

Comparative Study of the Use of FIFO and Average Inventory Accounting Methods in Manufacturing Companies

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Abstract

Inventory valuation and recording play a crucial role in shaping the quality of financial reporting, particularly in the manufacturing industry where production processes and inventory flow are complex. This study addresses how the use of different inventory accounting methods FIFO (First-In, First-Out) and Average (weighted average) impacts not only net income, but also inventory management efficiency and the company's strategic positioning in the market. The objective of this research is to conduct a comparative analysis of the effects of these two methods within the accounting practices of manufacturing companies in Indonesia. A qualitative approach was employed through case studies of two large-scale manufacturing firms, using data collected from in-depth interviews and internal financial documentation. The results show that the FIFO method tends to generate higher net profits during periods of rising raw material prices, although it also leads to increased tax obligations. In contrast, the Average method offers more stable reporting outcomes and administrative efficiency, especially in businesses with homogeneous products and high inventory turnover. The discussion draws connections between these findings and PSAK 14, as well as prior literature, highlighting the importance of aligning inventory valuation methods with the operational context and strategic objectives of each company. Ultimately, the study concludes that no single method is universally superior. The effectiveness of implementation depends largely on business characteristics, the company's internal recording system, and managerial priorities. These findings enhance theoretical understanding by framing inventory accounting choices as strategic financial decisions and offer practical insights for managers seeking to align financial reporting with long-term competitiveness.

Keywords: FIFO, Average, inventory_accounting, financial_statements, manufacturing_companies.

JEL Classification: M41, L60, M11

1. Introduction

In manufacturing companies, inventory is one of the most vital assets in supporting the smooth running of the production process and overall company operations (Adelwini et al., 2023). Inventories include raw materials, work in progress, and finished goods ready for sale, all of which play an important role in maintaining continuity of production activities and meeting market demand (Yusuf et al., 2023). The existence and effective management of inventory not only impacts operational efficiency, but also affects the Company's financial statements (Ramdan et al., 2024). The reported inventory value will determine the amount of cost of goods sold (COGS), which ultimately has a direct impact on the company's net profit (Dewi et al., 2021). Thus, inventory plays a strategic role in reflecting the financial condition of a company and is an important performance indicator for management, investors, and other external parties (Agrawal, 2023).



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The selection of accounting methods in inventory valuation is a crucial aspect because it directly affects the accuracy of a company's financial reporting (Petrović et al., 2023). The method used will determine the value of ending inventory recorded on the balance sheet, as well as affect the calculation of cost of goods sold (COGS) in the income statement. This difference in COGS will in turn affect the amount of net income reported by the company, and indirectly affect the amount of tax payable (Gina Sakinah et al., 2024). Therefore, the selection of inventory recording methods not only affects internal managerial aspects, but also the company's external obligations, including compliance with tax regulations (Christianah Pelumi Efunniyi et al., 2024). In practice, there are two commonly used inventory accounting methods, namely the FIFO (First-In, First-Out) method and the Average (Weighted Average) method (Azahra & Siauwijaya, 2022; Muna et al., 2023). The FIFO method assumes that the goods that were purchased or produced first are the goods that are sold first, so that the ending inventory value consists of the most recent units (Tjia, 2023). This method is often used in conditions where prices tend to rise, as it results in lower COGS and higher net profits. Meanwhile, the Average method calculates inventory costs based on the weighted average of all units available for sale, providing a more stable COGS and ending inventory value (Sulaj, 2023). These two methods have different implications for financial statements, so the selection of the appropriate method must be tailored to the needs and characteristics of the company.

