CHAPTER 2

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A THEORITICAL

2.0 STATEMENTS OF INFLATION ACCOUNTING ON WORLDWIDE BASIS

Anyone, who has studied accounting for some time, would know that the structure of accounting in description of financial aspect of immovable properties, and the recorded values in account-books are away from the truth.

We know that about the cash properties in account-books, the exchange and remaining of cash money, in every special exact time, is shown. But in the case of uncashed properties, which monetary value is better?

The monetary values of properties under the possession at every time must be representation of things that can be spent or used for paying debts or buying other properties. It seems that this expectation is not formed on the basis of values of historical real worth.

Then how we can explain the existence of some rules of accounting that are welcomed by people? However, it is unable to respond to information needs of users.

During several past decades, the doctrine of historical price, was criticized for some special technical reasons. The accusation was that it gave misleading information.
Having updated information is a very important need of managers today. Having financial information is one of the basic elements of management.

Accounting can be effective through two aspects in decision-making. First, decisions are based partly on the past experience, through which mistakes can be avoided and success can be repeated. Secondly, decisions are made on the basis of knowledge of existing conditions. This knowledge is very important because it can inform the managers about their facilities and existing situation.

For this any mistake in statements of situation and existing abilities of commercial unit, can result in decisions that lead to unfortunate results.

The other problem in accounting job is methods of measuring that must be searched and their effects must be stated. Jaedick and Ijiri: “Accounting with variety of methods of measuring is paralyzed. Over the years, accountants have searched for a criterion by which they can decide the best method of measuring”.

It seems that with notice to existing facts in the commercial world and unconformity of re-additional accounting with the fact especially in the inflation and instability situation we must find a solution.

Assessing the process of evolution of ideas and theories on one hand, and continued efforts of professional institutions on the other, gives a dynamic feature to accounting.
Experimental research shows that inflation accounting can have a more active role. Inflation accounting appears in specialized magazines of accounting. There are opposite and similar ideas about level of prices and the effects of accounting in the context of the inflation. All of them need to be studied in detail.

2.1. INFLATIONARY ACCOUNTING IN U.S.A.

2.1.1. Professional Accountings

In 1896, the American community of public accountants was formed according to law recognizing independent accounting job.

2.1.2. Inflationary Accounting

“Accountants’ association of America” made the first effort to reveal inflation effects on the financial lists and financial information. It published its specialized statements with this title: “Reporting financial effect of price-level change”.

This declaration proposed that appendixical information for showing a complete adjustment of all financial factors, with use of financial fixed price must be offered.

In 1974, financial accounting standards Board, published a statement called, financial reporting in the units of general purchasing power.

In this statement, using of fixed price accounting methods was proposed and gathering of this information as appendix to financial statements was accepted.
The continued process of increasing prices during the 1970s in America has shown the limitation of financial features.

One study in 1979 states that about 215 American companies have shown that income arising out of usual operations after the adjustment of figures on the basis of inflation, will decrease by 40 p.c. So, many companies have paid tax from their capital and dividend from their profits.

2.1.3 An Important Statement

In 1979, the American Standards Board, after assessing the statement of 1974, decided to find an appropriate solution for effects of inflation, and published the statement number (33). This statement number 33 is about financial reporting and changing prices.

Undoubtedly, it is one of the most important and complicated statements that has been published so far by “FASB”

The companies must reveal additional information about certain items according to fixed value of dollars. However they must have some flexibility in some of methods of following these demands in their procedure.

For this “Securities and Exchange Commission” its former demands that there were in “Accounting series release” number 190, have adjusted that can be conformed with statement FASB.

Based on the standard 33, companies are required to prepare completed reports in the following cases:
1. Operational profit, that is stated in terms of fixed monetary unit or current values.

2. Gain or loss of purchasing power of monetary items.

3. Increase or decrease in the value of assets that result in profit or loss.

4. Effects of general inflation.

5. Current values of assets and properties.

This standard demands that the companies bring out information in the following background:

1. Interpretation of revealed information and details about their importance in general conditions.

2. Any change in the methods of assessing useful life and values of decreasing assets, in order to compare before and after adjusting to inflation.

3. Income tax on companies related to statement of properties.

2.1.4 After 1980

During the 70’s inflation tended to create a crisis among all people in America. The declaration 33 was issued, but in 1980, as soon as the inflation tended to decrease, several declaration were published by Accounting Standard Board that in actuality made the declaration number (33) ineffective.

Publishing the declaration number (39) in October 1980 and declaration (40) and (41) in November 1980 and number (54) in January 1982 and declaration (70) in December 1982 and (82) in November 1984 and last
declaration (89) in 1986 killed the declaration number (33), that is was even not a
decade old.

2.2 INFLATIONARY ACCOUNTING IN U.K.

2.2.1 Professional Accounting

In U.K. similar to other developed countries, independent accounting job is
under the control of professional association. The professional accounting institute
of U.K. in 1980 was formed by an order by Government.

