Chapter – 7

Findings, Conclusions and Suggestions

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7.5 Conclusion
7.1 Introduction

Every person on this earth has been affected by inflation, some positively but most of the people negatively, because the inflation leads to the erosion of general purchasing power. The inflation spares none and it equally influences the business like the people.

In the last chapter, the result of analysis discussed. This chapter will summarize the finding of this study, and then it will continue to describe the important suggestions for SAIL Company and other steel companies which are using historical cost accounting in preparation of annual reports in India. The conclusion of this study will be presented. At the end will provide some recommendation for future research.

7.2 Empirical research and findings

- The presentation and preparation of inflation accounting is not very encouraging in India, as all of the steel companies in India are using historical cost basis in providing the annual reports.

- The major effect of inflation on firms is to discourage investment. Inflation brings with it less predictable returns on capital purchased and the also expectation that demand will fall in the future. This discourage of investment is one of the main reasons why the government wishes to limit inflation.

- Under conditions of continuous inflation, investors are primarily concerned with the protection of the purchasing power of their cash flows.
Purchasing power is maintained as long as management succeeds in realizing real operating profits and generating gains on monetary items.

- Valuation of both profits and balance sheets at historical cost can have a significant impact on rates of return (both on net trading assets and shareholder’s interest). Inflation costs rather than historical cost will lead to lower levels of corporate income and higher levels of assets and unambiguously lower rates of total return on both assets and net equity.

7.3 Conclusions

H1 is accepted. Null hypothesis is rejected.

H2 is accepted. Null hypothesis is rejected.

H3 is accepted. Null hypothesis is rejected.

After gathering data and analyzing and testing the hypotheses, the following results have been obtained.

1. In the first hypothesis, In order to test the hypothesis, the researcher has used SPSS software and Karle Pearson correlation of coefficient. The Net Profit Ratio (NPR) has been selected as an indicator of inflation accounting methods and it is an independent variable. Gross Profit Ratio (GPR), Operating Profit Ratio (OPR), Return on Working Capital (ROWC), Return on equity(ROE),Return on Investment(ROI) have been selected as indicator of performance measurement and those are dependent variables.

We have analyzed the impact of Net Profit Ratio as index of the inflation accounting and as dependent variables, Operating Profit Ratio, Gross Profit Ratio, and Return on Investment, Return on Equity, and Return on Working Capital as indexes of performance measurement. As per data analyzed in
inflation accounting method p-value between NPR with GPR, OPR, ROI, ROE and ROWC is 0.000, 0.000, 0.000, 0.000 and 0.000 respectively. All p-value obtained are less than 0.01. So correlation of coefficient is significant at the 0.01 levels. Then there is a positive relationship between NPR with dependent variable under this method. So inflation accounting method has positive impact on performance measurement in steel companies in India.

2. In order to test the second hypothesis, the researcher has used SPSS software and independent T-test. By calculating mean and standard deviation, difference between each ratio as per inflation accounting (current purchasing power method) and historical accounting has been done. In difference between these two methods of preparing financial statements, the researcher used 6 ratios in 6 sub hypothesis; OPR, ROI, ROE, ROWC, CR and QR. According to the statistical tables, in OPR, CR and QR the p-values are bigger than 0.05, therefore there is no significant difference between these variables in two methods of HCA and inflation accounting. As it has been showed in previous chapters the profit was overstated and assets understated in historical cost accounting, therefore after adjustment, we see that the amount of OPR has gone down on current purchasing power, and it declined, but the difference was not significant between HCA and CPP. The amount of CR, increased in CPP compare with Historical accounting, but this difference also was not significant between two methods. About QR, it shows that there is not any difference between HCA and CPP method in the amount of this ratio, as all the figures used to calculation of QR are monetary items and there
is no need to convert monetary items into CPP method, as they are already in current cost. Therefore there is no difference in QR between two methods. The other 3 ratios; ROI, ROE and ROWC, show that, there are significant differences between historical accounting and inflation accounting approach with 95% confidence, as their p-values are smaller than 0.05. CPP in these ratios have a double effect, as the numerator is understated and the denominator is overstated in this method. Therefore the amounts of these ratios after conversion are smaller than historical cost accounting.

