The need to be “financially bilingual” US GAAP vs IFRS

IX. INVENTORY

This presentation contains information, in addition to the material prepared and provided by the professor, from:

1. Elizabeth A. Gordon, Temple University, Jana S. Raedy, University of North Carolina, Alexander J. Sannella, Rutgers Business School, ©2016, Pearson | ISBN13: 9780132162302
2. Donald E. Kieso, Jerry J. Weygandt, Terry D. Warfield, Intermediate Accounting, 16th Edition
3. March 2016, ©2016
4. Doupnik T. and Perera H. INTERNATIONAL ACCOUNTING- CONT4029 (Custom Edition by Prof. Aida Lozada and Prof. Carmen Ríos. McGraw-Hill, 2014. ISBN 9781308235059.
5. Thimothy, D., Finn M., Gotti, G. and Perera, H. 5ed. INTERNATIONAL ACCOUNTING. Mc Graw Hill 2020, New York.
6. J. David Spiceland, James Sepe, Mark Nelson, Intermeiate Accounting, 6th edition, McGraw-Hill, 2014. ISBN-13: 978-0077614065 ISBN-10: 0077614062
7. Other: Official Websites

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IX. INVENTORY

Types of Inventory:

1. Retail (any to buy for sell) without modifications
2. Manufacturing (produce for sale)

Raw Material

Working Process

Finished Goods

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INVENTORY: COST

Balance Sheet	*	Income Statement
Cost		Expense

*Available For sale

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INVENTORY COSTS

Cost Included

- Cost of Purchases (purchases price plus costs directly attributable to acquiring material, finiched goos or services)
- Conversion Costs (labor and overhead)
- Product cos for specific customer
- Interest cost

Cost Excluded

- Abnormal waste
- Storage (unless necessary for production process e.g. wine)
- Administrative cost (expenses)
- Selling cost (expenses)

INVENTORY: DIFFERENCES SUMMARY

- Cost Flow
- Lower of Cost or Market Rule
- Recovery of Previous Losses

INVENTORY: DIFFERENCES SUMMARY

- Cost Flow

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INVENTORY: COST FLOW ASSUMPTION

COMPARISON

US GAAP FASB ASC 330	IFRS IAS 2
➢ ALLOWED LIFO	➢ NOT ALLOW LIFO

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INVENTORY: COST FLOW ASSUMPTION

COMPARISON

US GAAP FASB ASC 330

ALLOWED LIFO

Convergence would cause many companies lose the tax shelter (significant).

1. If the company taxed on the difference between LIFO method and other method, it will cost material amount (taxes) $ $ $

***Example: It will cost ExxonMobil $4 billion approximately.**

If LIFO is prohibited in U. S. federal, tax revenues will increase by **$76 billions over 10 years.

*Spiceland, J. D., Sepe, J. F., & Nelson, M. (2013). Intermediate accounting. New York: McGraw-Hill/Irwin.

**Spiceland, J. D., Nelson, M., & Thomas, W. (2018). *Intermediate accounting*. New York: McGraw-Hill/Irwin.

IFRS IAS 2

- **NOT ALLOW LIFO**

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INVENTORY: COST FLOW ASSUMPTION

COMPARISON

US GAAP FASB ASC 330

ALLOWED LIFO

IFRS IAS 2

- **NOT ALLOW LIFO**

2. A change to IFRS might also require companies to request permission from the IRS to change accounting method and might affect computation of U.S. earnings and profits for federal tax purposes. Transfer pricing policies may also be affected. (Tysiac, 2012)

The report identified two areas of state taxation that could be affected by the adoption of IFRS: (1) apportionment of income, if the adoption of IFRS changed underlying apportionment factors; and (2) taxes based on a company's net worth or equity, if the adoption of IFRS affected either of those. (Tysiac, 2012)

INVENTORY: DIFFERENCES SUMMARY

- Lower of Cost or Market Rule

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INVENTORY: LOWER OF COST OR MARKER RULE

WRITE DOWN: US GAAP FASB ASC 330

- ***USE REPLACEMENT COST: except**
  ***Note: Apply for LIFO only**

1. Exceed NET REALIZABLE VALUE, NRV
(selling price less cost of disposal)
OR
2. Be less than NRV less normal profit

In that case use the number in the middle of the three alternatives.

TYPE OF INVENTORY

- Can be applied to individual items, inventory categories, or the entire inventory

WRITE DOWN: IFRS IAS 2

- ***USE NET REALIZABLE VALUE**
  (selling price less cost of disposal)

TYPE OF INVENTORY

- Usually applied to individual items, although using inventory categories is allowed under certain circumstances

INVENTORY: DIFFERENCES SUMMARY

- Recovery of Previous Losses

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INVENTORY: RECOVERY OF PREVIOUS LOSS

COMPARISON

US GAAP FASB ASC 330

WRITE DOWN REVERSE

- **NOT ALLOWED**

  Any write-down of inventory below cost creates a new cost basis that subsequently cannot be reversed

IFRS IAS 2

WRITE DOWN REVERSE

- **ALLOWED**
  - Recovery of Inventory Loss (current income)
  - Previously recognized devaluation losses are reversed up to the amount of the original devaluation loss when the reasons for the devaluation no longer exist.

