

ACCT 101

Chapter 5 - COMPARISON OF INVENTORY METHODS

METHOD	ADVANTAGES	DISADVANTAGES
FIFO	Ending inventory amount on balance sheet approximates current replacement costs.	Passes through effects of inflation and deflation to gross profit reported on income statement.
LIFO	Matches current costs against current revenues on income taxes. During inflationary periods, reduces income taxes.	Ending inventory amount on income statement may be substantially different from current replacement cost.

**AVERAGE
COST**

Easy to understand.

Ending inventory amount on income statement may not represent current replacement cost.

Lose tax advantage available from LIFO when prices are rising.

Yields same answer whether prices start at \$1 and increase to \$2

or start at \$2 and decrease to \$1.