The main object of this institution was upgrading the position of accounting
jobs, increase sufficiency of the job by making new rules and regulations and
make the members follow them, increase in study and knowledge of members in
accounting technique teaching efficient people difficult responsibility of
professional accounting. The number of formal members of professional
associations in England was 123,900.

2.2.2 Inflationary Accounting

In 1940’s “Institute of chartered accountants of England and Wales”
released an order entitled: “recommendation on accounting practice.”
(the N series).

In 1960’s appeared an enormous series called basis and methods of
accounting that was recognized useful in reporting and adjusting the financial
statement in 1970, as a professional response to the using and misusing of
Accounting Methods. “Accounting Standard Steering Committee” (ASSC) was
formed and until 1976, all professional institutes of U.K., became the member of Accounting Standard Steering Committee, which was then called "Accounting Standard Committee". This committee, before its death in 1990, published 54 accommodations and 24 declarations.

In May 1990, "Financial Reporting Council" (FRC) was established and was given some powers to control the financial reportings.

According to 1989 law, two institutes were formed under the control of financial reporting council. One of them was Accounting Standard Board and the other Financial reporting review panel.

The duty of Accounting Standard Council is reporting of accounting standards, but the responsibility of financial reporting review panel is specifying and finding the difficulties and mistakes in the financial statements.

In March 1980, Accounting Standard Board published the standards of standard accounting number (16), about inflationary accounting.

2.2.3 Standard 16

Standard number (16) includes all companies that were accepted or not accepted in the stock market, with the exception of companies, whose sales in a year were less than 5 million pounds or their assets were less than 250,000 pounds or the number of their employees was less than 250.

According to this standard, we can use the current values for completing reportings or in the form of main reporting, beside historical reportings in financial statement.
According to standard number (16), companies must offer financial statements based on the current values and must give information about changing financial situation according to standard number (10) (SSAP-10).

According to standard (16), specifying the accounting profits in a financial period takes place in two stages.

In the first stage, operational profit of accounting will be specified and in the second stage, accounting profit, that is divisible will be specified.

In fact, divisible profits in this method is additional income of past financial period, of course, after considering the changing prices.

Briefly, in standard (16), objects of offering the current values are as follows: "the main object was, preparing useful data, contrast in the information offered by audit historical accountings for guiding the managers and other users of financial statements to specify the financial abilities of company, specifying the income of interests, make the distributions policies and specify the financial labels."

2.3 INFLATIONARY ACCOUNTING IN CANADA

In an article published in the Accounting Magazine, John M. Boersima presented the case for general price level accounting in Canada.

He mentions that inflation in Canada in 1983 touched the highest rate of 9.1 per cent in last twenty two years. In the context of unabated price rise, it was acknowledged in Canada that there was no choice but to recognize publicly and
firmly that accounting principles needed under conditions of chronic inflation were fundamentally different from those required under conditions of monetary stability.

In the report of the Study Group on the objectives of financial statements under the auspices of the AICPA, USA (October 1983), it was mentioned that ‘if the value of the unit of measure is unstable, that is, if inflation or deflation is so great that direct cost consequences are no longer comparable, such circumstances should be recognized in the financial statements’. The article notes that in January 1973 the Accounting Standards Steering Committees of accountants in London and Wales issued ED8 suggesting that all limited companies be required to issue general price–level statements as a supplement to the historic cost statements. The British Government started, alongside the debate on ED8, its own two year enquiry into accounting for inflation because ‘it has important implications for the efficiency of company management, the allocation of resources, investment decision making, industrial competitiveness, corporate taxation and counter–inflationary policy’. The Canadian Institute of Chartered Accountants, the author notes, has not yet taken an official stand on the issue. However, one of the sponsored research studies of CICA concluded that “the reporting of price–level restated historic costs of assets and liabilities – appear to have limited benefit”. The author contests the view of the CICA sponsored research study to underline that the general price-level accounting is the logical next step in the eventual move towards current value accounting.
2.4 INFLATIONARY ACCOUNTING IN AUSTRALIA

The Australia professional institutions, industry and academic institutions recorded response patterns similar to those in the UK and the USA. Attention was focussed on the features of inflation, adoption of the relevant index numbers for price adjustments and application of general price-level accounting in industry situations.

In his book accounting for Price Level Changes: Theory and Procedures, Professor R. S. Gynther has taken note of the main trends of thought expressed in the debate on inflation accounting in the USA, UK and Australia and has dealt with practical problems on brass tacks as to how to accommodate price-level changes in corporate accounts. He has expressed the view that the general response of Australian professional accountants towards reforming company accounts to make them more responsive to price-level changes has been rather lukewarm, if not totally indifferent. Discussing the pros and cons of accounting for price-level changes, the author has gone into different elements comprising the accounts to underline the changes that should be made for reorienting accounting figures. He presents an adaptation of a model formulated by Professor R. J. Chambers for demonstrating the necessity of calculating losses on monetary assets and profits on current liabilities during times of changing price-levels.

