LIFO and FIFO

LIFO (Last-in First-out) and FIFO (First-in First-out) are two important accounting methods used in calculation of the amount of money a company has in the form of inventory of produced goods, materials or livestock. These methods are applied in different accounting scenarios, and are frequently tested on exams. LIFO is calculated by assuming that the latest or newest goods produced and stored in inventory are the first to be sold. Since inflation causes goods to be more expensive over time, using this method results in higher COGS, lower income and less overall inventory cost. FIFO is calculated by assuming that the earliest or oldest goods produced and stored in inventory are the first to be sold. Using this method results in a less expensive cost of goods sold and therefore a higher income, but it also results in a higher overall inventory cost. It is very important to master the comparison between LIFO and FIFO in terms of inventory, cost of goods sold (COGS), and income, as these are commonly tested topics. For example, the inventory of LIFO is smaller than the inventory of FIFO, the COGS of LIFO is larger than the COGS of FIFO, and the income of LIFO is smaller than the income in FIFO. These relationships can be rationalized by examining the equation of LIFO and FIFO, but a good way to master them for the exam is by using this Picmonic.

Instructional audio

Last in First Out or LIFO and First in First Out or FIFO are two important accounting concepts that differentiate how the cost of inventory is calculated based on timeline of production and sale. In this Picmonic, LIFO is portrayed by the life boat in last place versus FIFO the fast fiery boat in first place of the race. It is important to remember how LIFO and FIFO compare in cost of goods sold, abbreviated COGS, inventory, and income. When LIFO is used, the COGS is usually higher than when FIFO is used. This concept is represented here by the life boat carrying a pile of clogs in contrast to the fast boat which is not. The inventory in LIFO is usually smaller than the inventory in FIFO, which is why the vent on the life boat is smaller than the vent on the fast boat. Lastly, the income in LIFO is typically smaller than the income in FIFO. This is depicted by the small ink money in the life boat versus the pile of ink money in the fast boat.

Creative story

Its a race between the **lifeboat** and fast **fire boat** to see who can net more income from the water. But the would be the winner was obvious right from the get go, as the **large** amount **clogs** have indeed clogged the **smaller vent** of the lifeboat. It didn't take long for the fast fire boat to sweep up all the ink cash with those powerful flames shooting out of a larger vent. Such a **small** amount of **ink cash** for the boy aboard the lifeboat has left him feeling lost at sea.

PLAY PICMONIC

LIFO

Life boat

Last-in First-out is an accounting method that calculates cost of inventory based on the fact that the last good produced and stored in the inventory is actually the first one being sold.

FIFO

Fast fiery boat

First-in First-out is an accounting method that calculates cost of inventory based on the fact that the first good produced and stored in the inventory is actually the first one being sold.

Larger COGS

Large pile of clogs on the life boat

Using LIFO as a calculation method results in higher cost of goods sold because the last good produced is typically more expensive due to the natural effect on inflation over time.

Smaller inventory

Smaller vent on the life boat

Using LIFO as a calculation method results in smaller inventory because the more expensive goods, produced at a later date, is first to be sold. Whatever is left in the inventory are the older, less expensive goods.

Smaller Income

Less cash on the life boat

Using LIFO as a calculation method results in smaller net income because the cost of goods sold is higher.