(iv) Constraints on information supply and
(v) Strengths and weaknesses of managements of data sources
and induces-user-units.

Management needs a variety of information for its decision making. As noted in Chapter-1, accounting is the major information system for this purpose because financial information is crucial for managerial decision making and the most of this type of information is supplied by accounting and its sub-systems. Thus, the knowledge of price level changes and their implications for business can greatly influence managerial decisions. This was accepted by all respondents during the course of the Study.

In fact, many an Indian Company has developed its own systems of inflation accounting for managerial use. Most of such systems are informal and crude. Moreover, written reporting on price level changes and their effects on regular basis is normally not done. These companies have been using certain specific techniques for specific decision-making situations rather than having formal, comprehensive inflation accounting systems. Attempts are made to incorporate the effects of price level changes in corporate planning, budgeting, capital budgeting, pricing and performance evaluation. Even government departments like P.U.O. have developed their own methods of incorporating effects of inflation in Schedule of Rates. Thus, a considerable amount of awareness exists among business circles towards need for inflation-adjusted information for managerial decision making.
However, a formal and comprehensive system of inflation accounting for decision making is rarely found. Among the companies covered through questionnaires, not a single one was found to be having such a system. Among others, Hindustan Lever Ltd. and Siemens India Ltd. were found to be using inflation-adjusted information in their decision making system in a comprehensive manner.

Efficiency and effectiveness of inflation accounting system for internal use will be largely influenced by the management’s awareness towards utility of such a system, availability of suitable indices and guidelines, and skilled manpower for designing and operating such a system. Though awareness is there, there exists grave dissatisfaction among executives and practitioners in the business world about present tax provisions and allowances on as they do not consider inflation-losses for tax purpose. Concerns have been repeatedly expressed about the government's policy towards pricing and allowances for replacement and modernisation. It should also to be noted that the present system of generation and publication of indices is inadequate and not satisfactory, particularly from the view point of indices required for inflation-adjustments for internal managerial purpose.

Considering the qualifications and experience of finance executives, it seems that most of them do not process the expected conceptual understanding of price level changes, their effects on financial performance of a company and implications for managerial decision making. However, practitioners and consultants seem to be in a slightly better position in this regard.
It seems that the maximum contribution towards encouraging inflation accounting for managerial use can come from the government and managements of companies. However, the rate of professional bodies and merchant bodies in this regard will also be crucial.

In short, (i) awareness towards the need for inflation accounting for managerial use exists in Indian business world, (ii) ability to generate inflation-adjusted information exists, even if, to a limited extent, and (iii) the adequate infrastructure, particularly in connection with providing suitable indices, is badly required. It is in the light of these findings that one will have to develop a system of inflation accounting for use in management decision making.

3 A MODEL FOR THE SYSTEM OF INFLATION ACCOUNTING FOR MANAGERIAL DECISIONS

(A) OBJECTIVE OF THE SYSTEM

Inflation accounting system for managerial decisions can be viewed from two broad angles; (i) the macro level system concerned with helping company managements in using inflation accounting for their purposes and (ii) the micro level system within the Company, existing as a part of its decision making and internal reporting systems.
The ultimate objective of such a system should be to help corporate managements improve the quality of their decisions, particularly in the context of price level changes, and their effects on business operations. Although the effects of price level changes are sometimes incorporated in managerial decisions on informal and ad hoc basis, a formal and comprehensive system of inflation accounting as a part of the decision making system is certainly desirable.

The macro level sub-system should be concerned with providing a suitable indices and other infrastructural framework while the micro level system within the company should aim at facilitating maximum use of price-level-adjusted information in managerial decision making. The integration of the two objectives with the ultimate objective is shown in the figure given below.

**FIGURE 6.1**

OBJECTIVES OF INFLATION ACCOUNTING SYSTEM FOR MANAGERIAL USE
(b) PRE-CONDITIONS FOR EFFICIENT SYSTEM DESIGN AND IMPLEMENTATION

The efficient designing and implementation of a system of inflation accounting for managerial decision making calls for certain pre-conditions which must be fulfilled. Such pre-conditions are given below.

(1) A Service to Business and Industry : This type of system should be viewed as a service to business and industry by all concerned. None of the groups involved in the structure and process of inflation accounting should expect any gain for itself. The reason is that the system is expected to help managements of companies improve the efficiency of their decisions. The benefit of improved managerial decision making will be a benefit to the community in general.

(2) Support from Government : In India, where the hold of government on business and industry is increasing directly as well as indirectly, no system of inflation accounting will be effective unless it receives active support from the government. The macro level system needs such support to a greater extent because it will be through such system only that appropriate indices will be received and used for price level adjustments. Government's support will also increase the acceptability of price-level-adjusted information for use in managerial decision making.

