De Filipps' LIFO LOOKOUT

A Quarterly Update of LIFO - News, Views and Ideas

Volume 7, Number 4 | Publisher: Willard J. De Filipps, C.P.A. | December 1997

LIFO UPDATE

If you had called me personally to ask "What's happening lately with LIFO that I need to know about?" ... Here's what I'd say:

#1. LIFO CONFORMITY YEAR-END UPDATE. In our year-end issue for 1997, we are taking a comprehensive look at the LIFO financial statement conformity requirements once again. This updates prior discussions to reflect the **special** relief recently granted **only** to automobile dealers for **certain** conformity violations.

There are significant implications from the recent IRS interpretations (Revenue Ruling 97-42 and Revenue Procedure 97-44) that extend far beyond auto dealers. The portion of the LIFO regulations which the IRS has interpreted in providing relief for auto dealers applies to all taxpayers using LIFO ... every year ... and there's no way to go back and "cure" any defects ... and the IRS has "forever" to go back and make you dig out all of the details.

The IRS offered relief only for conformity violations involving auto dealers' Factory income statements. How are countless other businesses on LIFO submitting similar formatted statements under similar circumstances to their manufacturers and credit sources going to be treated? What should medium and heavy-duty truck, equipment and implement dealers (to name a few) do now that we have more insight into their exposure for conformity violations? Aren't their LIFO elections also in jeopardy? What should these other businesses be told?

#2. MORE ON REV. PROC. 97-44 AND THE IRS' SPECIAL SETTLEMENT OFFER FOR AUTO DEALERS WITH CONFORMITY VIOLATIONS. With three months under our belt since the formalization of the IRS' relief for auto dealers with LIFO conformity violations, more problem areas and unanswered questions are emerging. But there are still no definite answers and no comfort on some key questions. Part of the problem is that IRS lawyers don't seem to understand dealership accounting, closing procedures, and some of the other deadline realities auto dealers and their CPAs face.

LOOKOUT LOOKS INTO

Since discussing "Some Questions In Need Of Answers" in our last issue, more new questions have come up and are discussed on page 9. NADA recently released its "*Dealer Guide to the LIFO Conformity Settlement*" which we have summarized on page 10.

Dealers and CPAs are just beginning to realize what a mess they're in ... unless, of course, they're willing to fork over 4.7% of their LIFO reserves hoping to buy their way out of trouble. Can anyone offer them sound advice on what to do? We're not sure, but we've tried anyway on page 12.

#3. USED VEHICLE LIFO ELECTIONS FOR 1997 ... THINK TWICE! ARE RECENT LIFO ELECTIONS STUCK IN REVERSE? With the year-end 1997 information now available, many dealers with used car LIFO elections are finding that what may have been small increases or decreases in used car prices in 1996 are being followed up by greater price decreases for 1997. This combination is undoing the prior benefits from used car LIFO elections

see **LIFO UPDATE**, page 2

(Continued from page 2)

made in 1995 and 1996. Furthermore, used vehicle price decreases are also forecast for 1998.

The December, 1997 issue of *Auto Remarketing* interviews several used vehicle industry experts, and their collective prognosis for 1998 used vehicle prices seems to be that 1998 prices will reflect the continuation of pressures felt during 1997. This suggests that any dealer contemplating used vehicle LIFO elections for 1997 ought to think twice about giving up their used car writedowns with near term price deflation experienced by many in 1997 and expected to continue over the next year or so.

All of this has caused us to reconsider our earlier comments about the advisability of used vehicle LIFO elections for 1997 ... and we've run some calculations assuming a dealer elected LIFO in 1996 with a small amount of used vehicle price inflation, but then experienced price deflation in 1997, 1998 and 1999. With $600,000 in inventories at each year-end over this period, that dealer would be looking at a ***negative*** LIFO reserve of roughly $60,000 by 1999.

Welcome to the world of ***negative*** LIFO reserves ... if you don't terminate your LIFO election! See page 25 for further discussions, calculations, and proofs.

#4. IRS AUDITS OF USED VEHICLE LIFO COMPUTATIONS. We have received many calls during the last quarter regarding how the IRS is auditing used vehicle LIFO calculations and pursuing more detail on unsettled computation questions. Some of these questions may be resolved through a Technical Advice proceeding in 1998. If you're computing used vehicle LIFO indexes for 1997 and come up with inflation indexes, you may want to seriously question the underlying assumptions or calculation approach. Are you sure you can justify showing price inflation while the rest of the industry is showing (on average) almost 10% price deflation?

#5. REVISED FORM 3115. The revised Form 3115 is now available, bearing a revision date of November, 1997. It reflects the changes made by Revenue Procedures 97-27 and 97-37. These include allowing the filing of Form 3115 at any time during the year of change (97-27), and an expansion of the "automatic consent" provisions regarding certain accounting method changes which permit the filing of Form 3115 well after the end of the year (97-37).

#6. "RETROACTIVE" LIFO TAX PLANNING. Under new Revenue Procedure 97-37, Forms 3115 filed to reflect "automatic" consent changes are not required to be filed until the filing of the tax return for the year of change. At that time, a copy of Form 3115 is required to be furnished to the IRS National Office in Washington, D.C. Section 6.02 provides that a taxpayer changing a method of accounting pursuant to this revenue procedure must complete and file an application in duplicate. The original must be attached to the taxpayer's timely filed (including extensions) original federal income tax return for the year of change. A copy of the application must be filed with the National Office...no earlier than the first day of the year of change and no later than when the original is filed with the federal income tax return for the year of change.

Accordingly, taxpayers now have added planning flexibility and more opportunities to use hindsight. The risk, of course, is that the longer one waits to file a Form 3115, the greater the possibility that during that "waiting period," the IRS may just start an audit. With the elimination of the 90-day audit window benefit that many LIFO taxpayers previously found quite favorable, this risk has to be carefully considered by those wishing to continue a questionable method of LIFO accounting for just one more year.

#7. YEAR-END PROJECTIONS FOR DEALERS BASED ON "ONE-OF-EACH." Each year we've provided a listing that can be used for auto dealer ***new*** vehicle LIFO reserve projection purposes showing for each model the weighted average information. In prior years, we reflected intro-to-intro prices. This year, for greater accuracy, our information compares everything in our database as of December 1, 1996 (i.e., the beginning of the year) ...with intro-'98 model prices, unless the '98 intro price was subsequently updated and that information is also in our database (i.e., the end of the year).

Generally, the overall price increases for new vehicles for '98 are small again this year. For calendar year-end 1997, you can again expect your year-end inflation indexes to be low and your LIFO reserve increases to be small due to competitive pressures among the manufacturers and dollar-to-foreign currency pressures. Another general observation is that there are fewer new item categories this year for Alternative LIFO purposes (there may even be *significantly* fewer). Therefore, the "pure inflation" amounts are even less diluted by the repricing of new items at 1.000 in our one-of-each computations. However, all of this needs to be qualified because not all manufacturers have made their information available and that means our database is not complete at this time.

The weighted averages we have computed are determined by taking all of the underlying item categories (for which information is currently available)

see **LIFO UPDATE**, page 28

FINANCIAL STATEMENT CONFORMITY REQUIREMENTS: STILL THE ULTIMATE LIFO TRAPS

With year-end approaching, it's time again to review the LIFO financial statement conformity requirements. When we last published an article on this subject there were many questions up in the air over how auto dealers should report LIFO on their year-end financial statements sent to the manufacturers or to their credit subsidiaries. Some, but by no means all, of these questions have been resolved during 1997 by the issuance of Revenue Procedure 97-44 and Revenue Ruling 97-42.

To keep things in proper perspective, there are other year-end LIFO conformity requirements, and there are many other kinds of taxpayers using LIFO besides automobile dealers. Accordingly, this article reviews the multiple LIFO conformity requirements that must be complied with in order to properly elect and remain eligible to use the LIFO method in later years.

BASIC LIFO ELIGIBILITY REQUIREMENTS: "CONFORMITY" IS ONLY ONE

First of all, keep in mind that the IRS can disallow a LIFO election if it finds a violation of any one of the following four eligibility requirements:

ELIGIBILITY REQUIREMENTS

1. Failure to value LIFO inventory at cost for tax purposes for the year preceding the year of LIFO election, the election year, and all subsequent years (Cost).
2. Violation of the financial statement reporting conformity requirements (Conformity).
3. Failure to properly elect LIFO...failure to file Form 970 (Consent).
4. Failure to maintain adequate books and records with respect to the LIFO inventory and all computations related to it (Books & Records).

Even if one of these situations exists, the Internal Revenue Service has the discretionary power to allow the election—if it can be persuaded to exercise that power in the taxpayer's favor. For example, Revenue Procedure 79-23 reflects the position of the Service that a LIFO election can be disallowed if the taxpayer fails to maintain adequate books and records with respect to the LIFO inventory and computations related to it. However, if a taxpayer is able to reconstruct the information necessary to calculate the LIFO inventory amount properly, it **may** be possible to avoid termination of the LIFO election for a "books and records" infraction.

Revenue Procedure 79-23 (1979-1C.B.564) clearly states that in other circumstances where LIFO infractions occur, such as computational errors, incorrect pool selection or item determination, or differences in the levels of costing inventories between financial statements and tax returns—the IRS is not authorized to take the taxpayer off of LIFO. However, where the LIFO violations involve conformity, cost or Form 970 consent matters, the Service usually looks to terminate the errant taxpayer's election.

CONFORMITY REQUIREMENTS

There are many conformity requirements. They exist as restrictions on a taxpayer's general desire to pay lower taxes using a LIFO (Last In, First Out) method for valuing inventories, while reporting more income to shareholders or banks and other creditors using a non-LIFO method. The intention underlying the financial statement conformity requirements is that LIFO should be used in all reports covering a full year to insure that the use of LIFO for tax purposes conforms as nearly as possible with the best accounting practice in the trade or business in order to provide a clear reflection of income.

Although it is commonly stated that LIFO must be used to compute income in the year-end financial statements, technically, the IRS only requires LIFO to be used in the primary presentation of income (i.e., in the Income Statement). For most taxpayers, the LIFO conformity requirements really pose at least two general sets of requirements:

- ***FIRST***, they require that any year-end financial statements issued in the traditional report form by the taxpayer to creditors, shareholders, partners or other users must reflect the year-end results on LIFO.
- ***SECOND***, they also require all year-end financial statements sent to a manufacturer or supplier (12th, 13th and any other fiscal year-end statements) to reflect LIFO.

A taxpayer may adopt LIFO only if it has used no other procedure than LIFO in preparing an Income Statement or a profit or loss statement covering the first taxable year of adoption. For subsequent taxable years, similar restrictions are imposed. However, as noted above, the Commissioner has the discretion to allow a taxpayer to continue to use the LIFO method even though conformity violations might have occurred.

see **CONFORMITY REQUIREMENTS: THE ULTIMATE LIFO TRAPS,** page 4

Accordingly, a LIFO reserve, no matter how large, can be completely and abruptly lost if careful attention is not paid to the conformity requirements in year-end financial statements sent to the Factory/ Manufacturer/Supplier...as well as to the more conventional year-end statements issued in report form by CPAs.

TRADITIONAL FINANCIAL STATEMENT REPORTS ISSUED BY CPAs

This section deals with reports issued by CPAs, where the CPA controls the release, content and format of the financial statements, notes and supplementary information. These are unlike monthly statements which may be prepared internally by the taxpayer's accounting department or controller and sent out to the manufacturer or supplier without direct CPA involvement or review.

The LIFO conformity requirement (relating to reports issued by CPAs) requires that in the primary presentation of income (i.e., the Income Statement), the results disclosed must only be the net-of-LIFO results. The primary Income Statement CANNOT show results before LIFO, followed by either an addition or subtraction for the net LIFO change, coming down to a final net income or loss after-LIFO figure. This means that during a period of rising prices a business using LIFO will usually be reporting lower operating results in order to satisfy the conformity requirement. This very strict disclosure limitation existed with no room for deviation for many years.

In 1981, the Regulations were liberalized to allow LIFO taxpayers to disclose non-LIFO operating results in supplementary financial statements, as long as those supplementary non-LIFO financial statements are (1) issued as part of a report which includes the primary presentation of income on a LIFO basis and (2) as long as each non-LIFO financial statement contains on its face a warning or statement to the reader that the non-LIFO results are supplementary to the primary presentation of income which is on a LIFO basis. Accordingly, in CPA-prepared year-end financial statements, a LIFO taxpayer's results on a non-LIFO basis can be fully disclosed in this manner as supplementary information.

Alternatively, the Regulations permit disclosure of non-LIFO results in a footnote to the regular year-end financial statements, as long as the Statement of Income itself does not disclose this information parenthetically or otherwise on its face and the notes are all presented together and accompany the Income Statement in a single report.

As a result of these "liberalizations" in the Regulations in 1981, these LIFO conformity requirements should not present any major reporting problems for reports issued by CPAs.

"GETTING AROUND" THE CONFORMITY REQUIREMENTS

Many businesses (especially publicly-held companies reporting to the SEC) using LIFO would like to reduce taxes by reporting lower taxable income/ earnings in tax returns while at the same time reporting higher earnings/more income to their shareholders and creditors for financial and market valuation purposes. This can be done easily, thanks to loopholes conveniently provided in the Regulations. But one has to know they are there.

