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Will There Be Life after LIFO? The Impact of LIFO's Repeal on the Value of the Firm

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Abstract

Recent impetus towards the abolishment of Last-in-First-Out (LIFO) accounting include its prohibition under the prospective implementation of International Financial Reporting Standards (IFRS) and proposed changes to U.S. tax law. Since the prohibition of LIFO would presumably require firms to retroactively realize past LIFO related tax deferrals, its repeal could have significant financial consequences for firms with large LIFO reserves. This study investigates the potential effect of the repeal of LIFO on the value of the firm. Introduced in 2007, bill H. R. 3970 mandated repeal of LIFO for tax years beginning after the date of enactment. Although no action was taken, this bill marked the beginning of domestic political initiatives to repeal LIFO that continue to this date. Results of this study show a post 2007 negative relation between LIFO firms' market value of equity and the magnitude of their LIFO reserves. We interpret these results to show that the increasing likelihood of LIFO related tax payments may be having a negative valuation effect on LIFO firms.