Target's Inventory Method

Copy of Target's 10-k Footnotes for year ended January 28th 2012

11. Inventory

Substantially all inventory and the related cost of sales are accounted for under the retail inventory accounting method (RIM) using the last-in, first-out (LIFO) method. Inventory is stated at the lower of LIFO cost or market. Cost includes purchase price as reduced by vendor income. Inventory is also reduced for estimated losses related to shrink and markdowns. The LIFO provision is calculated based on inventory levels, markup rates and internally measured retail price indices.

Under RIM, inventory cost and the resulting gross margins are calculated by applying a cost-to-retail ratio to the retail value inventory. RIM is an averaging method that has been widely used in the retail industry due to its practicality. The use of RIM will result in inventory being valued at the lower of cost or market because permanent markdowns are currently taken as a reduction of the retail value of inventory.

We routinely enter into arrangements with vendors whereby we do not purchase or pay for merchandise until the merchandise is ultimately sold to a guest. Activity under this program is included in sales and cost of sales in the Consolidated Statements of Operations, but the merchandise received under the program is not included in inventory in our Consolidated Statements of Financial Position because of the virtually simultaneous purchase and sale of this inventory. Sales made under these arrangements totaled $1,630 million in 2011, $1,581 million in 2010 and $1,470 million in 2009.

12. Other Current Assets

Just like Wal-Mart (one of Targets biggest competitors) and other retail companies, Target uses the last in, first out (LIFO) inventory accounting method. When calculated for accounting statement purposes, the inventory is valued at the lower of LIFO or market cost. This is done to insure that the numbers are as conservative as possible. LIFO values Target's Cost of Goods Sold (COGS) higher than the other inventory accounting methods (FIFO and Average Cost) therefore Net Income is lower with LIFO than with any other method.

Inventory is usually one of the largest current assets for retail companies so it is very important that investors feel that these numbers are not inflated. This is the basic reason for the popularity of LIFO. Also, Target updates its inventory numbers every time a purchase is made through barcodes and scanning product information directly into their master database when customers makes a purchases. This makes it easy for them to use the perpetual accounting method and devote more of their staff to customer service. Most retail companies find it accurate and effective to use bar codes to easily keep track of merchandise.

Also disclosed in the footnotes is information about some of the special sales contracts that Target makes with their suppliers/vendors. Target arranges contracts with vendors/suppliers whereby they do not pay for the merchandise until it is sold. Merchandise in the stores that are under those contracts is not recorded as inventory; instead the profits and cost of these items are consolidated under the Consolidated Statement of Financial Position. So in effect Target has merchandise on it's shelves that does not belong to the company or does not affect any inventory numbers. The sales received from these types of contracts are mentioned in the footnotes. They also show in the footnotes the sales that they actually accumulated from these kinds of contracts. So, shareholders and potential investors can see that the inventory numbers presented on the balance sheet is not a complete representation of the total amount of merchandise that the company has available to sell.