The Regulations allow taxpayers to legitimately avoid the intent of the conformity requirement by allowing them to use LIFO methods and sub-elections in their financial statements that are different from those LIFO sub-elections and methods that are used in their income tax return computations. That's right: DIFFERENT LIFO METHODS MAY BE USED FOR BOOK AND FOR TAX PURPOSES. It is not necessary for the year-end financial statements to use the same exact LIFO sub-elections that are used in the tax return LIFO calculations. The Regulations simply require that both sets of financial statements (i.e., those included in the financial reports and those inherent in the income tax returns) must report using LIFO methods.

This allows some companies to use more pools for financial reporting purposes than for income tax purposes. Others use link-chain or link-chain, index (dollar value) methods to lower LIFO income for tax purposes, while they use double-extension (dollar value) LIFO methods for financial reports. Still others reconstruct long distant base prices for new items in their tax return LIFO calculations while they price new items at current cost in their financial statements. These companies enjoy the best of both worlds without violating the fine print of the "conformity" requirements. (Ironically, many auto dealer groups that have "gone public" in 1997 have [foolishly] thrown away the benefits of their LIFO elections in pursuit of greater earnings per share and market valuations.)

INTERIM REPORTS

Interim reports covering a period of operations that is less than the whole of a taxable year may be issued on a non-LIFO basis without violating the LIFO conformity requirement for tax purposes. The Regulations are completely clear and unambiguous on this point. Although Generally Accepted Accounting Principles may present some difficulties in this regard, the Income Tax Regulations clearly do not. →

DEALERSHIP YEAR-END STATEMENTS SENT TO MANUFACTURER/ SUPPLIER/CREDITORS

The BAD NEWS for many LIFO taxpayers is that the Regulations contain several year-end LIFO reporting restrictions which apply to the specially formatted financial statements sent by auto dealerships and other businesses immediately after year-end to the Manufacturer/Supplier/Creditors. These restrictions on year-end dealership-issued statements pose fatal LIFO traps that are potentially harder to deal with than those for year-end reports issued by CPAs.

In this regard, the Regulations provide that any Income Statement that reflects a full year's operations must report on a LIFO basis. This would apply regardless of whether the Income Statement is the last in a series of interim statements, or a December statement itself which shows two columns, one for the current month results and one for year-to-date figures. The Regulations provide that a series of credit statements or financial reports is considered a single statement or report covering a period of operations if the statements or reports in the series are prepared using a single inventory method and can be combined to disclose the income, profit, or loss for the period. See Reg. Sec. 1.472-2(e)(6). If one can combine or "aggregate" a series of interim or partial-year statements to disclose the results of operations for a full year, then the last Income Statement must reflect income computed using LIFO to value the inventory.

Literally interpreted, this wording applies to all franchised auto dealers' 12th statement (i.e., December unadjusted) as well as to their 13th statements. The 12th statement is usually issued on a preliminary basis, before accruals and estimates are refined by detailed adjusting entries. The 13th statement is usually issued several weeks after the 12th statement, and it reflects year-end accrual adjustments and other computations not otherwise completed within the tight time frame for the issuance of the December or 12th statement (usually the 10th day of the following month).

IRS LETTER RULING INTERPRETATIONS IN 1995 HURT AUTO DEALERS

In May of 1995, IRS Letter Ruling/Technical Advice Memo 9535010 "officially" restated the IRS' restrictive position concerning dealer financial statements submitted to the manufacturer. In this Letter Ruling, a calendar year dealership raised the conformity question in the context of what happens when the monthly statements, including year-end, are not on LIFO but the CPA prepares annual audited financial statements for the dealership which reflect LIFO.

Here, the taxpayer's argument was that these audited statements reflecting LIFO were the primary financial statements, while the monthly statements sent by the dealership to the manufacturer and to the credit corporation were "supplementary statements." The IRS concluded that the dealer in LTR 9535010 had violated the LIFO conformity requirement because:

IRS TESTS

1. The dealership used an inventory method other than LIFO in ascertaining its income in the monthly financial statements,
2. The financial statements ascertain income for the "taxable year,"
3. The financial statements are "for credit purposes," and
4. The financial statements are not within any of the exceptions to the LIFO conformity requirements that are provided in the Regulations.

With respect to the use of the financial statement "for credit purposes," the IRS found that a debtor-creditor relationship did exist between the dealership and the manufacturer and the credit corporation. The IRS stated that if the taxpayer's "operations began to deteriorate, it is doubtful that Corp. X (the manufacturer) and Corp. Y (the Credit Corporation) would ignore these reports and continue to extend credit to T (the taxpayer) as though nothing has changed." The IRS noted that the taxpayer was unable to provide any explanation of what purpose other than credit evaluation the credit subsidiary might have for requesting the dealer's financial statements.

Also, in May of 1995, IRS Letter Ruling/Technical Advice Memo 9535009 "officially" restated the restrictive position of the IRS concerning financial statements submitted to the manufacturer where the dealer reported for tax purposes using a fiscal year. The IRS employed the same four-step analysis as above to determine whether the fiscal year dealership had violated the LIFO conformity requirements. In connection with the second "test" related to whether the dealership's financial statement to the Factory ascertained the taxpayer's income for the taxable year, the IRS noted that the year-to-date column information readily does this for the reader. Even without year-to-date accumulations on the face of the monthly Income Statement, any series of months could be added together to reflect a complete 12-month period of anyone's choice.

LTR 9535009 states that the fiscal year dealer taxpayer issued a financial statement (in January, 19xx) that ascertained its income for the entire prior calendar year and that calendar year statement is

see **CONFORMITY REQUIREMENTS: THE ULTIMATE LIFO TRAPS,** page 6

considered a statement covering the "taxable year" because it covers a 1-year period that both begins and ends in a taxable year or years for which the taxpayer used the LIFO method. (This is the IRS' interpretation of Reg. Sec. 1.472-2(e)(2) which covers *one-year periods other than a taxable year.*)

Extensive analyses of LTR 9535009 and 9535010 were published in the September, 1995 *LIFO Lookout* along with flowcharts to assist in their interpretation and practical application.

Both of the franchised auto dealerships in Letter Rulings 9535009 and 9535010 argued that the IRS should not be able to throw out their LIFO elections because they had anticipated that "audit protection" was available to them because they had changed to the Alternative LIFO Method for under Revenue Procedure 92-79. In denying their argument, the IRS in Letter Ruling 9535010 stated that "the LIFO Conformity requirement is not a method of accounting, nor is it a LIFO sub-method. Rather, it is a **condition** upon the use of any LIFO method of accounting. Rev. Proc. 92-79 does not provide audit protection with respect to violations of the statutory LIFO Conformity requirement."

FIRST YEAR ...AND EVERY YEAR THEREAFTER

All of the conformity requirements discussed previously must be met every year. To remain eligible to use LIFO, EVERY YEAR an auto dealership's December (or last monthly) statement sent to the manufacturer must reflect an estimate of that year's change in the LIFO reserve if the actual change cannot be computed before the statement has to be released.

If a taxpayer is considering or planning to make a LIFO election for the year, an ESTIMATE of the LIFO reserve (or the actual amount if it has been calculated) must be placed in the year-end statements (including those issued to the Factory/Manufacturer or issued to any other party) in order to preserve the ability to elect LIFO for the year by filing Form 970 when the tax return is filed at a later date.

Also, don't overlook this conformity requirement if a taxpayer already has one class of inventory (such as new vehicles or equipment) on LIFO and is considering extending LIFO to another class of inventory, (such as used vehicles, equipment or parts). In this case, the taxpayer's year-end Income Statements should also reflect an estimate of the LIFO reserve expected by extending the LIFO election(s) to the additional classes of goods under consideration.

DIFFERENT YEAR-ENDS FOR BOOK AND TAX PURPOSES (FISCAL YEARS)

LIFO conformity problems are multiplied where a taxpayer such as an auto dealer has a different year end for reporting to the Manufacturer/Supplier/Creditor (calendar year-Dec. 31) than the fiscal year used for income tax return purposes and for other financial statement reporting purposes. For these fiscal year taxpayers, in order to satisfy another strict conformity requirement, the Regulations require the full year Income Statements to reflect LIFO at the end of both twelve month annual reporting periods or years (Reg. Sec. 1.472-2(e)(2)).

This regulation states that the conformity rules also apply to (1) the determination of income, profit, or loss for a one-year period other than a taxable year and to (2) credit statements or financial reports that cover a one-year period other than a taxable year, but only if the one-year period both begins and ends in a taxable year or years for which the taxpayer uses the LIFO method for Federal income tax purposes. For example,...in the case of a calendar year taxpayer, the requirements...apply to the taxpayer's determination of income for purposes of a credit statement that covers the period October 1, 1981, through September 30, 1982, if the taxpayer uses the LIFO method for Federal income tax purposes in taxable years 1981 and 1982.

PLACEMENT OF LIFO CHANGE IN THE STATEMENT OF INCOME

As early as 1994, *Lookout* readers were warned that the top IRS LIFO specialist for dealerships had said that on the twelfth statement the LIFO adjustment had to go through cost of goods sold (via the beginning-of-the-year and the end-of-the-year inventory valuations), rather than through an other income/deductions account...or else dealers would not be complying with the LIFO year-end conformity requirement.

Under this interpretation, where and how the LIFO adjustment is placed on the Income Statement becomes critical. This IRS interpretation would result in even more LIFO election terminations where the (projected) change in the LIFO reserve was run through an "Other Income/Other Deductions" account. Fortunately, in Revenue Ruling 97-42, the IRS specifically stated (to auto dealers only) that the LIFO adjustment could be placed anywhere on the Income Statement.

→

SPECIAL RELIEF AVAILABLE *ONLY* TO AUTO DEALERS FOR *CERTAIN* CONFORMITY VIOLATIONS ... ANNOUNCED BY IRS IN SEPT., 1997

As evident from several of the foregoing discussions, many LIFO users—including auto dealers—are in a "no win" situation with respect to the IRS' harsh interpretations of conformity. Furthermore, many manufacturers' prescribed statement formats either did not permit or strongly discourage putting the LIFO adjustment in any (Cost of Goods Sold) account that affects gross profit determinations because that destroyed or greatly impeded their ability to analyze gross profit by line items/models. Accordingly, the IRS' LIFO conformity requirements and interpretations were not compatible with the manufacturers' year-end statement preparation requirements. Dealers were caught in the middle and would lose either way.

On September 25, 1997, the IRS issued Revenue Ruling 97-42 and Revenue Procedure 97-44. These have provoked mixed reactions in their so-called handling and "relief" for auto dealers with LIFO conformity violations. It should be stressed that both Revenue Procedure 97-44 and Revenue Ruling 97-42 only apply to automobile dealers: all other similar types of taxpayers using LIFO who issue monthly statements to manufacturers, suppliers, creditors or the like are not protected by these special "suspensions" modifications of the rules contained in the Regulations.

REVENUE RULING 97-42

Revenue Ruling 97-42 provides special rules under which auto dealers will be considered to satisfy the LIFO conformity requirements in connection with year-end financial statements prepared in a format required by an automobile manufacturer on preprinted forms supplied by the automobile manufacturer:

1. LIFO adjustments must appear in the twelfth month Income Statement...but they do not have to be reflected in the Cost of Goods Sold section through inventory valuation accounts ..., as long as they are reflected somewhere in the determination of net income in the Income Statement.

2. A "reasonable estimate" of the change in the LIFO reserve for the year may be reflected instead of the actual change..., as long as that "reasonable estimate" is reflected somewhere in the year-end Statement of Income.

3. If an auto dealer employs a fiscal taxable year, and reflects the LIFO change in Cost of Goods Sold or anywhere else in the Income Statement, the LIFO conformity requirements will be satisfied if the dealer makes either (1) an adjustment for the change in the LIFO reserve that occurred during the calendar year in the month and year-to-date column of the December Income Statement or (2) an adjustment for the change in the LIFO reserve that occurred during the fiscal year in the month and year-to-date columns of the Income Statements provided for the last month of the fiscal year.

In other words, the IRS does not require the change in the LIFO reserve to be updated twice in the fiscal year-end... calendar year-end sequence. The IRS will permit a timing mismatch under these limited circumstances. For example, in a situation where a dealer has a September fiscal year end and December (calendar) reporting year to the manufacturer: If the dealer reflects the (reasonable estimate) change in the LIFO reserve in the September monthly and year-end statement, that dealer does not need to recompute and update a LIFO change for the three month period from October 1 through December 31 and reflect a 3 month change in the December statement. The dealer may simply carry through the annual LIFO reserve change effect reflected in the September fiscal year-end Income Statement without modification in the December Income Statement. Note that the December Income Statement must reflect the charge against income for the prior fiscal year-end LIFO reserve change and that prior September fiscal year-end LIFO reserve change should not be reversed so that the December statement of income does not reflect any LIFO reserve charge for the twelve month period ending December 31.

It is clear from Revenue Ruling 97-42 that if a LIFO reserve adjustment is posted directly to the retained earnings account and reflected on the dealership's balance sheet, that treatment of the LIFO reserve change will not satisfy the conformity requirements because the LIFO change must be reflected in the Income Statement. For years ending after October 14, 1997, it is thus imperative that the LIFO adjustment be properly reflected in the Income Statement prepared for the last month of the year. See the analysis of Revenue Procedure 97-44 in the September, 1997 issue of the *LIFO Lookout* for full discussions of the Settlement Amount 4.7% penalty payment and a discussion of "Some Questions in Need of Answers."