The manufacturing industry has a high level of complexity in terms of inventory management, given the diversity of raw materials, layered production processes, and large volumes of goods (Javaid et al., 2021). This complexity requires a reliable inventory recording and reporting system, as inventory information greatly influences strategic decisions and the company's financial performance (Ria et al., 2023). Based on data from the Central Statistics Agency (BPS), the manufacturing sector contributed 18.67% to Indonesia's Gross Domestic Product (GDP) in 2023, making it the sector with the largest contribution to the national economy (BPS, 2024). This figure highlights the crucial role of the manufacturing industry as the primary driver of the economy, while also emphasizing the importance of transparent accounting practices within this sector. In accounting practices, most large manufacturing companies in Indonesia use the FIFO (First-In, First-Out) or Average (Weighted Average) method for inventory recording (Kartinah, 2021). The selection of these two methods refers to the provisions stipulated in PSAK 14 on Inventories, which recognizes and allows the use of these methods as long as they are consistent and in accordance with the operational characteristics of the entity (Suteja et al., 2024). The FIFO method is often chosen in inflationary conditions because it results in lower cost of goods sold and higher net income (Chen, 2024). Meanwhile, the Average method provides more stable results over time. Therefore, the choice of inventory valuation method not only affects financial statements, but also reflects the company's financial strategy in responding to price fluctuations and operational efficiency (Sandberg et al., 2023).

Given the importance of inventory in influencing the financial statements of manufacturing companies, a critical question arises regarding the impact of the choice of inventory accounting method on overall financial performance. One of the main issues to be examined in this study is whether there are significant differences between the financial statements of companies using the FIFO method and those using the Average method. These differences are primarily observed in terms of net profit, ending inventory value, and cost of goods sold (COGS). Furthermore, the choice of inventory accounting method can also affect the efficiency of inventory management itself, as the method used will determine how accurate and relevant the information available to management is for decision-making purposes (Shabani et al., 2021). Furthermore, in the context of a competitive manufacturing industry, financial reports that accurately reflect financial conditions are one of the determinants of a company's competitiveness (Abbas et al., 2023). Therefore, it is important to examine the extent to which the FIFO and Average methods not only have a technical impact on financial statements, but also on the company's financial strategy and competitive position in the market.

Although the topic of inventory accounting methods has been widely discussed in international accounting literature, most studies focus more on the technical aspects of calculations or compliance with accounting standards, such as PSAK or IFRS. In Indonesia, in-depth studies comparing the use of FIFO and Average methods qualitatively in the real context of manufacturing companies are still very limited. In particular, there are still few case study-based comparative studies that explore the strategic implications of the choice of inventory recording method on company profitability, managerial efficiency, and operational and taxation decisions. In fact, in practice, the choice of inventory method not only affects the value of financial statements, but also has an impact on cost control strategies, selling prices, and business competitiveness. Thus, this study fills the gap by conducting a comparative analysis of two manufacturing companies that

apply the FIFO and Average methods, in order to reveal the strategic and operational dynamics behind the chosen inventory accounting policy.

This research is highly relevant in the context of strategic decision-making by manufacturing company management. By understanding the differences and implications of the FIFO and Average methods, management can determine the most appropriate inventory recording method based on the operational characteristics and business conditions of each company. Accounting information generated from the appropriate method will enhance the reliability of financial statements, which in turn serve as the foundation for planning, cost control, and performance evaluation. In addition to benefiting internal management, the results of this research are also relevant to external parties such as investors who require reliable profit and asset information to assess company performance, auditors tasked with evaluating the compliance and fairness of financial statements, and tax regulators concerned with the accuracy of companies' fiscal reporting obligations. Thus, the main objective of this background is to emphasize the importance of conducting a comparative study between the FIFO and Average methods in the accounting practices of manufacturing companies. This study is expected to reveal the real implications of both methods on financial performance, operational efficiency, and the company's competitive position in the industry. The results of this research are expected to provide practical and academic contributions to the development of accounting science, particularly in the field of cost accounting and financial reporting in the manufacturing sector.