Professor Gynther has been emphatic that it is possible to make general price-level accounting a practical reality and he has noted that the Philips
Electrical Industries in Australia and New-Zealand have indeed applied inflation accounting the main features of which have been presented by J.P. Snoek reproduced in the Example. He has in fact taken the Australian professional accountants to task for the indifference to change that they have shown in general, particularly in the context of the practicability of general price-level accounting as demonstrated by Philips Electrical Industries. The procedures advocated by him, in his view, can be easily applied by any firm.

2.5 INFLATIONARY ACCOUNTING IN INDIA

In India, serious thinking on having to adjust conventional accounts to price-level changes has been rather few and far between. Original work on the subject did not attract much professional attention during the last three decades and a half. In fact, it is more in the context of national income accounting that the accommodation of changing price-level into the formal structure of national accounts has been discussed in a serious vain. Some of the accounting concepts of depreciation, profits or losses have attracted a good deal of attention of national income specialists and there have been papers on different aspects of the question in various conferences on national income. That company accounts require to be aligned to national income under planning and that such adjusted accounts respond better to the assessments made under planning regarding the progress made and the GNP created through various investment programmes can hardly be gainsaid.
In fact, inflation accounting would make it possible for the planners to integrate the sectoral plans with reference to the investments made, surpluses created and production of different varieties of goods all of which are part of plan estimates. Large scale investment programmes undertaken during the era under planning have in some way or the other been responsible for initiating cost push and demand push inflation.

Inflation accounting would make it possible for the enterprises to underline the effects that such inflation have created on company performance. In addition, inflation accounting would make assessment of financial operations of both public and private sector organizations more realistic, particularly in respect of profit or profitability as a criterion of such measurement.

S. L. N. Simha in his study on the impact of inflation on company finance notes that with respect to the Reserve Bank study of 350 companies with an aggregate paid up capital and reserves of Rs. 2,267 crores the picture of corporate performance in the three years from 1971 to 1973 suggests that while during the year 1971-72 there was 4 per cent rise in the index number of wholesale price than in the year 1970 – 71, profits before tax, rose by less than 3 percent. Again while in 1972-73 the index number or wholesale prices was about 10 per cent higher than in 1971 – 72, profits before tax declined fractionally, by about 0.25 percent. If profits after tax were taken into account, the position would be far worse. It is possible to conclude from these figures, as Simha has done, that these companies could not take benefit of the inflationary price rise in the country. The
growth recorded by these companies also do not suggest a proportionate increase as one would normally expect.

In the circumstances, there is a strong case for adjusting company accounts on the basis of historical values to their current price so that a more realistic picture emerged before company management and government that would make a case for less repressive case of corporate taxation more convincing than it is now.

2.6 INFLATIONARY ACCOUNTING IN IRAN

Accounting in Iran is very old, and is mixed within Iranian civilization. Accounting systems that are currently used in Iran are about 70 years old.

At first, modern accounting system was introduced in Iran by foreign companies that have offices in Iran.

Some Iranian companies, such as ‘Shahi Bank’ and ‘National Company of Iran and England’ also used these accounting systems.

In 1936, 12 Iranian accountants were sent abroad by ‘National Bank’. So that this group and the other groups established the modern accounting in Iran.

Now, there are about 55 state colleges and 15 university units that are teaching accounting graduates and also 72 non-governmental university units and schools, which are teaching accountants. In 12 state Universities, there is a postgraduate programme and in 13 non-governmental university units, there is postgraduate programme.
In Iran entry to any learning stages in Accountancy depends on passing the entrance exams. Accounting system in Iran is influenced by American accounting and then by England. Because of this, the teaching courses are influenced by these two countries' teaching systems.

Although, more than 70 years have passed since the inflationary effects on the accounting in general, its effects on financial statements in particular have developed, this concept is not attended properly in the theoretical, academic or executive aspects.

Despite the high inflation rate in Iran, and the belief of the majority of managers and decision-makers and users of financial statements about the information i.e. inflation not being used, the professional accountants in Iran do not pay attention to it. Perhaps it is due to rules and regulations.

Balance sheets that are now accepted by the companies in stock market of Tehran-Iran have no logical relation between the figures and also their results are not reliable.

The assets are priced according to the past years, also liabilities that are for current assets, damaged the structural relations and meaningful financial statement, and make it difficult to analyse the consequences.

Scientifically and academically, the subject of inflation in accounting has not received sufficient attention and its economic effects have not been considered.
On the other hand, the inflationary effects over accounting items and financial statements have theoretically interesting features and are challenging to the executives.

In Iran, Audit Organization (AO) formally is responsible for national accounting standards and they provide the necessary guidance, but about the accounting in the context of changing prices, they do not say anything.
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