As discussed more fully in the September 1997 *Lookout*, one of the major traps practitioners and dealers face lies in the lack of synchronization between the language of Revenue Ruling 97-42 and Revenue Procedure 97-44 with reference to the issuance of statements to a "credit subsidiary" in Revenue Ruling 97-42 and the broader language

see **CONFORMITY REQUIREMENTS: THE ULTIMATE LIFO TRAPS,** page 8

referring to the use for "credit purposes" in Revenue Procedure 97-44.

Revenue Procedure 97-44 provided "relief" to auto dealers who failed the conformity requirements at any time during a six-year "look-back period" by allowing those dealers to keep their LIFO elections if they pay a 4.7% penalty tax and satisfy certain other special requirements. See the September 1997 issue of the *LIFO Lookout* for full coverage of both Revenue Ruling 97-42 and Revenue Procedure 97-44.

WHAT ABOUT OTHER TAXPAYERS IN SIMILAR MONTHLY REPORTING SITUATIONS?

Unfortunately, the IRS "guidance" and "relief" for franchised auto dealers in Revenue Ruling 97-42 and Revenue Procedure 97-44 does not apply to any other type of taxpayer issuing what might be "similar" statements under "similar circumstances" to other manufacturers, suppliers or credit sources. Accordingly, what should a practitioner do for these types of businesses who have LIFO conformity violations as we now understand the IRS to interpret the Regulations?

What should these clients/taxpayers using LIFO be told about their LIFO elections? Are they subject to termination at any time, and literally at will, by the IRS? What responsibility does the CPA practitioner have as preparer of the tax return now that the IRS position has been more clearly set forth in Revenue Ruling 97-42?

LIFO CONFORMITY VIOLATIONS CANNOT BE CORRECTED

The position of the IRS is that once a year-end Income Statement has been issued or released on a non-LIFO basis, that statement cannot be recalled and corrected to reflect LIFO by the re-issuance of statements satisfying the conformity requirement.

The *William Powell Company* decision (81-1 USTC ¶ 9449) illustrates one taxpayer's success (or was it luck?) in avoiding termination of its LIFO election when it came down to "all-or-nothing" on this issue. This case, decided in 1981, involved what would have been the termination of a LIFO election made in 1973 because at the end of the first LIFO year, the taxpayer had issued non-LIFO statements and then later made a LIFO election when it filed its tax return. In that case, the taxpayer recalled its non-LIFO statements and replaced/reissued LIFO statements to all the banks, creditors and shareholders before the income tax return for the first year was filed. The taxpayer probably would have lost its LIFO election if it had litigated the issue in the Tax Court, but the taxpayer chose to litigate this issue in the District Court in Ohio.

The taxpayer took the position that is had not "used" FIFO within the meaning of Section 472(c). Its position with respect to Section 472(c)(2) was that non-LIFO "worksheets" were not used for "credit purposes," since the credit had been extended prior to the delivery of the worksheets. The District Court accepted that. With respect to Section 472(c)(1), *Powell* contended that use is determined at the time of the LIFO election and that this election need not be made until the taxpayer files its return. At the time Powell elected LIFO, it was no longer using the FIFO statements, inasmuch as they had been recalled prior to the election and LIFO statements had been reissued.

The District Court, while agreeing that *Powell's* activities seemed to violate the plain language of Section 472(c)(2), was hesitant to strictly apply the "plain meaning rule" in this case. The Court said that it is the general rule that the words of a revenue statute are interpreted "in their ordinary, everyday senses" and a rigid application of this rule would not be consistent with the Commissioner's ongoing interpretation of the conformity requirement.

***INSILCO* AND ITS AFTERMATH**

For another example of how seriously the Treasury/IRS polices the LIFO conformity requirement, consider the origin of Code Section 472(g). This subsection was added because the IRS lost the *Insilco* decision in the Tax Court. This case involved a subsidiary using LIFO who reported to its parent corporation using LIFO but the parent corporation reported its consolidated earnings (which included those of the LIFO-user subsidiary) to its own shareholders on a non-LIFO basis.

In upholding the taxpayer, the Tax Court told the IRS that if it didn't like the result, it should get Congress to change the law. And that's exactly what the IRS/ Treasury did! After its loss, the Treasury persuaded Congress to change the law (which it did by adding subsection (g) to Section 472) so that taxpayers in the future couldn't get around the conformity requirement the way *Insilco* had. Section 472(g) provides that all members of the same group of financially related corporations shall be treated as one taxpayer for purposes of the conformity provisions of the Internal Revenue Code. For purposes of these provisions, affiliated groups are determined by using a lower 50% ownership threshold (than 80%). Furthermore, Section 472(g)(2)(B) provides that any other group of corporations which consolidate or combine for purposes of financial statements...shall be treated as one taxpayer for purposes of the conformity provisions.

see **CONFORMITY REQUIREMENTS: THE ULTIMATE LIFO TRAPS,** page 16

ADDITIONAL PROBLEM AREAS AND UNANSWERED QUESTIONS

REV. PROC. 97-44

In our last issue, we discussed some questions and problems under Revenue Procedure 97-44. One of the most significant involves dealers who have LIFO conformity violations on statements sent to the manufacturer, but who never financed with the Factory's affiliated credit subsidiary (GMAC, FMCC, CCC, etc.). Dealers who sent non-conforming year-end Income Statements ***only*** to the manufacturers bear a tremendous risk and are left to proceed in the dark because the National Office may not rule on this issue before D-Day (May 31, 1998). Will any dealer step forward to request a ruling on this question? Any volunteers?

Another major issue involves coming to grips with what the IRS will accept as a ***reasonable*** estimate of the LIFO change on the year-end Factory Income Statement. There are no standards on this. Who really knows? How much risk are you willing to bear if you don't have projections to back up your "estimate" as reasonable? Here, too, the consequences to a dealer who "feels" there was a reasonable estimate could be extreme if the IRS "feels" that the estimate was not reasonable.

For a refresher on the other problem areas, see pages 10-12 of the September, 1997 *LIFO Lookout*. Since then, still more questions have emerged.

FIRST: Can a dealer with a conformity violation avoid paying the 4.7% Settlement Amount by simply terminating the LIFO election before May 31, 1998 ***and*** before any penalty payments have been made? The answer seems to be "**yes**", if you file a Form 3115 under Revenue Procedure 97-37 before making any payments. For more on this, see the discussion on "Will Terminating the LIFO Election Avoid the 4.7% Penalty?" in our analysis of NADA's *Dealer Guide To The LIFO Conformity Settlement* on page 11.

SECOND: What are fiscal year dealerships really supposed to do? See the discussion on page 10 regarding the fiscal year ***assumption*** trap. Also, see item #3 in discussion of Revenue Ruling 97-42 on page 7.

THIRD: What happens if one member of a consolidated or an affiliated group has a conformity violation? Does the 4.7% penalty apply only to the member with the violation, or does Code Section 472(g) require 4.7% to be applied to the LIFO reserves of ***all*** members? It would appear that Section 3 of Rev. Proc. 97-44 narrowly construes the definition of "taxpayer" in such a way that the 4.7% penalty tax would be applied only to the LIFO reserves of the group member with the conformity violation. However, it would be reassuring to see this spelled out more clearly.

FOURTH: Many CPAs have asked whether it would be advisable to provide an affirmative notice to the Internal Revenue Service... are we talking about the National Office, the Cincinnati/Covington special collection center or the District Director? ...that the self-audit found that the dealer had no conformity violations during the 1991-1996 period. The thought is that it would be important to affirmatively notify the IRS in some way that the dealer did not violate the conformity requirement during this period. Otherwise, might the IRS infer that since no penalty payment was made, the dealer was simply waiting for the IRS to come out and catch him?

"Remedies" discussed included attaching a statement to the corporate tax return or sending a copy of the Memorandum intended to accompany payments to the Cincinnati office stating that no payment was being made because no violation had been found (ditto to the IRS National Office). Some have thought that some type of affirmative notice to the IRS might "protect" them from an IRS audit or compliance check on this matter. In a recent discussion on this with Mr. Mitchell, he expressed the opinion that it would **not** be advisable to send a statement in this regard because of the likelihood that such statement would not be read, or might be interpreted to be missing an accompanying penalty payment! What do you think? Should you take a chance that the IRS might actually read something you send them?

FIFTH: Another "sleeper" in Rev. Proc. 97-44 relates to its reference to taxpayers "under examination" on October 14, 1997. For these taxpayers, the first payment of their Settlement Amount was due December 1, 1997 (and that's already past) instead of on the May 31, 1998 which is the date for the first installment date for taxpayers not under examination. It appears NADA—and many others—"thought" that this accelerated payment date related only to those two dozen or so auto dealers with the burning, big dollar LIFO termination liabilities hanging over their heads. Suprise! Now ... come to find out that some folks in the IRS interpret the provision requiring the first settlement payment on December 1, 1997 to apply to all taxpayers "under examination" on October 14, 1997 ... and not just those where the LIFO conformity issue had been raised and the IRS subsequently agreed to put the audit on hold pending finalization of the IRS' position on if and how relief might be granted.

NADA'S *DEALER GUIDE TO THE LIFO CONFORMITY SETTLEMENT*

NADA'S *GUIDE*

NADA recently mailed out its summary of the IRS' Revenue Ruling 97-42 and Revenue Procedure 97-44 in a pamphlet entitled *A Dealer Guide to the LIFO Conformity Settlement.*

In explaining the importance of these recent IRS pronouncements, NADA reminded dealers that previously, the consequences of LIFO conformity violations could have been catastrophic. In addition to the significant financial impact that might be imposed on dealers forced to cough up almost $400,000 in tax, plus interest, on a $1,000,000 LIFO reserve, the open-ended nature of the liability and the impossibility of ever rectifying or curing a conformity violation makes the "LIFO conformity settlement" look pretty attractive.

The normal 3-year statute of limitations does not apply as a defense to conformity violations... nor to any other LIFO eligibility issues. Often, in real audits, the IRS will seek out violations all the way back to the first LIFO year, which may be many, many years removed.

The NADA *Guide* explains the Ruling and the Procedure and it tells dealers how to conduct a self-audit of their Factory statements for the look-back years 1991-1996. In addition, it includes a list of "Frequently Asked Questions" and discusses the benefits of taking advantage of the IRS' conformity settlement.

Overall, the NADA *Guide* does not contain much new information nor further clarification regarding the settlement. Specifically, it sheds no light on any of the questions raised in the September, 1997 *LIFO Lookout.* NADA comments, and rightly so, that the IRS leniency on where a LIFO adjustment may be placed in the Income Statement will significantly reduce the number of dealers who have LIFO conformity violations. As most dealers and CPAs are aware, the LIFO adjustment can be made in any account as long as it impacts the computation of net income in the year-end Income Statement. In other words, a LIFO adjustment must appear somewhere on the year-end Income Statement ... and it does not have to be buried in Cost of Goods Sold.

FISCAL YEAR DEALERS—WATCH OUT FOR THAT ***ASSUMPTION***

In connection with fiscal year dealers, NADA's *Guide* states that: "A dealer who is on a fiscal year for tax purposes may make his/her LIFO adjustment on the fiscal year-end statement *or* on the December statement. The adjustment does not have to be made on both statements." It further adds: "*Note*: if Dealership A were a fiscal year taxpayer with a fiscal year ending in June, it would have been in compliance if it had made a LIFO adjustment on either the June (fiscal year end) statement *or* the December statement. The dealership would *not* have to make an adjustment in both months."

Readers should be careful to appreciate that the above general statements are based **on the assumption** that the LIFO reserve change adjustment reflected in the Income Statement for the end of the fiscal year will be carried forward automatically and appear as a LIFO reserve change adjustment in the December (calendar year-end) Income Statement. For more on this, see the discussion in the accompanying article on page 7. A few callers have interpreted NADA's generalizations to mean that if the fiscal year-end Income Statement reflected a LIFO adjustment, then the calendar year-end statement would not need to ... and that is clearly not the case!

CONDUCTING A SELF-AUDIT & GETTING A LETTER "FROM YOUR CPA"

For dealers who want to conduct their own "self-audit," NADA advises them to (1) check the 12th month Factory statements for the years 1991-1996 to determine if a LIFO conformity violation exists and (2) see whether or not LIFO adjustments were made on 12th month statements in a way that did impact the calculation of net income. If not, was a 13th month statement with a correct adjustment in the Income Statement sent to all parties who received the 12th month statement before the date the January statement for the following year was due? Yes___ No___. A *Yes* answer saves the dealer. Dealers are also advised to determine if copies of factory statements were provided to shareholders, partners, and creditors.

The *Guide* indicates that if a CPA conducts the self-audit for the dealer and indicates that no conformity violations exist, the dealership should "obtain a letter from your CPA indicating that the review has been completed and that the dealership is entitled to relief under Rev. Proc. 97-44." In addition, these dealers are advised to create a file containing the 12th month statements, highlighting the LIFO adjustment on each statement after they have been "specifically shown where on each 12th month statement the LIFO adjustment was made."