(3) Commitment of Management At Micro Level : The indices and other infrastructural facilities will have to be used by managements of companies in their decision-making. But unless and until company managements are committed towards more realistic decision making, no
use of indices and other facilities will be made. Similarly, certain structural changes required in the company for handling inflation accounting activities will not be introduced in absence of such a commitment. Further, all companies will be required to supply prices of its products to data-compiling agency for the purpose of data processing and generation of price indices. Unless the managements of companies understand and appreciate the need for this information, the entire system of inflation accounting will not function properly. In short, managements of all business and industry units will have to recognize inflation accounting as a need for them as well as for the community in general.

(4) Motivation, Rather Than Force Of Law : It should be clear that no management can be forced to use inflation accounting in its decision making. Even the force of law will not work in this matter. If the use of inflation accounting for managerial decision making is to be encouraged, managements will have to be motivated towards it. In fact, voluntary acceptance of inflation accounting for managerial purpose will reduce the scope for mal-practices and will increase the effectiveness of its decision making system.

(5) Maximum Possible Suitability of Price Indices : A very important aspect of the system is that each business unit has its unique needs of price indices. In such a circumstance, it is not possible to provide 100% suitable indices to each user-unit. The aim should be to provide price indices with maximum possible suitability to the user.
(6) **Agency for Price Indices - the Backbone**: As in the case of the system for external reporting, the agency supplying price indices to various users will be the backbone of the inflation accounting system for internal use also. In India, where a considerable number of companies are either small or do not have expertise and financial resources to generate their own price indices, such an agency would be a real service to the business world. Secondly, it will also increase comparability of price-level-adjusted information. Big companies which can afford their own indices-generating system will be able to divert their resources to other suitable directions.

(7) **Clear-cut and Comprehensive Guidelines**: Inflation accounting by itself is considered to be a complicated exercise. When used for managerial decision making, it is expected to be merged with the existing decision making techniques. This increases its complexity. Considering the conceptual and applied skills of the executives who will be handling price indices and using price-level-adjusted information, it seems that clear-cut and comprehensive guidelines will be very useful. Such guidelines should, in addition to the general approach, cover specific situations, like corporate planning, budgeting, and performance reporting.

(8) **A Centralised Function at Micro Level**: Activities related to inflation accounting would include supplying data on price level changes in company's own products to Agency for Price Indices, receiving price indices from the Agency, supplying them to concerned departments within the company and helping them in
using indices in decision making. Though difficult to generalise, one certainly feels that all these functions should be centralised at one place in an organisation. Finance Division or Accounts Division would be an appropriate place to have an Inflation Accounting Cell as a part of it. Such a Cell would also participate, along with other appropriate Cell, or departments in matters like income tax assessment or presentation before paye surveilence authorities. It would also be required to interact with other divisions and departments like Purchase Division, Production Division, Marketing Division and Corporate Planning Cell.

(9) Building Up the Suitable Environment: Though a number of inflation-adjustment techniques are used by Indian companies on adhoc basis motivating them to use price-level-adjusted information in a formal and regular fashion needs to influence the behaviour of Indian management. This calls for building up of a suitable environment for the use of inflation accounting in managerial decision making. The main reason is that influencing behaviour of managers is a long process. Secondly, we are not in a position to use the force of law and so a favourable environment only will help change the attitudes and behaviour of Indian managers towards inflation accounting.

(C) IMPLICATIONS FOR SYSTEM DESIGN AND IMPLEMENTATION

The pre-conditions we laid down for an effective design and implementation of the inflation accounting system for decision making have certain important implications for the one who is to design and implement the system. It is in the light of these that
one will have to perform the job. Let us have an overview of such implications.

(1) **Built-in Motivational Forces:** Since the use of the force of law will not be possible, the system to be proposed must have some built-in motivational forces. Recognition of price-level-adjustment-based price by price surveillance authorities will be a high motivator for Indian Companies. Similarly, acceptance of inflation-adjusted profit for the purpose of income tax assessment and other claims would also be a very high motivator. Such forces would have to be woven into the system of inflation accounting.

(2) **A Part of The Integrated Inflation Accounting System:** Inflation accounting system for managerial decision making can not be viewed in isolation. The macro as well as micro level components of it are closely connected with the macro level system for external reporting. One designing the system for managerial purpose will have to take the broader view of the system. This will help in avoiding duplication of certain activities and will also bring gaps to light. Further, in addition to achieving economy, it will also lead to uniformity in approaches.

(3) **Need-based Compilation and Dissemination of Price Indices:** As mentioned earlier, each business unit has its own unique need for price indices. Since it is not possible to provide perfectly suitable price indices a general price level index like WPI or CPI will not serve the purpose. In such a case one has to aim at need-based compilation and dissemination of price indices. This would call
for further research in the area of a detailed classification of industries and groups of indices suitable for them. Specific price indices will have to be developed through research and experiments.

