ACCOUNTING in the headlines

What does Home Depot's 2015 Form 10-K communicate about its inventory?

Home Depot (HD) is a retailer of home improvement and construction products. Home Depot is currently the world's largest home improvement retailer with revenues exceeding $83 billion in its fiscal year ending February 1, 2015.

The most commonly used inventory valuation methods are first-in first-out, last-in first-out, and average or weighted average cost. See the excerpts to follow from Home Depot's 2015 Form 10-K: its Consolidated Balance Sheet and a section from its Notes to Financial Statements (page 35 – 36).

Questions

1. Which method does Home Depot use to value its inventory?
2. What is shrink and how can a company prevent it?
3. What is the main difference between the FIFO, LIFO, and weighted average cost inventory valuation methods?
4. What benefits would using the FIFO method for inventory valuation provide for Home Depot?

Home Depot Partial Consolidated Balance Sheet (assets) from p. 32 of Form 10-K as of February 1, 2015:

THE HOME DEPOT, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

amounts in millions, except share and per share data	February 1, 2015	February 2, 2014
ASSETS		
Current Assets:		
Cash and Cash Equivalents	**$ 1,723**	$ 1,929
Receivables, net	**1,484**	1,398
Merchandise Inventories	**11,079**	11,057
Other Current Assets	**1,016**	895
Total Current Assets	**15,302**	15,279
Property and Equipment, at cost	**38,513**	39,064
Less Accumulated Depreciation and Amortization	**15,793**	15,716
Net Property and Equipment	**22,720**	23,348
Goodwill	**1,353**	1,289
Other Assets	**571**	602
Total Assets	**$ 39,946**	$ 40,518

Excerpt from Notes to Financial Statements on p. 35 – 36 of Form 10-K (Note 1) February 1, 2015:

Merchandise Inventories

The majority of the Company's Merchandise Inventories are stated at the lower of cost (first-in, first-out) or market, as determined by the retail inventory method. As the inventory retail value is adjusted regularly to reflect market conditions, the inventory valued using the retail method approximates the lower of cost or market. Certain subsidiaries, including retail operations in Canada and Mexico, and distribution centers, record Merchandise Inventories at the lower of cost or market, as determined by a cost method. These Merchandise Inventories represent approximately 26% of the total Merchandise Inventories balance. The Company evaluates the inventory valued using a cost method at the end of each quarter to ensure that it is carried at the lower of cost or market. The valuation allowance for Merchandise Inventories valued under a cost method was not material to the Consolidated Financial Statements of the Company as of the end of fiscal 2014 or 2013.

Independent physical inventory counts or cycle counts are taken on a regular basis in each store and distribution center to ensure that amounts reflected in the accompanying Consolidated Financial Statements for Merchandise Inventories are properly stated. During the period between physical inventory counts in stores, the Company accrues for estimated losses related to shrink on a store-by-store basis based on recent shrink results and current trends in the business. Shrink (or in the case of excess inventory, "swell") is the difference between the recorded amount of inventory and the physical inventory. Shrink may occur due to theft, loss, inaccurate records for the receipt of inventory or deterioration of goods, among other things.