→

These letters may be easy for CPAs to provide in some cases. In other cases, especially where the dealership has changed CPA firms during the 1991-1996 look-back period, such letters may prove to be very troublesome for CPAs to sign off. Nevertheless, dealers are well advised to request—or even insist on—such a letter because, according to NADA, "Dealers who conduct the self-audit for the period 1991-1996 and find no violations are deemed to be in compliance with Rev. Proc. 97-44 ***and are therefore protected from any conformity violations which may have occurred prior to 1991.***"

IF A CONFORMITY VIOLATION IS FOUND

NADA points out that if a conformity violation is found during the dealer's self-audit, a dealer must decide whether or not he or she wishes to take advantage of the IRS' settlement offer. The consequences of failing to pay the 4.7% settlement fee to the dealer are addressed. CPAs should be aware that if a violation is found during the self-audit, and the dealer decides not to take advantage of the settlement, that could place the CPA in a "no win" position relative to that CPA's responsibilities as a tax return preparer before the IRS. This involves possible liabilities and/or penalties that might be assessed for undervaluation of inventories and all the related infractions (against both taxpayer and practitioner) an overzealous IRS agent might come up with.

On this point, the *Guide* further provides that: "If XYZ does not elect to settle its conformity violation under Rev. Proc. 97-44 and is later audited by the IRS, it would be subject to immediate termination of its use of the LIFO method and could be required to include the full amount of its LIFO reserve in income immediately, in one taxable year." One might fear the consequences could be far worse than that for a dealer willing to play the "will they ever catch me" game: The LIFO election termination could be retroactive to a prior year with significant interest and penalties added. As a practical matter, it would appear that the likelihood of the IRS auditing dealers who do not pay a settlement fee seems very strong. Isn't it likely that every IRS auditor's checklist or document request from now on will include inquiries into the dealer's status relative to Revenue Procedure 97-44? The chances of a dealer with a LIFO conformity violation during the 1991-1996 look-back period not being found out by the IRS would seem to be extremely small. Although... it could happen!

Appendix C of NADA's *Guide* includes a Memorandum format that dealers paying the Rev. Proc. penalty amount might follow. Revenue Procedure 97-44 states in Section 5.04 that each Memorandum shall be signed under penalties of perjury. NADA's format does not specifically include an affirmative statement under the penalties of perjury, although it does include a statement that the dealer agrees to all terms of Revenue Procedure 97-44. More cautious taxpayers using the format in Appendix C might want to insert specific "penalties of perjury" language in this regard to avoid any doubt.

WILL TERMINATING THE LIFO ELECTION AVOID THE 4.7% PENALTY?

On page 8 of its *Guide*, NADA states three options open to a dealer with a violation: (1) pay the settlement fee, (2) "roll the dice," and (3) terminate LIFO. The *Guide* states that if a dealer is thinking about getting off LIFO, it should not pay the Settlement Amount. Instead, the dealer can elect to terminate its use of the LIFO method and simply pay the income tax owed on the LIFO reserve over a four-year period. It would appear that Rev. Proc. 97-44 offers a strong incentive for dealers with conformity violations to simply walk away now from their LIFO election with nothing but recapture of their LIFO reserves over a four year period.

NADA clearly states that if a dealer wants to get off of LIFO, it should not make any payment under Rev. Proc. 97-44 and it should simply go ahead and terminate its LIFO election. Under recent Revenue Procedure 97-37 (Appendix Section 10), the Service seems to have done away with the distinction it previously made between (1) taxpayers who were trying to terminate their LIFO elections because they had an eligibility violation in a prior year, and (2) taxpayers who simply wanted to terminate their LIFO election for other reasons—such as an anticipation that severe price deflation might lie ahead.

In the current situation, according to NADA, as long as the dealer goes off of LIFO before it makes its first 4.7% settlement installment payment, the dealer can avoid any liability for its former LIFO conformity violations. NADA's listing of "Frequently Asked Questions" includes: "If I no longer want to use the LIFO method, do I have to do the self-audit and make the settlement payment?" Its answer is: "No. You can voluntarily terminate your LIFO election and pay the income tax liability on your LIFO reserve over four years. You do not have to pay the settlement fee."

Section 7.03 of the Revenue Procedure provides that: "A taxpayer that makes one or more payments under this Revenue Procedure may not change from the LIFO inventory method pursuant to Rev. Proc. 97-37, 1997-33 I.R.B. 18, for a taxable year beginning before the date that the entire Settlement Amount is paid in accordance

see **NADA'S *DEALER GUIDE TO THE LIFO CONFORMITY SETTLEMENT,*** page 12

SOME GENERALIZATIONS & ADVICE FOR DEALING WITH REV. PROC. 97-44

PRACTICE AID

1. What you (a CPA) can say to your auto dealer client about Rev. Proc. 97-44 will depend on several factors including ... your prior oral and/or written advice on financial statement conformity to the dealer ... and whether the dealership accepted and reflected your prior advice.
2. Dealers with specific problem fact patterns should consider requesting a Letter Ruling from the Internal Revenue Service, and requesting expedited consideration in order to receive an answer before May 31, 1998.
3. A dealer's potential liability under Rev. Proc. 97-44 should be considered immediately so that any material amounts or implications may be reflected in the financial statements (or in accompanying notes thereto) issued in reports for the dealership for years ending after October 31, 1997.
4. It may be appropriate to advise a dealer with a conformity violation to seek legal advice before making its first payment under Rev. Proc. 97-44, especially if another CPA firm is involved in a prior violation year.
5. Each dealership should compile a "defense file" with respect to the years 1991-1996. This file should include:
   - A. Copies of dealer Factory financial statements for the years 1991 through 1996.
   - B. An attestation that those statements are copies of the statements originally filed.
   - C. Copies of any written communications in prior years to the dealership regarding conformity matters.
   - D. Copies of any year-end LIFO reserve change projections.
   - E. Copies of any adjusting entries or journal entries made to reflect LIFO reserve changes.
   - F. If another CPA firm was involved with any of the prior "look-back years:"
     - (1) Copies of any correspondence with that prior CPA firm relative to conformity matters or issues, and
     - (2) Copies of any replies received from that prior CPA firm.
6. Any CPA firm compiling a "defense file" for a dealership with respect to Revenue Procedure 97-44 should retain a complete copy of that file for its own purposes. The dealership may change CPA firms in a later year and questions may arise in the future relative to these determinations and/or liabilities thereunder.
7. Under certain circumstances, if a CPA firm needs to compile a "defense file" of its own, notification to its insurance carrier should be considered.
8. If a dealership requests a CPA firm to provide a written opinion relative to its liability under Revenue Procedure 97-44, consideration should be given to having that opinion reviewed by legal or insurance counsel prior to its issuance.
9. As early as practical, CPAs should begin to communicate with prior CPA firms who might be involved with prior look-back years in which there may be LIFO conformity violations. Consideration should be given to reducing all such communication to writing.
10. Consideration should be given to the ramifications of the IRS positions expressed in Revenue Ruling 97-42 and Revenue Procedure 97-44 to other business on LIFO that submit year-end pre-formatted financial statements to manufacturers, suppliers and/or creditors.

See the September, 1997 *LIFO Lookout* (pages 10-12) and the December, 1997 *LIFO Lookout* (page 9) for discussions of problem areas and unanswered questions arising under Revenue Procedure 97-44.

NADA's *Dealer Guide to the LIFO Conformity Settlement* (Continued from page 11)

with this Revenue Procedure." Apparently, the key here is that in order for a dealer to get off Scot-free, he should have made no payments under the Revenue Procedure before he decides to terminate the LIFO election and effects that termination by filing Form 3115.

This was recently confirmed "unofficially" by phone calls as the current position of NADA and of several IRS officials, including the principal authors of Rev. Proc. 97-44 and of Rev. Proc. 97-37. Consequently, it appears the IRS has intentionally conferred a real benefit to dealers by letting them walk away from their LIFO elections with only a 4-year repayment spread of their LIFO reserves... if they act fast.

PROJECTING YEAR-END LIFO RESERVE CHANGES

Projecting changes in LIFO reserves at year-end usually is not too difficult or time-consuming. These LIFO reserve change projections involve two **estimates**: (1) the ending inventory level, and (2) the overall inflation percentage for the year. All other factors necessary to compute projected year-end changes in the LIFO reserves for dollar-value LIFO pools are **known** at the time the projections are made because they are **"facts"** related to the beginning of the year.

- Beginning-of-the-year inventory expressed in total dollars and in base dollars,
- Beginning-of-the-year LIFO valuation of the inventory,
- Method used for valuing current year increments, and
- Cumulative inflation index as of the beginning-of-the-year.

The computation of the projected change in a LIFO reserve is made by plugging in the estimates of (1) the year-end inventory level and (2) the current year's rate of inflation or inflation index, ... and then "working backwards".

PROJECTION STEPS

(1) **DETERMINE** the cumulative index as of the end-of-the-year—this is the estimated current year inflation index times (i.e., multiplied by) the beginning-of-the-year cumulative index,

(2) **DIVIDE** the end-of-the-year estimated (or, if known, actual) inventory dollars by the year-end cumulative index—to determine the end-of-the-year inventory stated or expressed in base dollars,

(3) **COMPARE** the end-of-the-year inventory expressed in base dollars with the beginning-of-the-year inventory stated in base dollars to determine whether there is an increment or a decrement projected for the year,

(4) **VALUE** the projected increment under the method already selected for valuing increments on Form 970, item 6(a). Alternatively, if a decrement is projected for the year, carry back the decrement (expressed in base dollars) against prior years' increments (also expressed in base dollars) on a LIFO or reverse-chronological-order basis.

(5) **ADD** all the resulting layers of inventory at their respective LIFO valuations to get the end-of-the-year inventory stated at its LIFO valuation,

(6) **SUBTRACT** the ending inventory at its LIFO valuation from the ending inventory at its actual or estimated current non-LIFO cost to determine the projected LIFO reserve as of the end-of-the-year,

(7) **FINALLY, SUBTRACT** the *actual* LIFO reserve as of the beginning-of-the-year from the *projected* LIFO reserve as of the end-of-the-year. The result determined in this final step is the estimate of the change in the LIFO reserve for the year.

WHY LIFO RESERVES GO UP OR DOWN

Taxpayers using LIFO are often surprised when they find out that even though their year-end inventory levels are projected to be lower than they were at the beginning-of-the-year, their LIFO reserves are expected to increase. And often these increases are very large. As the example shows (pp. 14-15), often the net change in the LIFO reserve for a year is the result of complementing or offsetting price and inventory investment payback factors.

CHANGE FACTORS

Upward influences...causing increases:
- Price increases ...inflation.
- Quantity increases, if a dual index methodology/approach is used.

Downward influences...causing decreases:
- Price decreases ...deflation.
- Decreases in inventory investment levels—i.e., pay-backs of previously built-up LIFO reserves to the extent necessitated by the carryback of a current year quantity decrease (referred to as "decrements") against increases ("increments") built up in prior years.

If year-end LIFO projections show that the dollar amount of the ending inventory (expressed in terms of base dollars) is projected to be lower than the beginning-of-the-year inventory amount (also expressed in base dollars), that means there is going to be a liquidation or decrement in a technical LIFO sense. However, that liquidation

see **PROJECTING YEAR-END LIFO RESERVE CHANGES**, page 16

XYZ CADILLAC-OLDSMOBILE, INC.
LIFO INVENTORY RESERVE REPORT
ALTERNATIVE LIFO METHOD PER REVENUE PROCEDURE 92-79
FOR THE YEAR ENDED DECEMBER 31, 1997
REPORT #1 - CALCULATION OF ANNUAL LIFO INVENTORY AND RESERVE CHANGES - NEW AUTOS POOL #1

	NEW AUTOS POOL #1 1996	NEW AUTOS POOL #1 1997
A. BEGINNING OF YEAR INVENTORY AT BASE DATE COST - AS REBASED	3,858,107	3,816,606
B. END OF YEAR INVENTORY AT END OF YEAR (CURRENT) PRICES	4,546,379	3,596,943
C. END OF YEAR INVENTORY AT BEGINNING OF YEAR (BASE) PRICES	NOT FULLY REPRICED	NOT FULLY REPRICED
D. CURRENT YEAR PRICE INDEX RATIO OF: END OF YEAR INVENTORY PRICED AT END OF YEAR PRICES (DIVIDED BY) / END OF YEAR INVENTORY PRICED AT BEGINNING OF YEAR PRICES	1.02653	1.01928
E. CUMULATIVE LINK-CHAIN INDEX CURRENT YEAR PRICE INDEX (LINE D) MULTIPLIED BY (X) PRIOR YEAR'S CUMULATIVE INDEX (LINE E OF PRIOR YEAR)	1.19121	1.21418
F. END OF YEAR INVENTORY AT BASE DATE COST (LINE B DIVIDED BY LINE E)	3,816,606	2,962,446
G. CURRENT YEAR INVENTORY INCREASE (DECREASE) - EXPRESSED IN BASE DOLLARS		
1. END OF YEAR INVENTORY AT BASE DATE COST (LINE F)	3,816,606	2,962,446
2. BEGINNING OF YEAR INVENTORY AT BASE DATE COST (LINE A)	(3,858,107)	(3,816,606)
3. CURRENT YEAR INCREMENT (G(1) EXCEEDS G(2)) OR DECREASE (IF G(2) EXCEEDS G(1))	(41,501)	(854,160)
4. LIFO VALUATION OF CURRENT YEAR INCREMENT (IF G(1) EXCEEDS G(2), MULTIPLY LINE G(3) BY LINE E)	N/A	N/A

H. ANALYSIS OF YEAR-END INVENTORY LIFO "LAYERS" - AS REBASED

	BASE DOLLARS		VALUATION FACTOR	1996	1997
JANUARY 1, 1974 INCREMENT	778,915	X	0.39457	307,336	307,336
CALENDAR YEAR 1975 INCREMENT	145,647	X	0.41706	60,744	60,744
CALENDAR YEAR 1981 INCREMENT	240,456	X	0.67184	161,548	161,548
CALENDAR YEAR 1982 INCREMENT	405,372	X	0.69050	279,909	279,909
CALENDAR YEAR 1984 INCREMENT	253,488	X	0.74440	188,696	188,696
CALENDAR YEAR 1985 INCREMENT	122,987	X	0.77983	95,909	95,909
CALENDAR YEAR 1987 INCREMENT	174,073	X	0.86245	150,129	150,129
CALENDAR YEAR 1989 INCREMENT	408,334	X	0.93237	380,718	380,718
CALENDAR YEAR 1991 INCREMENT	433,174	X	1.00000	638,083	433,174
CALENDAR YEAR 1994 INCREMENT	0	X	1.12908	319,551	0
CALENDAR YEAR 1995 INCREMENT	0	X	1.16042	424,983	0
	2,962,446				
ENDING INVENTORY AT LIFO VALUATION, TOTAL PER ABOVE				3,007,606	2,058,163
LESS: ENDING INVENTORY AT END OF YEAR PRICES (LINE B)				4,546,379	3,596,943
LIFO RESERVE AT END OF CURRENT YEAR				1,538,773	1,538,780
LESS: LIFO RESERVE AT END OF PREVIOUS YEAR				1,421,259	1,538,773
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR				117,514	7

DECEMBER 22, 1997

XYZ CADILLAC-OLDSMOBILE, INC.