INVENTORY: DIFFERENCES SUMMARY

EXAMPLE #1

INVENTORY VALUATION: LCM RULE BY INDIVIDUAL ITEMS

ITEM	COST	NRV
A- Standard	$20,000	$30,000
B- Standard	30,000	29,000
C- Superior	7,000	5,000
D- Superior	18,000	25,000
E-Superior	25,000	22,000

INVENTORY VALUATION: LCM RULE BY INDIVIDUAL ITEMS

ITEM	COST	NRV	LCM RULE
A- Standard	$20,000	$30,000	$20,000
B - Standard	30,000	29,000 (1,000)	29,000
C- Superior	7,000	5,000 (2,000)	5,000
D- Superior	18,000	25,000	18,000
E- Superior	25,000	22,000 (3,000)	22,000
TOTAL	$100,000		$94,000
Dr. Loss on Inventory Write-down Cr. Inventory or Allowance to reduce Inventory to Market	6,000 6,000		

INVENTORY VALUATION: LCM RULE BY GROUPS

ITEM	COST	NRV	LCM RULE
A- Standard	$20,000	$30,000	
B - Standard	$30,000	$29,000	
Category Sub Total:	**$50,000**	**$59,000**	**$50,000**
C- Superior	$7,000	$5,000	
D- Superior	$18,000	$25,000	
E- Superior	$25,000	$22,000	
Category Sub Total:	**$50,000**	**$52,000**	**$50,000**
No adjustment (NO LOSS)			

INVENTORY: DIFFERENCES SUMMARY

EXAMPLE #2

Company XYZ reported the following Inventory information for 2019.

Cost		20,000
Selling Price	$18,000	
Selling Cost	$1,000	
Net Realizable Value:		$17,000

Under IAS 2, what should the Balance Sheet report for Inventory?

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Cost		$20,000
Selling Price	$18,000	
Selling Cost	$1,000	
Net Realizable Value:		$17,000

Under IAS 2, what should the Balance Sheet report for Inventory?

Income Statement:

Loss due Inventory write down is $3,000

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Cost		$20,000
Selling Price	$18,000	
Selling Cost	<u>$1,000</u>	
Net Realizable Value		$17,000

If the selling price increase to $25,000 for 2020.

(the rest of the information remains the same)

What adjustment to inventory should be made?

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2019

Cost		20,000
Selling Price	$18,000	
Selling Cost	$1,000	
Net Realizable Value:		$17,000

What adjustment to inventory should be made?

2020

COST: $20,000 vs (NEW) NRV: $24,000 (Selling Price: $25,000 – Selling Costs: $1,000)

The New Inventory Value is: $24,000???

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2019

Cost		20,000
Selling Price	$18,000	
Selling Cost	<u>$1,000</u>	
Net Realizable Value:		$17,000

What adjustment to inventory should be made?

(2019): **$17,000** vs New NRV (2020) **$24,000**

Increase by: $7,000

Dr. Inventory / Allowance to adjust Inventory to market ***$7,000**

Cr. Recovery of Inventory loss (current income) **$7,000**

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Can't be… $24,000

<u>2019</u>

Cost		20,000
Selling Price	$18,000	
Selling Cost	<u>$1,000</u>	
Net Realizable Value:		$17,000

What adjustment to inventory should be made?

Increase only up to cost amount: $20,000

COST (2019): **$20,000** vs New NRV (2020) **$24,000**

Dr. Inventory / Allowance to adjust Inventory to market *$3,000

Cr. Recovery of Inventory loss (current income) $3,000

**The inventory cannot be valued above its cost (Previous Valuation $17,000 + $3,000) = $20,000*

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INVENTORY

2019: COST: **$20,000** vs NRV: **$17,000 = Loss $3,000**

2019: NRV: **$17,000 + 7,000 = 2020 NEW NRV= $24,000**

2019 **BEGINNING BALANCE (COST)** **$20,000**	**Reduce Inventory to Market by:** **$3,000** **Direct Method** **Dr. Loss... 3,000** **Cr. Inventory 3,000** **Indirect Method** **Dr. Loss… 3,000** **Cr. Allowance 3,000**
2019 **ENDING BALANCE (NRV)** **$17,000**	
2020 Can't recover more than the previously lost amount: $3000 (NRV:2019: $17,000 vs NRV: 2020 $24,000) Increase by: $7,000 **RECOVER ONLY: $3,000** **Direct Method** **Dr. Inventory... 3,000** **Cr. Recovery 3,000** **Indirect Method** **Dr. Allowance… 3,000** **Cr. Recovery 3,000**	
2020 **ENDING BALANCE (COST)** **$20,000**	

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LOSS…

2019 $3,000 **Direct Method** Dr. Loss... 3,000 Cr. Inventory 3,000 **Indirect Method** Dr. Loss… 3,000 Cr. Allowance 3,000	Closing Entry $3,000
ENDING BALANCE	$0
	2020 Transaction on the credit side ONLY to show the effect RECOVER : $3,000 Increase current income by $3,000 **Direct Method** Dr. Inventory... 3,000 Cr. Recovery 3,000 **Indirect Method** Dr. Allowance… 3,000 Cr. Recovery 3,000

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ASSESSMENT ACTIVITY

5. INVENTORY