3. For the third hypothesis, the researcher has calculated the correlation between the variables with each other in 6 steps in 6 profitability ratios, and investigated the relationship between these profitability ratios to see if there is the significant relationship between the inflation accounting and decision making of the users of the financial statements in order to protection of operating capability of the company. The result shows that there is significant relationship between the variables but only between ROWC and other ratios there is no significant relationship. Therefore we can say that the disclosure of inflation accounting can help the users to take optimal decisions about the protection of operating capability of the company.

The following are the conclusions point were found after analyzing the data and testing the hypothesis:

4. All the profitability ratio viz. profit before interest and taxes to net sale, profit after tax to net sale, profit after tax to investment, profit after tax to equity, profit after tax to working capital have declined on current purchasing
power as compared to historical cost. Though the ratio of profit on turnover has gone down on current purchasing power, but return on investment and return on equity shares ratio have a double effect, as the numerator is understated and the denominator is overstated in current purchasing power. This indicates that the ratios calculated on inflation accounting basis will change the behavior of the users of financial statements. Hence, the need is felt for the investors and users to use the current cost before taking any material decisions.

5. The capital base on current purchasing power is higher because of maintenance of current purchasing power reserve/revaluation reserve resulted from using of replacement cost for valuing the fixed block.

The variation in performance, when measured on current purchasing power and historical cost basis indicates that inflation, which is a persistent phenomenon in the recent decades, has significant impact on the performance and financial structure of an enterprise.

6. It is concluded that historical cost accounts provide distorted picture of the profits, real value of the fixed assets, working capital, etc. of the companies. The distorted picture of financial statements is rectified to a great extent by current purchasing power method.

7. It appears that inflation adjustment, based on current purchasing power procedure, decreases the level of profitability and altered the ranking of profitability ratios by steel companies significantly. This reflects the importance of considering the potentially distorting effects of inflation.
8. The methodology developed in this study allows for a concise assessment of management capacity to protect investor’s command over resources. It is built around the general price level adjustment model. Its application is simple and the interpretation of its findings straightforward.

9. From the study observation, it is concluded that historical cost accounts provide distorted picture of the profit, real value of fixed assets, capital employed, etc. of the companies. This distorted picture of financial statements is rectified to a great extent by current purchasing power accounting.

7.3 Suggestions and recommendations

1. In times of inflation the purchasing power of money is falling and thereby this unit of measure does not have a constant value. As such, in accounts based on historical cost, income, expenditure, assets and liabilities have a mixture of value depending on the date at which each item was originally brought into the accounts. In view of this, it is widely accepted that historical cost accounting is exposed to the potentially distorting effects of inflation. In particular, for periods of high inflation, historical cost accounting is not sufficient to reflect the true financial position of the business. Therefore, it is urgent need for the companies to change their methods of preparing financial statements from historical cost accounting into inflation accounting.
2. The stock exchange in India should also modify the listing requirements to the effect that the listed companies publish financial information explaining the effects of changing prices of financial statements.

3. The government of India should amend the company law, fiscal and economic laws to give recognition to the effect of changing prices, and the department of company affairs should play their encouraging role for the adoption of such accounts.

4. The analysis of this study shows that, financial statements based on historical cost accounting are not much reliable and useful, therefore for safeguard the interest of the investors, Securities and Exchange Board of India should make it mandatory to provide current cost information along with historical cost accounting.

5. It is recommended that the users of the financial statements should be educated to understand the utility of price level accounting and one way is, when the companies publish this information in their annual reports, the users would automatically become aware of it.

7.4 Recommendation for further Researcher

1. Despite a right method of presenting financial statements, inflation accounting is still not widely present due to certain limitations. But with more research and development of accounting software in this field, there is no doubt that inflation adjusted accounting is the future of financial accounting.

2. Development of inflation accounting are not plenty in India, the area of changing prices and its effect on business income, tax liability and real
worth offers a vast scope for further research. As inflation is a wide phenomenon and increasing prices has its impact, it is need to explore the following areas further in Indian context.

- Changing prices and behavior of investments of share prices
- Price level adjusted accounts and informational needs of the users
- Changing prices and consolidated statements of holding and subsidiaries of different foreign countries