LIFO INVENTORY RESERVE REPORT

ALTERNATIVE LIFO METHOD PER REVENUE PROCEDURE 92-79

FOR THE YEAR ENDED DECEMBER 31, 1997

REPORT #3 - ANALYSIS OF LIFO RESERVES - NEW AUTOS POOL #1

DECEMBER 31, 1997 LIFO RESERVE CONSISTS OF:	BASE DOLLARS		INDEX FACTOR		COMPOSITION OF LIFO RESERVE
JANUARY 1, 1974 INCREMENT	778,915	X	0.81961	(1.21418 - 0.39457)=	638,407
CALENDAR YEAR 1975 INCREMENT	145,647	X	0.79712	(1.21418 - 0.41706)=	116,098
CALENDAR YEAR 1981 INCREMENT	240,456	X	0.54234	(1.21418 - 0.67184)=	130,409
CALENDAR YEAR 1982 INCREMENT	405,372	X	0.52368	(1.21418 - 0.69050)=	212,285
CALENDAR YEAR 1984 INCREMENT	253,488	X	0.46978	(1.21418 - 0.74440)=	119,084
CALENDAR YEAR 1985 INCREMENT	122,987	X	0.43435	(1.21418 - 0.77983)=	53,419
CALENDAR YEAR 1987 INCREMENT	174,073	X	0.35173	(1.21418 - 0.86245)=	61,227
CALENDAR YEAR 1989 INCREMENT	408,334	X	0.28181	(1.21418 - 0.93237)=	115,073
CALENDAR YEAR 1991 INCREMENT	433,174	X	0.21418	(1.21418 - 1.00000)=	92,777
CALENDAR YEAR 1992 INCREMENT	0	X	0.17258	(1.21418 - 1.04160)=	0
CALENDAR YEAR 1993 INCREMENT	0	X	0.13746	(1.21418 - 1.07672)=	0
CALENDAR YEAR 1994 INCREMENT	0	X	0.08510	(1.21418 - 1.12908)=	0
CALENDAR YEAR 1995 INCREMENT	0	X	0.05376	(1.21418 - 1.16042)=	0
CALENDAR YEAR 1996 INCREMENT	0	X	0.02297	(1.21418 - 1.19121)=	0
ROUNDING					1
TOTALS	2,962,446				1,538,780

PROOF / RECONCILIATION OF INCREASE IN LIFO RESERVE AS OF DECEMBER 31, 1997					NEW AUTOS POOL #1
AMOUNT OF BASE DOLLARS THAT REMAINED INTACT THROUGHOUT DECEMBER 31, 1997					2,962,446
(X) MULTIPLIED BY CURRENT YEAR INFLATION (1.21418 - 1.19121)					X 0.02297
INCREASE (DECREASE) IN LIFO RESERVE DUE TO INFLATION (DEFLATION) FACTOR					68,047
LESS PAYBACK DUE TO DECREMENT CARRIED BACK AGAINST PRIOR YEAR LAYER(S)					
DECEMBER 31, 1991	204,909	X	0.19121	(1.19121 - 1.00000)=	(39,181)
DECEMBER 31, 1994	283,019	X	0.06213	(1.19121 - 1.12908)=	(17,584)
DECEMBER 31, 1995	366,232	X	0.03079	(1.19121 - 1.16042)=	(11,276)
	854,160				
TOTAL PAYBACK DUE TO DECREMENT					(68,041)
ROUNDING					1
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR					7

Conformity Requirements: The Ultimate LIFO Traps

(Continued from page 8)

The *William Powell Company* and the *Insilco* decisions are the only recorded cases where taxpayers contested the IRS termination of their LIFO elections in court. The bottom line is that the IRS takes all of these conformity requirements seriously. On many audits, instead of assuming that the taxpayer has complied, the IRS asks for proof that financial statements at year-end were not in violation of the LIFO conformity requirements.

In these situations, the IRS asserts that there is no statute of limitations preventing it from inquiring as to conformity eligibility ... and that it can go as far back as the initial LIFO election year. Furthermore, the burden of proof would fall on the taxpayer—not on the IRS—in these inquiries.

CONCLUSION

The multi-faceted LIFO conformity requirements are broad and potentially treacherous... just like silent icebergs in the icy North Atlantic waiting for the next Titanic to come by. The IRS recognizes no limit on its ability to go back to any prior year to ferret out a possible conformity violation ...except for its recently self-imposed limitation in this regard found in Revenue Procedure 97-44 for automobile dealers. One cannot be too fearful, careful or respectful of that potential power.

Projecting Year-End LIFO Reserve Changes

(Continued from page 13)

or decrement may not necessarily cause, or result in, any pay-back of some or any of the LIFO reserve at the beginning-of-the-year. Whether or not there is a "pay-back" depends on how the prior year layers were built up over time and how they were valued for LIFO purposes.

DECREMENT CARRYBACKS

The general rule is that the LIFO liquidation or decrement for a given year is carried back against layers built up in prior years on a LIFO or reverse-chronological sequence. This means that the most recent/last layer built up is the first one eliminated, and then prior years' layers are eliminated in reverse-chronological order. In other words, a decrement in 1997 is carried back first against any 1996 increment, then against 1995, then against 1994, then against 1993, etc. until the entire amount of the 1997 decrement (expressed in base dollars) has been fully accounted for. In some instances, a decrement may end up being carried all the way back to the original first LIFO year base layer.

EXAMPLE

In the example on pages 14 and 15, the decrease projected for 1997 is carried back against increments that remain from the prior years 1995, 1994, and 1991. In the actual fact pattern of the example, there were no (net) base dollars for the years 1996 and 1993 because there were decrements in those years which were previously carried back. The cumulative index at the end of 1996 is 1.19121 and the cumulative index at the end of 1997 (projected) is 1.21418. The projected increase in the LIFO reserve due to inflation is $68,047 and that is offset by a payback of $68,041 due to the significant decrease in ending inventory level. The net change in the LIFO reserve is an increase of $7... even though the ending inventory for 1997 is projected to be $1 million less than the year before.

MODEL / ITEM CATEGORY INFLATION SURVEY
FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES
AS OF DECEMBER 31, 1997

INFLATION ESTIMATE REPORT BY MAKE - BASED ON INFORMATION AVAILABLE

	POOL #1 NEW AUTOMOBILES	POOL #2 NEW LIGHT-DUTY TRUCKS
ACURA	1.60%	1.56%
AUDI	1.51%	-
BMW	1.46%	-
BUICK	2.42%	-
CADILLAC	1.80%	-
CHEVROLET	2.80%	2.22%
CHRYSLER	0.84%	0.98%
DODGE	1.75%	1.88%
EAGLE	2.64%	-
FERRARI	0.31%	-
FORD	2.94%	1.35%
GMC TRUCKS	-	2.72%
HONDA	0.22%	0%
HYUNDAI	N/A	N/A
INFINITI	0%	N/A
ISUZU	-	0.10%
JAGUAR	0%	-
JEEP	-	1.71%
KIA	N/A	N/A
LAND ROVER / RANGE ROVER	-	(0.27%)
LEXUS	1.87%	0.51%
LINCOLN	0.70%	0%
MAZDA	0.18%	0.02%
MERCEDES	(0.02%)	0%
MERCURY	2.34%	0.43%
MITSUBISHI	4.25%	1.76%
NISSAN	0.32%	3.60%
OLDSMOBILE	1.72%	0.64%
PLYMOUTH	(2.45%)	3.73%
PONTIAC	5.53%	0.12%
PORSCHE	0%	-
ROLLS ROYCE / BENTLEY	2.55%	-
SAAB	2.10%	-
SATURN	0.79%	-
SUBARU	0.13%	0%
SUZUKI	0%	0%
TOYOTA	1.25%	1.88%
VOLKSWAGEN	0.68%	N/A
VOLVO	1.82%	-

Complete 1998 intro price information is not currently available for all models.
Accordingly, some inflation indexes exclude certain item(s) for which 1998 information is missing.
New items are repriced at current cost - i.e., no inflation.

Source: W.J. De Filipps' Make / Model Analysis Data Base Report, Preliminary Edition (Copyright, 1998)