2. Method, Data, and Analysis

This study uses a qualitative approach with a comparative case study to gain an in-depth understanding of the practices and implications of using the FIFO and Average inventory accounting methods in manufacturing companies. This approach was chosen because it allows researchers to explore the contextual reasons for choosing a method, its impact on financial reporting, and its influence on inventory management efficiency and strategic decision-making within the company. The research subjects are financial managers, accountants, or accounting department staff at two manufacturing companies, each using the FIFO and Average methods, respectively. Informants were selected purposively, i.e., by choosing individuals with knowledge and direct involvement in inventory management and financial reporting. Data collection was conducted through in-depth interviews with key informants, supported by documentation such as financial reports, standard operating procedures (SOPs) for inventory accounting, and non-participatory observation where possible. The data obtained will be analyzed through data reduction, presentation of data in narrative and thematic forms, and drawing conclusions based on patterns and comparisons between cases. To ensure the validity of the findings, this study uses source triangulation, which involves comparing data from various informants and supporting documents, as well as conducting member checks to confirm the findings with the relevant informants. The researcher will also maintain an audit trail to systematically document the research process to ensure transparency and traceability of data. Through this approach, it is hoped that a more comprehensive understanding of the practical impact of the FIFO and Average methods on accounting systems and managerial strategies in manufacturing companies will be obtained.

The data obtained were analyzed using thematic analysis, with the following steps: First, researchers transcribed the interview results, then continued with the open coding process to identify the initial categories of informants' answers. Second, the codes were grouped into main themes relevant to the research objectives, such as: "cost control strategy", "recording efficiency", and "impact on net profit". Third, the researcher conducted thematic interpretation based on the relationship between themes and the context of each company. To maintain data validity, triangulation of sources and methods (cross-checking between interviews, documents, and observations) was used.

3. Results

This study was conducted on two medium-sized manufacturing companies in Indonesia engaged in the food and beverage processing industry. To maintain confidentiality, the two companies will be referred to as Company A and Company B. Company A uses the First-In, First-Out (FIFO) inventory recording method, while Company B applies the Average (weighted average) method. Both companies have implemented an accrual-based accounting system in accordance with PSAK standards, supported by modern accounting software integrated with the inventory system. Company A has been using the FIFO method for more than eight years as part of its inventory management policy, which is consistent with the characteristics of its products that have a limited shelf life. Meanwhile, Company B began using the Average method five years ago, considering the efficiency of recording and its suitability for large production volumes with relatively high product homogeneity. This information serves as the basis for further analysis of how each method affects financial statements and overall inventory management.

The selection of inventory accounting methods by each company is based on strategic, technical, and operational considerations. Company A, which has consistently used the First-In, First-Out (FIFO) method for more than eight years, revealed that the main reason for choosing this method is its suitability for products that are perishable and have a limited shelf life, such as processed beverages and snacks. In an operational context, the FIFO method is considered to reflect a more realistic physical flow of goods (Heydarov, 2022), where the first goods to enter the warehouse are the first to be sold. This is considered to minimize the risk of product damage and maintain the quality of goods until they reach consumers. In addition, Company A's financial manager said that in inflationary conditions, the FIFO method tends to result in higher ending inventory values and lower cost of goods sold (COGS), thereby increasing net profit. This condition indirectly provides short-term fiscal benefits, although it has the potential to increase tax expenses.

Meanwhile, Company B chose to use the Average (weighted average) method, considering the efficiency of the accounting information system and its suitability for mass-produced and homogeneous products, such as packaging materials and food additives. This method is considered more practical because it does not require detailed unit recording like FIFO, but rather calculates the average value of each purchase made within a period. According to a senior accountant at Company B, the Average method simplifies the calculation of COGS and the preparation of monthly financial statements without requiring extensive technical adjustments. Additionally, in a managerial context, this method supports the preparation of more stable production cost budgets because it is less sensitive to fluctuations in raw material purchase prices. The interviews also revealed that the selection of the method was conducted through internal evaluation by the accounting and management teams, and consulted with external auditors to ensure compliance with PSAK 14 and tax reporting requirements. Thus, the selection of inventory accounting methods by each company is not merely a technical decision but part of a business strategy that considers operational efficiency, reliability of financial reporting, and compliance with regulations.

