO reserve = FIFO inventory – LIFO inventory.

Adjustments for Comparison

```

    graph TD
      AC[Adjustments for Comparison] --> INV[Inventory]
      AC --> COS[Cost of Sale]
      INV --> INV_EQ["Inventory LIFO + LIFO reserve = inventory FIFO"]
      COS --> COS_EQ["COGS LIFO - ↑ LIFO reserve = COGS FIFO"]
  
```

3.2 LIFO Liquidations

- LIFO reserve ↑ due to
 - ↑ Δ of costs to value inventory under LIFO & FIFO method.
 - No. of units purchase > no of units sold.
- Check LIFO reserve footnote disclosure ⇒ ↓ reserve indicate LIFO liquidation.
- Units sold > units purchased = LIFO liquidation.
- ↑ G.P due to lower COGS ⇒ one time event ⇒ not sustainable.
- Variety of reasons (labor strikes, recession) outside control or potential manipulation by management.

4. INVENTORY METHOD CHANGES

Valuation Method Changes

```

    graph TD
      VMC[Valuation Method Changes] --> IFRS
      VMC --> USGAAP[U. S. GAAP]
  
```

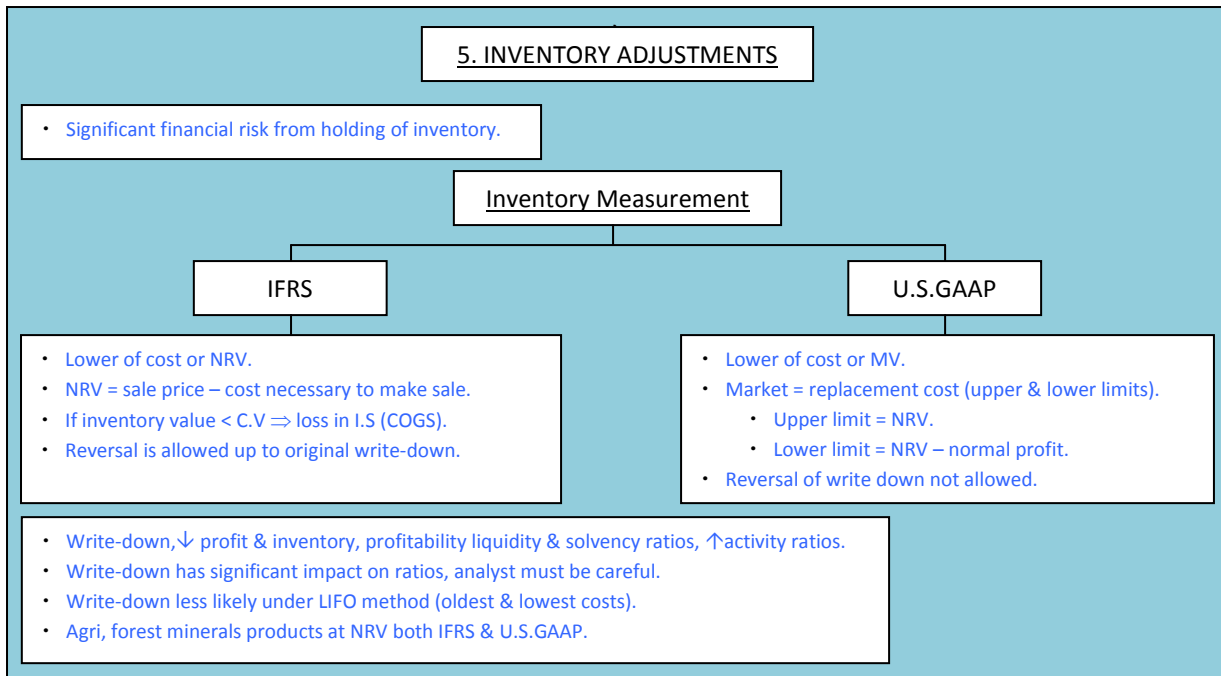
IFRS

- Allow, if Δ is justifiable.
- Applied retrospectively.
- Cumulative amount, periods prior to current F.S.
- Exemptions to restatement if effects are impracticable to determine.

U. S. GAAP

- Δ In accounting & inventory policy are similar to IFRS.
- LIFO to other method ⇒ retrospective.
- Other method to LIFO ⇒ prospective basis.

- Analyst should evaluate the real purpose of changes (e.g. reduce I.T, ↑ profits).



6. FINANCIAL STATEMENT ANALYSIS ISSUES

- Disclosure about suitable inventory classification (both standards).
- \uparrow Raw material or W.I. P may signal, \uparrow demand, sales & profits.
- \uparrow Finished goods, \downarrow raw material & W.I.P, \downarrow demand, sales & profits.
- Compare sales growth rate with finished goods growth rate.
- Too much or wrong type inventory \Rightarrow less cash & W.C