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
ACURA						
NEW AUTOS - POOL #1						
CL	6	127,923		130,940	3,017	2.36%
INTEGRA	14	248,880		256,170	7,290	2.93%
NSX	2		144,194	144,194	0	0%
NSX-T	2		151,060	151,060	0	0%
RL	0				0	N/A%
TL	2	55,741		57,050	1,309	2.35%
TOTAL NEW AUTOS	26	432,544	295,254	739,414	11,616	1.60%
NEW LIGHT-DUTY TRUCKS - POOL #2						
SLX SPORT UTILITY	3	62,801	32,251	96,537	1,485	1.56%
TOTAL NEW L-D TRUCKS	3	62,801	32,251	96,537	1,485	1.56%
TOTAL ACURA	29	495,345	327,505	835,951	13,101	1.59%
AUDI						
NEW AUTOS - POOL #1						
A4 SERIES	11	181,120	82,792	270,436	6,524	2.47%
A6 SERIES	3		89,644	89,644	0	0%
A8 SERIES	2	106,108		106,978	870	0.82%
CABRIOLET SERIES	1	30,424		30,424	0	0%
TOTAL NEW AUTOS	17	317,652	172,436	497,482	7,394	1.51%
TOTAL AUDI	17	317,652	172,436	497,482	7,394	1.51%
BMW						
NEW AUTOS - POOL #1						
3 SERIES	17	370,870	110,900	487,750	5,980	1.24%
5 SERIES	4	156,670		159,640	2,970	1.90%
7 SERIES	3	188,265		192,270	4,005	2.13%
8 SERIES	2	146,515		148,030	1,515	1.03%
Z3	2	56,665		57,250	585	1.03%
TOTAL NEW AUTOS	28	918,985	110,900	1,044,940	15,055	1.46%
TOTAL BMW	28	918,985	110,900	1,044,940	15,055	1.46%
BUICK						
NEW AUTOS - POOL #1						
CENTURY	2	34,271		35,334	1,063	3.10%
LESABRE	2	43,536		44,153	617	1.42%
PARK AVENUE	2	58,815		59,934	1,119	1.90%
REGAL	2		40,841	40,841	0	0%
RIVIERA	1	27,250		29,413	2,163	7.94%
SKYLARK	0				0	N/A%
TOTAL NEW AUTOS	9	163,872	40,841		4,962	2.42%
TOTAL BUICK	9	163,872	40,841	209,675	4,962	2.42%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
CADILLAC						
NEW AUTOS - POOL #1						
CATERA	2	59,165		60,044	879	1.49%
DE VILLE	3	108,870		111,441	2,571	2.36%
ELDORADO	2	72,641		74,599	1,958	2.70%
SEVILLE	2	77,765		78,075	310	0.40%
TOTAL NEW AUTOS	9	318,441		324,159	5,718	1.80%
TOTAL CADILLAC	9	318,441		324,159	5,718	1.80%
CHEVROLET						
NEW AUTOS - POOL #1						
CAMARO	4	76,513		79,303	2,790	3.65%
CAVALIER	6	57,861	18,148	80,091	4,082	5.37%
CORVETTE	1		32,808	32,808	0	0%
LUMINA	3	50,453		51,455	1,002	1.99%
MALIBU	2	30,799		31,238	439	1.43%
METRO	3	25,818		26,336	518	2.01%
MONTE CARLO	2	33,838		34,852	1,014	3%
PRIZM	2		24,939	24,939	0	0%
TOTAL NEW AUTOS	23	275,282	75,895	361,022	9,845	2.80%
NEW LIGHT-DUTY TRUCKS - POOL #2						
ASTRO VAN	7	129,825		133,088	3,263	2.51%
BLAZER	4	80,650		84,778	4,128	5.12%
C-K CHASSIS CAB	13	236,135		241,566	5,431	2.30%
C-K PICKUP	29	463,491	43,049	517,942	11,402	2.25%
CHEVY VAN	10	189,798		194,416	4,618	2.43%
COMMERCIAL CUTAWAY VAN	8	142,746		143,378	632	0.44%
EXPRESS VAN	5	108,128		110,403	2,275	2.10%
S10 PICKUP	14	196,969		204,057	7,088	3.60%
SUBURBAN	4	92,985		95,042	2,057	2.21%
TAHOE	4	96,279		97,248	969	1.01%
TRACKER	4	54,559		55,955	1,396	2.56%
VENTURE	6	77,452	37,040	114,512	20	0.02%
TOTAL NEW L-D TRUCKS	108	1,869,017	80,089	1,992,385	43,279	2.22%
TOTAL CHEVROLET	131	2,144,299	155,984	2,353,407	53,124	2.31%
CHRYSLER						
NEW AUTOS - POOL #1						
CIRRUS	1		17,794	17,794	0	0%
CONCORDE	0				0	N/A%
LHS	0				0	N/A%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SEBRING	4	75,470		76,256	786	1.04%
TOTAL NEW AUTOS	**5**	**75,470**	**17,794**	**94,050**	**786**	**0.84%**
NEW LIGHT-DUTY TRUCKS - POOL #2						
TOWN & COUNTRY	5	134,183		135,494	1,311	0.98%
TOTAL NEW L-D TRUCKS	**5**	**134,183**		**135,494**	**1,311**	**0.98%**
TOTAL CHRYSLER	**10**	**209,653**	**17,794**	**229,544**	**2,097**	**0.92%**
DODGE						
NEW AUTOS - POOL #1						
AVENGER	2	29,478		29,594	116	0.39%
INTREPID	2		38,574	38,574	0	0%
NEON	2	19,700		20,830	1,130	5.74%
STRATUS	2	28,997		29,790	793	2.73%
VIPER	0				0	N/A%
TOTAL NEW AUTOS	**8**	**78,175**	**38,574**		**2,039**	**1.75%**
NEW LIGHT-DUTY TRUCKS - POOL #2						
CARAVAN	10	214,405		219,623	5,218	2.43%
DAKOTA	5	71,845		71,915	70	0.10%
DURANGO	1		23,318	23,318	0	0%
RAM CAB & CHASSIS	6	107,519		109,895	2,376	2.21%
RAM PICKUP	28	309,888	202,094	521,774	9,792	1.91%
RAM VANS	0				0	N/A%
RAM WAGON	0				0	N/A%
TOTAL NEW L-D TRUCKS	**50**	**703,657**	**225,412**		**17,458**	**1.88%**
TOTAL DODGE	**58**	**781,832**	**263,986**	**1,065,313**	**19,495**	**1.86%**
EAGLE						
NEW AUTOS - POOL #1						
TALON	4	62,153		63,796	1,643	2.64%
VISION	0				0	N/A%
TOTAL NEW AUTOS	**4**	**62,153**			**1,643**	**2.64%**
TOTAL EAGLE	**4**	**62,153**		**63,796**	**1,643**	**2.64%**

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
FERRARI						
NEW AUTOS - POOL #1						
456 GT	2	386,630		386,630	0	0%
550 MARANELLO	1	172,304		172,304	0	0%
F355	3	331,485		334,228	2,743	0.83%
TOTAL NEW AUTOS	**6**	**890,419**		**893,162**	**2,743**	**0.31%**
TOTAL FERRARI	**6**	**890,419**		**893,162**	**2,743**	**0.31%**
FORD						
NEW AUTOS - POOL #1						
CONTOUR	3	26,243	20,270	48,248	1,735	3.73%
CROWN VICTORIA	4	39,900	41,134	81,509	475	0.59%
ESCORT	5	32,957	24,732	59,942	2,253	3.91%
MUSTANG	5	94,254		96,573	2,319	2.46%
TAURUS	4	76,377		80,069	3,692	4.83%
TOTAL NEW AUTOS	**21**	**269,731**	**86,136**	**366,341**	**10,474**	**2.94%**
NEW LIGHT-DUTY TRUCKS - POOL #2						
CUTAWAY VAN	15	250,567		257,271	6,704	2.68%
E SERIES VAN/WAGON	11	218,086		221,771	3,685	1.69%
EXPEDITION	4	106,576		109,332	2,756	2.59%
EXPLORER	13	324,010		319,225	(4,785)	(1.48)%
F SERIES CAB & CHASSIS	7	131,699		134,437	2,738	2.08%
F150 PICKUP	44	797,100		810,974	13,874	1.74%
F250 PICKUP	24	451,063		460,171	9,108	2.02%
F350 PICKUP	7	129,961		132,700	2,739	2.11%
RANGER	16		231,135	231,135	0	0%
WINDSTAR	5	103,328		103,435	107	0.10%
TOTAL NEW L-D TRUCKS	**146**	**2,512,390**	**231,135**	**2,780,451**	**36,926**	**1.35%**
TOTAL FORD	**167**	**2,782,121**	**317,271**	**3,146,792**	**47,400**	**1.53%**
GMC TRUCKS						
NEW LIGHT-DUTY TRUCKS - POOL #2						
C-K CAB & CHASSIS	13	236,207		241,567	5,360	2.27%
C-K SIERRA PICKUP	29	465,271	43,171	519,720	11,278	2.22%
CHASSIS LO-PRO	3	41,248		43,512	2,264	5.49%
JIMMY	4	81,022		86,230	5,208	6.43%
S15 SONOMA	14	199,340		205,937	6,597	3.31%
SAFARI	6	110,435		113,105	2,670	2.42%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SAVANA	16	316,571		323,542	6,971	2.20%
SUBURBAN	4	93,213		95,966	2,753	2.95%
YUKON	2	52,935		54,433	1,498	2.83%
TOTAL NEW L-D TRUCKS	91	1,596,242	43,171	1,684,012	44,599	2.72%
TOTAL GMC TRUCKS	91	1,596,242	43,171	1,684,012	44,599	2.72%
HONDA						
NEW AUTOS - POOL #1						
ACCORD	23		423,926	423,926	0	0%
CIVIC	17	213,890		215,156	1,266	0.59%
PRELUDE	3	64,839		65,106	267	0.41%
TOTAL NEW AUTOS	43	278,729	423,926	704,188	1,533	0.22%
NEW LIGHT-DUTY TRUCKS - POOL #2						
CR-V	2		35,933	35,933	0	0%
ODYSSEY	0				0	N/A%
PASSPORT	10		234,480	234,480	0	0%
TOTAL NEW L-D TRUCKS	12		270,413	270,413	0	0%
TOTAL HONDA	55	278,729	694,339	974,601	1,533	0.16%
HYUNDAI						
NEW AUTOS - POOL #1						
ACCENT	0				0	N/A%
ELANTRA	0				0	N/A%
SONATA	0				0	N/A%
TIBURON	0				0	N/A%
TOTAL NEW AUTOS	0				0	N/A%
TOTAL HYUNDAI	0				0	0%
INFINITI						
NEW AUTOS - POOL #1						
I30	0				0	N/A%
J30	0				0	N/A%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
Q45	2		86,915	86,915	0	0%
TOTAL NEW AUTOS	2		86,915	86,915	0	0%
NEW LIGHT-DUTY TRUCKS - POOL #2						
QX4	0				0	N/A%
TOTAL NEW L-D TRUCKS	0				0	N/A%
TOTAL INFINITI	2		86,915	86,915	0	0%
ISUZU						
NEW LIGHT-DUTY TRUCKS - POOL #2						
HOMBRE	10	48,102	88,043	137,359	1,214	0.89%
OASIS	2	43,547		43,753	206	0.47%
RODEO	8		163,678	163,678	0	0%
TROOPER	2	47,285		46,248	(1,037)	(2.19)%
TOTAL NEW L-D TRUCKS	22	138,934	251,721	391,038	383	0.10%
TOTAL ISUZU	22	138,934	251,721	391,038	383	0.10%
JAGUAR						
NEW AUTOS - POOL #1						
XJ8	4		214,645	214,645	0	0%
XK8	2	118,576		118,576	0	0%
TOTAL NEW AUTOS	6	118,576	214,645	333,221	0	0%
TOTAL JAGUAR	6	118,576	214,645	333,221	0	0%
JEEP						
NEW LIGHT-DUTY TRUCKS - POOL #2						
CHEROKEE	10	165,933		171,077	5,144	3.10%
GRAND CHEROKEE	7	106,795	86,694	194,017	528	0.27%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
WRANGLER	3	45,715		46,969	1,254	2.74%
TOTAL NEW L-D TRUCKS	20	318,443	86,694	412,063	6,926	1.71%
TOTAL JEEP	20	318,443	86,694	412,063	6,926	1.71%
KIA						
NEW AUTOS - POOL #1						
SEPHIA	0				0	N/A%
TOTAL NEW AUTOS	0				0	N/A%
NEW LIGHT-DUTY TRUCKS - POOL #2						
SPORTAGE	0				0	N/A%
TOTAL NEW L-D TRUCKS	0				0	N/A%
TOTAL KIA	0				0	0%
LAMBORGHINI						
NEW AUTOS - POOL #1						
DIABLO	0				0	N/A%
TOTAL NEW AUTOS	0				0	N/A%
TOTAL LAMBORGHINI	0				0	0%
LAND ROVER/RANGE ROVER						
NEW LIGHT-DUTY TRUCKS - POOL #2						
LAND ROVER DISCOVERY	2	32,040	33,820	64,525	(1,335)	(2.03)%
RANGE ROVER	2	104,875		105,751	876	0.84%
TOTAL NEW L-D TRUCKS	4	136,915	33,820	170,276	(459)	(0.27)%
TOTAL LAND ROVER/RANGE ROVER	4	136,915	33,820	170,276	(459)	(0.27)%
LEXUS						
NEW AUTOS - POOL #1						
ES 300 SEDAN	2	51,942		53,490	1,548	2.98%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
GS 300 SEDAN	2		63,928	63,928	0	0%
GS 400 SEDAN	2		76,922	76,922	0	0%
LS 400 SEDAN	0				0	N/A%
SC 300 COUPE	2	69,314		71,052	1,738	2.51%
SC 400 COUPE	2	87,224		90,486	3,262	3.74%
TOTAL NEW AUTOS	10	208,480	140,850	355,878	6,548	1.87%
NEW LIGHT-DUTY TRUCKS - POOL #2						
LX 450	2	83,190		83,618	428	0.51%
TOTAL NEW L-D TRUCKS	2	83,190		83,618	428	0.51%
TOTAL LEXUS	12	291,670	140,850	439,496	6,976	1.61%
LINCOLN						
NEW AUTOS - POOL #1						
CONTINENTAL	1	33,999		34,524	525	1.54%
MARK VIII	2	69,412		70,374	962	1.39%
TOWN CAR	3		108,449	108,449	0	0%
TOTAL NEW AUTOS	6	103,411	108,449	213,347	1,487	0.70%
NEW LIGHT-DUTY TRUCKS - POOL #2						
NAVIGATOR	2		71,514	71,514	0	0%
TOTAL NEW L-D TRUCKS	2		71,514	71,514	0	0%
TOTAL LINCOLN	8	103,411	179,963	284,861	1,487	0.52%
MAZDA						
NEW AUTOS - POOL #1						
626	4		69,482	69,482	0	0%
MILLENIA	2	57,076		57,114	38	0.07%
MX-5 MIATA	2	21,805	20,306	42,383	272	0.65%
MX-6	0				0	N/A%
PROTEGE	3	37,909		37,965	56	0.15%
TOTAL NEW AUTOS	11	116,790	89,788	206,944	366	0.18%
NEW LIGHT-DUTY TRUCKS - POOL #2						
B SERIES PICKUP	16		226,984	226,984	0	0%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MPV	4	94,959		95,039	80	0.08%
TOTAL NEW L-D TRUCKS	20	94,959	226,984	322,023	80	0.02%
TOTAL MAZDA	31	211,749	316,772	528,967	446	0.08%
MERCEDES						
NEW AUTOS - POOL #1						
C CLASS	2	56,960		56,960	0	0%
CL CLASS	2	195,590		197,330	1,740	0.89%
CLK	1		34,505	34,505	0	0%
E CLASS	5	73,360	124,785	200,405	2,260	1.14%
S CLASS	5	365,955		368,875	2,920	0.80%
SL CLASS	2	185,060		177,930	(7,130)	(3.85)%
SLK	1		34,375	34,375	0	0%
TOTAL NEW AUTOS	18	876,925	193,665	1,070,380	(210)	(0.02)%
NEW LIGHT-DUTY TRUCKS - POOL #2						
M CLASS	1		29,375	29,375	0	0%
TOTAL NEW L-D TRUCKS	1		29,375	29,375	0	0%
TOTAL MERCEDES	19	876,925	223,040	1,099,755	(210)	(0.02)%
MERCURY						
NEW AUTOS - POOL #1						
GRAND MARQUIS	2		42,639	42,639	0	0%
MYSTIQUE	2	28,274		30,943	2,669	9.44%
SABLE	3	58,033		56,761	(1,272)	(2.19)%
TRACER	3	33,387		35,785	2,398	7.18%
TOTAL NEW AUTOS	10	119,694	42,639	166,128	3,795	2.34%
NEW LIGHT-DUTY TRUCKS - POOL #2						
MOUNTAINEER	3	50,942	25,878	75,874	(946)	(1.23)%
VILLAGER	3	65,058		65,391	333	0.51%
TOTAL NEW L-D TRUCKS	6	116,000	25,878	141,265	(613)	(0.43)%
TOTAL MERCURY	16	235,694	68,517	307,393	3,182	1.05%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MITSUBISHI						
NEW AUTOS - POOL #1						
3000GT	5	138,271		144,306	6,035	4.36%
DIAMANTE	2	25,492	23,776	51,863	2,595	5.27%
ECLIPSE	12	216,388		227,455	11,067	5.11%
GALANT	5	64,548	15,565	82,002	1,889	2.36%
MIRAGE	8	90,464		93,275	2,811	3.11%
TOTAL NEW AUTOS	32	535,163	39,341	598,901	24,397	4.25%
NEW LIGHT-DUTY TRUCKS - POOL #2						
MONTERO	1		28,663	28,663	0	0%
MONTERO SPORT	6	87,024	40,889	130,662	2,749	2.15%
TOTAL NEW L-D TRUCKS	7	87,024	69,552	159,325	2,749	1.76%
TOTAL MITSUBISHI	39	622,187	108,893	758,226	27,146	3.71%
NISSAN						
NEW AUTOS - POOL #1						
200SX	6	85,443		85,820	377	0.44%
240SX	2		44,493	44,493	0	0%
ALTIMA	7		113,202	113,202	0	0%
MAXIMA	5	106,594		106,949	355	0.33%
SENTRA	7	93,494		94,179	685	0.73%
TOTAL NEW AUTOS	27	285,531	157,695	444,643	1,417	0.32%
NEW LIGHT-DUTY TRUCKS - POOL #2						
4X2 PICKUP	0				0	N/A%
4X4 PICKUP	0				0	N/A%
PATHFINDER	8	195,121		202,144	7,023	3.60%
QUEST	0				0	N/A%
TOTAL NEW L-D TRUCKS	8	195,121			7,023	3.60%
TOTAL NISSAN	35	480,652	157,695	646,787	8,440	1.32%
OLDSMOBILE						
NEW AUTOS - POOL #1						
ACHIEVA	1	15,349		16,835	1,486	9.68%
AURORA	1	32,340		32,544	204	0.63%
CUTLASS	2	33,443		34,061	618	1.85%
EIGHTY EIGHT	2	42,355		42,995	640	1.51%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
INTRIGUE	2		39,163	39,163	0	0%
LSS	1	25,341		25,707	366	1.44%
REGENCY	1	25,615		25,981	366	1.43%
TOTAL NEW AUTOS	10	174,443	39,163	217,286	3,680	1.72%
NEW LIGHT-DUTY TRUCKS - POOL #2						
BRAVADA	1	27,408		27,734	326	1.19%
SILHOUETTE	3	45,983	22,109	68,381	289	0.42%
TOTAL NEW L-D TRUCKS	4	73,391	22,109	96,115	615	0.64%
TOTAL OLDSMOBILE	14	247,834	61,272	313,401	4,295	1.39%
PLYMOUTH						
NEW AUTOS - POOL #1						
BREEZE	1	13,573		13,476	(97)	(0.71)%
NEON	4	23,016	20,810	41,640	(2,186)	(4.99)%
PROWLER	1		35,863	35,863	0	0%
TOTAL NEW AUTOS	6	36,589	56,673	90,979	(2,283)	(2.45)%
NEW LIGHT-DUTY TRUCKS - POOL #2						
GRAND VOYAGER	3	35,734	20,171	58,612	2,707	4.84%
VOYAGER	3	33,741	19,255	54,355	1,359	2.56%
TOTAL NEW L-D TRUCKS	6	69,475	39,426	112,967	4,066	3.73%
TOTAL PLYMOUTH	12	106,064	96,099	203,946	1,783	0.88%
PONTIAC						
NEW AUTOS - POOL #1						
BONNEVILLE	2	44,596		47,379	2,783	6.24%
FIREBIRD	6	126,684		134,869	8,185	6.46%
GRAND AM	4	55,830		57,367	1,537	2.75%
GRAND PRIX	3	51,832		54,785	2,953	5.70%
SUNFIRE	4	52,611		55,482	2,871	5.46%
TOTAL NEW AUTOS	19	331,553		349,882	18,329	5.53%
NEW LIGHT-DUTY TRUCKS - POOL #2						

