Accounting standards

To determine the value of inventory to be reflected in the balance sheet, purchases are added to the beginning inventory and then cost of goods sold are subtracted. The FIFO and LIFO Methods are accounting methods used to value inventory. FIFO stands for " first-in, first-out", meaning that the oldest inventory items are recorded as sold first. LIFO stands for " last-in, first-out" which means that the most recent inventory are recorded as sold first. In theory, the cost of items purchased for sale or the materials purchased to manufacture finished goods Increases periodically In time. Sing the FIFO method, the balance sheet loud show Inventory at current costs since the ending Inventory Is represented by the most current purchases as older Inventory would have been sold. The compass income statement would show costs of goods sold as costs associated with the costs of older inventory. A company's balance sheet therefore would show a higher amount of assets under the FIFO method. Likewise, a company's income statement would also reflect a higher gross margin because the cost of goods would be smaller. Opting for the LIFO method would create a reverse picture.

A company's balance sheet would reflect a lower balance of inventory and assets because the ending inventory value would be based on older costs since the most recent inventory is sold first. Its Income statement would show a smaller gross margin due to its cost of goods sold being higher since the cost of goods would base Its amount on the most recent Inventory purchased. Under the current US Generally Accepted Accounting Principles (US CAP), both Inventory methods are acceptable. However, under the International Accounting Standards, the LIFO is now allowed.

In my opinion, the balance sheet that uses the FIFO method of inventory would be more useful in making decisions to buy or sell shares of a company's stock because the FIFO method ivies users a better indication of the value of the ending inventory and the balance sheet under the FIFO method would show a bigger amount of assets compared to the LIFO method. Likewise, the income statement of a company that uses the FIFO method would also show a higher gross margin and thus, the bottom line would be higher as well.

However, Investors also need to look at other components of the financial statements and analyze the trend of an entity to gain a better understanding of an entitles operations, performance and net worth prior to deciding on whether to sell or buy that company's stocks. B. Discuss the concept of conservatism. In your pollen, which Is more conservative, approach of choosing an accounting method when in doubt that will least likely overstate assets and net income. " (http://www. Wiley. Com/college/AC/ weygandt347736/site/glossary/home. Tm#c). Conservatism conflicts with the qualitative characteristics such as neutrality. Because of this, the FAST has attempted to modify the principle of conservatism. The Abs's Statement of Financial Accounting Concepts (SFA) No. 2 defines conservatism as " A prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in business situations re adequately considered. " These uncertainties should and risks should be reflected in accounting information to improve its predictive value and neutrality.