(4) **Multi-group Approach** : Use of inflation accounting for managerial decisions calls for the involvement of more than one groups. It seems that in India; government, company managements, professional bodies and merchant bodies will be major groups playing very important role in smooth and effective functioning of inflation accounting system.

(5) **Agency for Price Indices** : The agency generating and disseminating price indices should be a single agency exclusively concerned with this activity. It should be distinct from governmental agencies involved in similar function, and should consist of, experts in accounting, valuation, statistics, law and other disciplines related to generation and dissemination of suitable price indices for managerial use.

(6) **Single Monitoring Agency** : The overall performance of the inflation accounting system for managerial purpose should be monitored by a single agency. It seems that a small group consisting of representatives from business, professional bodies and the government should be in charge of this very important task. Needless to say, such an agency should be free from political affiliations and should monitor the performance of Agency for Price Indices, user companies, sources-of data on price level changes and other components of the system.
(7) **Encouraging Research and Experiments**: The system should be such as would encourage thinking, research, writing and experiments on various aspects of inflation accounting for managerial use. In fact, there is scope for constant research on suitability and reliability of indices, changes in the needs of users, operational problems etc. Professional bodies and merchant bodies can offer noteworthy contribution towards this. Effectiveness of this activity can be further enhanced by linking it with rewards for marked achievements.

(8) **Training**: As mentioned earlier, inflation accounting in India will require a framework for training in the areas like identification of industry-needs for price level adjustments, collection of data, development of price indices and their revision, dissemination of indices, use of indices for generating price level adjusted information etc. Such training will be important for executives in Price Indices Agency, executives in user-companies, Income Tax Authorities and Price Surveilance Authorities. One designing a system of inflation accounting for managerial use will have to give some thought to a framework for training in inflation accounting.

What is mentioned above should provide a general background for preparing a broad framework of the inflation accounting system for managerial use. A proposed framework is given below.
At the outset, let us be clear that it is impossible at this stage to give a detailed and universally applicable model of inflation accounting for managerial decisions. This is so mainly due to varying information needs of companies. Each company requires different types of price indices and each index carries different weight for each company. Secondly, different companies have different organisation structures and management styles. Thus, one can only develop a broad, conceptual framework of the system for a single, hypothetical unit.

(1) The System should provide indices that can be used by managements in cost determination, pricing, cash flow projections, capital budgeting, working capital management, budgetary control and profit planning, management of earnings and project financing decisions.

(2) Price Indices Agency should aim at providing specific price indices to companies. Though 100% suitable indices cannot be generated, efforts should be made to provide as suitable indices as possible. This will call for a detailed classification of industries and a study of weightages to be assigned to various items of costs. This aspect of the proposed system also calls for further research on these issues.

(3) Activities related to inflation accounting at micro level include the following:

(i) Compilation of data on prices of own products.
(ii) Supplying above data to Price Indices Agency.
FIGURE 6.2
BROAD FRAMEWORK OF INFLATION ACCOUNTING SYSTEM FOR MANAGERIAL USE

BOARD OF DIRECTORS

Wholesale Director

Corporate Planning & Monitoring Cell

Other Divisions

Finance Division

Accounts

Taxation

Inflation Accounting Cell

Financial

Internal Audit

Income Tax Authorities

Price Indices Agency

System Monitoring Agency

Price Surveillance Agencies

Supportive Agencies

Line Relationship

Staff Relationship

Two-way Relationship

Between Departments within the Company

Two-way Relationship

of I.A.Cell with External Agencies

Area of Inflation Accounting System within the Company
Various points interacting with each other and the issues of interaction are mentioned below.

<table>
<thead>
<tr>
<th>Interacting Points</th>
<th>Issues of Interaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) IAC and Corporate Planning &amp; Monitoring Cell</td>
<td>(i) Corporate Planning, (ii) Management Control through budgeting, (iii) Representations to price surveillance agencies, (iv) Capital Budgeting.</td>
</tr>
<tr>
<td>(3) IAC and Tax Department</td>
<td>(i) Income Tax assessment and recoveries.</td>
</tr>
<tr>
<td>(4) IAC and Accounts Department</td>
<td>(i) Collection of price data on raw materials, wages, overheads, sales, capital expenditure and revenues.</td>
</tr>
<tr>
<td>(5) IAC and Other Divisions</td>
<td>(i) Operational control of divisional activities.</td>
</tr>
<tr>
<td>(6) IAC and PIA</td>
<td>(i) Supply of data on prices of own products, (ii) Receipt of Suitable indices.</td>
</tr>
<tr>
<td>(7) IAC and System Monitoring Agency</td>
<td>(i) Reporting feedback, (ii) Receiving Guidelines and instructions.</td>
</tr>
<tr>
<td>(8) IAC and Supportive Groups</td>
<td>(i) Participating in programmes of research and training, (ii) Making use of services provided by supportive Groups.</td>
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