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
TRANS SPORT	3	39,683	20,254	60,011	74	0.12%
TOTAL NEW L-D TRUCKS	3	39,683	20,254	60,011	74	0.12%
TOTAL PONTIAC	22	371,236	20,254	409,893	18,403	4.70%
PORSCHE						
NEW AUTOS - POOL #1						
911 CARRERA SERIES	8	496,167		496,167	0	0%
BOXTER	2		74,447	74,447	0	0%
TOTAL NEW AUTOS	10	496,167	74,447	570,614	0	0%
TOTAL PORSCHE	10	496,167	74,447	570,614	0	0%
ROLLS ROYCE						
NEW AUTOS - POOL #1						
BENTLEY	8	1,123,890	615,369	1,787,492	48,233	2.77%
ROLLS-ROYCE	4	428,403	473,391	920,874	19,080	2.12%
TOTAL NEW AUTOS	12	1,552,293	1,088,760	2,708,366	67,313	2.55%
TOTAL ROLLS ROYCE	12	1,552,293	1,088,760	2,708,366	67,313	2.55%
SAAB						
NEW AUTOS - POOL #1						
900 SERIES	11	232,775	93,069	332,919	7,075	2.17%
9000 SERIES	5	132,897	34,024	170,171	3,250	1.95%
TOTAL NEW AUTOS	16	365,672	127,093	503,090	10,325	2.10%
	16	365,672	127,093	503,090	10,325	2.10%
SATURN						
NEW AUTOS - POOL #1						
SC1	2	22,472		22,664	192	0.85%
SC2	2	24,560		24,926	366	1.49%
SL	1	9,218		9,218	0	0%
SL1	2	20,906		20,924	18	0.09%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SL2	2	22,472		22,490	18	0.08%
SW1	2	21,950		22,142	192	0.87%
SW2	2	23,516		23,882	366	1.56%
TOTAL NEW AUTOS	13	145,094		146,246	1,152	0.79%
TOTAL SATURN	13	145,094		146,246	1,152	0.79%
SUBARU						
NEW AUTOS - POOL #1						
IMPREZA	10	122,902	35,525	158,423	(4)	(0)%
LEGACY	19	332,233	46,136	379,094	725	0.19%
TOTAL NEW AUTOS	29	455,135	81,661	537,517	721	0.13%
NEW LIGHT-DUTY TRUCKS - POOL #2						
FORESTER	7		135,887	135,887	0	0%
TOTAL NEW L-D TRUCKS	7		135,887	135,887	0	0%
TOTAL SUBARU	36	455,135	217,548	673,404	721	0.11%
SUZUKI						
NEW AUTOS - POOL #1						
ESTEEM	0				0	N/A%
SWIFT	2	17,342		17,342	0	0%
TOTAL NEW AUTOS	2	17,342		17,342	0	0%
NEW LIGHT-DUTY TRUCKS - POOL #2						
SIDEKICK	2		31,301	31,301	0	0%
X90	0				0	N/A%
TOTAL NEW L-D TRUCKS	2		31,301		0	0%
TOTAL SUZUKI	4	17,342	31,301	48,643	0	0%
TOYOTA						
NEW AUTOS - POOL #1						
AVALON	4	86,151		89,234	3,083	3.58%
CAMRY	7	120,128		123,605	3,477	2.89%
CELICA	12	217,954		218,518	564	0.26%

DECEMBER 23, 1997

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/97
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	TOTAL ITEMS	12/01/96 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
COROLLA	6		72,772	72,772	0	0%
PASEO	4	54,260		54,400	140	0.26%
SUPRA	4	128,946		130,638	1,692	1.31%
TERCEL	6	62,315		62,607	292	0.47%
TOTAL NEW AUTOS	43	669,754	72,772	751,774	9,248	1.25%
NEW LIGHT-DUTY TRUCKS - POOL #2						
4RUNNER	9	193,393		198,689	5,296	2.74%
LAND CRUISER	0				0	N/A%
RAV4	7	101,859		104,076	2,217	2.18%
SIENNA	4		81,364	81,364	0	0%
T100 PICKUP	10	176,505		177,025	520	0.29%
TACOMA PICKUP	14	214,942		221,371	6,429	2.99%
TOTAL NEW L-D TRUCKS	44	686,699	81,364	782,525	14,462	1.88%
TOTAL TOYOTA	87	1,356,453	154,136	1,534,299	23,710	1.57%
VOLKSWAGEN						
NEW AUTOS - POOL #1						
BEETLE	0				0	N/A%
CABRIO	8	73,576	74,770	149,540	1,194	0.80%
GOLF	9	131,478		133,326	1,848	1.41%
JETTA	23	269,233	74,524	346,134	2,377	0.69%
PASSAT	8		168,441	168,441	0	0%
TOTAL NEW AUTOS	48	474,287	317,735	797,441	5,419	0.68%
NEW LIGHT-DUTY TRUCKS - POOL #2						
EUROVAN CAMPER	0				0	N/A%
TOTAL NEW L-D TRUCKS	0				0	N/A%
TOTAL VOLKSWAGEN	48	474,287	317,735	797,441	5,419	0.68%
VOLVO						
NEW AUTOS - POOL #1						
70 SERIES	16	334,670	133,965	477,935	9,280	1.98%
90 SERIES	2	64,750		65,165	415	0.64%
TOTAL NEW AUTOS	18	399,420	133,965	543,100	9,695	1.82%
TOTAL VOLVO	18	399,420	133,965	543,100	9,695	1.82%

USED VEHICLE LIFO ELECTIONS FOR 1997 ... ARE RECENT LIFO ELECTIONS STUCK IN REVERSE?

In March of 1997 (LIFO Update #3, *Used Car LIFO Tidbits*), we said, "Some CPAs have reported negative LIFO reserves for some of their auto dealer *used* vehicle LIFO elections. In some cases, that's not a mirage: it really happened. Some dealers elected used car LIFO in 1995 and experienced only small (2%) price increases. In 1996, they experienced equal or greater price decreases (3%), thus resulting in net negative LIFO reserves for their used vehicles.

"This goes to show how important timing is. In the long run, however, used car prices are expected to be trending upward so the 1996 negative LIFO reserve would seem to be a short-term reversal, rather than something to expect every year."

At mid-year (June, 1997, page 2), we were still favorably inclined toward used vehicle LIFO elections for 1997. We even chided one report of emerging interest in terminating these elections as follows:

"One publication aimed at the auto dealer niche recently reported that it had received 'numerous requests' for an article on opting out of used car LIFO in light of the sizable decrease in used car prices in 1996, threatening negative reserves. The Government published used car index declined from 158.2 to 155.6, or a decrease of 1.6% in 1996." Tsk! Tsk! What appalling logic!"

Then we went further and added:

"Another consideration in connection with making a used car LIFO election for 1997 is prompted by the recent announcement by GM that it plans to raise its prices on '98 models by "only" an average of 1.5% on cars and 1.1% on trucks. Many dealers last year put off making a used vehicle LIFO election—for whatever reason—because they experienced fairly significant inflation in their new vehicle inventories and that was "enough for them." With the prospects of relatively flat inflation for new vehicles for 1997, perhaps the prospect of greater inflation for used vehicle inventories—coupled with the ability to spread the prior (Dec. 31, 1996) year-end writedowns over three years—may make a LIFO election for used vehicles for 1997 even more attractive."

Gulp! The chide's on us.

With full-year results for 1997 now available and "predictions" for 1998 suggesting more of the same, it now looks like the advisability of making used vehicle LIFO elections for 1997 is far from a sure thing. In some situations, terminating one's (recent) used vehicle LIFO elections may be the more appropriate strategy.

Consider a LIFO election made for 1996 by a dealer who consistently would have used vehicle inventories at year-end of $600,000. Assume that dealer experienced a small amount of used vehicle price inflation in 1996 (2%) ... which would have given him a small LIFO reserve ...$11,765... at the end of 1996. Assume further that after 1996, his used vehicle inventories experienced price deflation for 1997 (3%), 1998 (6%) and 1999 (3%). The accompanying calculations show that dealer would be looking at negative LIFO reserves that would grow to roughly $60,000 "in the red" by 1999.

Welcome to the world of ***negative*** LIFO reserves ... unless the dealer terminates his used vehicle LIFO election.

Now, a taxpayer wishing to terminate a LIFO election may do so under either Revenue Procedure 97-37 or 97-27. Rev. Proc. 97-37 requires termination of LIFO elections for all inventories on LIFO. In contrast, Rev. Proc. 97-27 would allow a dealer to selectively terminate only the used vehicle LIFO election, while retaining a new vehicle LIFO election.