The use of inventory accounting methods has a direct impact on the presentation of financial statements, particularly in terms of determining ending inventory value, cost of goods sold (COGS), net income, and accrued tax expenses. In the case of Company A, which uses the FIFO method, ending inventory values tend to be higher because the last items recorded are the most recently purchased, thereby reflecting more up-to-date prices. The impact of this higher inventory value is a decrease in COGS, which ultimately increases the company's net income. Company A's financial manager emphasizes that this situation presents a more favorable financial image, especially when communicated to investors and creditors. However, he also acknowledges that the increase in net income results in higher income tax expenses, which requires specific fiscal mitigation strategies.

Conversely, Company B, which applies the Average method, produces a more stable ending inventory value over time, because the cost per unit is calculated based on the weighted average of purchases during the current period. This results in a relatively moderate COGS that is not overly influenced by fluctuations in the purchase price of raw materials. As a result, the net profit generated tends to be more stable, although not as high as that obtained by companies using FIFO in inflationary conditions. From a managerial perspective, this stability provides an advantage in budget planning and the preparation of medium-term financial projections. The senior accountant of Company B stated that the Average method also facilitates internal and external audit processes as it does not require overly detailed historical tracking of each unit of goods. This comparative narrative shows that the FIFO method better reflects the dynamics of an upward-trending market and can strengthen short-term profit positions, but with higher tax implications. On the other hand, the Average method is more suitable for use in mass production environments with fluctuating raw material prices, as it provides stability and efficiency in record-keeping. Both FIFO and Average have their own benefits and risks, and the decision to use them depends heavily on the company's financial strategy, operational characteristics, and considerations for reporting to internal and external stakeholders.

The inventory accounting method used by a company directly affects the efficiency of the recording system, internal controls, and the quality of managerial decision-making. Company A, which applies the FIFO method, states that the recording system has become more detailed and requires the recording of goods units based on the chronology of their arrival. This impacts the need for an integrated accounting information system and personnel with high competence in managing the flow of goods in and out in a timely manner. However, the advantage of this method lies in its ability to improve the accuracy of inventory control and tracking the age of goods, which is crucial for companies with products that expire quickly. Decision-making processes such as rescheduling purchases or setting discounts on old goods can be carried out more accurately based on accurate historical data.

In contrast, Company B, which uses the average method, acknowledges that this method offers greater efficiency in terms of recording, as it is not necessary to track each unit of goods individually. The information system used simply accumulates all purchases in a given period and calculates the average cost per unit, which simplifies the data entry and monthly reporting processes. However, challenges arise when there are extreme fluctuations in raw material prices, which can cause the average value to no longer accurately reflect the actual economic value of a product. Additionally, this method has limitations in detecting older inventory that has been stored longer in the warehouse, posing a risk of reducing inventory turnover efficiency if not combined with a strict warehouse management system.

The difference in approach between companies that use FIFO and Average is also evident in complex inventory management strategies. FIFO companies tend to rely on batch-based management systems and implement strict physical rotation policies to ensure that goods flow in the order they were received. On the other hand, Average companies place greater emphasis on cost stability and the ease of periodic inventory reconciliation, although this requires more intensive visual and physical monitoring of inventory to prevent the accumulation of old goods. These findings indicate that the selection of accounting methods is not merely a matter of financial reporting but is closely tied to operational efficiency and supply chain management effectiveness. The choice of inventory accounting methods not only impacts the technical aspects of financial reporting but also has strategic implications that influence a company's competitiveness in the market. In an interview with the financial manager of Company A, which uses the FIFO method, it was explained that higher ending inventory values and lower cost of goods sold (COGS) allow the company to set larger profit margins. This provides flexibility in developing competitive pricing strategies, especially when competing in price-sensitive retail markets. Higher profit margins also create room for the company to reinvest in product innovation and distribution expansion. Meanwhile, Company B, which uses the Average method, leverages the stability of COGS to maintain consistent selling prices and create a more predictable market perception. This approach is considered effective for maintaining customer loyalty in the long term, especially in homogeneous and large-scale markets.

