

LIFO Reserve Reporting

TLC Technologies can save your LIFO! (Reserve that is!)

Many non-financial folks often wonder how corporations are able to reduce the tax rate percentage they pay to the government, while as individuals we pay a higher tax percentage. The LIFO reserve is one way they are able to reduce their tax rate.

In a previous solution sheet on Inventory Management Reporting, we highlighted the importance of the physical care of inventory, the methods that may be used to maintain and refresh inventory, and the importance of accurately reporting on the management of inventory. Now that the inventory is on the warehouse shelves and well cared for, let's look at how companies deploy and process that inventory off the shelves to realize revenue while saving on taxes.

We can start by understanding what FIFO and LIFO methods are and why they can be so financially impactful to an organization. Here is a simple example: take a regular deck of playing cards and deal them into one pile of 52 cards. Think of the cards as inventory that has been shipped into your warehouse. The first card that you dealt (sitting on the bottom of the pile) was the first one into the warehouse, or "FI" in accounting terms. The last card that you dealt (sitting on the top of the pile) was the last one in the warehouse, or "LI". When you deal the cards out to the players (AKA ship out inventory to customers) if you deal from the bottom of the deck, you are following the **FIFO method** of first card in, first card out. If you deal from the top of the deck, you are following the **LIFO method** of last card in, first card out.

Companies are allowed to report the value of their inventory differently for internal and external purposes. Most companies use FIFO for internal reporting and LIFO for external reporting. The LIFO Reserve is the difference between these two reporting methods. Why do companies do this? During periods of rising costs inventory becomes more expensive over time, so companies use LIFO to reduce taxes. For example, using LIFO while prices are rising means the cost of the inventory is higher than using FIFO, thereby increasing the Cost of Goods Sold and decreasing pre-tax income. The lower the pre-tax income, the lower the taxes. That same company can use FIFO reporting internally which reduces costs and improves margins. This is appealing to management and investors.

If you're thinking this sounds like two sets of books, you'd be right! This is why auditors or analysts for public companies will focus heavily on the details behind the LIFO Reserve. LIFO reserve is a simple calculation: **LIFO Reserve = FIFO - LIFO**. However, it becomes complex when considering a large amount of inventory, SKUS, product lines, geographies, and foreign currencies.

TLC Technologies provides a LIFO Reserve solution through OneStream Software

It gives you access to easy-to-use reports and dashboards, allowing companies to ensure that all elements of inventory are properly absorbed into the calculation within the appropriate timeframes. Our solution also compares internal and external reporting and delivers that information to the appropriate consumers. The largest benefit of the LIFO Reserve is the comparison between LIFO and FIFO as well as the illustration of the differences, including the all-important tax impact.

Many organizations use spreadsheets or create ad hoc reports from a BI or reporting tools in an attempt to calculate the LIFO Reserve. This is dangerous as it is extremely difficult to ensure all of the inventory is accounted for within the proper time without errors. TLC utilizes validation and confirmation rules to ensure the base data is accurate, timeframes are aligned, and the results are error-free. Data can be imported from any number of existing inventory management, supply chain, procurement software systems, ERPs, or G/Ls. The power of TLC and OneStream allows precise calculation and analysis regarding the health of your inventory across multiple product lines, divisions, geographies, and currencies. This creates the foundation for an accurate LIFO Reserve calculation. It is ill-advised to treat this extremely important process as a one-off calculation. You never want to have to restate numbers or pay a tax penalty due to an error in your LIFO Reserve.

If you would like to find out more, please contact Robert Fitzgerald, a partner with TLC Technologies, at rfitzgerald@tlctechnologies.com.