These choices require not only careful crystal ball gazing, but also coordinating the timeliness of filing Form 3115 for a LIFO method termination: Under Revenue Procedure 97-37, the LIFO method termination can be filed ***after*** the end of the year. In contrast, a LIFO election termination under Revenue Procedure 97-27 must be filed ***before*** the end of the year.

Under either revenue procedure, a dealer terminating a used vehicle LIFO election that was recently made would have an accelerated (i.e., shortened) spread period for the repayment of the LIFO reserve. He would also have to wait five years before a LIFO re-election could be made without obtaining prior approval from the IRS. And finally, if that dealer were repaying used vehicle writedowns at the beginning of the first LIFO year under Section 472(d), that 3-year spread might also be compromised.

XYZ USED VEHICLE, INC.

LIFO INVENTORY RESERVE REPORT
ALTERNATIVE LIFO METHOD PER REVENUE PROCEDURE 92-79
FOR THE YEAR ENDED DECEMBER 31,

REPORT #1 - CALCULATION OF ANNUAL LIFO INVENTORY AND RESERVE CHANGES - USED AUTOS POOL #1

	USED AUTOS POOL #1 1996	USED AUTOS POOL #1 1997	USED AUTOS POOL #1 1998	USED AUTOS POOL #1 1999
A. BEGINNING OF YEAR INVENTORY AT BASE DATE COST - AS REBASED	600,000	588,235	606,428	645,134
B. END OF YEAR INVENTORY AT END OF YEAR (CURRENT) PRICES	600,000	600,000	600,000	600,000
C. END OF YEAR INVENTORY AT BEGINNING OF YEAR (BASE) PRICES	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED
D. CURRENT YEAR PRICE INDEX RATIO OF: END OF YEAR INVENTORY PRICED AT END OF YEAR PRICES (DIVIDED BY) / END OF YEAR INVENTORY PRICED AT BEGINNING OF YEAR PRICES	1.02000	0.97000	0.94000	0.97000
E. CUMULATIVE LINK-CHAIN INDEX CURRENT YEAR PRICE INDEX (LINE D) MULTIPLIED BY (X) PRIOR YEAR'S CUMULATIVE INDEX (LINE E OF PRIOR YEAR)	1.02000	0.98940	0.93004	0.90214
F. END OF YEAR INVENTORY AT BASE DATE COST (LINE B DIVIDED BY LINE E)	588,235	606,428	645,134	665,085
G. CURRENT YEAR INVENTORY INCREASE (DECREASE) - EXPRESSED IN BASE DOLLARS				
1. END OF YEAR INVENTORY AT BASE DATE COST (LINE F)	588,235	606,428	645,134	665,085
2. BEGINNING OF YEAR INVENTORY AT BASE DATE COST (LINE A)	(600,000)	(588,235)	(606,428)	(645,134)
3. CURRENT YEAR INCREMENT (G(1) EXCEEDS G(2)) OR DECREASE (IF G(2) EXCEEDS G(1))	(11,765)	18,193 X 0.98940	38,706 X 0.93004	19,951 X 0.90214
4. LIFO VALUATION OF CURRENT YEAR INCREMENT (IF G(1) EXCEEDS G(2), MULTIPLY LINE G(3) BY LINE E)	N/A	18,000	35,998	17,999

H. ANALYSIS OF YEAR-END INVENTORY LIFO "LAYERS" - AS REBASED

	BASE DOLLARS	VALUATION FACTOR	1996	1997	1998	1999
BASE INVENTORY, JANUARY 1, 1996, NET	588,235 X	1.00000	588,235	588,235	588,235	588,235
CALENDAR YEAR 1997 INCREMENT	18,193 X	0.98940	0	18,000	18,000	18,000
CALENDAR YEAR 1998 INCREMENT	38,706 X	0.93004			35,998	35,998
CALENDAR YEAR 1999 INCREMENT	19,951 X	0.90214			0	17,999
	665,085					
ENDING INVENTORY AT LIFO VALUATION, TOTAL PER ABOVE			588,235	606,235	642,233	660,232
LESS: ENDING INVENTORY AT END OF YEAR PRICES (LINE B)			600,000	600,000	600,000	600,000
LIFO RESERVE AT END OF CURRENT YEAR			11,765	(6,235)	(42,233)	(60,232)
LESS: LIFO RESERVE AT END OF PREVIOUS YEAR			0	11,765	(6,235)	(42,233)
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR			11,765	(18,000)	(35,998)	(17,999)

DECEMBER 23, 1997

XYZ USED VEHICLE, INC.

LIFO INVENTORY RESERVE REPORT
ALTERNATIVE LIFO METHOD PER REVENUE PROCEDURE 92-79
FOR THE YEAR ENDED DECEMBER 31, 1996

REPORT #3 - ANALYSIS OF LIFO RESERVES - USED AUTOS POOL #1

DECEMBER 31, 1996 LIFO RESERVE CONSISTS OF:	BASE DOLLARS		INDEX FACTOR		COMPOSITION OF LIFO RESERVE
BASE INVENTORY, JANUARY 1, 1996, NET	588,235	X	0.02000	(1.02000 - 1.00000)=	11,765
TOTALS	588,235				11,765

PROOF / RECONCILIATION OF INCREASE IN LIFO RESERVE AS OF DECEMBER 31, 1996					USED AUTOS POOL #1
AMOUNT OF BASE DOLLARS THAT REMAINED INTACT THROUGHOUT DECEMBER 31, 1996					588,235
(X) MULTIPLIED BY CURRENT YEAR INFLATION (1.02000 - 1.00000)					X 0.02000
INCREASE (DECREASE) IN LIFO RESERVE DUE TO INFLATION (DEFLATION) FACTOR					11,765
LESS PAYBACK DUE TO DECREMENT CARRIED BACK AGAINST PRIOR YEAR LAYER(S)					
FYE JANUARY 1, 1996	11,765	X	0.00000	(1.00000 - 1.00000)=	0
	11,765				
TOTAL PAYBACK DUE TO DECREMENT					0
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR					11,765

DECEMBER 31, 1997 LIFO RESERVE CONSISTS OF:	BASE DOLLARS		INDEX FACTOR		COMPOSITION OF LIFO RESERVE
BASE INVENTORY, JANUARY 1, 1996, NET	588,235	X	(0.01060)	(0.98940 - 1.00000)=	(6,235)
CALENDAR YEAR 1996 INCREMENT	0	X	(0.03060)	(0.98940 - 1.02000)=	0
CALENDAR YEAR 1997 INCREMENT	18,193	X	0.00000	(0.98940 - 0.98940)=	0
TOTALS	606,428				(6,235)

PROOF / RECONCILIATION OF INCREASE IN LIFO RESERVE AS OF DECEMBER 31, 1997	USED AUTOS POOL #1
AMOUNT OF BASE DOLLARS THAT REMAINED INTACT THROUGHOUT DECEMBER 31, 1997	588,235
(X) MULTIPLIED BY CURRENT YEAR INFLATION (0.98940 - 1.02000)	X (0.03060)
INCREASE (DECREASE) IN LIFO RESERVE DUE TO INFLATION (DEFLATION) FACTOR	(18,000)
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR	(18,000)

DECEMBER 31, 1998 LIFO RESERVE CONSISTS OF:	BASE DOLLARS		INDEX FACTOR		COMPOSITION OF LIFO RESERVE
BASE INVENTORY, JANUARY 1, 1996, NET	588,235	X	(0.06996)	(0.93004 - 1.00000)=	(41,153)
CALENDAR YEAR 1996 INCREMENT	0	X	(0.08996)	(0.93004 - 1.02000)=	0
CALENDAR YEAR 1997 INCREMENT	18,193	X	(0.05936)	(0.93004 - 0.98940)=	(1,080)
CALENDAR YEAR 1998 INCREMENT	38,706	X	0.00000	(0.93004 - 0.93004)=	0
TOTALS	645,134				(42,233)

PROOF / RECONCILIATION OF INCREASE IN LIFO RESERVE AS OF DECEMBER 31, 1998	USED AUTOS POOL #1
AMOUNT OF BASE DOLLARS THAT REMAINED INTACT THROUGHOUT DECEMBER 31, 1998	606,428
(X) MULTIPLIED BY CURRENT YEAR INFLATION (0.93004 - 0.98940)	X (0.05936)
INCREASE (DECREASE) IN LIFO RESERVE DUE TO INFLATION (DEFLATION) FACTOR	(35,998)
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR	(35,998)

DECEMBER 31, 1999 LIFO RESERVE CONSISTS OF:	BASE DOLLARS		INDEX FACTOR		COMPOSITION OF LIFO RESERVE
BASE INVENTORY, JANUARY 1, 1996, NET	588,235	X	(0.09786)	(0.90214 - 1.00000)=	(57,565)
CALENDAR YEAR 1996 INCREMENT	0	X	(0.11786)	(0.90214 - 1.02000)=	0
CALENDAR YEAR 1997 INCREMENT	18,193	X	(0.08726)	(0.90214 - 0.98940)=	(1,588)
CALENDAR YEAR 1998 INCREMENT	38,706	X	(0.02790)	(0.90214 - 0.93004)=	(1,080)
CALENDAR YEAR 1999 INCREMENT	19,951	X	0.00000	(0.90214 - 0.90214)=	0
ROUNDING					1
TOTALS	665,085				(60,232)

PROOF / RECONCILIATION OF INCREASE IN LIFO RESERVE AS OF DECEMBER 31, 1999	NEW AUTOS POOL #1
AMOUNT OF BASE DOLLARS THAT REMAINED INTACT THROUGHOUT DECEMBER 31, 1999	645,134
(X) MULTIPLIED BY CURRENT YEAR INFLATION (0.90214 - 0.93004)	X (0.02790)
INCREASE (DECREASE) IN LIFO RESERVE DUE TO INFLATION (DEFLATION) FACTOR	(17,999)
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR	(17,999)

 (Continued from page 2)

and simplistically assuming that a dealer at year-end had an inventory mix of one-of-each.

CPAs have a variety of ways for arriving at an estimate of the inflation or deflation for projection purposes. Our simplified inflation indexes, based on one-of-each, may be used in the year-end projections as a substitute for selecting some other arbitrary or assumed inflation rate (like 1%, 2% or 3%) or coming up with a guesstimate number to use by some other method, such as a roll of the dice. But, if a dealer is going to reflect an ***estimate*** of the LIFO change for the year in his year-end Income Statement sent to the Factory, that ***estimate*** must be a ***reasonable*** estimate in order to satisfy the Conformity requirement under Revenue Ruling 97-42. As discussed elsewhere, no one really has any idea of what the IRS will accept as reasonable—or as unreasonable. So be careful and save your projection calculations.

We have found the best way to project year-end LIFO changes is to input all of the dealer's invoices on hand as of a date close to the end of the year. By doing this, we achieve a more realistic and accurate model mix. In addition, this allows us to factor in the actual average beginning-of-the-year item category costs for continuing models. Using our ***SUPERLIFO*** software projection module, these projection results are automatically verified and analyzed (see #8).

When the year-end LIFO repricings are made to compute inflation using all actual year-end invoices (including all vehicles in transit), the inflation increases or deflation decreases based on detailed item categories may be significantly different from the one-of-each weighted average assumed for all item categories within the given model. Also, a dealer's beginning-of-the-year average cost for an item category may be considerably lower than the 1997 intro dealer cost used in compiling the rough intro-to-intro averages and this would result in a slightly higher inflation index. Despite these limitations, some readers have found our one-of-each results to be useful in estimating LIFO reserve changes or in comparing their results with ours. We are pleased to present this year's analysis beginning on page 17.

#8. DO COMPUTER PROGRAMS MAKE MISTAKES? We recently noticed another LIFO software program showing a computed LIFO reserve increase to be roughly $200,000 instead of $20,000, apparently because of the absence of built-in verification procedures in the program. Unfortunately, the (clerical) people ordinarily inputting numbers have no way of knowing what "makes sense" and/or what does not.

If an *"estimate"* of $200,000 instead of $20,000 were reflected in the year-end Income Statement, would the IRS consider that to be "unreasonable..." or just plain stupidity or carelessness? Worse yet, what if some dealer paid tax on that wrong amount?

The *De Filipps' LIFO Lookout* newsletter is a quarterly publication of LIFO News, Views and Ideas by Willard J. De Filipps, CPA, P.C., 317 West Prospect Avenue, Mt. Prospect, IL 60056. It is intended to provide accurate, general information on LIFO matters and it should not be construed as offering accounting or legal advice or accounting or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only. Readers should consult their certified public accountant, attorney and/or other competent advisors to discuss their own situations and specific LIFO questions. Mechanical or electronic reproduction or photocopying is prohibited without permission of the publisher. Annual subscription: $325. Back issues available for $70 each. Not assignable without consent. Any quoted material must be attributed to *De Filipps LIFO Lookout* published by Willard J. De Filipps, CPA, P.C. Editorial comments and article suggestions are welcome and should be directed to Willard J. De Filipps at (847) 577-3977; FAX (847) 577-1073. **INTERNET**: http://www.defilipps.com.
De Filipps' LIFO Lookout format designed by *Publish or Perish, Inc.* (630) 627-7227.

De Filipps' LIFO LOOKOUT
Willard J. De Filipps, C.P.A., P.C.
317 West Prospect Avenue
Mt. Prospect, IL 60056

First-class postage paid at Mt. Prospect, IL