Furthermore, informants from both companies stated that the accounting method applied had an influence on the perceptions of external stakeholders, such as auditors, investors, and tax authorities. In the case of FIFO, an increase in net profit in financial statements is often a positive indicator for investors who assess a company's performance fundamentally. However, this also invites auditors to conduct feasibility tests on the validity of inventory values and their impact on tax liabilities. Conversely, the Average method is considered more conservative and efficient from an audit perspective because it produces more stable financial data from period to period, which is deemed credible by regulators and tax authorities. These findings indicate that the chosen inventory recording method not only affects cost structure and margins but also shapes the company's competitive position in the eyes of the market and stakeholders. Therefore, this decision needs to be considered holistically in the context of business strategy and corporate governance.

Table 1. Comparison of the Effect of FIFO and Average Methods on Manufacturing Companies

Aspect Analysis	Company A (FIFO)	Company B (Average)
COGS (Cost of Goods Sold)	Higher when raw material prices rise → lower gross profit	More stable, tends to be lower when prices fluctuate
Net Profit	Volatile, depending on the first-in price	Tend to be more consistent from period to period
Tax Strategy	Lower tax liability in inflationary periods	Less than optimal in tax savings
Recording Efficiency	More complex, need strict stock control per batch in.	Simpler, administratively efficient
Competitive Implications	Can be used for low margin strategies when prices rise	Suitable for long-term stable price strategy

The field findings show that the choice of inventory accounting method has a real impact on the strategic and operational aspects of the company. As shown in Table 1, Company A that uses FIFO tends to face higher fluctuations in cost of goods sold and net profit, especially during raw material price inflation. However, this provides strategic advantages in terms of tax savings and selling price flexibility. Meanwhile, Company B, which applies the Average method, enjoys stability in profit reporting, record-keeping efficiency, and operational ease. However, this method is less optimal in tax efficiency when there is a spike in raw material prices. The competitive implications of this difference suggest that the choice of inventory method is not just a technical accounting issue, but part of a company's financial strategy and market positioning.

The findings of this study indicate that the choice of inventory accounting method not only affects financial reporting but also reflects broader managerial strategies in managing production cost dynamics and operational decision-making. Company A, which applies the FIFO method,

demonstrates a tendency to use inventory information as part of a broader pricing and tax efficiency strategy. A finance manager from the company stated:

“We chose FIFO because we can immediately reflect older inventory costs in our reports. When material prices go up, we’re still able to maintain margins and reduce the short-term tax burden.” (Informant A1)

This quote highlights how FIFO can be strategically utilized in times of rising input prices, giving management room to manage margins and tax obligations more adaptively.

Meanwhile, Company B adopted the Average method with the rationale of administrative simplicity and reporting consistency. One of the accounting staff mentioned:

“Average helps us maintain consistent inventory values. Management also prefers financial statements that are more stable, especially when presenting to investors.” (Informant B2)

This reflects that the Average method was not selected merely for its ease of application, but because it supports a more stable financial communication strategy that appeals to external stakeholders. Thus, this discussion reinforces that the selection of inventory accounting methods embodies a company’s strategic orientation. FIFO tends to be favored for its adaptability to cost changes and fiscal efficiency, whereas Average supports long-term reporting stability and stakeholder confidence. These findings align with contingency theory in accounting, which posits that accounting practices are most effective when tailored to the organization's operational context and strategic objectives.

4. Discussion

Based on the results of field studies and in-depth interviews, a comparative analysis was conducted between Company A (using the FIFO method) and Company B (using the Average method) to assess the differences in method characteristics, their impact on financial performance, and implementation experiences in operational practices. In terms of characteristics, the FIFO method demonstrates superiority in reflecting the actual physical flow of goods, particularly for products with limited shelf life. Conversely, the Average method stands out for its administrative ease and efficiency in record-keeping, making it highly suitable for homogeneous goods and large production volumes. Financially, Company A recorded higher net profit due to lower COGS when raw material prices increased, but this resulted in higher tax expenses. Meanwhile, Company B demonstrated more stable financial performance from period to period because the Average method mitigates price fluctuations, thereby providing advantages in terms of predictability and budget control.

