ABSTRACT

Introduction

The most significant and persistent complaint about published financial statements in recent years has been that they do not recognize the economic facts of life. In India most of the companies prepare their primary financial records on the historical cost basis of accounting without regard either to change to in the general level of prices or to increase in prices of assets held.

Under historical cost accounting (HCA) the amounts are recorded by business at the price at which they are acquired and there will be no change in their values even if the market values of such assets change.

Historical cost accounting is alright, if monetary unit is stable and there is no erosion in its values as a result of inflation. Inflation refers to state of continuous rise in prices. It brings downwards changes in the purchasing power of money unit. Thus, financial statements prepared without taking into account the changes in purchasing power of the monetary unit lose their significance.

Inflation accounting is a system of recording all transaction on their current market price which is calculated by price index. Inflation is a reality throughout the world, yet its effects go unrecognized in financial statements prepared in accordance with generally accepted accounting principles in most of the companies.

According to this research, the researcher has been tried to perform the way to convert historical figures of financial statements to current cost as the basic objective of accounting in preparation of financial statements is a way that they give a true and fair view of the operating result and the financial position of the business to its various users.

Before proceeding to explain how financial information intended as a response to the effects of changing prices could be prepared in a number of ways, it is
proposed to discuss the limitations of conventional historical accounting. These limitations include:

**Hypothesis of the study**

**Hypothesis 1:**
There is a significant relationship between inflation accounting and performance measurement.

**Hypothesis 2:**
There are significant differences between financial statements according to historical cost accounting approach and inflation accounting approach.

**Hypothesis 3:**
Disclosure of financial statements as per inflation accounting helps the users of financial statements in making effective decisions for protection of operating capability of the company.

**Research Methodology**

The researcher uses the following methodology:

The population is total steel companies in India from the years “2006-2007 to 2010-2011.” There are 23 steel companies in India.

The sample size is SAIL and 7 more steel companies (Tata steel, Jindal steel, Bhushan steel, Jsw steel, Viza, Ispat and Vizag) in India. For selecting the companies, the researcher has used Simple Random Sample (SRS) method; out of 23 steel companies in India, 8 companies and mainly SAIL have been selected by random, from Bombay Stock Exchange. All the said companies have prepared the annual reports according to historical basis.

**Data collection:**

For collection of data the researcher has selected the annual reports (balance sheet and profit and loss account) of the companies that all of them have
been prepared as historical accounting method, and then among them selected ratios (Profitability ratio, Liquidity ratio) for 5 years have been calculated. That is one part of the research data. For the purpose of conversion of historical figures to inflation accounting, the researcher has chosen Current Purchasing Power (CPP) method and the WPI (Wholesale Price Index), then according to the related formulas conversions have been done. According to CPP, opening balance sheet and closing balance sheet adjustment is needed and also for profit and loss account, depreciation adjustment, cost of goods sold adjustment, gain on borrowing and loss on holding money would have been calculated. The researcher again calculated the same ratios for current purchasing power data. This is the other part of the research data. Therefore with these data’s the researcher has discussed about the research hypothesis.

12. Conclusion

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 dependent variables and indicator of performance measurement.

As per data analyzed in inflation accounting method p-value between NPR with all other variables is 0.000. 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 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.