In operational practice, FIFO requires a more stringent internal control system and accuracy in chronological stock recording, while Average is more flexible and easier to implement in companies with less complex recording systems. These findings show that no single method is absolutely superior, but the relevance and effectiveness of the method greatly depend on the business context of the company. As an initial conclusion, the FIFO method is more suitable for companies operating in sectors with perishable goods or highly fluctuating product prices, and prioritizing maximum profit margins. Meanwhile, the Average method is more appropriate for large manufacturing companies with homogeneous products, emphasizing system efficiency, price stability, and simplicity in audit and reporting processes. The choice of method should be aligned with the company's business strategy and the needs of its key stakeholders.

The findings of this study are in line with the provisions of PSAK 14 on Inventories, which explicitly recognizes the First-In, First-Out (FIFO) and Weighted Average methods as valid methods for recording inventories. PSAK 14 emphasizes that inventory valuation methods must be consistent and reflect the fair value of the inventory held by the company, as well as provide reliable information for economic decision-making. In this context, Company A's application of the FIFO method has proven to generate higher profit information when raw material prices increase, which is consistent with cost accounting literature stating that FIFO can increase margins in inflationary conditions. Meanwhile, findings from Company B also support the theory that the Average method is more suitable for industries with large production volumes and fluctuating raw material prices, as it can smooth out the impact of price volatility and simplify reporting.

Comparatively, the results of this study support the findings of previous studies conducted by Icebge et al (2022), which concludes that companies that use FIFO tend to have higher profit fluctuations (Ling & Tinkelman, 2024). Meanwhile, companies that use the Average method are more stable in their financial reporting (Pizzi et al., 2022). However, this study provides additional insight by showing that the choice of method not only affects accounting figures, but also has implications for business strategy, stakeholder perceptions, and operational efficiency. Thus, the results of this study not only confirm the existing literature, but also broaden the understanding of

the importance of industry context and managerial objectives in determining the most relevant and effective inventory accounting method.

5. Conclusion, Limitations, and Suggestions

Conclusion

Based on the results of a comparative analysis of the application of the FIFO and Average methods in two manufacturing companies, it can be concluded that the choice of inventory accounting method has a significant impact on financial performance, business strategy, and stakeholder perceptions. The FIFO method tends to produce a higher net profit value in conditions of increasing raw material prices, which has the potential to increase investor attractiveness, but also has an impact on a greater tax burden. Meanwhile, the Average method provides stability in financial reporting and ease of administration, making it more suitable for companies with homogeneous product characteristics and standardized recording systems. The findings of this study also confirm that the choice of inventory method is not only based on compliance with PSAK 14, but also influenced by managerial considerations, system efficiency, and the company's competitive strategy. Therefore, this study emphasizes the importance of adjusting the inventory recording method to the company's operational context and business objectives so that the resulting financial information is relevant, reliable, and supports strategic decision-making. The findings demonstrate that inventory accounting methods have practical implications for financial performance, reporting, and operational control. However, more importantly, this study supports the theoretical view that inventory method selection is part of broader financial strategy decisions within the firm, not merely a technical accounting choice.

Limitations and suggestions

This study has several limitations that need to be considered. First, the number of companies analyzed is limited to two manufacturing entities, so generalization of the findings to the entire industrial sector still requires caution. Second, the qualitative approach used focuses more on the narrative perspective and experiences of informants, so it does not include broader quantitative data such as comparative financial ratios between methods. In addition, the data obtained depends on the openness of the informants and the internal documentation available, which may affect the depth of the analysis. Based on these limitations, it is recommended that future research involve more companies from various subsectors of the manufacturing industry to obtain a more representative picture. Research can also be developed using a quantitative or mixed methods approach to statistically test the effect of inventory recording methods on profitability, operational efficiency, and tax liabilities. In addition, it is important to consider external variables such as fluctuations in raw material prices, tax regulations, and the adoption of information technology in the inventory recording system that can affect the effectiveness of the application of the FIFO and Average methods.

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